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***The EC Rules on Fiscal State  
Aid***

-an imperfect instrument in the work against  
harmful tax competition

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# Summary

The EC provisions on fiscal State aid have since 1997 become an important part of the work against harmful tax competition. The application of the State aid rules to harmful measures is a reversal of the common direction of aid (i.e. leading to preferential tax treatment). This creates several interesting legal problems, for example if these rules provide a suitable method to tackle harmful tax competition and if such application is in line with the purpose of these rules. Another legal problem is the relation between the Code of Conduct, that is a soft law instrument, and the legally binding State aid rules. The thesis does not only focus on these questions but it also tries to analyse the problems on a deeper level. A question that then arises is if it is necessary to work against harmful tax competition at all. Finally, the practical side of the usage of the State aid rules is analysed, have the application been successful at all?

The first chapters are of a more descriptive character. These show that there are different opinions on how extensive the impact of EC law shall be in the area of direct taxation. Some economists mean that there is no need to limit tax competition since it will adjust the tax burden to the market with less negative effects than one created on a market without free and fair competition. On the other hand, the institutions and several Member States are convinced that there are parts of tax competition that need to be fought.

The field of direct taxation is characterised by enormous problems in adopting legally binding reforms. The Member States fiscal sovereignty is an important reason for these problems together with a weak legal base for such reforms in the Treaty. These past problems are dealt with in order to provide a wider understanding for the later switch to other legal solutions such as soft law. Another of these solutions, when the work against harmful tax competition was started, was the use of negative integration via the State aid rules. The application of these rules in order to tackle harmful tax competition was part of the more systematic approach often labelled “the tax package”. Following these chapters, an examination of the EC Treaty rules on State aid is made before I turn to the further analysis of the State aid rules as an instrument to work against harmful tax competition.

Via a Commission notice from 1998 and the Code of Conduct the application of the State aid rules was changed, or more correct broadened. An obvious link between harmful tax competition and the set of rules in Article 87-89 was also created. The State aid provisions provide an attractive method to use since they are, if no problem because of the selectivity criterion arises, of legally binding nature. However, the rules were not designed or intended to restrict harmful tax competition. Another problem with the application is that, mainly because of the selectivity criterion, not all measures will be covered by the State aid rules. The only instruments that can catch these

measures are the Code of Conduct and the Treaty rules on coordination. In practice, the latter is not a probable solution and the first is limited in scope because of its soft law character.

The arguments in favour of applying the State aid rules to tackle harmful tax competition have not completely convinced me, this is above all the case if the selectivity criterion is broadened beyond the wording of the Treaty. Even if the State aid rules might be used as a complementary instrument in the work against harmful tax competition they can clearly not be the main method to accomplish reforms of community taxation. Therefore I believe that to use the EC State aid rules to tackle harmful tax competition is not the preferred solution. It can be questioned if the application is in line with the purpose of these rules and they cannot, in my opinion, be used as substitute to reforms adopted via legally binding acts.

The final part of the last chapter deals with the factual usage of the State aid rules. It also includes a comparison of the measures identified as harmful under the Code of Conduct and the State aid provisions. The Conclusion that is drawn from these chapters can be summarised as with today's system there is need to have both a Code of Conduct and to make use of the State aid rules if harmful tax competition should be limited successfully.

# Preface

I would like to express my gratefulness to my supervisor Christina Moëll, Doctor of Laws, for all her help and support. I would also like to thank Professor Alain Steichen for his friendliness and inspiration.

Lund, May 2003,

Johan Tollgerdt

# Abbreviations

EATLP - European Association of Tax Law Professors

EC - European Community

ECJ - European Court of Justice

ECOFIN – Ministers for Economic Affairs and Finance

EC Treaty – The European Community Treaty

ECSC – The Treaty Establishing the European Coal and Steel Community

EESC – The Economic and Social Committee

EU - European Union

EMU - European Monetary Union

OECD – Organisation for Economic Co-operation and Development

O.J. - Official Journal of the European Communities

VAT - Value Added Tax



# 1 Introduction

## 1.1 Background and presentation of the subject

The internal market, the EMU and other community projects have turned the focus of the work in the Community towards the remaining barriers of trade. This has led to an increased amount of attention to taxation in EC law. These questions have also acquired a high profile within the EU policy work. Another challenge for the union is the goal set by the European Union itself in Lisbon 2000 to become the most competitive and dynamic knowledge-based economy in the world. In order to fulfil this goal it is necessary to continue to improve the conditions for the actors on the internal market. One area of law where the importance of EC law has for long been limited is the field of direct taxation (another is criminal law). However, recent developments clearly show that EC law is of great importance also in this area of law.

The key question for the work regarding taxation in the union has been what degree of harmonisation that is appropriate. Indirect taxes have already been harmonised to a significant degree but problems early arose in the field of direct taxation. One of the main problems in adopting legal documents relating to direct taxation has been the unanimity requirement, another the lack of a clear legal basis in the Treaty. The idea of an overall harmonisation has more or less been abandoned today but a number of authors and institutional papers seem to be certain that parts of the direct taxation field need to be more integrated than they currently are. These parts are often considered to be the more mobile tax bases such as corporate taxation and the taxation of capital.

Another side of these efforts is the focus on harmful tax competition. This work is not limited to the EU; a similar approach has been taken in the OECD. As a result of this the Ecofin Council agreed on a package of measures to tackle harmful tax competition in the European Union in 1997. One part of this “tax package” was the Code of Conduct for business taxation and a lot of attention has been given to this in the work within the Community. As a result of this work, with the Code of Conduct as a base, 66 harmful tax measures were located in 2001.<sup>1</sup>

In the same agreement of 1997 the Commission committed itself to publish guidelines on the application of the State aid rules to measures relating to

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<sup>1</sup> Report of the Code of Conduct group on business taxation, 29 November 1999. This report was made available to the public on 29 February 2000 and can be found online on the web site of the Commission:  
[http://europa.eu.int/comm/taxation\\_customs/taxation/law/primarolo/primarolo\\_en.pdf](http://europa.eu.int/comm/taxation_customs/taxation/law/primarolo/primarolo_en.pdf)  
(2003.02.15).

direct business taxation, i.e. fiscal State aids. The Commission also committed itself to clarify its application of these provisions regarding fiscal State aids. Thereby a link was created between the work against harmful tax competition and the EC State aid rules. The first official document specifically concerning the application of the State aid rules to the fiscal area was issued in 1998. This Commission notice was adopted within the framework of the process meant to tackle harmful tax competition.<sup>2</sup>

This application of the State aid rules is a reversal of the common direction of State aid (i.e. leading to preferential foreign tax treatment). This creates several interesting legal problems; the State aid rules were not intended to tackle competition between Member States that are competing for the tax-payments of the citizens. Another problem that arises is how the Code of Conduct (a political agreement) and the State aid provisions (legally binding Treaty based rules) relate to each other.

## **1.2 Purpose of the thesis and the questions at issue**

The purpose of this thesis is to clarify the relationship between fiscal State aid and harmful tax competition and to describe how these sets of rules have been applied in practice. It is also important to clarify how the usage of the State aid rules to measures relating to direct business taxation relate to the development of EC law in the field of direct taxation. The thesis is based on the following questions:

- Why should harmful tax competition be fought?
- Do the EC State aid rules provide a suitable method to tackle harmful tax competition? What actualised the application of them? What is the purpose of these rules and is the application of these rules within the work against harmful tax competition in line with this purpose?
- Have the application of the State aid rules to tackle harmful tax competition been successful?
- Is it meaningful to have a separate tool (the Code of Conduct) that applies to the same, or at least similar, measures that are covered by another tool (the State aid rules)?

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<sup>2</sup> Commission notice on the application of the State aid rules to measures relating to business taxation, O.J. C-384, 10.12.1998.

## **1.3 Material and methodology**

The legal rules affecting fiscal State aids and the work against harmful tax competition are limited in scope. It has therefore been necessary to use soft law documents from the Commission, the Council, etc. When reading these documents it is of course important to keep in mind that they will not be as critical to developments as for example articles written by authors with no relationship to the EU institutions. Nevertheless the access to European Parliament, Council and Commission documents provides an important tool for the understanding of the developments of EC taxation policy. As in all areas of EC law the judgements of the European Court of Justice have also been important for the study. Apart from this the thesis has been based on legal doctrine in the form of books and articles. I have also had some help from Internet sources.

The treatment of fiscal State aids and their importance in the work against harmful tax competition is limited in the academic works, probably because most attention has been given to the Code of Conduct on business taxation. The treatment of the subject is often not considered to any large extent in the more general works on EC tax law. There are however a fairly good examination of fiscal State aids and their role in the work against unfair tax competition in various articles. Most articles are however limited in space and this often makes the entirety of the subject unclear. A major source of inspiration has been the documents from the EATLP-meeting in Lausanne 2002.

The first chapters of the thesis are to a large extent the result of a legal dogmatic descriptive method in order to give an extensive background that I believe is of great importance to understand the entirety of the subject. The method will after this become more analytic. These following chapters are mainly based on a comparative text analysis. I have also included some of my own opinions where this has seemed appropriate. The literature has in some cases been clear-cut but in other cases the opinions differ, something that I have then tried to clarify in the thesis. Case law has been analysed with a traditional judicial method.

## **1.4 Delimitation**

I have chosen to limit my research of the EC State aid rules to the first part of Article 87. I will therefore not discuss the exemptions in the Treaty to any larger extent. The reason for this delimitation is not because the other parts of the provisions concerning State aids are less important. The reason is that this thesis does not focus on the precise application of fiscal State aid but rather on their role in the work against harmful tax competition and their relationship to the Code of Conduct. In order to make the entirety of the subject more clear I have therefore found it appropriate to limit the discussion of the exemptions in Article 87 (2-3).

Furthermore, I have chosen not to examine other parts of the tax package than the Code of Conduct for business taxation and the application of the State aid rules to measures relating to business taxation. The reason for this is that the other parts of the tax package fall outside the scope of the thesis. However, the Code of Conduct will not be discussed in detail other than the parts that are of direct relevance to the State aid rules since the Code is mainly used as a benchmark in comparison with the scope of the State aid rules.

Finally, I have chosen not to discuss the OECD work against harmful tax competition to any larger extent. The main reason for this is that the thesis primarily concerns the EC State aid rules and these have not the same relationship to the OECD project as the EC work against harmful tax competition. Therefore, I have only found it necessary to discuss the OECD project when it is of more direct influence on the EU initiative.<sup>3</sup>

## 1.5 Previous related research

There is no work solely devoted to fiscal State aids, though there are books that treat the State aid rules in detail. One of these is the “European Community Law of State Aid” by Andrew Evans and another is Despina Schina’s “State aids under the EEC Articles 92-94”. One problem that I have found obvious when studying these works is that the material that has been available to me often are too old to have the latest developments for fiscal State aids included.

Fiscal State aids are given some treatment in the more recent general works regarding EC tax law. One such is Terra and Wattel’s book “European Tax Law” from 2001. However the treatment of State aid is limited, which is natural in general works like these. Commissioners Frits Bolkestein and Mario Monti have published some material that has been used in the thesis. This material is of great importance because the authors are often more free-spoken in these articles than the officially published documents.

Amongst the large number of articles that I have used I have found that the most important works regarding taxation and State aid law is Wolfgang Schön’s article from 1999 in the *Common Market Law Review* together with the articles by Carlo Pinto the same year. Fiscal State aid and its role in the work against harmful tax competition is satisfactory discussed in Frans Vanistendael’s article “Fiscal support measures and harmful tax competition” and in Augusto Fantozzi’s 2002 article on the subject. Finally, Alex Easson’s article in the *EC Tax Journal* should be mentioned since it has been a great source of inspiration regarding the usage of the fiscal State aid rules to harmful tax measures in practise.

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<sup>3</sup> For further information on the progress of the OECD project see for example: Pinto, Carlo: “The OECD 2001 progress report on harmful tax competition”. In: *European Taxation*, 2002, p. 41-45.

## **1.6 Disposition of the thesis**

The thesis is structured as follows: the opening chapter will provide a terminological base that will be used in the remaining thesis. The next chapter will discuss some theoretical and political sides of the arguments in favour of tax competition and tax coordination. I will, even though a clear link to the State aid provisions exist (see further under the chapter dealing with terminology), take my starting point in a brief discussion on the development of the harmonisation efforts in the Community up to now. This background is of importance since I believe that this is one of the main reasons for turning to the State aid provisions as a method to tackle harmful tax competition. It is my belief that it is important to see the usage of the State aid rules as a short-term solution of the past problems with finding a suitable instrument to co-ordinate direct taxes.

Before I will examine the application of the State aid rules to taxation measures in chapter 6, I will provide a short background on how EC competition law can be linked to EC tax law. The final chapter will focus on three different topics. First, the role of the State aid provisions in the work against harmful tax competition will be discussed further. Secondly, the relationship between the Code of Conduct and the State aid rules will be examined and finally the application of these rules will be compared, examined and analysed.

# 2 Terminology

## 2.1 General remarks

I will begin with addressing a couple of practical issues. I will in the following refer to Article-numbers, Articles in general or simply to “the Treaty”. In the following all these terms refer to the Treaty establishing the European Community as it was amended via the Treaty on European Union<sup>4</sup> and the Treaty of Nice.<sup>5</sup> If I intend to refer to another treaty or Articles in directives, regulations etc. this will be explicitly stated. The Article-numbers that are used in the following refer to the numbering system that was introduced by the Treaty of Amsterdam (entered into force in May 1999).

Furthermore, I will refer to the European Community in singular and not in plural even though the latter might be more correct. The reason for this is that it is long out of fashion to refer to the European Communities in the plural. I will also refer to the European Court of Justice as the Court of the Community and not the Court of the Union since the European Court of Justice only has competence to deal with pillar one matters, i.e. questions concerning the Community.<sup>6</sup>

The importance of explaining some terms that will be used frequently in the thesis cannot be exaggerated. The remainder of this chapter will therefore be used to try to clarify a couple of terms.

## 2.2 Direct tax

Direct tax is a generally accepted term for taxes that are paid and borne by the taxpayer. Such taxes include income tax, wealth tax, corporation tax, many local taxes, etc. When the term direct tax is used in a tax competition/harmonisation discussion, as it will be in this thesis, it is important to make clear that the effects of a direct tax on the Community level is more unclear than the effect of indirect taxes. Let me explain this further.

While an indirect tax visibly affects the community trade it is much harder to point at the distort effects of a direct tax. Direct taxes affect investment, establishment and employment decisions, but so do many other factors. However, if the effective tax burdens on labour and on investment differ substantially due to border crossing of economic activities, it will frustrate both free competition and free movement of labour and capital. Eventually it will hinder the optimum allocation of production factors. Another problem

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<sup>4</sup> The so-called Maastricht Treaty and entered into force in November 1993.

<sup>5</sup> Entered into force in February 2003.

<sup>6</sup> Rasmussen, Hjalte: *European Court of Justice*, Copenhagen, 1998, pp. 26.

with direct taxes can be of administrative nature. Fifteen different (in the future even more) tax systems and authorities are bound to create administrative problems. These differences can also be an incentive to tax avoidance and tax planning.<sup>7</sup>

## 2.3 Tax competition

Tax competition is a term that is not very often explained although it is used frequently. In my opinion Prof. Alain Steichen gives a satisfactory explanation in his additional report to the EATLP-meeting in Lausanne 2002.<sup>8</sup> He explains tax competition as tax policies in a country, which give that country a competitive advantage when selling its products and services. However, in order to explain tax competition fully he adds one important element to the explanation, namely the impact on foreign economies. This means that tax competition is at hand when a decision in one country affects the welfare of another country.<sup>9</sup>

## 2.4 Harmful tax competition

Harmful tax competition is often used to describe one of the main action areas in today's work regarding direct tax in the EC and it forces us to take the above definition one step further. It can be questioned whether a "fair" tax competition exists or not. As shall be shown later on there are economists that claim that all competition is positive and that this alone will lead to a optimal system. However, as far as the term harmful tax competition concerns it is only necessary to say that, when this term is used, it is clear that a "bad" tax competition is believed to exist. Such harmful tax competition can, opposed to a positive "loyal" tax measure, be seen as actions that aim to attract different activities away from other countries.<sup>10</sup> There are no legal rules that provide a definition of harmful tax competition and it is therefore difficult to find a starting point for the definition.<sup>11</sup>

The Code of Conduct, 1997, includes the following two situations when defining harmful tax competition. First, "measures which affect, or may affect, in a significant way the location of business activity in the Community" are included. Secondly, and within the scope of this, the definition includes "tax measures which provide for a significantly lower effective

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<sup>7</sup> Terra, B. and Wattel, P.: *European Tax Law*, The Hague 2001, pp. 145.

<sup>8</sup> All reports from this meeting are available online at: <http://www.eatlp.org>. All documents from this page were printed 2003.01.25.

<sup>9</sup> Steichen, Alain: Tax competition in Europe or the taming of leviathan, <http://www.eatlp.org> (2003.01.25), Lausanne 2002, p. 7.

<sup>10</sup> Malherbe, Jaques: "Harmful Tax Competition and the Future of Financial Centres in the European Union". In: *Intertax* 2002, pp. 220.

<sup>11</sup> Schön, Wolfgang: "Tax competition in Europe – the national perspective". In: *European Taxation*, 2002, p. 492.

level of taxation, including zero taxation, than those levels which generally apply in the Member State in question”.<sup>12</sup>

The first leg of this definition may create problems since it seems to include tax regimes that provide low tax rates throughout the country, for example Ireland. The dividing line between fair and unfair competition would in that case depend on the impact on the high-tax country by the low-tax country. The higher the impact is, the more likely it is that the tax competition measure would be deemed unfair. This may, if understood this way, create a subjective grey area between what is harmful and what is not.<sup>13</sup>

Another definition can be found in the OECD report from 1998.<sup>14</sup> This will not be dealt with to any larger extent, but some main differences compared to the EU initiative are that the OECD report’s definition of harmful tax competition is closely linked to tax havens which are not dealt with in the Code of Conduct. This is natural since none of the Member States falls under this definition. Another difference is that while all economic activities are covered under the EU definition, the OECD report focuses on income from more mobile financial activity. Finally, the documents differ in their main concerns. The OECD is mainly concerned with the erosion of revenues while the EU work highlights the effects on the location of business activity, etc. From my point of view this shows clearly that a uniform definition of what is to be considered unfair or harmful is impossible to make although it might be possible to agree on many elements that could qualify in such definitions.<sup>15</sup>

So, what are the main reasons for the lack of a universally accepted definition of harmful tax competition? One reason is that the concept of harmful tax competition and the work to tackle this is a relatively new issue. In fact the problems have only been occurring in the debate during the last couple of years. To this comes that the issue for long was one that was not very openly discussed since it was believed that the best way to cope with it was to actively engage in it. A second reason is that it is, still, unclear what the exact economic consequences of harmful tax competition are.<sup>16</sup> From a legal point of view it is important to notice that the Code of Conduct does not refer to any specific set of rules (as for example those enshrined in the Treaty). Instead the Code tries to outline general elements that may constitute unfair tax competition. This makes the definition primarily economic

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<sup>12</sup> Resolution of the Council and the Representatives of the Governments of the Member States, meeting with the Council of 1 December 1997 on a code of conduct for business taxation (found as Annex I to “Conclusions of the ECOFIN Council meeting on December 1 1997 concerning taxation policy”), O.J. C-2, 06.01.1998, Article A-B.

