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## 11.1 The Harmful Tax Competition as an Emerging Value of the EU Legal System

### 11.1.1 The Notion of “Harmful Tax Competition”

The topic of “harmful tax competition” has been for many years one of the main arguments used by international organizations (and therefore not only by the EU) to assess the compliance of decisions taken by the individual States in relation to the tax advantages with respect to the development purposes and even to the peaceful coexistence of the States in the international context.

The recruitment of national measures involving tax benefits in favour of those economic agents that are allocated in the State is in fact able to distort materially the ordinary rules of business competition, producing discrepancies and distortions with regard to the normal operation of the market. Therefore, the international organizations that promote the value of free competition in the market have gradually developed a strategy to contrast with the rules and the practices adopted by some Member States for promotional purposes of its territory.

In this perspective, the definition of the tax policies with emphasis on territorial facilitation, aimed in particular at promoting the localization of economic activities

or capital investment in the country, were judged as an expression of choices which are “harmful” to the processes of globalization and international integration and, therefore, as an element to counteract or at least to restrict. Thus, some forms of integration of fiscal policies of individual States are promoted by international organizations in order to reduce the fiscal competition between the States.

Consistent with that approach in the EU law it has gradually been shaping the belief that tax competition exerted between the various Member States is to be judged as a negative factor, potentially suitable to alter the operation of the common market and then to distort the effectiveness of the principle of free competition.

Although it is not formulated a specific definition of “harmful tax competition” in the EU law, it has been progressively identified an area regarding the behaviours of the States (and in particular the regulatory regimes adopted into national law) which may be judged incompatible with the general principles expressed in the Treaty and in any case inadequate to permit the process of European integration.

The “harmful tax competition” is so identified with the adoption of fiscal policies by a Member State which determines, at least potentially, a subversive tax order compared to the majority of the other States, as it introduces elements of fiscal facilitation or, however, some tax benefits that induce the economic agents to be located in the territory of the same State, including the allocation of resources and factors of production, at the expense of the State of residence (and therefore with a disregard to the “natural” development of business).

Typical expression of the fight against the harmful tax competition in the EU law can be found in the adoption of the “Code of Conduct” (following the ECOFIN decision of 1997, as part of the “*Monti package*”) intended to achieve the block of new favourable fiscal measures and, above all, to promote the gradual dismantling of the existing tax regulations, devoted to encourage the location of economic activities in a given country, which are capable of producing competitive situations compared to other countries. The rules established by the Code of Conduct have been able to render concrete and effective the value of harmful tax competition within the European legal system.

### **11.1.2 The “Harmful Tax Competition” as a Paradigm of the Limitation of National Taxation**

At a first glance, the fight against the “harmful tax competition” seems to look like a mechanism of protection of national taxation with respect to the tax policy of foreign States, avoiding or at least mitigating those forms of interference with respect to the behaviours of economic agents which are resident in the national territory. In this perspective the discipline to contrast the “harmful tax competition” may be ascribed to the category of acts realised in defence of the fiscal sovereignty of the individual State.

On a closer inspection, indeed, the conceptual background of the harmful tax competition expresses a completely different logic than the protection of national fiscal sovereignty.

It is well known that the use of tax relief operates as a mechanism for promoting economic and social assets to be pursued in line with the fundamental aims laid down generally in the national Constitutions. Particularly, the adoption of tax incentives represents a means, often inescapable, to ensure the economic recovery of depressed areas or to facilitate the rise to a level of a minimum acceptability for some business underdeveloped categories.

In this perspective, the tax relief, which is used to determine the reduction or even the cancellation of the ordinary tribute, where it introduces a discrimination with respect to the generality of the associates, who are in an objectively better starting situation, pursues the achievement of the substantial equality of the members of the civil society according to a primary goal of the Constitution. The provision of promotional tax rules is so understood as a fundamental option for the fiscal sovereignty of each State, through which are effectively and substantially realised the core values of the protection of human dignity and individual development. The tax benefits contribute, therefore, to mark the pace of the sovereign State towards a path of equality and justice in the direction of the economic development and social support.

The compression of national fiscal policies pursued by the international organizations (and among them also by the European Union) is proposed actually to ensure the full equality of the Member States and to protect the competitiveness of business in the international market by excluding that the tax factor can be distortionary compared to the allocation of resources.