<sup>13</sup> Steichen 2002, p. 8.

<sup>14</sup> OECD: *Harmful Tax Competition – An Emerging Global Issue*, Paris 1998, para. 40.

<sup>15</sup> A comparison of the EU and the OECD actions can be found in: Easson, Alex: “Harmful tax competition: The EU and OECD responses compared”. In: *The EC Tax Journal*, 1998, p. 1-16.

<sup>16</sup> Pinto, Carlo: “EU and OECD to fight harmful tax competition: Has the right path been undertaken?”. In: *Intertax*, 1998, p. 394.



and political. Such an approach can be criticised with legal certainty as a basis.<sup>17</sup>

## 2.5 Tax harmonisation and coordination

Tax harmonisation is generally understood as a process that aims to create a common tax policy via adjusting tax systems of different jurisdictions. Tax harmonisation, in the field of EC law, involves the removal of tax distortions that affect the free movement of goods in order to make the integrated internal market more efficient. It also leads to a more uniform tax burden across EC Member States.<sup>18</sup> To define harmonisation satisfactory it is however necessary to go even further. Harmonisation seems to require that each Member State adapts its legislation to a standard that has been set forth by the EU supranational bodies. Such top to bottom tax harmonisation with centrally mandated tax rates were for long the preferred, although unsuccessful, approach within the Community.

The grandiose tax harmonisation theories failed due to problems with the Member States' tax sovereignty, the subsidiarity principle and the broader acceptance of tax competition theories. The work therefore switched to *tax coordination* instead. This term can be translated into meaning "specific and limited proposals respecting double taxation and cross-border trade and investment".<sup>19</sup> However, this terminology can easily be criticised since it is possible to uphold that coordination is nothing but harmonisation in stages. At the best the approach in the EU can be seen as a mixed approach where greater uniformity is preferred in some areas while others will remain more differentiated.<sup>20</sup>

The terminology is however not entirely clear and tax coordination and harmonisation are often used without clarifying any differences. In my opinion, as influenced by Prof. Alain Steichen, harmonisation in its most narrow meaning is if one follows the *equalisation approach*. This consists of a method that tries to achieve a full harmonisation by the adoption of standardised tax rates, tax base and tax regulations throughout a given area. The method puts the group within this area as a whole above the Member States. To a large extent, this is the method that has been used when harmonising VAT. To be precise, the equalisation approach means that tax policy law is passed from the national level to the Community level when the Member States agree on a single taxation system. However, another approach to harmonisation is the *differentials approach*. This means a partial harmonisation

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<sup>17</sup> Schön 2002, national, p. 492; Pinto 1998, p. 394.

<sup>18</sup> Kopits, George: *Tax Harmonisation in the European Community*, Washington DC 1992, p. 3.

<sup>19</sup> Bratton, W and McCahery, J: "Tax coordination and tax competition in the European Union: Evaluating the Code of Conduct on business taxation". In: *Common Market Law Review* 2001, p. 681.

<sup>20</sup> Steichen 2002, p. 10.

or approximation which allows each Member State to continue managing its economy so as to maximise its own welfare but that aims to minimise the harmful effects of one Member State's system on another.<sup>21</sup> The main difference between these approaches is of course that under the differentials approach the tax policy is left to the Member States instead of the Community and it also acknowledges different social and economic circumstances in the Member States. If common rules would arise as a result of tax competition (see further on this theory under the economic side of tax competition below) I will refer to these as *tax convergence*, which should be in line with the above definitions.

I have chosen to use the term coordination as corresponding to approximation (i.e. the differentials approach) and not, as some authors seem to do, use it in the same meaning as harmonisation. The term coordination can also be used in its everyday meaning but this will as far as possible be avoided. A partial harmonisation will lead to a level of common ground which can be achieved in various ways, for example via minimum or maximum legal requirements. It is hereby important to keep in mind that the differentials approach refers to legally binding harmonisation, although limited in scope.

The question remains how to link the usage of State aid to this terminology. The link is not entirely clear since the usage of the State aid rules is a form of negative integration. It can certainly be questioned if negative integration has anything to do with harmonisation at all since negative integration does not fill out the space that is left when an obstacle has been removed. It is however clear that the purpose is to improve the integration and the free movement within the Community (by removing harmful tax competition measures). But even though it may be seen as Community action it is not a legally binding approximation as required under the differentials approach. Nevertheless, a link does in fact exist between state aid and the differentials approach since these provisions result in less need for partial harmonisation as the Commission has made it clear that the State aid provisions must be used correctly in the field of taxation.

It is also necessary to say a few words on the subject of fiscal State aid and harmful tax competition. Fiscal State aid is just one form of State aid and does not enjoy any special status amongst the other types of aids. The link to State aid has been created via the Community work against unfair tax competition. The details of the relationship between fiscal State aid and the work against harmful tax competition will be discussed further on in this thesis.

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<sup>21</sup> Steichen 2002, p. 9.

# 3 Tax competition, coordination and harmonisation – an economic perspective

## 3.1 The political and economic side of the tax policy work

The question of harmonisation, coordination and competition of tax law is a highly political and economic one, but I shall nevertheless try to outline some main thoughts on these angles of approach since I believe that this background is important for the following chapters. Economics often participate in the discussion on tax competition. It is not as often that you see lawyers that participate in the discussion though.<sup>22</sup> It seems, from my point of view, that the attention given to the topic from a legal point of view has increased.

While indirect taxes are harmonised to a rather high degree the case with direct taxes is more or less the opposite. Some states, like Germany and France, advocates for a higher degree of tax harmonisation/coordination. The reason for this is most likely that they consider today's high level of taxes necessary if the public services shall remain as they are today. Other countries, like Great Britain and Ireland, are of another opinion. They seem to mean that it is unthinkable to give up the right to tax to the EC. Many of the countries in this second group have also lowered their taxes,<sup>23</sup> a measure that might lead to tax competition.

Tax competition is a phrase used more frequently today than only a decade ago. The term represents an economic concept; just as undertakings compete with each other, so do governments via creating an attractive business environment.<sup>24</sup>

## 3.2 Tax competition – a spontaneous approximation of legal orders?

Tax harmonisation is often considered to be the classical theory on coordination of tax systems. In the Community it is unquestionably a fact that competition between private enterprises is of high priority (i.e. no harmoni

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<sup>22</sup> Schön 2002, national, p. 490.

<sup>23</sup> Wickman, Kurt: *Skattjakten – En kritik av skatteharmonisering inom EU*, Stockholm 1999, pp. 7,19.

<sup>24</sup> Bracewell-Milnes, Barry: "Editorial – Tax competition: harmful or beneficial?". In: *Intertax*, 1999, p. 86.

sation) while, on the other hand, the Member States' legal systems are to a high degree harmonised within the European Union. Tax competition is a theory that turns this ideal upside down and supplies us with a radical alternative, namely that further harmonisation should be avoided.<sup>25</sup>

The opinion of some economists is that any efforts that aim to harmonise, even to a very limited degree, are nothing but an attempt to defend the States' right to tax and to use tax money without any control mechanism. This is, according to these economists, the last existing monopoly in the common market. Instead, tax competition would be a better solution since this method leads to that the different tax systems would be measured and judged by the market. It is more or less accepted that competition between undertakings is good, how can competition between governments be bad?<sup>26</sup>

Furthermore this theory means that in order to create a complete image of taxation and its effects it is necessary to take into account that the aim of taxation is that the taxpayers should benefit from public institutions, a legal system, infrastructure, education, public health, etc. As always, the goal for any system of this kind should be that the resources are allocated as efficient as possible. These economists doubt that this goal is possible to achieve in a closed governmental system. Nevertheless, tax competition on international level forces the states to present a well-balanced tax system. Tax harmonisation will, according to the supporters of this theory, not lead to an optimal tax system but to a cartel of selfish oligopoly of state governments.<sup>27</sup>

In the long run tax competition will lead to a "spontaneous approximation of legal orders". After years of competition the level of state services and tax burden will settle into a balanced level. Why is then this method better than a politically decided harmonisation? The advocates of the theory mean that the tax level that will be harmonised via competition will be a lower one than a politically agreed level. They also mean that the quality of the system will be higher since it has been developed and judged by the market. In this way the tax burden will be on a level more adjusted to the market with less negative effects than one created on a market without free and fair competition.<sup>28</sup>

From this point of view the theory of tax competition (the competitive approach to provide a link to the terminology used in this thesis) leads to an approximation in the same way as the differentials approach referred to above. One big difference is however obvious. The approximation achieved via the competitive approach is not a legally attained harmonisation and does therefore not qualify as harmonisation according to the terminology used above. The result may be the same but this kind of approximation can

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<sup>25</sup> Schön, Wolfgang: "Tax competition in Europe – the legal perspective". In: *EC Tax Review* 2000, p. 91.

<sup>26</sup> Malherbe 2002, p. 220; Bracewell-Milnes 1999, p. 86.

<sup>27</sup> Schön, 2000, p. 93.

<sup>28</sup> Schön 2000, p. 93.

only be referred to as a “soft” harmonisation or perhaps even more correct tax convergence in order to follow the terminology outlined above.

The tax competition theory has been subject to a lot of criticism. The main arguments against the theory is that it will not at all lead to a balanced level of tax burden but instead lead to a “race to the bottom” which limits the tax base more and more and eventually lead to enormous limitations of state action. Another problem that is feared is that the taxpayers that are financially stronger will be free riders in such systems. Finally the theory might lead to problems since income from capital is much more mobile than for example labour income. This might lead to a higher tax burden on human labour than on capital income.<sup>29</sup> Another argument that I find important is that an approximation via this theory would take very long time and is due to create problems when the Union is enlarged.

There are of course also objections to these arguments but in my opinion it is not possible and not necessary for this thesis to make a final judgement on which theory that is the right one. The theories are obviously based on different views on how the state functions and which interests it guards. There are, in my opinion, both good and bad arguments in favour of the different theories.

### **3.3 Why should harmful tax competition be fought?**

Why harmful tax competition should be fought is a very difficult and extensive issue to address and it is one without any single correct answer. It is quite obvious that the Member States and the institutions are in favour of elimination or reduction of the effects of harmful tax competition since much of the work within the EU has aimed at combating these effects. One commentator even suggests that there is a “common ground across the EU that cooperation against harmful tax competition is desirable”.<sup>30</sup> It is important to keep in mind that this position is the official opinion of the States.<sup>31</sup> In practice there might be different opinions throughout the Member States. To this comes the Code of Conduct on business taxation. This is a political agreement that was part of the “tax package” in 1997. It shifted the attention in the Community regarding the distortion of the market from basic structural elements to specific privileged tax regimes.<sup>32</sup> The States willingness to

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<sup>29</sup> Schön 2000, pp. 94.

<sup>30</sup> Bolkestein, Frits: “The future of European tax policy”. In: *EC Tax Review*, 2002, p. 20. Also compare with the opinion in the Commissions yearly rapport on competition policy: Europeiska Kommissionen: “XXIX:e rapporten om konkurrenspolitiken”, 1999, SEK (2000) 720 slutlig, p. 68.

<sup>31</sup> Scön 2002, national, p. 491.

<sup>32</sup> Commission Staff Working Paper – Company taxation in the internal market, SEC (2001) 1681, p. 19.

work against harmful tax competition can also be seen on a wider international level.<sup>33</sup>

So, what are the arguments put forward on the institutional level? In 1996 a Commission Staff working paper states that tax competition leads to erosion of the tax base and thereby creates fiscal degradation.<sup>34</sup> The year after this it is highlighted in a Commission communication that harmful tax competition will lead to increased conflicts between Member States and that it is one of the main factors behind the shift in tax burden to the less mobile tax base labour. Harmful tax competition may also distort taxation structures.<sup>35</sup> The only argument that seems to be supported by hard facts though is the shift in tax burden on less mobile tax bases.

It is obvious that most States fear a loss in revenues if what they label harmful tax competition is allowed to continue. Lately, as will be shown below, the institutional bodies do point out that tax competition as such is not a bad thing; it is the harmful part that needs to be fought. My opinion is that whether it is necessary to fight against the “unfair” tax competition or not, is not a question as easy to answer as it might seem when examining the arguments just laid out. As has been shown above, such arguments can be questioned since it is not proved that any form of tax competition will lead to the feared revenue losses etc.

### **3.4 Measures against harmful tax competition**

For a Member State that is exposed to tax competition from other Member States there are two main paths to choose between. The first of these is when the Member State introduces corresponding tax incentives in the domestic tax system. The second main path is to introduce countermeasures that aim at neutralising the advantageous effects that the other Member States’ actions have had. Such measures include CFC-legislation, the usage of different definitions on residence and emigration, application of tax abuse rules, etc.<sup>36</sup>

There are different aspects that must be taken into consideration when fighting harmful tax competition. For the first the measures can be national, bilateral or multinational. National methods include CFC-legislation, lowering of the tax level to compete with other states, etc. Two States can also

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<sup>33</sup> For example in the OECD. The latest positions in the work against harmful tax practices can be found in: The OECD’s project on harmful tax practices: “The 2001 progress report”. It can be found online at <http://www.oecd.org> (2003.03.10).

<sup>34</sup> Taxation in the European Union - Discussion paper for the informal meeting of Ecofin Ministers, SEC (1996) 487 final, p. 3.

<sup>35</sup> Communication from the Commission, Towards tax co-ordination in the European Union. A package to tackle harmful tax competition, COM (1997) 495 final, not yet published in the O.J., pp. 3, 9.

<sup>36</sup> Schön, Wolfgang: Tax competition in Europe – General report, <http://www.eatlp.org> (2003.01.25), Lausanne 2002, p. 29.

bilaterally exempt certain measures from taxation treaties via for example exclusion clauses and limitation-on-benefits clauses. Finally, States can tackle harmful tax competition via multinational measures such as the EU and OECD projects.<sup>37</sup>

On the international level there are in principle two different solutions when dealing with tax competition (if we assume that it needs to be fought). The first one would be to eliminate every form of tax competition. Such a rigorous solution would mean that all Member States would have to draw up a common tax system to be mandated for all of them. This alternative would naturally be inefficient and is not a solution that very likely would be fulfilled. The second solution would be to only eliminate the harmful parts of tax competition and on the same time promote the desirable tax competition. This is the chosen path within the EU and it is not very hard to see why this has been the preferred one.<sup>38</sup> It is important though, that a clear definition of what is to be considered harmful and what is considered desirable is made. Without such definition the whole concept of harmful tax competition stands on very fragile grounds.

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<sup>37</sup> Schön 2002, p. 28-38.

<sup>38</sup> Pinto 1998, pp. 409.

# 4 Direct tax and EC law

## 4.1 Direct tax reforms – a weak legal basis

There are various articles in the EC Treaty that refer to taxation, for instance Article 23 concerning customs duties, Articles 90-93 regarding indirect taxes and Article 58 stating special rules on the freedom of capital and payments. Apart from these the Treaty refers to taxes only in Articles 163(2), 174(2) and 293.

It follows from this that there are no provision in the EC Treaty that refers to direct taxes and these are not mentioned anywhere in the Treaty. The conclusion can therefore be drawn that any legally binding measures regarding direct taxes, for instance harmonisation or approximation, have a weaker legal basis in the Treaty than indirect taxes. In order to harmonise direct taxes the only legal grounds that can be used are the general provisions on approximation of laws in Articles 94-95 and the provision in Article 308 that can be used to adopt what is referred to as “appropriate measures”. Instead the Community institutions have used the general objectives in the Treaty to justify legal action in the field of direct taxation. Such are for example the free movement of workers in Article 39, the freedom of establishment in Article 43, the free movement of capital in Article 56, the functioning of the common market in Article 94 and the prevention of distortions of competition in Article 96.<sup>39</sup>

When the Community has adopted direct tax measures, these have with only one exception been based on the general provisions in Article 94-95. However, Article 95 is not applicable to tax matters since Member States are not prepared to limit their sovereign rights without having the possibility of vetoing.<sup>40</sup> This leaves us only Article 94 as a legal authority for harmonising direct taxes. This Article is directed at domestic laws that directly affect the establishment or functioning of the common market and can only provide for directives.<sup>41</sup> So far, only two directives dealing with direct taxes have been based on Article 94. These are the so-called Mergers Directive and the Parent-subsidiary Directive that were adopted during the same Council meeting in July 1990.<sup>42</sup> There have been many other proposals with Article 94 as a legal base but none of these have been adopted.<sup>43</sup>

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<sup>39</sup> European Parliament Working Paper: *”Tax Co-ordination in the EU – the latest position”*, ECON 128 EN 12-2001, Luxembourg 2001, p. 9; Quitzow, Carl Michael von: *State measures distorting free competition in the EC*, The Hague, 2002, pp. 183.

<sup>40</sup> Article 95 (2).

<sup>41</sup> Article 94.

<sup>42</sup> Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States, O.J. L-225, 20.08.1990; Council Directive



The decision-making process laid down in Article 94 has a demand for a unanimous voting in the Council. It is not hard to understand why this condition has acted as a brake for adopting common rules for direct taxation. Some countries, like Germany and France, demand that the unanimity in the taxation area shall be abandoned while other countries, like Great Britain and to some extent Sweden, oppose this since it would eliminate an important part of the national sovereignty. Such a change would also create a greater deal of federalism in the Union. Another problem is that the number of Member States has increased. This has of course not made it easier to deal with the veto-right. The Treaty of Nice changed many voting procedures in different areas of EC law but the requirement for unanimity in Article 94 was left unchanged.<sup>44</sup>

As just stated, Article 308 is not commonly used as a legal base for tax measures and it has rarely been used at all. The article provides that if action should prove necessary in order to safeguard the common market the Council may carry out the appropriate measures. Article 308 requires unanimity and that the “Treaty has not provided the necessary powers”.<sup>45</sup> The only adopted act of interest to us is the EC regulation on the European Economic Interest Grouping. The tax provision in this regulation is however only of interest when looking at the tax treatment of such an Interest Grouping and will not be discussed further.<sup>46</sup>

Article 293 of the EC Treaty is another provision that encourages the Member States to negotiate with each other in order to secure the abolition of double taxation within the Community. Only one tax measure has had this Article as the basis. That measure is the Convention on Arbitration in Transfer Pricing Disputes that was adopted by the Council in 1990 and it is of no further interest to this thesis.<sup>47</sup>

Finally, Articles 96-97 provide a safety valve for certain crises that demands Community action even if the requirement for unanimity is not fulfilled. In order to take the appropriate measures to handle such market crises a procedure with qualified majority in the Council and with the consultation of the

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90/435/EEC of 23 July 1990 on the common system of taxation applicable to parent companies and their subsidiaries in different Member States, O.J. L-225, 20.08.1990

<sup>43</sup> For example: Proposal for a Council Directive on a common system of taxation applicable to interest and royalty payments made between parent companies and subsidiaries in different Member States, COM (1990) 571 final, O.J. C-53, 28.02.1991.

<sup>44</sup> Treaty of Nice, amending the Treaty on the European Union, The treaties establishing the European Communities and certain related acts, O.J. C-80, 10.03.2001, entered into force 1 February 2003.

<sup>45</sup> Article 308.

<sup>46</sup> Council Regulation (EEC) No 2137/85 of 25 July 1985 on the European Economic Interest Grouping, O.J. L-199, 31.07.1985, Article 31 (1) 2p.

<sup>47</sup> 90/436/EEC: Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises - Final Act - Joint Declarations - Unilateral Declarations, O.J. L-225, 20.08.1990.

Commission is laid out.<sup>48</sup> The Commission has so far only threatened to use these Articles in tax matters. However, it is possible that these provisions in the future will be used in order to enforce consultations and recommendations. They can then be used in order to put pressure on a state to amend a national tax policy that is disturbing cross-border competition.<sup>49</sup> If these measures should not be enough, and the distortion has to be eliminated, the only available remedy is legislative actions. To use the safety valve in this way should not be contrary to the subsidiarity principle in Article 5.<sup>50</sup>

To summarise the legal grounds for judicial action regarding direct taxes it is obvious that the basis in the EC Treaty for such tax measures is weak. Judging from the Articles the decision-making process remains as a collective right for the Member States and not a Community institution right. Opposite to indirect taxes that can be harmonised via regulations and other measures, the only available instrument in the field of direct taxation is, because of the wording in Article 94, directives. However, the Commission also use Recommendations, but these are not legally binding even though they may have influence on the case law of the ECJ. But even if the Treaty does not provide extensive ground for legal action in the field of direct taxation, the Member States' right to tax is nevertheless limited mainly through the judgements of the ECJ, as will be described below, but also via the State aid provisions.

## 4.2 The role of the ECJ

Even though EC law does not interfere much on the Member States' right to tax there are limitations on the adoption of national legal acts. Just by becoming a member of the European Union the Member States has given up parts of their right to tax as guaranteed under international law. The ECJ has for instance stated that national income taxation must not lead to that discrimination of cross-border transactions is possible. Neither is it allowed for tax law to complicate the development of the internal market.<sup>51</sup> These aspects will now briefly be examined.

The EC Treaty provisions on fundamental freedoms have formed an important part of EC law in many areas. Taxation is not excluded from this. The fundamental freedoms (including the free movement of goods, persons, services, capital and the elimination of restrictions of the right to establishment) form an important part of the internal market.<sup>52</sup> The provisions are

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<sup>48</sup> Articles 96-97.

<sup>49</sup> Unless the measure falls under the provisions regarding State aid in Article 87 which is a stronger tool, see further on in the thesis.

<sup>50</sup> Terra 2001, pp. 16.

<sup>51</sup> Ståhl, K and Österman, R: *EG-rätten och det svenska skattesystemet*, Expertrapport 5 till Skattebasutredningen, Stockholm 2001, p. 79.

<sup>52</sup> Articles 3, 14. The four freedoms are developed in Articles 23, 39, 43, 49, 56.

characterised by non-discrimination and the guaranteed free access for economic subjects from one Member State in all the other Member States.

In the Treaty it is clearly stated that the fundamental freedoms exercise their prohibitive effects in the area of indirect taxes.<sup>53</sup> However, the ECJ early made it clear that these provisions also apply to direct taxes.<sup>54</sup> The ECJ has strengthened the effect of the freedoms during the last years and it is now settled case law that the Articles also will cover indirect discrimination.<sup>55</sup> This was very important for tax law since such provisions normally discriminate on a taxpayer's residence rather than on nationality.<sup>56</sup> The Court has not settled with this but has also interpreted the Articles as meaning that the Member States must also avoid restrictions that restrain access to a national market irrespective of any distinction between domestic and foreign legal subjects.<sup>57</sup>

It is also clear that the fundamental freedoms cannot be used to establish a legal ground for any extensive approximation in the area of direct taxation. The ECJ has in its case law made it clear that mere differences between domestic tax systems, tax bases or tax rates cannot be regarded as a restriction or discrimination.<sup>58</sup> This conclusion is fully compatible with the strong sovereignty that the Member States have in the taxation area and there is no right to claim the same level of taxation throughout the Community. Some authors refer to the ECJ case law as a "hidden harmonisation"<sup>59</sup> but we face the same problems here as when we were trying to link the State aid provisions to the concept of harmonisation above.<sup>60</sup>

One negative aspect of the fundamental freedoms, as far as the EU (and OECD) fight against harmful tax competition is concerned, is that reverse discrimination is not covered by these.<sup>61</sup> Harmful tax competition aims at attracting foreign investors via tax advantages. Reverse discrimination, i.e. when a Member State puts its own citizens at a disadvantage, is not covered by the fundamental freedoms since the EC law provisions on free

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<sup>53</sup> Articles 90-91.

<sup>54</sup> See for example: Case 270/83, *Commission v. France*, [1986] ECR 273, para. 23-24; Case C-264/96, *Imperial Chemical Industries plc (ICI) v. Kenneth Hall Colmer*, [1998] ECR I-4695, para. 19.

<sup>55</sup> Case C-279/93, *Finanzamt Köln-Altstadt v. Roland Schumacker*, [1995] ECR I-225, para. 38.

<sup>56</sup> Schön, Wolfgang 2000, p. 97.

<sup>57</sup> For example Case C-10/90, *Masgio v. Bundesknappschaft* [1991] ECR I-1119, para.18, 19 Case C-18/95, *Terhoeve v. Inspecteur van de Belastingdiens*, [1999] ECR I-345, para. 39, 41.

<sup>58</sup> Compare with references in Schön 2000, p. 98.

<sup>59</sup> Lehner, Moris: "Limitation of the national power of taxation by the fundamental freedoms and non-discrimination clauses of the EC treaty". In: *EC Tax Review* 2000, p. 6.

<sup>60</sup> Since it is a form of negative integration it does not fill out the space that is left when an obstacle has been removed. Therefore it cannot be labelled harmonisation with the terminology used in this thesis.

<sup>61</sup> The State aid rules provide an alternative tool from this point of view and will be discussed in detail further on.

movement will not be applicable if the situation is purely internal.<sup>62</sup> This means that it, under EC law, is considered to be up to the Member State itself to handle internal matters like these.

If a cross-border link should be established, the situation would be different and the tax treatment would be an infringement with EC law if the rule in question interferes with a Community freedom. The ongoing discussion on so-called home-state restrictions regarding the freedom of establishment is important with regard to this.<sup>63</sup>

## 4.3 The switch of priorities in the work of the Commission

### 4.3.1 The early days - extensive harmonisation

Tax competition is an area that has been highlighted more and more during the last two decades. During the same period several of the Member States have carried out tax reforms. These reforms have led to a broadening of the tax bases and a reduction of tax levels.<sup>64</sup> In the following chapter I will give a brief background on the development of direct tax reform efforts in the EC.

The effects of having different tax systems in the Member States are not a newly discovered problem. In the sixties a financial and fiscal committee emphasised that it was necessary to abolish these differences. The early proposals were very extensive and demanded more or less a full harmonisation, i.e. from the collection of tax to the tax base, in line with the above mentioned equalisation approach. However, it was soon to be seen that harmonisation of direct taxes was a larger problem than anyone could have imagined. The results of different proposals became, with only a few exemptions, nothing more than delayed compromises that were almost meaningless. Not even one proposal concerning harmonisation of direct taxes was accepted for nearly 25 years. One of the main reasons for this failure is the veto-right for the Member States in the taxation area.<sup>65</sup>

Some important but not pioneering decisions and proposals were made up to 1990. For example in 1968-69 there was a proposal for a Merger Directive

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<sup>62</sup> Case C-132/93, *Volker Steen v. Deutsche Bundespost*, [1994] ECR I-2715, para. 9-10; Cases C-330/90 and C-331/90, *Lopez Brea*, [1992] I-323, para. 7.

<sup>63</sup> This term can be defined as meaning rules that prohibit the Member State of origin from hindering one of its own nationals from making use of the freedom of establishment in another Member State. See further on this matter, Bergström, S. and Bruzelius, A.: "Home-state restrictions on the Freedom of Establishment in a Swedish Income Law Perspective". In: *Intertax* 2001, p. 233-241.

<sup>64</sup> SOU 2002:47, Andersson, Krister: *Expertrapport 6 till skattebasutredningen*, Stockholm 2002, p. 125.

<sup>65</sup> Andersson 2002, p. 125; Schön 2000, pp. 95.

and a Parent-Subsidiary Directive. These were however not adopted until 1990. The Commission tried to propose different models in the seventies and eighties but none of these led to any results.<sup>66</sup> The only directive that was adopted concerning direct taxes during the seventies was the Mutual Assistance Directive but this had nothing to do with the taxes as such. It only dealt with the administrative side of direct taxes and concerned the exchange of tax information between Member States.<sup>67</sup>

Corporate tax has always been high on the agenda and several attempts to harmonise it has been made. In 1992 the important conclusions of the Ruding Committee was delivered in an extensive report.<sup>68</sup> The assignment was to examine whether the differences in corporate taxation between the Member States caused major distortions to the internal market and what measures that were necessary to remove such distortions. The Committee found that there were considerable differences in the national tax laws of the Member States and several recommendations for the future were made. If one should summarise the conclusions it can be said that they aimed at an extensive harmonisation of corporate income taxes and the elimination of double taxation. As far as this thesis concerns the harmonisation should be carried out in three phases leading to a common system with a standardised tax base and an express stipulation of minimum tax rates.<sup>69</sup> Even though the report was met with general approval the Commission did not convert the recommendations into proposals for directives, etc. Some of the ideas in the report regarding the discriminatory effects of imputation systems have however been followed by some Member States and in the judgements of the ECJ. The report also led to a change of the Commissions guidelines and a couple of propositions, but none of these led to any result.<sup>70</sup>

### **4.3.2 Coordination and alternative methods in the field of direct taxation – the work against harmful tax competition**

From 1990 a clear change in attitude can be seen in the proposals put forward by the Commission even though the original idea of an extensive harmonisation was not completely abandoned. The work in the institutions today is much more political and less theoretical compared to the earlier work. In its guidelines the Commission stresses that Member States should remain free to adopt national tax policies except when this could lead to major distortions. That today's attitude is a lot softer can for example be seen in the "tax package" that was proposed by the Commission in 1997 after discus

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<sup>66</sup> Terra 2001, p. 174-176.

<sup>67</sup> Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation, O.J. L-336, 27.12.1977.

<sup>68</sup> Commission of the European Communities: *Report of the committee of independent experts on company taxation*, March 1992, Luxembourg 1992.

<sup>69</sup> The Ruding Report, pp. 201.

<sup>70</sup> Terra 2001, pp. 183, 187-189.

sions in the High Level Group.<sup>71</sup> This Commission communication talks about a coordinated approach to tax competition instead of harmonisation and tax competition is even welcomed in some parts.<sup>72</sup> In 1990 the Council finally adopted the Merger Directive and the Parent-Subsidiary Directive that had been proposed more than 20 years earlier but apart from this there has been no new luck with legally binding measures. However there are several proposals that might lead to decisions in the future that are pending at the time of writing.

The nineties saw not only a change of attitude in the work of the Commission. The attitudes in the Member States also changed. International tax competition is much more obvious today and as a result of this many States feel that the national fiscal sovereignty (i.e. the right to tax) is already being limited to a high degree. Compared to this development the coordination of tax provisions within the Union would not limit the sovereignty more than international tax competition already does.<sup>73</sup>

Following the difficulties in adopting binding legal documents the Commission turned to soft law instead, i.e. recommendations, policy guidelines, political gentlemen's agreements and other non-binding documents.<sup>74</sup> Even if recommendations are not legally binding they can still be important for the judicial process.<sup>75</sup> An advantage for recommendations is that the Commission has an explicit right to formulate such recommendations, which makes them a lot easier to adopt than directives, which require unanimity in questions regarding taxation. The Commission may formulate recommendations on matters of the Treaty when it expressly so provides or if the Commission considers it necessary.<sup>76</sup>

The Commission issued two recommendations in 1994,<sup>77</sup> although more important, as far as this thesis concerns, is the so-called "Monti paper" that was issued two years after this. This is the first time that unfair competition and its potentially negative effects is set out as one of the main challenges of taxation policy in the EU. The discussion paper recognises the problems with a tax burden that has shifted to a less mobile tax base, namely labour. The two main problems for coming to conclusions in the area were, according to the paper, the demand for unanimity and the lack of a comprehensive strategy for tax policy.<sup>78</sup> Many proposals are put forward but what is most

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<sup>71</sup> See more on this further on in the thesis.

<sup>72</sup> COM (1997) 495, p. 2. The tax package will be discussed further under chapter.

<sup>73</sup> Schön 2000, p. 96.

<sup>74</sup> This increased importance of soft law solutions is not exclusive to direct taxation, see for example: Craig, P and De Búrca, G: *EU Law – Text Cases and Materials*, Oxford 1998, pp.108.

<sup>75</sup> Article 249.

<sup>76</sup> Article 211.

<sup>77</sup> None of these are of any concern to the following text and will therefore not be dealt with, for further reading see: Terra 2001, pp. 189.

<sup>78</sup> SEC (1996) 487, p. 3, 4, 10.

interesting is that a clarification of the State aid to tax incentives is deemed necessary.<sup>79</sup>

Further support to the work against harmful tax competition came later the same year. A report from the High Level Group that was formed as a result of the “Monti paper” gave the need to eliminate or restrain unfair tax competition high priority. The need to apply State aid rules consistent and transparent was also highlighted.<sup>80</sup>

#### **4.4 Current focus and priorities in the EU – harmful tax competition high on the agenda**

Tax competition is most obvious, although not limited to, within the area of company taxation. New tax reductions are notified in this area and it is quite clear that the States consider that they can gain from continuing with tax competition. The focus on tax competition with direct taxes in the EU today will now be described.

One of the most important problems that the European tax systems face today are that when the Member States’ economies are getting closer linked together via the EMU, the differences between the different taxation systems are getting more and more obvious. Tax obstacles are also a problem for companies (and citizens of the Union) when they wish to use the internal market. Increasing globalisation is also making it easier to move capital and in this way evade tax and it challenges every tax system to a high degree.<sup>81</sup> Altogether this means that the internal market is disturbed, a disturbance that needs to be reduced. To this comes that Member States fear the loss of tax revenue. One can add to this that in community discussions it is often highlighted that an extensive problem is the trend that tax on labour income has increased while it has decreased on more mobile tax bases, like capital. This is something that the Institutions and the Member States would like to reverse.<sup>82</sup>

Another problem that will challenge the European tax systems is the enlargement of the Union. The community is facing its biggest enlargement ever (13 candidate countries). Adopting new legal tax law documents will certainly not be easier in the future if the system remains the same.<sup>83</sup>

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<sup>79</sup> SEC (1996) 487, p. 13.

<sup>80</sup> Taxation in the European Union – Report on the Development of Tax Systems, COM (1996) 546 final, not yet published in the O.J., para. 3.13, 3.15.

<sup>81</sup> Bolkestein, Frits: ”Taxation and Competition: The Realization of the Internal Market”. In: *European Taxation*, 2000, p. 401.

<sup>82</sup> See for example: COM (1997) 495, p. 2.

<sup>83</sup> Birk Jacobsen, Susanne: “Editorial, Enlargement of the European Union – taxation”. In: *EC Tax Review*, 2000, p. 216.

The EMU argument has been criticised since some commentators mean that there is no grounds for such an argument since the level of taxation in the individual Member State depends on the standard of social welfare. EMU should not change this, according to their opinion, since it must remain possible for each country to determine these questions itself. The same commentators states that the shift in tax burden to labour is primarily caused by the States failure to make adjustments in their collective sector and their traditionally low tax burden on capital. Therefore, this is not a successful argument according to them.<sup>84</sup>

Mario Monti was replaced by Frits Bolkestein as Taxation Commissioner in 2000 and he soon made it clear once and for all that a full harmonisation is neither necessary nor desirable. This is off course a statement that is obvious against the background laid out above. A communication from the Commission from 2001 outlines the tax policy in the Union during the coming years. When studying this it is clear that one of the main focuses is to fulfil the strategic goal for the EU to become the most competitive economy in the world. This, states the communication, is a reason to see European tax policy in a new perspective. It is also highlighting the importance to see the European Economy as a part of the global economy. Other goals that a European taxation policy should try to fulfil are that the internal market will continue to develop and to create a reduced tax burden within the EU.<sup>85</sup>

According to the communication the work aimed at tackling *harmful* tax competition must continue in the years to come. Such harmful tax practices have been identified and the plan is that many of these will be eliminated. This work is not limited to the Member States since a similar work has, as mentioned above, been done in OECD. However, it is certainly not clear how extensive the co-operation should be in the corporate tax area. The main challenge is if today's problems can be fought with intact national tax systems or if other measures are needed. The Commission opinion seems to be that a common set of rules in the corporate area would be a good solution.<sup>86</sup>

Onno Ruding considers that it would be contradictory and illogical to do nothing to remove the tax distortions that remain in the EU. After having created an internal market, the EMU and an increased cross-border activity, he believes that the progress towards a corporate tax reform is unavoidable.<sup>87</sup> That the work to tackle harmful tax competition is high on the

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<sup>84</sup> Klaver, J. and Timmermans, A.: "EU taxation: policy competition or policy coordination?". In: *EC Tax Review*, 1999, pp. 186.

<sup>85</sup> Communication from the Commission, Priorities for the years ahead, COM (2001) 260 final, O.J. C-284, 10.10.2001, p. 6, 8.

<sup>86</sup> COM (2001) 260, p 15, 25.

<sup>87</sup> Ruding, Onno: "The long way to removing obstacles in company taxation in Europe". In: *European Taxation*, 2002, p. 3.



agenda can also be seen in the Commission's yearly rapport on the EU competition policy.<sup>88</sup>

## 4.5 Conclusions

The way I see it there are three dimensions that need to be analysed when trying to understand the problems with reforms and harmonisation/coordination efforts in the Community. The first, and most important to this thesis, is the legal dimension. The problems in this area are at least two-fold. To begin with the lack of a clear legal base in the area of direct taxation is naturally a problem and tends to make efforts strained. Furthermore, the unanimity rule has acted as a major brake to all measures in this area. This has led to more or less successful compromises and methods that would not have been the first choice if alternatives were given. To this comes that the founders of the Treaty probably did not intend many of these reforms.