Evidently the idea of the harmful tax competition between the Member States lies in the conviction that there exists a *standard* tax, that is a consistent level of tax burden on the international market, in which the main national tax legislation will be lining up—at least as a trend line—resulting in a treatment which is broadly equivalent for the corporate and business taxation over the economic agents. Sensitive deviations from the *standard*, and in particular the facilitations of the tax burdens, are regarded as a clear interference with respect to the allocation decisions of economic agents and thus are essentially classified as acts of “international tax competition”, aimed to attract capital and enterprises in the national territory distracting them from the territory of residence.

The perspective through which the rules related to the harmful tax competition are framed must be identified around the market values: the normative acts of the State which introduce some mechanisms to facilitate the ordinary taxation are not considered as an expression of concern to fiscal sovereignty, nor as a search for a balance between the different constitutional values or as an instrument for the development of the substantial equality, but rather as obstructive acts which distort the international market, almost as a gesture of defiance for the other countries that comply with the standard tax policy.

This transfiguration of a legislative act in a competitive behaviour is evident in Europe, where the emerging trend is to counter not only and not so much the actual “tax havens”, which proclaimed the absence of any withdrawal tax and therefore can actually produce serious distortions to the international allocation decisions, but also the single and specific regulations of tax relief adopted by each Member State

as likely to determine a sectorial interference compared to the ordinary taxation applied in other States.

Therefore, the “harmful tax competition” aligns conceptually the “negative” taxation of the EU legal order, connecting to the same liberal axiological system. It expresses, on the one hand, the desire to contain and to limit the national fiscal sovereignty and to eliminate the expansionary potential, at least compared to a promotional use of taxation as an instrument of development and restoration of the substantial equality; on the other hand, it denotes the opening towards the “market” as a reference point of the fiscal choices, clearly showing the collapse of the fiscal sovereignty to the logic of full competition of enterprises and economic agents in the common market.

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## **11.2 The Fight Against Harmful Tax Competition Within the EU Legal System**

### **11.2.1 The “Monti Package” and the Introduction of the Code of Conduct**

As mentioned before, a key role with respect to the fight against the harmful tax competition is covered by the package of programmatic provisions issued by the Commission on 10/01/1997 and endorsed by the ECOFIN Council in the form expressed in its Resolution of 12/01/1997 (so-called “*Monti package*”); in this document a key element is expected to be the enactment of a “Code of conduct”, whose content is not legally binding, having the characteristics of a political commitment, which lays down rules designed to contain the phenomena of harmful tax competition between the Member States.

Harmful tax competition is presented as a growing source of conflicts between the Member States because of the ability to influence the choices of economic and tax policy taken at the national level, which must be countered through a strong coordination at the EU level.

Unlike the OECD report on harmful tax competition, the European Code of conduct is not directed so much to counter the relocation of financial assets or business which could lead to costs to the firm (and therefore to modify the determination of the tax base in the territory where ordinarily operates the company), but rather to slow down the logic of an artificial location of the business in countries with a more convenient tax regime. The Code of conduct is typically in contrast with the fiscal practices that may result in substantial benefits so as to change the allocation choices of the firm in an area different from the usual one (or where it is expressed the main economic activity).

It is to point out that harmful tax competition is identified as a major cause of the shift of tax burden from capital to labour by the Member States. In fact, the provision of preferential tax regimes is able to attract especially the inputs with greater mobility (such as capital and enterprises), but not also the labour that is configured as a factor strongly rooted to the native territory and poorly mobile.

Therefore, the mobility of capital and business triggers a vicious circle: to counteract the shift towards preferential tax regimes, the States lessen the tax burden on these factors, and conversely are forced to increase the tax burden on the factor of the labour in order to maintain stable the tax revenues. In this view, the contrast to the harmful tax competition is considered as a functional element not only to the pursuit of free competition within the common market, but also as an element of social healing, directed to redressing the balance in the level of taxation on labour and capital and ultimately to promote the growth of employment in Europe.

Given the nature of a political commitment, ineffective to condition the legal system (given the absence of specific obligations and especially of sanctions in the event of default), the Code of conduct was originally implemented for a prolonged period by embodiments spontaneously adopted by the main Member States.

Subsequently, following the agreements reached during the ECOFIN meeting on 06/03/2003, the Code of conduct has found an explicit recognition in the EU law with the final agreement on the forms of harmful tax competition determined through some company regimes deemed “harmful”, particularly with regard to the profile of the taxation of business income (except to establish a temporary extension for some of these schemes). In this document have been identified five categories of potentially harmful measures: the intra-group services, the financial services, the offshore companies, some sector-specific schemes, the tax incentives of a regional nature.