Secondly, it is quite obvious that the political dimension has acted restraining. The starting point when looking at any action in the taxation field from this point of view must be the importance of national sovereignty. This principle has for long been an accepted part of the public international law. Taxation is an important part of this principle. The main reason for this is that the government cannot realise any political goals without tax revenues. The right to tax is a very powerful tool and of essential importance to all Member States. This is probably the reason why the impact of EC law on direct tax is rather limited compared to many other areas. The Member States are very afraid to let go of the tax sovereignty, which is one of the holiest parts of the State's functions. This makes measures that challenge the tax sovereignty of a Member State a highly sensitive and delicate question. This is also reflected in the just mentioned demand for unanimity in Article 94. The third dimension, and perhaps less important than the others, is of an economic character. Nevertheless the theory on tax competition as something positive has strengthened its position and I am quite positive that this has affected the attitude in the institutional work.

As has been shown above these difficulties and the problems they have created have driven the institutions to new and more creative attempts than the classical harmonisation approach. Soft law solutions, a more active role of the ECJ and new concepts for company taxation are a couple of these measures. However, soft law solutions tend to get ineffective and have not got the same dignity as legally binding measures. The problems in the area are also characterised by the approaching expansion of the EU that puts a time limit on the work. Another factor in favour of a quick solution of the problems is if one is convinced by the arguments in favour of fighting harmful tax com

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<sup>88</sup> Europeiska Kommissionen, "XXXI:e rapporten om konkurrenspolitiken", 2001, SEK (2002) 462 slutlig, p. 80.

petition and the approximation of tax law in areas like corporate tax. The trend in the work of the Commission is that Member States will in principle continue to be free to set their tax systems and tax policies but specific measures will be tested against the regulations of free and fair competition.

Much of the work regarding direct taxation in the Community over the last couple of years has been directed against harmful tax competition. The Commission has more and more accepted that partial tax competition may be positive but there seems to be a relatively widespread consensus that parts of the tax competition shall be deemed harmful and therefore be eliminated or restrained. The will to work against such competition has at least got a broad base of followers in the institutions. However, the difficulties with positive integration, i.e. decisions via the political decision-making process (leading to the adoption of legally binding documents in the Council), remains. This has made negative integration (i.e. the removal of obstacles) a more attractive way to fight harmful tax competition. One of these methods, that have a strong legal basis in the Treaty, is the EC State aid provision in Article 87. Another positive factor is that this method, if it can be used, is a tool already available. I will now examine these rules and the role that they can play in the work against harmful tax competition.

# 5 State aid as a method for fighting harmful tax competition – general aspects

## 5.1 A more systematic approach - the tax package and the Code of Conduct

As has been seen above, the Commission abandoned its rigorous plans for full direct tax harmonisation more and more during the first part of the nineties. Instead, the idea of eliminating and restraining harmful tax competition via soft law and other alternatives to Article 94 (then Article 100) grew stronger via the “Monti paper” and the report from the “high level group” as discussed above. The next step in this process was the Commission's proposition on a so-called tax package in October 1997.<sup>89</sup> Three of the measures in this package to tackle harmful tax competition concerned direct taxes. The most important of these were the Code of Conduct for Business Taxation (in the future referred to as the Code of Conduct or the Code) along with a communication from the Commission on fiscal State aid (was instead adopted as a notice).<sup>90</sup> The Code of Conduct is said to be the key element of the tax package and the Council endorsed it in an amended version in December 1997.<sup>91</sup>

The Code of Conduct is a non-legally binding document (a political agreement of soft law character), though it is binding on the political level.<sup>92</sup> The definition of harmful tax competition in the Code has already been discussed in the terminology chapter. The Code of Conduct deals with two different commitments of the Member States. According to paragraph C the States commit themselves not to introduce new tax measures that are harmful (this commitment is labelled standstill) and according to paragraph D they commit themselves to re-examine their existing laws against the principles in the Code of Conduct and eliminate existing harmful measures in five years (this commitment is labelled rollback).<sup>93</sup> Other important measures in the Code of Conduct were an information exchange and co-operation in the fight against tax evasion and avoidance.

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<sup>89</sup> COM (1997) 495.

<sup>90</sup> The other two direct tax measures concerned taxation of capital income and withholding taxes on interest and royalties.

<sup>91</sup> Code of Conduct for business taxation; Communication from the Commission, A package to tackle harmful tax competition, COM (1997) 564 final, not yet published in the O.J.

<sup>92</sup> See for example COM (1997) 495, para. 14.

<sup>93</sup> Code of Conduct for business taxation, para. C-D; Conclusions of the ECOFIN Council meeting on December 1 1997, para. 1.

A High Level Working Group was established in 1998, the so-called Primarolo Group. It was set up to examine and exchange information on tax measures that could be included under the Code of Conduct.<sup>94</sup> The Primarolo Group has delivered its final report in November 1999.<sup>95</sup> The Group examined 271 tax measures within the Member States and in Territories that had some kind of association to these. The Group found that 66 of these affected the location of business in a significant way.<sup>96</sup>

It is stated in the communication from 1997 that many Member States had urged the Commission to re-examine its policy in the field of fiscal State aid. The purpose was to make it possible for the Commission to make full use of the rights conferred to it under the Treaty rules in order to combat harmful tax competition. The intention was to conduct this work in parallel with the implementation of the other parts of the tax package.<sup>97</sup> State aid is also discussed in the Code of Conduct. The Council noted that some of the measures that the Code of Conduct aimed to tackle might also fall within the scope of the State aid rules in the Treaty.<sup>98</sup> It is against this background that the notice on the application of the State aid rules from the Commission must be seen.<sup>99</sup> This notice was published in December 1998 and explains how the Commission considers that Article 87 (1), then Article 92, should be applied in the field of corporate taxation. It will be discussed further in the following.

On November 27 the Ecofin ministers of finance agreed on two documents that are of importance to the work under the Code of Conduct. The first was a timeline for phasing out the measures considered harmful under the Code. According to the timeline for rollback (as described above) the phasing out of harmful tax measures should start in 2002 and be completed in December 2005. However, this deadline may be extended on a case-by-case basis. The second document includes guidelines for identifying and eliminating harmful finance branch, holding company and headquarter company regimes.<sup>100</sup>

## 5.2 EC competition law and taxation

As far as taxation is concerned it might seem unclear at first sight how this should be linked to competition law. It is clear though that advantages via taxation incentives might create an indirect subvention similar to State aids. Before the Monti paper and the measures following this initiative the Com

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<sup>94</sup> Terra 2001, p. 194.

<sup>95</sup> Primarolo Report.

<sup>96</sup> Primarolo Report 1999, para 30.

<sup>97</sup> COM (1997) 495, para. 17; COM (1997) 564, para. 13.

<sup>98</sup> Code of Conduct for business taxation, para. J.

<sup>99</sup> Commission 1998 notice.

<sup>100</sup> Conclusions of the Ecofin Council, 27 November 2000, Doc. 13898/00 FISC 207. The Ecofin Council agreed on the solutions that were proposed by the Presidency on November 20 2000; Presidency note, 20 November 2000, Doc. 13555/00 FISC 190.

mission was very restrictive in handling fiscal measures under the State aid rules.

State aid is by no means a set of rules only aimed at measures regarding taxation. On the contrary, Article 87 has a broad application. Aid via taxation measures, i.e. fiscal aid, is just one of many measures that can be discussed under this set of rules. Instead the main goals with the rules concerning distortions of free and fair competition are to ensure that private companies act on the basis of economic rationality in a free market.<sup>101</sup> This includes the desire that the State should minimise its influences on economic behaviour. Any taxation system will however influence this sphere and no economy could probably be able to function without such systems. Another issue is that this influence needs to be reduced to a minimum level.<sup>102</sup>

The State aid provisions in the Treaty have for long been an important part of EC Competition law. The main reason for the EU institutional bodies to maintain a control over this area is that aids granted by governments affect free competition by giving some competitors an advantage. There are however aids that have a desirable justification from economic and social points of view. Examples of such measures can be aid granted to firms that invest in depressed areas of a country or to a big firm with financial problems in order to preserve employment. In those cases it is important that free competition is restored as soon as possible and that the benefit from these actions outweighs the harm created to free competition.<sup>103</sup> It is important to observe that the Commissions right to enforce these rules is a *de facto* monopoly since there up to 1997 were practically no Council legislation in this area. This has led to a large discretion for the Commission when applying these rules and creating a State aid policy. The Commission has with different soft law measures created a substitute for hard legislation.<sup>104</sup>

The usage of these provisions in taxation matters is not a new phenomenon. The rule regarding the constraints of support measures has for example played an important role in shaping parts of the indirect taxation system. They have also been frequently used in the income taxation field but before the Code of Conduct and the Commission notice from 1998 were adopted the usage of the rules focused on the question of whether the tax measure

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<sup>101</sup> The rules concerning free and fair competition are apart from the State aid rules also the rules on the fundamental freedoms.

<sup>102</sup> Schön, Wolfgang: "Taxation and State aid law in the European Union". In: *Common market law review*, 1999, pp. 913; Quitzow 2002, pp. 154.

<sup>103</sup> Pinto, Carlo: "EC State aid rules and tax incentives: A U-turn in Commission policy? (Part I)". In: *European Taxation*, August 1999, p. 295.

<sup>104</sup> Fantozzi, Augusto: The Applicability of State aids rules to tax competition measures: A process of "de facto" harmonisation in tax field?, <http://www.eatlp.org> (2003.01.25), Lausanne 2002, pp. 1.

had any adverse effects on the functioning of the common market and if this measure could be justified.<sup>105</sup>

Fiscal State aid differs from the classical usage of the State aid term since instead of spending the revenues the State forgoes the revenue it would otherwise receive from the taxpayer. This creates a possibility for the Member States to persuade international businesses to relocate. Another attractive side of these aids, from the government's point of view, is that the aid is often well hidden from control.<sup>106</sup>

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<sup>105</sup> Vanistendael, Frans: "Fiscal support measures and harmful tax competition". In: *EC Tax review*, 2000, pp. 153.

<sup>106</sup> Monti, Mario: "European policy towards fiscal state aid", Speech 22.01.2002, available online in the Commission pressroom: [http://europa.eu.int/comm/press\\_room/](http://europa.eu.int/comm/press_room/) (2003.03.20).

# 6 EC law provisions on State aid

## 6.1 Introduction, EC Treaty Articles affecting State aid

The State aid rules are an important part of monitoring free competition within the Union. Article 3 (g) of the Treaty states that one of the Unions main activities shall be the creation of a “system ensuring that competition in the internal market is not disturbed”.<sup>107</sup> Further rules on competition are to be found under Title VI, Chapter 1 in the Treaty. The second section under this title concerns State aid, i.e. Articles 87-88. The substantial legal provisions are contained in Article 87 while Article 88 is of procedural character. None of these are comprehensive which, as will be shown further on, has led to increased importance for secondary EC law and the case law from the ECJ.

## 6.2 Article 87 (1) EC

### 6.2.1 Introduction

Article 87 consists of three different parts. The first leg of Article 87 (1), “save as otherwise provided”, shows that the paragraph is of secondary nature.<sup>108</sup> In line with the *lex specialis* principle the Article should only be used only when another rule does not exist. Such rules can be found in the transport sector, in the agricultural sector, etc.<sup>109</sup>

The first part continues by laying out the criteria that must be fulfilled in order to apply the principle of the incompatibility of State aid with the common market. A couple of exceptions to this is laid out in paragraph 2 and 3 and if these are fulfilled the State aid will be considered acceptable. The wording of Article 87 (2) provides three categories of aid that *shall* be compatible with the common market and paragraph 3 provides five situations/categories that *may* be considered compatible with the common market. Measures under paragraph 2 must be authorised by the Commission but if the criteria is met this will automatically make the exemption applicable. The only power conferred to the Commission is therefore to examine whether the criteria is satisfied by the facts.<sup>110</sup>

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<sup>107</sup> Article 3 (g). This Article is one of the means to fulfil the main goals set up in Article 2.

<sup>108</sup> Article 87.

<sup>109</sup> See, for example Article 76 and Article 34.

<sup>110</sup> Article 87 (2).

The third paragraph differs from the second since the Commission is given discretionary power to examine if the criteria in the paragraph are met or not. The Commission has published a number of materials in order to clarify the conditions that it uses when it applies the paragraph. This discretion of the Commission is extensive, which has been confirmed by several of the judgements from the Court of the Community.<sup>111</sup> When exercising its rights the Commission considers whether the State aid measure is in line with the Union interest as a whole and if it is limited only to the necessary methods.<sup>112</sup> Whether an aid will be comprised by the prohibition in paragraph 1 is therefore to a high degree depending on how the application of the exemption provisions in paragraph 2-3 is carried out.

I will now examine the criteria in the first paragraph of the Article before I will continue with the application of these rules in order to combat harmful tax competition. I will not discuss the exceptions that can be found in paragraph 2-3 further since they are in my opinion of little relevance to the purpose of this thesis.

## **6.2.2 The criteria laid out in Article 87 (1)**

### **6.2.2.1 The broad definition of aid**

Article 87 covers, according to the first part of paragraph one, “any aid... in any form whatsoever”. The Article itself does not provide any definition of aid and the ECJ and the Commission have adopted a broad interpretation on what constitutes State aid. The intention behind not providing any definition is clearly that this makes the scope of the concept less restricted.<sup>113</sup> The normal situation is when the State is funding a single enterprise or a group of enterprises and thereby interfering the market otherwise not affected by the State. In the area of tax legislation the situation is quite the opposite. For the first, the State is present everywhere and secondly the free competition is not guaranteed by non-interference from the public but instead by the collection of taxes from all taxpayers who are in a comparable situation.<sup>114</sup>

The Commission notice from 1998 states that the application of the Article is possible regarding tax measures since the Article applies to aid measures in any form whatsoever.<sup>115</sup> This statement is not very controversial since it is long accepted in EC law that a tax measure that lead to that the State refrains to collect tax, or collects less than it should have, from a group of taxpayers (or a single one) will qualify as aid under Article 87. The shape

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<sup>111</sup> See, for example, Case C-78/76 *Firma Steinike and Weinlig v. Bundesamt für Ernährung und Forstwirtschaft* [1977] ECR 595.

<sup>112</sup> Evans, Andrew: *European Community Law of State Aid*, Oxford 1997, p. 10.

<sup>113</sup> Evans 1997, p. 26.

<sup>114</sup> Schön 1999, pp. 920.

<sup>115</sup> Commission 1998 notice, para. 8.



that the aid takes is thereby irrelevant.<sup>116</sup> The Treaty does not provide any further definition of aid and there is not one provided in the notice either.

If we examine the Court's case law more closely aid was defined for the first time as early as 1961. However, this case has remained a landmark decision long after this. According to this Judgement State aid includes "not only positive benefits, such as subsidies themselves, but also interventions which, in various forms, mitigate the charges which are normally included in the budget of an undertaking and which, without, therefore, being subsidies in the strict meaning of the word, are similar in character and have the same effect".<sup>117</sup> It is clear from this that the concept of aid is broader than that of subsidy. The neutrality of the concept of aid has been confirmed in later decisions.<sup>118</sup>

It is possible to systematise fiscal State aid in three categories based on the different elements used to calculate the tax liability and to ensure the collection of the taxes due.<sup>119</sup> One category will then include tax incentives that effect the calculation of the taxable base. Measures included in this group are those that effects or modifies the method that would normally be used when the final taxable amount is calculated. The main problem that this group faces is that they are often well hidden in the general tax system or granted via administrative powers that are not published or accepted at all. This makes these measures hard to detect. The second category consists of measures that via for example a reduced or a zero tax rate applying to income from certain activities lead to a modification of the tax liability due by taxpayers. The third and final category deals with the enforcement of tax claims. An example of a measure falling under this is every measure that leads to that the state gives up or abandons its right to collect the tax. Also incentives falling under this final category are very hard to detect since they often take place on a case-by-case basis.

### **6.2.2.2 Granted by a Member State or through State resources**

The advantage of the aid must be "granted by a Member State or through State resources".<sup>120</sup> This criterion is not likely to create problems when discussing tax measures since these measures have a natural connection to State resources. The leading case concerning State resources is the *PreussenElektra AG* case from 2001. In this case the ECJ defined state re

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<sup>116</sup> For example: Case 70/72, *Commission v. Germany*, [1973] ECR 813; Case C-387/92, *Banco Exterior de España SA v. Ayuntamiento de Valencia*, [1994] ECR I-877, para. 13-14.

<sup>117</sup> Case 30/59, *De Gezamenlijke Steenkolenmijnen in Limburg v. High Authority*, [1961] ECR English special edition 3, para 19. This case did not concern Article 87 (1) but Article 4c in the ECSC Treaty.

<sup>118</sup> See for example, Case 173/73, *Republic of Italy v. Commission*, [1974] ECR I-709, para. 13.

<sup>119</sup> This categorisation is based on Pinto (Part I) 1999, p. 303.

<sup>120</sup> Commission 1998 notice, para. 10.

sources in the following way. In order to qualify as State aid it was not enough that the prerogative was supplied by the State. It should also be granted direct or indirect by State resources.<sup>121</sup> The distinction between “aid granted by a Member State” and aid granted “by State resources” does not imply that all advantages given by a State should be included. It does however imply that only advantages granted directly by a Member State or a private or public organ set up or appointed by the State should be included under the wording of Article 87 (1).

The term “Member State” is given a broad application and includes aid granted by federal, regional and local bodies in the Member States.<sup>122</sup> The State aid rules may be applicable also when the reduction of the State revenues is of potential nature.<sup>123</sup> However, it will not be in conflict with the Article if the measure improves the general economic and legal prerequisites and does not in itself inflict any cost upon the State.<sup>124</sup> The requirement for aid “granted” from the State will neither be fulfilled in some cases when the State places extra tax burden on certain agents or activities.<sup>125</sup>

In order to separate a tax incentive from a tax disincentive (that will not qualify as an aid) we need to separate between advantageous and normal treatment of taxpayers. The Court and the Commission will, when they examine these questions, see to the effects of a tax rule and not its aims and causes. They will therefore try to distinguish between a preferential and a normal tax regime. This makes the need to outline a normal level of tax burden essential to the application. This can then be used to see if the tax treatment is advantageous or disadvantageous.<sup>126</sup> The test that will be made with regard to this part of the Article will be if the recipient of the measure is treated advantageous compared to other taxable persons according to the general tax system in the relevant Member State.<sup>127</sup> This application makes the general tax system of a Member State of great interest and the Commission states in its notice that tax measures in line with the natural and general scheme of the tax system are not deemed to be contrary to Article 87.<sup>128</sup> I will now examine this closer.

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<sup>121</sup> Case C-379/98, *PreussenElektra AG v. Schleswag AG*, [2001] ECR I-2099, para. 66.

<sup>122</sup> Case 78/76, para. 21; Case 248/84, *Germany v. Commission*, [1987] ECR 4013, para. 17.

<sup>123</sup> Aldestam, Mona: “Skatteåtgärder som statligt stöd enligt artikel 87 I unionsfördraget”. In: *SkatteNytt*, Stockholm 2001, p. 89.

<sup>124</sup> See for example, Case 72, 73/91, *Firma Sloman Neptun Schiffahrts AG v. Seebetriebsrat Bodo Ziesemer der Sloman Neptun Schiffahrts AG*, [1993] ECR I-887, para. 21.

<sup>125</sup> Cases 142 and 143/80, *Amministrazione delle Finanze dello Stato v. Essevi SpA and Carlo Salengo*, [1981] ECR 1413, para. 21.

<sup>126</sup> Schön 1999, pp. 922; Commission 1998 notice, para. 9.

<sup>127</sup> Case C-387/92, para. 14.

<sup>128</sup> Commission 1998 notice, para. 13-16.

### 6.2.2.3 General measures and State aid

The process of separating the so-called “general measures”, which fall outside the scope of the State aid rules, from the measures that will constitute State aid, is not an easy one. The distinction between State aid and general measures creates a grey area that is hard to determine. I will nevertheless try to outline some thoughts on the subject.

The Commission notice starts by stating that general measures in principle consist of tax measures “which are open to all economic agents operating within a Member State”.<sup>129</sup> This is further developed via a requirement that the tax measures are open to all undertakings and that these can be accessed on an equal basis. Furthermore it is important, states the Commission notice, that the *de facto* application of the measure does not lead to a result that limits the measure in scope via for example the discretionary powers of the authorities in the State. At the same time the Commission accurately states that this does not limit the power of the Member States to decide on a preferred economic policy and, within this, to spread the tax burden across different factors of production in a way that is considered appropriate.<sup>130</sup>

The Commission ends this reasoning by coming to the conclusion that two different categories of measures should fall outside the core of Article 87 if they apply to all firms and to the production of all goods. The first of these categories is tax measures of a “purely technical nature” and the second is measures that aim at achieving the “general economic policy objectives” via a tax burden reduction related to certain production costs.<sup>131</sup> An immediate question that arises is whether this conclusion is altered if the result of the measures is that some firms or some sectors benefit more than others. However, the Commission states in its notice that this shall not be the case.<sup>132</sup>

When separating general measures from State aid the Commission lays out the following method. The main criterion when applying Article 87 to tax incentives is that the measure provides an exception to the application of the tax system in favour of certain undertakings in the Member State. Therefore it is necessary to first determine the common applicable tax system in order to then examine if the favouring of certain undertakings is an exception to the application of this system.<sup>133</sup> This has led to a debate on how to determine what shall be considered as the common system and what constitutes an exception and not just a different subsystem.<sup>134</sup> This is because if one follows the Commissions arguments a measure must, in order to fall under

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<sup>129</sup> Commission 1998 notice, para. 13.

<sup>130</sup> Commission 1998 notice, para. 13.

<sup>131</sup> Commission 1998 notice, para. 13.

<sup>132</sup> Commission 1998 notice, para. 14.

<sup>133</sup> Commission 1998 notice, para. 16.

<sup>134</sup> See further on this matter: Schön 1999, p. 930; Sutter, Franz Philipp: “The Adria Wien Pipeline Case and the State Aid Provisions of the EC Treaty in Tax Matters”. In: *European Taxation*, July/August 2001, p. 241

the scope of the State aid provisions, depart from the general tax system in the Member State. Only the legal order of a Member State can serve as a point of reference since there are no standards prescribed by Community law.

### **6.2.3 Advantage conferred to a firm or firms**

The tax treatment (i.e. the aid) must, following what has just been stated, be advantageous to the recipients, may it be a specific undertaking or an unspecified group of undertakings. The notice from 1998 defines such advantage as relieve of charges that would normally be borne from their (the recipients) budgets. This is a codification of ECJ judgements.<sup>135</sup> Such advantages may be provided via a number of ways. The notice gives three examples of this. The first example is reduction in the tax base via for example entering of reserves in the balance sheet or special deductions. The second example is total or partial reduction in the amount of tax via tax credit, tax exemption, etc. The third example is deferment, cancellation or special re-scheduling of tax debt.<sup>136</sup>

As has been mentioned above, a preferential tax treatment can also be granted indirect. An example of this can be if the State grants aid with consumers as direct beneficiaries. This does not in itself create a problem but if the aid at the same time promotes the competitive situation of a group of undertakings because the aid reduces the consumers' costs to purchase goods from this group of enterprises it is most likely that an indirect preferential tax treatment exists.<sup>137</sup>

### **6.2.4 Favouring certain undertakings or the production of certain goods – the selectivity criterion**

#### **6.2.4.1 Introduction**

If a tax incentive deviates from the normal treatment of taxpayers as discussed above it will in principle constitute State aid. This does not naturally mean that it is prohibited. In order to be prohibited the aid must also qualify as aid under the selectivity criterion.

This creates an obvious difference between the rules on fundamental freedoms (which also aim at limiting distortions on the common market) and the State aid rules, since the latter distinguish between general and specific tax measures that have discriminating or restrictive effects in a way that the fundamental freedoms do not. This follows from the criterion that the meas

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<sup>135</sup> Commission 1998 notice, para. 9; Case 61/79, *Amministrazione delle finanze dello Stato v Denavit italiana Srl.*, [1980] ECR 1205, para. 31.

<sup>136</sup> Commission 1998 notice, para. 9.

<sup>137</sup> Sutter 2001, pp. 242.

ure prohibited under Article 87 (1) shall be “favouring certain undertakings or the production of certain goods”.<sup>138</sup> This makes the so-called selectivity criterion most important and it is clearly necessary to provide a distinctive examination of this. The “test” includes the examination of whether the advantage conferred by the State is selective or specific in some way.<sup>139</sup> Such selective advantages may be a result of an “exemption to the tax provisions of a legislative, regulatory or administrative nature or from a discretionary practice on the part of the tax authorities”.<sup>140</sup> If the tax measure should not fulfil this criterion then it will not fall under the scope of the Article. Even if a tax incentive should be considered selective, and therefore be forbidden by the State aid provisions, it can still be justified by the “nature or general scheme” of the tax system.

#### **6.2.4.2 Selectivity or specificity of an aid**

In order to fall under the scope of the Article the recipients of the State aid must either be a private or public undertaking or a whole branch of production. However, also indirect benefit from State aid will, as seen above, qualify under Article 87.<sup>141</sup> On the other hand, if a Member State action does not distort the common market in specific areas the Member States are free to offer economic programs and incentives that are available to all within the economy (i.e. general measures). The selectivity criterion is naturally also a restriction of the Commissions competence in these matters since it will always have to distinguish between State aids granted to selected recipients and broadly designed economic incentives.

An interesting consequence of this is that the selectivity criterion therefore will create the dividing line between the State aid control system, as laid out in Article 87, and the approximation of laws under Article 94 (as discussed above). The only open solution for the Commission to act against a market distortion that falls outside the scope of the selectivity criterion is to use Article 96-97 where the measure will have to be amended or abolished through a consultation procedure with the Commission. If this does not lead to the wished result the Council shall, after a proposition from the Commission, issue the necessary directives.<sup>142</sup> If a measure is considered as State aid this will therefore have important legal effects. The review of the provisions in Article 87-88 will be in the hands of the Commission. The Commission may decide on the measures compatibility with the common market and require the State to amend or abolish the aid. If the measure on the other

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<sup>138</sup> Schön 1999, p. 916.

<sup>139</sup> The Selectivity Criterion is sometimes referred to as the principle of specification. However, in order to avoid any terminological problems I will only refer to it as the Selectivity principle.

<sup>140</sup> Commission 1998 notice, para. 12, emphasis added.

<sup>141</sup> Therefore, tax relieves for private persons are not covered by the provision. Schina, Despina: *State aids under the EEC Treaty Articles 92 to 94*, Oxford 1987, p. 31; Sutter 2001, pp. 240.

<sup>142</sup> Pinto (Part I), pp. 299; Sutter 2001, pp. 241.

hand would fall outside the rules laid down in Article 87, and still be discriminatory, the only action left will be the measure in Article 94.<sup>143</sup>

The selectivity criterion is often more problematic when examining State aid derived from taxation than in other State aid matters. The effects of a tax are widespread and in many cases of indirect nature which lead to great problems when trying to identify the recipient. In order to locate the beneficiary it is necessary to apply the selectivity test with respect to all involved parties. An example where problems may occur is if the tax incentive is granted to private consumers and not to undertakings or producers as required under Article 87 but nevertheless has major effect for their suppliers.<sup>144</sup>

The meaning of “certain undertakings or the production of certain goods” as stated in Article 87 has been given a broad interpretation.<sup>145</sup> In the *Maribel* case the Court was very generous on the selectivity criterion. In this case there were a very large amount of beneficiaries but the ECJ nevertheless found that:

“...a measure aimed at promoting the creation of jobs by reducing, for certain undertakings, the amount of social security contributions which they must pay must be regarded as State aid when it is not justified by the nature or general scheme of the social welfare system.”<sup>146</sup>

The main problem when applying the selectivity criterion to tax measures is when the tax provisions are disguised as general measures by the State. This can be the case if the State tries to disguise the measures as being “general” although they not actually are. It is obvious that cases occur in which an aid, although labelled as general, only applies to one company or a limited group of companies. Aid that is not disguised can be the result of the discretionary power of the authorities or the rule itself may be selective. There is no doubt that a provision that leaves to the national administration to discretionary decide on the application of the measure and thereby making it possible for the administration to grant aids to branches, regions or single undertakings may fulfil the selectivity criterion. This is specifically the case if the discretionary power goes beyond the managing of tax revenues according to objective criteria.<sup>147</sup>

The Commission notice adds to this that decisions that benefit individual enterprises in principle create a presumption of State aid. This presumption is limited in scope if the interpretation barely consists of an interpretation of

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<sup>143</sup> Bacon, Kelyn, “State aids and general measures”. In: *Yearbook of European Law* 1997, p. 271.

<sup>144</sup> Schön 1999, p. 931. Several examples of problems with secondary or indirect effects of aid can be found in the ECJ case law, see for example: Case 102/87, *France v. Commission*, [1988] ECR 4067, para. 5.

<sup>145</sup> See for example Case C-75/97, *Belgium v. Commission*, [1999] ERC I-3671, para. 31-32.

<sup>146</sup> Case C-75/97, para. 34.

<sup>147</sup> Case C-241/94, *France v. Commission*, [1996] I-4551, para. 23-24; Commission 1998 notice, para. 21.

general rules and will then not be covered by the presumption. If on the other hand the publicity of the decisions from the administration is limited this might support the presumption that the decisions will have a forbidden effect in some cases.<sup>148</sup>

If, on the other hand, the application of the tax provision is not left to the discretionary of the administration one has to determine if the provision itself is selective in that it favours a certain group of enterprises or the production of certain goods. The selectivity criterion does not require an indication of the recipients by name. It will also be fulfilled if common distinguishing features exist within the group. It is possible to distinguish between three different State aid measures with regard to the pursued aim. If the advantage is specific or selective with regard to the beneficiary this is often labelled “sectoral” aid. If it is instead selective with regard to the activity encouraged it is labelled “horizontal” aid and if it is selective with regard to the territory assisted it is labelled “regional” aid. This categorisation is based on objectives.<sup>149</sup>

#### 6.2.4.3 Justifiable derogations

The selectivity criterion itself is an insufficient tool for the separation of general measures (that fall outside the scope of Article 87) and State aids. The main reason for this conclusion is that most State regulatory measures will at least have a small differential impact on undertakings (this might even be unintentional).<sup>150</sup> In the Courts case law a principle on justification on derogation’s from the nature and general scheme of the system has been established. This ground of justifiable derogation was first established by the ECJ and has been followed in the decisions of the Commission.<sup>151</sup> The criterion is however still very vague. It means that measures will not be considered as State aid when they are “necessary to the functioning and effectiveness of the tax system” from a rational economic point of view.<sup>152</sup> It will then be considered to be a general measure rather than State aid.

It is difficult to provide the exact meaning of this ground of justification since it does not have any legal basis and neither the scope of the principle nor its exact content is laid out in the Courts case law. This is probably the main reason behind how this matter is tackled in the Commission notice. No general criterion on how to evaluate if a measure is justifiable is provided. Instead the Commission provides examples of when the measure should be justified because of its necessity for the functioning and effectiveness of the tax system. These different cases will not be discussed further.

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<sup>148</sup> Commission 1998 notice, para. 22.

<sup>149</sup> Sutter 2001, pp. 241; Pinto (Part I), pp. 297-300.

<sup>150</sup> Bacon 1997, p. 296, 320.

<sup>151</sup> Case C-173/73, *Italy v. Commission*, [1974] ECR 709, para. 15; Commission Decision of 13 March 1996 concerning fiscal aid given to German airlines in the form of a depreciation facility, O.J. L-146, 20.6.1996, p. 42.

<sup>152</sup> Commission 1998 notice, para. 23.

#### 6.2.4.4 A couple of critical remarks

The distinction of measures that are open to all economic agents within a Member State was a criterion raised under the chapter dealing with the separation of general measures. This criterion can naturally also be of relevance to the selectivity criterion. If the distinction of incentives open to all agents has already been used in the separation process of general measures the question is how it shall be applied with regard to the selectivity criterion. Should a decision that a measure is not a general one and neither justifiable by the nature and general scheme of the tax system automatically also be regarded as specific? Or should a new examination be performed and in that case why?<sup>153</sup>

As has been shown above the Commission clearly pleads that a new examination should be performed. What is then the difference between the two? One author tries to explain this by pointing at the different wording. The selectivity criterion refers to certain undertakings or certain productions while the general measures examination only refers to undertakings. If this is the explanation then the selectivity criterion should at least not be relevant to “certain undertakings” because this situation should be covered in the first examination. The same author criticises the Commission for not following the ECJ judgements that seem to imply that the “test” should seek to establish if a measure is in accordance with “the nature and the general scheme of the system and not whether that measure is open to all undertakings.”<sup>154</sup> In my opinion, this reasoning shows that there is not a sufficient answer to the question just raised.

#### 6.2.5 The distortion of competition

In order to apply Article 87 the tax incentive must “distort or threaten to distort competition”.<sup>155</sup> When the Commission looks at this criterion it has to regard two different angles of the problem. First it must be examined whether the aid has direct and immediate effects on the market position of the recipients. It is however not enough to examine this direct competitive relation between two products, for example the relationship between car brand A and car brand B. The effects on potential competitors and the recipient’s suppliers and purchasers must also be examined. An example of such impact on competition can be the competitive relation between cars and rail transport.<sup>156</sup> At this stage the distort effects can only be guessed.<sup>157</sup>

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<sup>153</sup> Visser, Klaas-Jan: “Commission expresses its view on the relation between state aid and tax measures”. In: *EC Tax Review*, 1999, p. 225.

<sup>154</sup> Visser, p. 225.

<sup>155</sup> Article 87 (1).

<sup>156</sup> Evans 1997, p. 79; Sutter 2001, p. 243.

<sup>157</sup> Schina 1987, p. 24.



Competition is distorted when the interplay between supply and demand in the market is disturbed. However, such an academic definition is hardly useful when handling real cases. Instead it might be more useful to examine the potential distort effects via the extent that the potential recipient will receive support to its budget.<sup>158</sup>

In order to carry out an examination on whether competition is distorted or not the relevant market must be stipulated. When such an examination is made in State aid matters the ECJ normally discuss generally about the determination of the relevant market and about possible effects on the market.<sup>159</sup> It is considered that Article 87 will be applied even if only a potential market that will be developed in the foreseeable future can be distorted and if the aid will hinder the market entry for new competitors.<sup>160</sup>

Finally, if a Member State tries to argue that an aid measure compensates for legal differences between the Member States and therefore does not affect competition this will probably not help the measure from being deemed contrary to Article 87. For example, the Italian government tried to introduce a tax credit scheme for non-Italian hauliers from within the Community. They argued that competition was not distorted since Italy ranks among the Member States with the highest level of taxes and duties. The Commission did not agree. The ECJ declared that a measure as the one implemented by Italy “cannot deprive the measures in question of their character as aid”.<sup>161</sup> Such approximation will have to be carried out via Article 94 as mentioned above.

## 6.2.6 Effects on intra-community trade

The State aid must, according to the final condition set out in Article 87, affect trade between Member States. This condition is not very hard to fulfil but the recipient must pursue trade within the Union and not just on a local level. A good example of this is the *Phillip Morris Holland Case*. In this case the Netherlands had proposed to grant Phillip Morris an investment in order to increase employment. The Commission held that the grant would be incompatible with Article 87. The Court agreed with the Commission. Regarding the affection on trade between Member States the Court held that “when state financial aid strengthens the position of an undertaking compared to other undertakings competing in intra-community trade the latter must be regarded as affected by that aid”.<sup>162</sup> However, it is not necessary that the recipient exports its products to other Member States (or exports at all) and the Court has given the Commission the right to presume that the

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<sup>158</sup> Schina 1987, p. 24.

<sup>159</sup> Cases 62/87 and 72/87, *Exécutif régional wallon and SA Glaverbel v. Commission*, [1998] ECR 1573, para. 15.

<sup>160</sup> Sutter 2001, p. 243.

<sup>161</sup> Case C-6/97, *Italy v. Commission*, [1999] ECR I-2981, para. 21.

<sup>162</sup> Case 730/79, *Phillip Morris Holland B.V. v. Commission*, [1980] ECR 2671, para. 11.

condition is fulfilled when the recipient is competing on a market where competition from producers in other Member States exists.<sup>163</sup>

This leads us to the conclusion that intra-community trade can be affected both by export promotion and by a domestic program that improves the conditions for the national suppliers and thereby limiting the possibility for foreign suppliers to enter the market. It is therefore clear that establishing the existence of potential trade is enough and will be protected in the same way as actual trade.<sup>164</sup>

The Commission confirms this case law. In its opinion the mere fact that the aid strengthens the firm's position compared to other competitors in the intra-community trade is enough to fulfil the condition now discussed.<sup>165</sup> If aid is given to local producers etc. and does not affect intra-community trade, or potential intra-community trade, the State aid rules will not apply.<sup>166</sup> However, the mere fact that the aid is relatively small in amount or that the recipient is small in size and only holds a small share of the Community market will not lead to any other conclusion than that intra-community trade is affected.<sup>167</sup>

It has been questioned if this final criterion (i.e. that the measure affects intra-community trade) really relates to the question of whether a measure constitutes State aid or not.<sup>168</sup> However, the Commission clearly considers that this is the case in its notice and it is also confirmed by its application of a *de minimis* rule as soon shall be shown.<sup>169</sup> The main criticism against this point of view is that the effect on trade is a condition of the compatibility of the aid with the common market.<sup>170</sup>

### 6.3 *De minimis* limitation

*De minimis non curat lex* is a general principle of law that applies also to EC law. The meaning of the principle in the fiscal State aid area is that certain measures are of too little importance to be dealt with by a system of law. Addressing all minor measures would lead to a tremendous workload for the Commission and thereby creating an impossible task. Such distinctions are off course always very hard to make and even small aids may in some areas lead to extensive effects on competition.<sup>171</sup>

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<sup>163</sup> Case 102/87, para. 19; Case C-142/87, *Belgium v. Commission*, [1990] ECR 4067, para. 35.