### 11.2.2 The Content of the Code of Conduct

The Code of conduct is applied at first with reference to the business taxation that significantly affects (or influences) the choice of location of the economic agents in the European territory. Secondly, the Code of Conduct also applies to special tax regimes reserved to the employment which may be conditioning on the location of the business activities.

The tax provisions considered by the Code of conduct are those contained in the national legal acts (laws and regulations), as well as those resulting from administrative practices held in the Member States.

The Code of conduct provides basically two distinct categories of prescriptive directions.

At first, it is programmed to block new provisions of direct taxation which, by encouraging the location of production activities in a national territory, produce competitive situations compared to other countries (so-called *standstill clause*). In essence this rule determines a sort of freezing on some existing tax reliefs in the Member States, preventing that they can grow in quantity and quality.

At second, it is foreshadowed the gradual dismantling of the fiscal provisions established in the Member States which produce the effects of the harmful tax competition (so-called *rollback clause*). This is a more effective measure, as instrumental in achieving a fair competitive fiscal structure through the elimination

of preferential tax regimes that can produce distortions of the natural allocation of the business in Europe.

The guiding principle of the contrast to the harmful tax competition is identified in the express recognition of a parameter for the identification of the incompatible cases: the national tax provisions are considered potentially harmful, when they lead to an effective level of taxation in the privileged territory which is smaller than the taxation generally applied in the other countries.

The facilitation effect can be achieved through the tax rate or through the tax base or even through other elements of the structure of the tribute.

In order to proceed with the assessment of tax favourable regimes some indices of harmful tax competition are determined in the Code of conduct:

- tax relief that is intended only to non-residents or only to transactions with non-residents;
- tax relief that is isolated from the national economy and do not affect the overall tax base of the State;
- tax relief that is attributed regardless to any genuine and material business activity carried out in the national territory;
- rules for determining the operating result of the business (profit or loss) which sensibly differ from those provided usually at international level (with particular reference to the models developed by the OECD);
- tax provisions that lack transparency and disclosure, including cases where the tax benefits are granted by the administrative authorities.

It is also established that the control of the fiscal provisions is to be carried out not only by the Commission but also by the Member States, which may request information directly to the State which applies tax benefits deemed potentially liable to be qualified as harmful tax competition. This is a generalised form of control about the fiscal competition in Europe, that may emphasize the compliance with the instructions contained in the Code of conduct.

To ensure a constant monitoring of the implementation of the commitments undertaken with the Code of conduct has been set up a “monitoring group” which is open to all Member States, whose main task is to examine the tax favourable provisions adopted by the Member States and to verify the potentially distorting effects that can be produced on the common market.

### **11.2.3 The Effects of the Code of Conduct. The Assimilation to the State Aids**

The Code of conduct is essentially a political document, which is expressly qualified as a non-legally binding commitment. Therefore it is an act that can be classified typically in the category of the European *soft law*.

It has been repeatedly observed that the fiscal provisions capable to produce harmful tax competition show an undoubted affinity with respect to the State aids,

given the amenability of both cases to the category of tax benefits. This affinity seems to constitute the logical assumption for the application of the rules on State aids envisaged by the Treaty also to the tax provisions regulated by the Code of conduct.

Indeed, in the Code of conduct it is expressly recognized that some of the tax provisions potentially amenable as an expression of harmful tax competition fall within the scope of the EU regulation on the State aids. It must be noted that not every tax provision likely to produce a potentially harmful tax competition is able to be qualified as a State aid, given the non-recurrence of the necessary requirements established by the art. 107 TFEU.

The amenability of the tax provisions falling within the scope of harmful tax competition in the category of the State aid was then subject to a specific Commission communication (communication C-384 of 12/10/1998), which explicitly affirmed the applicability of the provisions of art. 107 to the measures of fiscal policy.

The use of the procedure for the verification of the compatibility of State aids allows to give a stronger legal significance to the Code of conduct, and permits to evaluate the direct tax systems of the Member States which may distort the competition between the economic agents and encourage the location of the artificial entrepreneurial activities in some privileged territories.

The Commission has thus opened up numerous examination procedures against some Member States with regard to the legality of national tax regimes potentially harmful by virtue of the rules on the State aids. These procedures are in majority concluded with a decision of incompatibility, however without determining an order for recovery of the unlawful State aid because of the formation of a legitimate expectation of the recipient.