<sup>164</sup> Case 102/87, para. 19; Cases C-278/92, C-279/92 and C-280/92, *Spain v. Commission*, [1994] ECR I-4103, para. 40.

<sup>165</sup> Commission 1998 notice, para. 11.

<sup>166</sup> Sutter 2001, p. 243.

<sup>167</sup> Cases C-278/92, C-279/92 and C-280/92, para. 42; Case C-142/87, para. 43.

<sup>168</sup> Bacon 1997, p. 273.

<sup>169</sup> Commission 1998 notice, para. 11;

<sup>170</sup> Bacon 1997, p. 273.

<sup>171</sup> Schina 1987, pp. 26.

For State aids this means that the Commission considers that “not all aid has an appreciable effect on trade and competition between Member States”.<sup>172</sup> This is, according to the Commission, especially the case if the amount is small. Therefore the Commission introduced the *de minimis* principle in its practices in 1992. A measure that falls under the *de minimis* rule does not have to be notified by the State.

It is arguable whether a *de minimis* rule is suitable when looking at the wording of Article 87. The rule as such does not seem to allow any exceptions so far as minor hindrances are concerned. The quality of the application under the rule can also be questioned from this point of view and it has been said that ignoring Treaty obligations is very destructive to political harmony and market unity.<sup>173</sup> On the other hand arguments in favour of such a rule are strong. These can be based mainly on practical considerations.<sup>174</sup>

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<sup>172</sup> The *de minimis* rule can now be found in: Commission Regulation No 70/2001 on the application of Articles 87 and 88 of the EC Treaty to State aid to small and medium-sized enterprises, O.J. L010, 13.01.2001. The definition of small and medium-sized enterprises is however the same as in the earlier Commission notice on the *de minimis* rule for State aid, O.J. C-68, 6.03.1996 and in Community guidelines on State aid for small and medium-sized enterprises: O.J. C-213, 23.7.1996.

<sup>173</sup> Evans 1997, p. 99.

<sup>174</sup> Evans 1997, p. 103.

# 7 The State aid rules as an instrument in the work against harmful tax competition

## 7.1 State aid within the context of harmful tax competition

The main source on how the State aid rules should be linked to fiscal aid and the work against harmful tax competition is the above-mentioned Commission notice on the application of the State aid rules to measures relating to business taxation.<sup>175</sup> This notice is not legally binding but a soft law act in the same way as the Code of Conduct. However, as has been shown above, soft law acts are of specific meaning in the field of State aid since the Commissions *de facto* monopoly has provided it with a large discretion in the application of the State aid rules. This, together with the absence of hard legislation, gives the importance of soft law in the State aid field a specific status that cannot be found in other parts of EC law.<sup>176</sup> This makes the notice an important tool and a text that is of essential need when the State aid rules shall be applied to harmful tax measures. Authors also point out that the notice is evidence of the Commissions change in policy regarding fiscal State aid. It is also evidence of the Commissions wish to warn the Member States that the Commission is seriously committed to ending those incentives that might lead to harmful tax competition.<sup>177</sup>

The notice is also important in another sense. As has been seen above up to 1998 the State aid rules had only been used in a strict way regarding income taxation. The focus of the examination was on the question as to whether the specific tax measure had negative effects on the common market and if these could be justified. The 1998 notice and the Code of Conduct changed, or more correct broadened, this application to a large extent since it stated that rules covered by the Code of Conduct, i.e. incentives promoting harmful tax competition, might also be covered by the State aid rules.<sup>178</sup> Thereby an obvious link between harmful tax competition and the set of rules in Article 87-89 has been created.

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<sup>175</sup> Commission 1998 notice.

<sup>176</sup> In *Ladbroke v. Commission* the Court of First Instance questioned the discretionary power of the Commission. The Court of First Instance meant that it is doubtful whether the Commission really have a far-reaching discretionary power to assess whether a general measure or State aid is involved. Case T-504/93, *Tiercé Ladbroke SA v. Commission* [1997] ECR II-923.

<sup>177</sup> Fantozzi 2002, pp. 4; Pinto, Carlo: "EC State aid rules and tax incentives: A U-turn in Commission policy? (Part II)". In: *European Taxation*, September 1999, p. 346.

<sup>178</sup> See for example: Commission 1998 notice, para. 1.

Tax competition, may it be harmful or not, differs from the traditional meaning of competition as meaning free and fair competition from an economic point of view. A measure with the effect that another Member State will reduce its tax revenues cannot in itself constitute a measure prohibited under Article 87. This is because the Article refers only to the distortion of free and fair competition and is not intended to tackle problems arising from tax competition between Member States. Therefore, tax competition differs from the traditional disturbance of free competition between undertakings as normally discussed under Article 87. Tax competition consists of competition between Member States competing for the tax-payments of the citizens. This leads us to the question if such tax competition that results in the reduction of tax revenues in another Member State can be a threat to the free and fair competition in the common market and thereby be covered by Article 87, even though this application obviously not were intended and never used in this way before. Some authors seem very doubtful to this question and holds that it certainly can be questioned whether the loss of tax revenue could be compared to a tax subsidy. The Commission's answers this question affirmative since its view is that incentives promoting harmful tax competition may also have negative effects on competition in the traditional sense and thus be covered by Article 87.<sup>179</sup>

The State aid rules are attractive to use as a method to combat harmful tax competition from a number of perspectives. To attract foreign companies and capital via tax incentives is of major concern in the debate regarding harmful tax competition and the State aid plays an important role in this discussion. The State aid rules are not limited in this area as the rules on the fundamental freedoms are. The State aid rules can be applied also when a Member State treats capital and companies from another country in a favourable way. Such, *reverse discrimination* cannot be tackled by the fundamental freedoms, as discussed above, and it is considered to be of concern only to the law in the affected Member State and not a matter under the EC law provisions on fundamental freedoms. A problem that is obvious when trying to apply the State aid rules to these measures is the selectivity criterion. No problems occur if the tax incentive is of specific nature but the question arises if the rules can also be applied to tax incentives offers preferential treatment to foreign interests independent of their activities. This is where the Code of Conduct may be of assistance, since measures that entice capital and companies from other Member States by low tax rates etc. are included in the work against harmful tax competition. However, since the Code of Conduct is not legally binding, it is of great importance that the line between selective and general tax measures is identified.<sup>180</sup> I will soon return to this issue.

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<sup>179</sup> Vanistendael 2000, pp. 156; Commission 1998 notice, para. 1-4; Fantozzi 2002, p. 9; Andersson, Krister: "Bolagsbeskattningen inom EU – blir det EG-domstolen och statsstödsreglerna som avgör den framtida utformningen?". In: *Svensk Skattetidning*, 2001, p. 731.

<sup>180</sup> Schön 1999, pp. 918.

The main advantages of applying the State aid rules to this area of law and creating a link to the Code of Conduct is that the rules have the force of law. It is also backed with powerful sanctions<sup>181</sup>, which is an important difference to soft law agreements like the Code of Conduct. The legally binding nature of these rules provides us with the effective EC law principles on enforcement of these principles in the Member States.<sup>182</sup> Finally it shall also be pointed out that the political arguments in favour of applying the State aid rules to harmful tax competition are important.

So, what are the arguments that are put forward to support the usage of Article 87 in tax competition cases and what can be said to meet these? The Commission's point of view is based on a presumption that a difference in tax burdens will affect the location of undertakings and investments. This is so because fiscal considerations will influence and lead to relocation and redirection of investments, etc. This influence is regarded as a distortion of economic reality and thereby creating an infringement of the free and fair competition. So, in principle their opinion is that State aids distort competition, and fiscal aids are one form of State aid.<sup>183</sup> This point of view can be criticised in many ways. If the State aid rules are applied to these measures it will lead to a quite extensive limitation in the sovereignty of the States in these parts of their fiscal policy. The big "winners", if one looks at the power to decide on these matters, would instead be the Commission and the ECJ.<sup>184</sup>

It is suitable to look closer at the Commission's argument that fiscal policy might lead to "relocation of business" and this can be examined from different angles. It is clear that fiscal conditions are important to this argument. From a financial point of view it is clearly debatable if punctual fiscal support incentives have any effect on the location of investments, etc. from undertakings.<sup>185</sup> On the other hand, if one looks at fiscal support measures of larger scale, as for example the low corporate tax in Ireland, it is clear that this kind of measures will lead to relocation of companies and revenues. Nevertheless, these are not considered to be incompatible with the State aid rules.<sup>186</sup> Even though it is unclear what effects fiscal support measures will have, it is still debatable if free and fair competition is infringed. The incentives that fall under the concept of harmful tax competition will not in itself create an obvious disruption of the free and fair competition amongst undertakings since these are still free to choose their preferred location. If they want, every company may move to Ireland.

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<sup>181</sup> If the Member State does not comply with the rules the Commission has the right to refer the matter to the Court of Justice, Article 88 (3).

<sup>182</sup> Easson, Alex: "State aid and the Primarolo list". In: *The EC Tax Journal*, 2001, p. 124.

<sup>183</sup> Monti, Mario: "How State aid affects tax competition". In: *EC Tax Review*, 1999, p. 208; Vanistendael 2000, pp. 156, Compare with the Ruding Report, pp. 362.

<sup>184</sup> Since the institutional bodies would gain the right to decide on parts of the Member States fiscal policies that they have not had before.

<sup>185</sup> Vanistendael 2000, p. 157.

<sup>186</sup> Irelands corporate tax rates including surcharges and local taxes was 10 % 2001; SEC (2001) 1681, p. 94.

It is not only fiscal measures and policies that influence the selection for business establishment or investment. This might also be influenced by structural conditions. The quality of infrastructure, education and political stability will clearly also determine business establishment. Tax incentives are just one way amongst others to attract foreign companies. These conditions are however not regarded as having a negative effect on trade and their advantages are open to all companies just like the fiscal condition. It has therefore been criticised and questioned why some of the tax incentives are considered as harmful while these other conditions (i.e. the structural conditions) are not considered to have these effects. The criticism does also include questioning the way the Commission did not address these problems in the Code of Conduct but simply said that structural elements were not to be taken into consideration.<sup>187</sup>

If a tax measure aims at attracting foreign undertakings in general these measures will most likely fall outside Article 87. The situation is however, with the Code of Conduct as background, different if the tax incentive aims at attracting a specific group of enterprises. This makes the selectivity criterion very important when trying to outline the grounds on which tax measures that shall be deemed contrary to the Treaty.

This difference between specific and general measures can be criticised from an economic perspective since the Treaty itself does not hinder the relocation of business activities from one Member State to another because of fiscal purposes. It can therefore be questioned why fiscal measures that appear in a limited sector automatically shall be rejected if both domestic and foreign economic subjects are treated the same way.<sup>188</sup> In my opinion, this critical approach is based on a negative view on the States right to tax.

There are also authors that see no problem with applying the State aid rules to measures that lead to harmful tax competition. One argument is that even though the application of the State aid rules to fiscal aids is a reversal of the common direction of State aid (i.e. leading to preferential foreign tax treatment) one can not disregard that the goal for the Member State applying these rules is to strengthen the States economy. This means that in the end it will be a domestic company (i.e. the subsidiary, etc. of a foreign undertaking) that benefits from the preferential tax treatment.<sup>189</sup> These arguments might have a point of relevance but from some aspects I find them to far-reaching since many measures could then be in breach of free and fair competition.

The main disadvantages with applying the State aid rules in this way are that only using the State aid rules to combat against unfair tax competition is not

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<sup>187</sup> Pinto (Part II), p. 351; Vanistendael 2000, p. 157.

<sup>188</sup> Vanistendael 2000, p. 157.

<sup>189</sup> Schön 1999, pp. 934.

a welcomed solution from a legal point of view. The rules laid out in Article 87 were not designed or intended to restrict tax competition. Another disadvantage with the State aid provisions is that even if it is obvious that these rules, with a broad interpretation of the selective criteria (see more on this in the next chapter), can cover many harmful measures, some will fall outside their scope. This is so because not only selective measures but also general tax measures might lead to unwanted consequences. If the State aid rules are not backed with the Code of Conduct, it is possible that the Member States will replace specific measures that fall under the scope of the State aid rules, with general tax measures that have the same effects but cannot be caught with the legal system.<sup>190</sup>

## **7.2 Some further notes on the selectivity criterion and its relationship to harmful tax competition**

As has been hinted above the 1998 Commission notice introduced a far wider interpretation of the selectivity criteria than for example the Monti package in 1996. While the selectivity in this earlier work mainly focused on regional and sectoral aid the notice states that:

“Some tax benefits are on occasion restricted to certain types of undertaking, to some of their functions (intra-group services, intermediation, or coordination) or to the production of certain goods. In so far as they favour certain undertakings or the production of certain goods, they may constitute State aid...”<sup>191</sup>

The key element in the legal problems that may occur when applying Article 87 in order to fight against harmful tax competition, is that this situation deals with methods that do not discriminate against foreign traders. It aims at favouring them.

Double taxation provisions are important in this discussion. As long as a national tax provision favours foreign investors in order to compensate the effects of double taxation the provision will not constitute aid at all. These rules merely aim at creating an equal treatment of domestic and foreign taxpayers.<sup>192</sup> Double taxation agreements as well as reductions in withholding tax are generally welcomed since these measures often limit the discrimination of foreign investors and avoid the barriers to the free movement of capital that would otherwise be at hand.<sup>193</sup> The examination will therefore have to focus on tax provisions that go even further than creating an equal treatment as the double taxation relief rules do. The category of these measures that can be deemed specific or selective can then be dealt with under

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<sup>190</sup> Easson, Alex: “State aid and the Primarolo list”. In: *The EC Tax Journal*, 2001, p. 125.

<sup>191</sup> O.J. C-384, 10.12.1998, para. 20.

<sup>192</sup> Schön 1999, p. 935.

<sup>193</sup> Easson, Alex: “Tax competition and investment incentives”. In: *The EC Tax Journal*, 1996/97, p. 80.



Article 87 et seq., while the more general measures that constitute unfair tax competition will be dealt with according to the method laid down in the Code of Conduct. This will then work as a political alternative to the legal mechanism.<sup>194</sup>

Dividing up the scope of the application in this way seems natural if one looks at the wording of Article 87 (1). It seems unlikely that tax incentives that are granted to all sorts of foreign investors should be able to fall under the Article. However, as some authors point out, this might nevertheless be the case given the Commissions and the Courts broad interpretation of Article 87 as covering all sorts of aids, which are not available to all agents present in the economy.<sup>195</sup>

In order to examine if a tax measure will meet the selectivity criteria Santos provides a model of two tests, the specificity test and the exceptionality test. Under the first of these the following questions are asked:<sup>196</sup>

- Is the measure applicable to the entire national territory? (regional aid)<sup>197</sup>
- Does it apply only to limited sectors or types of activities? (sectoral aid)
- Does it benefit certain general functions of enterprises? (horizontal aid)
- Is it discriminatory under the law or in practice?

This test has the purpose of identifying those measures that de facto favour one or more undertakings or sectors in a Member State. The latter test aims at distinguishing the measures that are driven by principles inherent in the system (and thereby a general measure) and those that are external to the system itself. All other measures than those inherent in the system itself would be regarded as exceptional and thereby selective.<sup>198</sup>

The notice confirms the case law of the ECJ and it mentions as selective three groups of provisions: regional and local, sectoral and horizontal provisions. In 1998 the Commission approved another document affecting regional aid. This was the “Guidelines on national regional aid”.<sup>199</sup>

Some authors are critical to the different treatment of general and specific measures. The reason for this is that it can be questioned how these meas

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<sup>194</sup> Santos, António Carlos: “Point J of the Conduct and the Primacy of Politics over administration”. In: *European Taxation*, 2000, p. 420.

<sup>195</sup> Schön 1999, p. 935. The Court has enlarged the selectivity criteria in for example Case C-75/97, para. 28-31 and Case C-143/99 *Adria Wien Pipeline and Wietersdorfer & Peggauer* [2001] ECR I-8365, para. 48.

<sup>196</sup> Santos 2000, p. 920.

<sup>197</sup> My notes in parenthesis.

<sup>198</sup> Santos 2000, p. 920.

<sup>199</sup> Guidelines on national regional aid, O.J. C-74, 10.3.1998.

ures differ in their effects on free and fair competition. Vanistendael means that the effect that general measures have on competition is generally more drastic than that of the specific ones. Another criticism is that when the Commission applies the selectivity criteria and follows its established principles it will not apply the State aid rules to any fiscal measures (of a selective character) that infringe the competition. It will rather apply the State aid provisions to the measures that are considered as fiscal aid from a political point of view.<sup>200</sup> This conclusion is of course controversial but not unreasonable, since the Commission clearly has widened the application of the selectivity criterion in order to tackle measures deemed harmful from a political point of view.

### **7.3 The Code of Conduct and its relationship to State aid**

A very important issue is how the State aid rules, when used as part of the package to tackle harmful tax competition, relate to the Code of Conduct. As has been shown above one significant difference is that the Code of Conduct will cover also general tax measures that have harmful effects. In order to fall under the scope of Article 87 the measure must be selective or specific. On the other hand the State aid rules definitely cover taxes, social security contributions and assimilated charges while the Code of Conduct is limited to the taxation of companies and possibly social security contributions.<sup>201</sup>

From the Commission notice of 1998 it is clear that the application of the State aid rules and the application of the Code of Conduct shall not influence one another. It states in Article 30 that if a tax measure qualifies as harmful under the Code of Conduct this shall not affect its possible qualification as State aid under Article 87. The effects that are found when the examination is performed under the Code of Conduct are however to be regarded when examining whether the fiscal aid is compatible with the common market.<sup>202</sup>

This non-influence of one another is most likely the result of two different grounds. To begin with the State aid rules are a legally binding set of rules based on the EC Treaty while the Code of Conduct is a political agreement without any legal binding force. Furthermore the different sets of rules have different institutional bodies in charge of their supervision and interpretation. While the State aid rules are one of the important tasks of the Commission the Council is the body in charge of the application of the Code of Conduct via the Primarolo group.<sup>203</sup> As the second above quoted part of

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<sup>200</sup> Fantozzi 2002, p. 9; Vanistendael 2000, pp. 159.

<sup>201</sup> Santos 2000, p. 419.

<sup>202</sup> Commission 1998 notice, para. 30.

<sup>203</sup> This obligation of the Commission can be found in Article 211 where the Commission is bound to take action to ensure that the provisions of the Treaty are applied.

paragraph 30 in the notice shows, the Code of Conduct and the State aid rules do not ignore each other completely. This wording reflects what is already stated in the Code of Conduct. It can be added to this that the work in the different bodies is of importance to on another. This is shown in the Code of Conduct where the Council notes the Commission's work in the field.<sup>204</sup>

The Code of Conduct also takes the Treaty rules on regional aid (and especially the exceptions in Article 87 (3) a) and c)) in concern in Article G (2), where it states that "insofar as the tax measures are used to support the economic development of particular areas... particular attention will be paid to special features and constraints in the case of outermost regions and small islands".<sup>205</sup> On the other hand the Commission notes that when it examines if regional aid is to be considered as compatible with the common market it may take in account effects brought to light by the Code of Conduct.<sup>206</sup>

If one puts the relationship at its peak from a judicial point of view it is clear that the Code of Conduct is the specific tool for handling unfair tax competition and that the State aid rules are secondary tools. From a legal technical point of view this means that the State aid rules are in their nature a *lex generalis* set of rules. However, since the Code of Conduct is not a legal instrument it might be described as *specialis* but certainly not *lex*. Authors mean that the natural limitations of a soft law tool is apparent and that this makes the Code of Conduct a weak instrument without guarantees of political sanctions against smaller economies. And, despite being a more specific tool, it has therefore become a subsidiary tool in relation to the State aid rules. It depends on the application of the taxation package if the Code of Conduct is to become more effective.<sup>207</sup>

The developments in this area are not as they were presumed in 1997. Many authors seem to mean that a proper application of the Code of Conduct depends on how the other two parts of the tax package are carried out. This package also included proposed directives on savings income and on withholding tax on inter-corporate payments. A new savings directive has been proposed but the outcome of this process is unknown.<sup>208</sup> Therefore the Code risks becoming a preparatory work for the future application of the State aid rules and this set of rules will continue to gain in importance.<sup>209</sup> The State aid rules can be used to tackle these problems but it is an imperfect tool. Many measures are likely to fall outside its scope since these rules do not

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<sup>204</sup> Pinto (part II), p. 346; Code of Conduct for business taxation, para. J; Santos, p. 419.

<sup>205</sup> Code of Conduct for business taxation, para. G (2).

<sup>206</sup> Commission 1998 notice, para. 33.

<sup>207</sup> Easson, 2001, p. 114; Santos, p. 420.

<sup>208</sup> Proposal for a Council directive to ensure effective taxation of savings income in the form of interest payments within the Community, COM (2001) 400 final, O.J. C-270 E, 25.09.2001; Santos, p. 420.

<sup>209</sup> Santos, p. 420.

cover general measures. To this comes that they cannot be applied to measures outside the Community.

The time aspect is also relevant to the relationship presented by the State aid rules and the Code of Conduct. The Code can be criticised for not being a tool that can be applied quickly. From this point of view the State aid rules provide a sharper weapon against unfair tax competition since the Commission has the power to order immediate removal of the offending provision. It can be pointed out though that in practice the time aspect could be the reversed. If all harmful tax measures should be attacked on a case-to-case basis it would probably take much longer than a similar action under the Code of Conduct. This would especially be the case if the Member States brought the Commission actions before the ECJ.<sup>210</sup>

These conclusions are in principle similar to the ones that the EESC came to in 2002. They are encouraged by the Commission activity in the area of State aids regarding harmful tax competition and urge the Commission to use the ECJ in order to eliminate illegal State aids. On the same hand they note that it is important not to lose track of the Code of Conduct (they refer to the tax package). The statement that concludes their point of view is that the preparation of this report was a great step forward but the failure to act would be two steps backwards.<sup>211</sup>

The definition of terms might also depend on whether you use it under the Code or the State aid provisions. One such term is the main concept of harmful tax competition. The main practical difference is that the State aid rules focus on the impact on trade between Member States (they are competition law regulations). On the other hand the Code of Conduct is mainly based around measures that might affect the location of mobile capital within the Union. In some cases the State aid regulations may even encourage the location of certain businesses to certain regions in order to develop this. There are examples of measures that have been found non harmful under the Code of Conduct while they were found in breach with the State aid rules.<sup>212</sup>

Vanistendael comes to the conclusion, when comparing the criteria in the Code of Conduct with the criteria that determines fiscal State aid, that the former is of little help when trying to clarify the latter (i.e. the State aid provisions). He means that tax measures will have to be primarily tested against the criteria in Article 87. Therefore a conflict with the Code of Conduct is not very likely.<sup>213</sup>

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<sup>210</sup> Easson 2001, pp. 114

<sup>211</sup> Opinion of the Economic and Social Committee on "Fiscal competition and its impact on company competitiveness", O.J. C-149, 21.06.2002, p. 78.

<sup>212</sup> Monti 2002.

<sup>213</sup> Vanistendael 2000, p. 161.

## 7.4 The Primarolo list and the State aid rules compared

As shown above a High level Working Group was established in 1998. It is generally called the Primarolo group (after the first chairman Ms Dawn Primarolo). In its work since 1998 it has examined 271 different tax measures within the Member States and associated territories. Many of these measures were considered potentially harmful and thereby contrary to the Code of Conduct in the above-mentioned report from November 1999. This report is final, but only in the sense that it concludes this stage of the group's work. It is also important to remember that since the report has never been formally adopted, its current status is unclear.<sup>214</sup> The measures will now be examined.

The purpose of this examination is that such examination will most likely show how the relationship between the Code of Conduct and the State aid rules is in practice. This is so because it is possible to see if these measures could also fall under the scope of the State aid rules. Alex Easson has made an extensive comparison of the measures and this examination will be used as basis in many cases. The examination will deal with the measures that were found in the Member States while the ones from the dependent or associated territories will not be regarded. The reason for this is that the State aid rules can only deal with measures within the Community and could therefore clearly not be used for the measures just mentioned.

Easson provides us with a classification different from the one in the report in order to facilitate a clearer comparison. Easson discusses the following categories<sup>215</sup>:

- Location-Specific Regimes
- Sector-Specific Regimes
- Activity-Specific Regimes
- Holding Company Regimes
- Particular Types of Income
- Rulings and Presumptive Taxation

The two first categories seem to be those that are most likely to also fall under the scope of the State aid provisions. The location-specific regimes include measures that are restricted to enterprises or activities in a specific region while the sector-specific regimes include measures that favour a particular sector of economic activity. These categories fall under the scope of Article 87, because it is most likely that the selectivity criteria would be met

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<sup>214</sup> Nijkamp, Heleen: "Landmark agreement on EU tax package: new guidelines stretch scope of EU Code of Conduct". In: *EC Tax Review*, 2001, p. 148.

<sup>215</sup> Easson 2001, p. 115. A complete list of the measures that falls into these categories can be found in supplement A.

in these situations and they are therefore most likely to constitute aid under the definition in Article 87.<sup>216</sup>

The activity-specific regime is the largest category and consists of 14 measures. Easson defines this category as regimes that govern special types of companies that perform particular activities. This group includes many centres that often form part of multinational groups of companies. The group of measures includes many of the measures that the Commission later initiated procedures against under the State aid provisions (see more on this below). On some of the measures there can be raised the question if the special rules constitute a tax advantage (and thereby creates aid), since only 4 of the measures in this group make use of a lower rate than the standard. The investigations that the Commission launched in 2001 (see more on this below) do however show on a broad interpretation and willingness to bring this category under the scope of Article 87.<sup>217</sup>

Holding companies is one of the most discussed categories of harmful tax competition, mainly since it is a common feature in many tax regimes. While special treatment for holding companies might be used to eliminate double taxation these rules might also result in double taxation. They are therefore interesting for the concept of unfair tax competition. The question when trying to apply the State aid provisions to these measures is whether the regimes are specific or general (and therefore not constituting aid at all). The conclusion is probably that some provisions that create special treatment for holding companies create specific regimes while others do not.<sup>218</sup> The ones that are most likely to constitute fiscal aid are when a country establishes a “special regime under which holding companies are incorporated”.<sup>219</sup>

The measures falling under the next category are most likely to fall outside the scope of the State aid rules since they probably constitute general measures. However, Easson states that two of the four measures in this group might be problematic (the Greek and Irish regimes). This observation was correct since these two measures were part of the investigation launched by the Commission in 2001. The reason for this result is most likely that the rules applied to companies that have obtained appropriate certification. This was probably enough to fulfil the requirement for favouring “certain undertakings” as stated in Article 87 (1).<sup>220</sup>

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<sup>216</sup> Primarolo report 1999, p. 19-20, 35-36, 40-41, 85; Easson 2001, pp. 115; Article 87.

<sup>217</sup> Commission press information: Commission launches large scale state aid investigation into business taxation schemes, IP/01/982, 11.07.2001; Easson 2001, pp. 118.

<sup>218</sup> Easson 2001, pp. 119.

<sup>219</sup> Easson 2001, p. 120. The only one of the measures in the Primarolo report that could fall under Article 87 should then be the Luxembourg holding companies (Measure number A013 in the report). None of these measures were part of the investigation launched in July 2001.

<sup>220</sup> Commission launches large scale state aid investigation 2001; Easson 2001, pp. 120.

The final group identified by Easson concerns special methods of taxing income deriving from transactions between related companies. Presumptive taxation and advance rulings might create harmful tax competition if they are excessively favourable. Easson comes to the conclusion that these measures are not likely to constitute State aid even though some of the measures apply only to a particular group of companies and might therefore fulfil the selectivity criteria. A measure in this group might also constitute aid if the discretionary power of the authorities leads to a favourable ruling in a specific case. None of these were identified as potentially forbidden State aid in the Commission 2001 investigation.<sup>221</sup>

The examination of whether the measures now discussed could also fall under the scope of the State aid provisions is not easy to do. The precise application of these rules is hard to predict. The main problems appear to be the selectivity criterion and the distinction between general and specific measures. The examination can lead us to the conclusion that a large majority of the measures that the Primarolo group found harmful could, and probably would, also fall under the scope of Article 87. As will be seen below actions have already been taken against some of these measures. However, it is also clear that there are situations that cannot be covered by the State aid rules. These measures can only be tackled via the Code of Conduct or possibly harmonisation efforts as described above. The latter is in principle not a realistic tool when you look at the development in the past.

Finally, as mentioned above, the Ecofin Council agreed on guidelines for standstill and rollback in November 2000 (see chapter 5.1).<sup>222</sup> It is unclear how these guidelines relate to the measures identified in the Primarolo report. Not all harmful measures that are identified by the Primarolo group are included in the guidelines but on the other hand the Primarolo Group did not identify some measures that are included in the guidelines. The wording of the agreement does however give some indication that all the identified measures (both under the guidelines and the Primarolo list) shall be rolled back. The main reason for the new guidelines is that the Primarolo group used a wider range of criteria than provided in the Code of Conduct. This has now been formalized in some areas of harmful measures. The guidelines are also meant to enable equal treatment of comparable situations and it is therefore likely that more measures, than those identified by the Primarolo group, will be influenced by the guidelines.<sup>223</sup>

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<sup>221</sup> Easson 2001, pp. 121; Commission launches large scale state aid investigation 2001.

<sup>222</sup> Conclusions of the Ecofin Council, 27 November 2000.

<sup>223</sup> Nijkamp 2001, p. 148, 153; Conclusions of the Ecofin Council, 27 November 2000.

## 7.5 Commission actions against harmful tax competition with the State aid rules as legal basis

As shown above in the meetings leading up to the tax package, the Member States urged the Commission to re-examine its policies regarding direct taxation and the State aid rules and to make use of the powers conferred to it under the Treaty.<sup>224</sup> As seen the Commission clarified its policies in the 1998 notice. The Code of Conduct has also aimed at linking the State aid rules to the fight against unfair tax competition. The Commission will in its application of these rules control if these measures are harmful (i.e. in conflict with the regulations on free and fair competition). It is against this background that the Commission in July 2001 initiated procedures against 12 Member States regarding their special corporation taxation regimes. The Commission writes in its press release on the subject that it believes that these measures might constitute State aid and doubt whether this aid would be compatible with the Treaty.<sup>225</sup>

The Commission once more makes clear that this examination is of no relevance to the Member States' sovereignty in the field of direct taxation. This Commission makes this under reference to a speech by Commissioner Mario Monti. The investigation that was launched in 2001 comprised 15 different tax provisions. The main focus of the exercise was "preferential tax arrangements granted to multinational companies or to companies active in the insurance and financial sector".<sup>226</sup> A formal investigation procedure was only launched at 11 of the measures concerned. The remaining measures were measures that were either in force before the Member State's accession to the European Union or in the past declared compatible with the common market by the Commission. The Member States had therefore in these four cases to decide if they could agree with the Commission's proposals and alter their measures. If not, they would risk a formal investigation procedure. The 15 investigations were the result of an examination of the cases that were identified by the Primarolo group.<sup>227</sup>

The measures that formal investigations were opened to include co-ordination centres, offshore company rules, etc. and include provisions in eight different countries. Illegal aid, is in line with the principles in the above mentioned 1998 notice, either an advantage conferred via for example a reduction in the tax base or a consequence of the discretionary powers by the national administrators. One Swedish measure is included in the tax provisions for which the Commission proposed the Member States to take appropriate measures in order to put them to an end. The appropriate measures

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<sup>224</sup> See for example: COM (1997) 495, para. 17.

<sup>225</sup> Fantozzi 2002, pp. 7; Commission large scale state aid investigation 2001.

<sup>226</sup> Commission large scale state aid investigation 2001; Monti 2002.

<sup>227</sup> Commission large scale state aid investigation 2001; Monti 2002.



that the Commission proposed consists of a phasing out of the advantages in order to create future compatibility.<sup>228</sup>

The Commission ends the press release by stating that the investigation of fiscal aids is not a new domain of activity for the Commission.<sup>229</sup> I find this final note interesting. It seems to me that by this stating the Commission clearly shows that there are doubts on whether the State aid provisions could/should be used in this way. In my opinion, if the case were so clear as the Commission seems to believe, it would not be necessary to point this out specifically. It is off course dangerous to draw any further conclusions from this statement but in my opinion it clearly shows that it can be questioned whether the State aid rules are a good method to tackle harmful tax competition.

Fantozzi means that from a judicially point of view this progress is not at all in line with the Treaty rules concerning State aid on one side and the field of direct taxation on the other side. The political will might be another, namely to advance in the harmonisation process in the field of direct taxation. The Commission policy and the Member States that support this opinion show this. Fantozzi further means that in order to achieve these political goals there is a willingness to go beyond the competence conferred to the institutions under the Treaty.<sup>230</sup>

This leads him to the conclusion that it can be argued that the development of fiscal State aids as a method to fight against harmful tax competition is merely a new method to accomplish the old approach of creating harmonisation of direct taxes. As before, this method bypasses the unanimity requirement in the Treaty as mentioned and discussed above. This might lead to democratic problems since it is most likely that only a certain set of Member States would be supported by this development according to Fantozzi. The solutions proposed in order to avoid these problems is a move towards qualified majority voting in taxation matters together with a legal base for Community action regarding direct tax harmonisation.<sup>231</sup>

The outcome of the investigation is not surprising. A majority of the measures (9) had already been declared as constituting forbidden State aid when the Commission in February 2003 declared that the investigation of the special tax schemes in Belgium, the Netherlands and Ireland should have the same outcome. The Commission declared that these findings were an im

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<sup>228</sup> Monti 2002: The Swedish provision was changed from January 1, 2002: Government Bill Proposition 2001/02:42, *Övergång till en konventionell beskattningsmetod för utländska skadeförsäkringsföretag*, Stockholm 2001.

<sup>229</sup> Commission large scale state aid investigation 2001.

<sup>230</sup> Fantozzi, 2002, p. 8.

<sup>231</sup> Fantozzi, 2002, p. 10.

portant step towards the abolishment of the tax schemes that were deemed harmful by the Code of Conduct.<sup>232</sup>

The examination that the Commission does is in line with the procedure that has been described above. An example of this is the Commission decision regarding the Finish regulations concerning “Åland Islands captive insurance companies” that was the first of the decisions to be given. The Commission states that four main criteria must be fulfilled if prohibited aid shall be found.<sup>233</sup> These criteria are in principle the same as has been discussed above and the Commission does the examination with references to the 1998 notice.<sup>234</sup>

The conclusions that can be drawn from this is that the Commission takes the powers conferred to it seriously. All the 2001 initiatives were measures that had already been examined and identified by the Primarolo group and it is of course important that the State aid rules are not only used as a method to implement and carry out the opinions as established under the Code of Conduct. It is further clear that the Commission will continue to make use of these powers, if necessary, as part of its obligations in the work against harmful tax competition. Whether this is the right way from a legal point of view is a question that I will return to in my analysis and conclusions.

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<sup>232</sup> Commission press release: Final negative State aid decisions on special tax schemes in Belgium, the Netherlands and Ireland, IP/03/242, 18.02.2003.

<sup>233</sup> The criteria are: an advantage must be conferred on the beneficiaries that relieves them of charges they normally incur (1), this advantage must be granted from State resources (2), competition and trade must be affected (3) and the selectivity criteria must be met (4).

<sup>234</sup> Commission decision, of 10 July 2002, on the aids scheme implemented by Finland for Åland Islands captive insurance companies, O.J. L-329, 5.12.2002.

## 8 Analysis and Conclusion

Throughout this thesis it has been my intention to emphasise the connection between the earlier efforts to reform direct taxation and the usage of the State aid rules to fight harmful tax competition. The reasons for this are two-fold. First, from my point of view it seems obvious that the development in this area of EC law would not have been the same if the earlier propositions and ideas had been fulfilled. To this comes that many articles on harmful tax competition (although exceptions exist) do not focus on these questions. It has therefore been important for me to describe and analyse the main focuses in the past in order to create a picture of the subject as a whole.

The early work regarding direct taxation within the EC was characterised by extensive harmonisation, or at least the wish to achieve this. It is natural that the problems with having different tax systems in the Member States are not newly discovered. The result of the many different proposals (aiming at harmonisation in line with the equalisation approach) was however not successful and most of them lead to no action at all or to delayed compromises. These problems lead to a clear change in attitude from the Commission. Today's work in the institutions is much more political than before and the idea of an extensive harmonisation has more and more been abandoned. This is at least the case if one believes the opinions put forward by the Commission since 1990.

The larger extent of political will and the more limited theoretical arguments does in my opinion create arguments and conclusions that are not always logical from a legal point of view. It has been shown in the thesis that much of today's work concern tax competition. It is important to keep in mind that the reasons behind labelling some measures harmful are that they have negative effects on public revenue and social policies. Therefore, the question is highly political. In the end it will lead to the question of whether the institutional bodies should interfere in the right for each country to determine its levels of tax revenue and thereby affecting the parameters of the welfare State.

I am not completely convinced by this change in attitude from the institutional bodies. In the recent work the Commission and the other institutions try to divide the area of direct taxation into one part that needs further coordination (for example corporate taxes) and one part that should be left as it is (for example personal income taxes). The problem with this is that when the first category has been coordinated there is no guarantee that the latter is left alone. Today's approach could be seen as one that tries to accomplish greater uniformity in some areas while others will remain differentiated. However, such part coordination could also be seen as harmonisation in stages and thereby just a different method to achieve the original, nowadays "hidden", goals.

The reasons for the failure of the original plans in the field of direct taxation are multiple. The lack of a clear legal basis together with the requirement for unanimity does of course create an important reason. These legal limits have acted as a brake in the area of direct taxation. Another important reason is the Member States' fiscal sovereignty that is one of the holiest parts of the State's functions. This has made any limits on this right hard to obtain. Therefore the right to tax remains a collective Member State right and not an institutional question. These different factors are in my opinion likely to continue to act as a brake for reforms in this area of EC law.

This failure has not been easy to accept for the EC institutions. They have instead taken their recourse to soft law solutions and negative integration (i.e. integration via prohibitions that are revised by the ECJ). The ECJ has included taxation on its agenda and just by becoming a member of the European Union a State gives up parts of its rights to tax as originally guaranteed under international law. The general principle of non-discrimination together with the fundamental freedoms has been the starting-point of this development. For now the ECJ holds that these rules cannot be used to catch mere differences between domestic legal systems, tax rates or tax bases. This makes it clear that any extensive approximation, for now, is not possible with these rules as a legal ground. To this comes that reverse discrimination is not covered by the fundamental freedoms. I do not think that the fundamental freedoms are a suitable ground to co-ordinate direct taxation within the EU. Such application would be outside the jurisdiction of the Court since the wording of the Treaty would not cover it. Therefore, I believe that the chosen path is correct. It is also in line with the strong national fiscal sovereignty.

There are authors that question the current case law in the field of direct taxation since they hold that the ECJ does not have jurisdiction to handle these questions. However, it is important to remember that the ECJ often has been a precursor and has created important EC law principles from a legal basis that has sometime been weak. The broad jurisdiction of the ECJ is a well-established EC law principle and from this point of view the taken path seems less surprising. Can the case law on fundamental freedoms be linked to the concept of harmonisation? The ECJ case law has not harmonised direct taxes. What it might have done is that it has made the need for harmonisation less since the need for partial harmonisation under the differentials approach should have been limited. There is in my opinion probably a political will to make progresses in the direct taxation field that goes beyond the competence conferred to the Court and the Commission. This is most likely one of the underlying problems resulting in the difficulties to deduce the development in this field from a legal basis.

The legal approaches have also changed because of the problems with adopting binding legal documents. Soft law (i.e. recommendations, policy guidelines and other non-binding agreements) has become the main method

to approach the area of direct taxation. Today's work in this field focuses much on different sub-areas. One is the much-discussed area of corporate reforms and another is the work against harmful tax competition as introduced in the mid-nineties. It is also against these developments that the application of the State aid rules to harmful measures was actualised. Along with these new priorities of the Commission the Member States' attitudes have also changed. Since international tax competition is much more obvious today there are States that believe that coordination within the EU to fight against tax competition does not limit the fiscal sovereignty as much as the international tax competition already does.

Soft law solutions are in my opinion not a very successful method from a legal point of view and should not be the preferred method in the field of direct taxation. These tend to get ineffective since they do not have the same dignity as legally binding measures. However, the EU faces several problems and it is necessary that a clear fiscal policy is made for the EU. One problem that the EU currently faces is intra-community market disturbances. Another is the obvious time limit that affects all EC law since the enlargement of the EU is not going to make policy decisions easier. Therefore, a quick solution of the discussions regarding direct taxation is highly desirable. This time limit is in my opinion most obvious in the field of direct taxation because of the past problems with adopting reforms. Another problem with the enlargement is that fiscal State aid is currently operating in the candidate countries as well (for example certain tax breaks, tax holidays and tax credits used to attract foreign investments). It will take a lot of effort to tackle these and the problems linked to them.

Much of the recent work in the Community regarding taxation has, as stated above, been directed against harmful tax competition. The official line of many Member States and the institutions of the Community is that partial competition is desirable. There are however, in their opinion, parts of the competition that should be eliminated or restrained because it is regarded harmful or unfair. Since the problems with positive integration remains, negative integration and soft law solutions have become a more attractive way to fight against harmful tax competition. The most important soft law approach is the Code of Conduct for business taxation and the most important negative integration approach is the usage of the State aid rules to tackle rules relating to business taxation. One question does however remain before these can be addressed; why should harmful tax competition be fought?

My initial opinion was that the wish to fight against harmful tax competition was based on a fear from the Member States that they would loose tax revenues. This is an important reason but the question is more complex than this. The advocates of complete tax competition hold that all other approaches is a way to uphold the last existing monopoly in the common market, i.e. the right to tax. One main argument is that since tax competition is wanted between companies it should also be encouraged between Member States? They do have a point in this.

On the other hand the institutions and some Member States point at fiscal degradation, increased conflicts between Member States and the shift in tax burden to less mobile tax bases such as labour. In this question there seems to be a good objection to each good argument. I have come to the conclusion that it is not possible for me to answer the raised question since the different theories are based on different views on how the State functions and which interests it guards. It is therefore enough to accept that there are two different groups with different opinions. I believe that the stronger support for the advocators of complete tax competition has influenced the change in attitude in the institutional bodies (i.e. that some parts of tax competition is positive).

The adoption of the so-called “tax package” in 1997 was a systematic approach to tackle harmful tax competition. Both the Code of Conduct and the Commission’s re-examination of the application of the State aid rules in Article 87-88 was part of this. Up to now the Commission had been very cautious in applying the State aid rules to fiscal measures. The usage of these rules, prior to 1997, had focused on whether the tax measure had any adverse effects on the functioning of the common market. The new application turned this practice upside-down. I find it positive that the Commission presented a more systematic approach to the application of Article 87 since it has increased the clarity of the subject.

Fiscal State aid differs from the traditional usage of the State aid rules since instead of spending the revenues the State forgoes the revenue it would otherwise receive. It must therefore be discussed if this usage of the rules is in line with the purpose of these rules? It is not hard to understand why the usage of the State aid rules to tackle harmful tax competition is a desirable method. To begin with the State aid rules are not limited in the same way as the rules on fundamental freedoms are (the latter cannot catch reversed discrimination). The selectivity criteria, to which I will soon return, might however create problems for the application. To this comes that the State aid rules have the force of legally binding law and can be enforced by the ECJ. It is also a tool that is already available and this makes it desirable since the future enlargement makes a quick solution necessary. It is therefore a method that is much more attractive than soft law solutions.

The main purpose of the State aid rules is broad. It aims at preventing aids that distort free and fair competition and complicate companies to act on the basis of economic rationality in a free market. Fiscal State aid is therefore just one of many measures discussed under this set of rules. The original intent of the State aid rules was not to tackle problems arising from tax competition between Member States. To this comes that the Commission has a broad right to enforce these rules since the Council legislation is limited in scope. This has been an important factor in the development of these rules.

It is important to look at the Commission notice from 1998 when trying to answer if it is in line with the purpose of these rules to apply them to measures in order to fight harmful tax competition. This is the main EC law source when discussing the link between Article 87 and the work against harmful tax competition. The Commission notice can be criticised for being vague and unclear. To this comes that it does not clarify more than a few topics and leaves the more important parts more or less untouched (for example the relationship between general measures and selective ones). This vagueness might however be positive since it offers the possibility for the Member States to raise the argument of legitimate expectations. This might give the notice the effect that the Member States are offered to get their house in order before the Commission will do so the hard way. The notice also preserves the discretionary powers of the Commission. This has both positive and negative effects.

It is clear that the Code of Conduct and the 1998 notice broadened the application of the State aid rules. There are however many authors that are not convinced by the arguments behind this application. The question remains, can a measure that leads to reduced revenues in another Member State be a threat to free and fair competition and therefore be covered by Article 87? Can a loss in revenue be compared to a tax subsidy? The mere measure itself cannot constitute prohibited aid but the Commission sees no problems in applying the State aid rules to incentives promoting harmful tax competition if the criteria laid out in Article 87 are fulfilled (the measure must be selective, etc.). These incentives have, in the Commission's opinion, negative effects in the traditional sense.

In my opinion, the strongest argument in favour of an application in line with the Commission's point of view is that the goal of an incentive causing harmful tax competition is to strengthen the Member States economy. In the end it will therefore be a domestic undertaking that benefits from the preferential tax treatment. I am nevertheless not fully convinced by these arguments. To begin with, harmful tax competition does not have to infringe free and fair competition since each and every company is free to move to different Member States within the EU (this right is of course in practice more limited for certain business types). Another argument against this application is that fiscal incentives is just one of many ways to attract foreign companies (others are structural conditions such as infrastructure and education). These other measures are however not labelled harmful.

From my point of view it is not an ultimate solution to apply the State aid rules in order to tackle harmful tax competition, it is not even the preferred alternative. First, because of the arguments just raised, it can certainly be questioned if the application of the State aid rules in this way is in line with the purpose behind these rules. The purpose of these rules was originally not to deal with tax competition or its effects on public revenue; it was to deal with the internal market where competition between undertakings should not

be distorted. Therefore these rules are not a sufficient tool to serve as foundation for a community policy in the field of direct taxation.

Secondly, and more important in my opinion, the solution is not acceptable from a legal point of view. The intention was not to apply Article 87 in this way and this makes the application strained since the role of the article has been overdone. In my opinion, the State aid rules are not an appropriate substitute for a proper harmonisation via legally binding acts. The State aid rules cannot lead to harmonisation (and thereby an equal starting point for the Member States). It can only force the States to give up exceptions. Despite the Commission's effort to clarify the application of the selectivity criterion (see more on this below) these rules cannot be the central instrument in the regulation of tax competition. They might be used as a complementary tool but the main role should and must be played by other instruments.

Several other problems occur even if one accepts that the State aid rules are applied in line with the Commission's opinion. This is because only selective or specific measures fall under the scope of Article 87. The Code of Conduct together with the 1998 Commission notice broadened the scope of the selectivity criteria and introduced a far wider interpretation than what had been used before. Groups of companies that just share some sort of generic feature have for example fulfilled the criterion. This enlargement of the selectivity criteria is confirmed in the case law of the ECJ in for example the *Adria Wien Pipeline* case. On the other hand, an examination of the effect of the measure on competition and on intra-community trade has not been made to any larger extent. Therefore it can be held that the ECJ has taken over the leading role in the coordination process together with the Commission. Since the discretion of the Commission is extensive there is a potential danger in that the Commission will continue to broaden the scope of the selectivity criteria and thereby catching most measures that are labelled harmful under the Code of Conduct. I think that it would not be positive if the application of the selectivity criteria would be broadened further. The reason for this is that such an application would not, in my opinion, be possible to make with Article 87 as legal basis.

To apply the State aid rules to a larger extent of harmful measures could certainly be seen as proof of a method that tries to bypass the unanimity requirement for reforms in the field of direct taxation. The application of the State aid rules could then be seen as a new method to fulfil an old goal, namely to harmonise direct taxes. Such a development might also lead to democratic problems since the European Council, that represents the 400 million inhabitants of the EU, should be the institutional body in charge of decision-making in this field of EC law.

I have in my thesis showed that the difference created between selective and general measures is criticised by some authors since the effects of the latter might be even more drastic. Another problem is that the selectivity criteria,



even if it is broadly interpreted, will not cover all measures. Such general measures that constitute harmful tax competition can be caught under the Code of Conduct. Therefore it is important that the Code of Conduct is applied properly if the work against harmful tax competition should not be undermined. If the Code were not applied strictly it would be very easy for the States to replace specific measures with general measures that have the same effects.

Finally, it is important to remember that tax competition is not limited to the Member States. If tax competition is eliminated within the EU it is possible that investors will turn to other attractive industrialised countries like Switzerland, the USA and Japan instead. Therefore the work in the OECD is important if tax competition should be fought.

In my introduction I raised the question whether or not the application of the State aid rules in the field of direct taxation in order to tackle harmful tax competition has been successful? In order to answer this question I have looked at some of the cases that the Commission has initialised after the adoption of its 1998 notice. Whether the application has been successful or not will have to take its starting point in a presumption that there is a need to fight against harmful tax competition and that the State aid rules provide a suitable method to accomplish this. The reason for this is that an application of the rules could never be successful if one is negative to the usage of them from the beginning. The investigation that was initiated by the Commission in 2001 (i.e. the large scale investigation) is under these premises clearly a success since the measures were found harmful. However, the measures that were under investigation were just a minority of the measures that had been found harmful under the Code of Conduct. Just 20% of the 66 measures that was identified by the Primarolo group were included in the investigation that was launched in 2001. From this point of view the success can certainly be questioned. State aid rules can clearly not be the main method to accomplish reforms of community taxation.

Another conclusion that can be drawn from this is that there is obviously need for a mechanism like the Code of Conduct (or a positive integration mechanism) for the harmful measures that do not fulfil the State aid criteria. Negative integration can only remove barriers but where the negative integration ends there is need for more creative instruments to make further progress (i.e. positive integration). The measures that were examined in large scale investigation were measures that had already been found harmful in the Primarolo group report. There is in my opinion a danger if the State aid rules are primarily used to enforce the Code of Conduct. The State aid rules are, even though they are linked to the Code, a separate tool and should primarily be used as a method to identify measures that are selective.

A final important relationship will have to be analysed. The question is if it is necessary to have both a Code of Conduct and a set of State aid rules. I believe that the analysis so far has shown that the State aid rules might cover

many (with a broad interpretation of the selectivity criterion) harmful measures, but there is in my opinion no doubt that this mechanism cannot cover all measures that need to be tackled if the work against harmful tax competition should be successful. Therefore, the State aid rules cannot act alone. Just to use the State aid rules for all harmful measures would in my opinion be problematic from a legal point of view since such interpretation of the State aid provisions cannot be accepted. It is therefore meaningful to have the Code of Conduct as a separate tool.

The Code of Conduct is the more specific tool while the scope of the State aid rules is more general. At the same hand it is clear that the Code of Conduct, because of its non-legally binding force, is not a method that has any powerful sanctions to guarantee its enforcement. Soft law tools have a natural limitation in that they are weak methods without any guarantees of political sanctions against smaller economies. These factors have made the State aid rules a strong and important method in the work to tackle unfair tax competition (compared to the Code of Conduct). Whether the application of the Code of Conduct will be more successful in the future primarily depends on whether the other parts of the tax package are to become more effective or not.

The relationship between the two tools in practice has been examined in this thesis via a comparison of the measures that was identified by the Primarolo group under the Code of Conduct and the State aid rules. The aim of this examination was to see if the measures that were identified could also fall under the scope of the State aid rules. Many of the identified measures could most likely also fall under the scope of Article 87. The most important criterion with regard to this is the selectivity criterion and the interpretation of this will draw the line between general and specific measures. As just mentioned it is possible to draw another conclusion from the large scale investigation in 2001 since only a minority of the identified measures was included in this.

It is also important to remember that the Code of Conduct is a tool in the hands of the Council via the Primarolo group while the enforcement of the State aid rules is an important task for the Commission. This is probably one reason why there are two different methods instead of one. It seems logical, and in my opinion also preferred from a legal point of view, to just have one legally binding tool that covers all harmful tax competition measures. Today's system tends to get divided between two different institutional bodies which is likely to complicate the work and it might even lead to application problems.

If harmful tax competition shall be fought it is important that this is done with a clear and comprehensive scheme to phase out these measures. From my point of view it is a less preferable method to use the State aid rules on a case-by-case basis. However, it is possible that these rules, since they are backed with sanction, work as an incentive for the Member States to fulfil

their commitments under the Code of Conduct, even if the tax package is not completed. Once again it is necessary to remind of the above-identified risk that Member States replace the specific measures with more general that cannot be caught with the State aid rules as a base. From this it is obvious that a clear legal method to co-ordinate the reform ideas in the field of direct taxation are preferred.

# Supplement A

## Classification of the measures identified by the Primarolo group:<sup>235</sup>

### *1. Location-Specific Regimes*

A004 Basque Country Co-ordination Centres – Spain  
A005 Navarra Co-ordination Centres – Spain  
B001 International Financial Services Centre – Ireland  
B002 Trieste Financial Services and Insurance Centre – Italy  
B006 Madeira and Sta Maria Free Zones – Portugal  
B008 Åland Islands Captive Insurance – Finland\*<sup>236</sup>  
D017 Shannon Airport Zone – Ireland

### *2. Sector-Specific Regimes*

B07 Provisions for fluctuations in reinsurance – Luxembourg\*  
B008 Åland Islands Captive Insurance – Finland  
C024 10% Manufacturing Rate – Ireland  
C025 Petroleum Taxation - Ireland  
CAM025 Investigation and Exploitation of Hydrocarbons – Spain  
CAM058 Provisions for Renewal of Mineral Reserves – France  
CAM059 Provisions for Renewal of Oil and Gas Reserves - France

### *3. Activity-Specific Regimes*

A001Co-ordination Centres – Belgium  
A002 Distribution Centres – Belgium  
A003 Service Centres – Belgium  
A004 Basque Country Co-ordination Centres – Spain  
A005 Navarra Co-ordination Centres – Spain  
A006 Headquarters and Logistic Centres – France  
A007 Co-ordination Centres – Luxembourg  
AAM019 Control- and Co-ordination Centres of Foreign Companies – Germany  
B001 International Financial Services Centre – Ireland  
B002 Trieste Financial Services and Insurance Centre – Italy  
B003 Finance Companies – Luxembourg  
B004 International Financing Activities – Netherlands  
B005 Finance Branch – Netherlands  
Z002 Finance Branches – Luxembourg

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<sup>235</sup> As it appears in Easson 2001, p. 115-121. The numbering system is the same as the one in the Primarolo group report 1999.

<sup>236</sup> Measures that relates to several groups has been listed in all of them and are marked with \* the first time they appear in the listings.

#### *4. Holding Company Regimes*

A013 1929 Holding Companies – Luxembourg  
A014 Holding Companies – Netherlands  
AAM002b Holdings Intra-Group Relief – Austria  
AAM021 Holding Companies - Denmark

#### *5. Particular Types of Income*

A012 Patent Royalty Income – France  
A015 Royalties - Netherlands  
B011 Offices of Foreign Companies under the Law 89/67 – Greece  
E007 Foreign Income – Ireland

#### *6. Rulings and Presumptive Taxation*

A008 Cost Plus Ruling – Netherlands  
A009 Resale Minus Ruling – Netherlands  
A010 Intra-Group Finance Activities – Netherlands  
B007 Provisions for fluctuations in reinsurance – Luxembourg  
E001 US Foreign Sales Companies Ruling – Belgium  
E002 Informal Capital Ruling - Belgium  
E003 US Foreign Sales Companies Ruling – Netherlands  
E004 Informal Capital Ruling – Netherlands  
EAM009 Tax Exemptions – Austria  
Z003 Non-standard rulings - Netherlands

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