TAXES: COMPETITION'S ALLY OR FOE?

Francisco Andrade de Portugal

Abstract: *This article shows that taxes are frequently a foe but also an ally of competition. Traditionally, both the legal doctrine and economic theory see taxes as an obstacle to competition. The imposition of a tax affects the supply and demand and therefore interferes with the normal balance of the market. Custom duties and tax aids are basic examples of how taxes can restrict competition. Despite of the obstacles that taxes often represent to competition, the author believes that taxes must also be regarded as an ally to the extent that they can foster competition as well as be used to correct serious market failures, some of the most important purposes of competition policy.*

Index:

1. INTRODUCTION

The main purpose of this essay is to show that taxes are frequently a foe but also an ally of competition. Traditionally, not only legal doctrine but also economic theory sees taxes as an obstacle to competition. The imposition of a tax whether on production or on consumption interferes with the normal balance of the market, affecting supply and demand as it raises prices on the market.[1] Furthermore, transfers of financial resources from market actors to the State and vice versa always open doors for distortions of competition. Thus, taxes affect the natural allocation of financial resources in the market

1 Ribeiro Brazuna, 2009: 43.

and there is the possibility that they affect it in an inappropriate way from a public interest perspective.

However, the fact that distortions of competition may occur whenever there is a transfer of financial resources from market actors to the State and vice versa does not necessarily mean that undue distortions will occur. Not denying that taxes frequently constitute a significant obstacle to competition, one cannot restrict the effects of taxes to their negative side. In spite of the obstacles that taxes often represent to competition, it is the author's opinion that taxes must also be regarded as an ally, to the extent that they can foster competition as well as be used to protect the interest of all market participants and correct serious market failures. For instance, governments can make use of the tax system to foster competition in monopolistic markets, protecting all market participants from the harmful effects that such a market can originate and thus correcting a market failure.

Therefore, the author sustains that the negative and the positive effects that taxes have on competition are two sides of the same coin. Whereas in some cases taxes are a foe of competition, in other cases they function as a true ally.

As the OECD notes, "[t]he actual impact of [tax] state aids and subsidies is difficult to assess. On the one hand, they may cause distortions and inefficiencies. On the other hand they are frequently rationalised as an instrument to tackle market failures and to produce positive externalities".[2] The assessment of whether the impact of taxes on competition is positive or negative will ultimately depend on the delimitation of the main purposes of competition law. If we consider that the protection of the free market *per se* is the main goal of competition law, we will easily find situations where taxes have a negative impact on competition. Conversely, if we consider that the ultimate purpose of competition law is the protection of all market participants (producers, distributers, sellers, consumers and ultimately society) and that the protection of the free market is just a mean to achieve a superior end (societal welfare) taxes will more often be considered an ally of competition. The author tends towards the latter approach.

Even though this is a topic with relevance at WTO level, this study will be limited to the European context. The legal framework in the European Union regarding taxes and competition is very peculiar and provides an excellent theoretical basis to launch a pertinent debate. Irrespectively of what we

2 OECD, 2010: 1.

consider to be the ultimate goal of competition law, the lack of tax coordination prevailing in the EU must be considered a major factor responsible for distorting competition in the internal market. Companies exercising activities in the same single market are treated differently according to the location of their headquarters, which results in unfair competition. Furthermore, the lack of tax coordination involves high compliance costs for companies exercising activities throughout the internal market, which makes them less competitive, efficient and innovative. As a consequence, we will fundamentally focus on the problems that the legal *status quo* in the European Union regarding taxes entails for competition. Nevertheless, the fact that this work is limited to the European context does not preclude the possibility of making sporadic references to other regimes like the WTO, OECD and EFTA, when convenient.

2. TAXES AS A FOE OF COMPETITION

2.1. General Context

Competition can be a really valuable tool to improve the welfare of European citizens. Increased competition can lead to higher efficiency, innovation, and cheaper and better products. As a consequence, the competitive process should remain undistorted, unless there is a valid reason of public interest justifying the distortion.

Since taxes represent a significant financial burden and affect the supply and demand of resources in the market, they affect market participants' performance. Consequently, taxes are liable to create obstacles to the competitive process. When governments make use of the tax system to benefit certain firms, sectors or regions, without the public interest in their horizon, they may be creating serious obstacles from a competition policy perspective.

In the present Part of this article, the author analyses numerous situations where taxes affect competition. We will begin by explaining the negative impact that custom duties and tax aids can have, from a competition policy perspective. Both custom duties and tax aids are instruments that governments have at their disposal to protect certain national companies, restricting competition. These issues are, nonetheless, satisfactorily regulated in EU law in order to avoid serious distortions of competition.

Then, we will analyse some of the problems that the current legal tax framework implies for European companies, distorting competition and preventing them from being fully competitive and efficient, some of the most important purposes of competition policy. That is the case, for instance, of the application of different tax rules in the internal market.

The author will then analyse the serious problems originated by tax competition, which emerge when countries compete with each other through the tax system on an individual basis in order to attract direct investment to their jurisdictions. These problems include waste of fiscal revenues and obscurity in national tax systems. But the most serious problem that tax competition originates from a competition policy perspective is that it affects the level playing field, making competition in the internal market very unfair.

Finally, the author will describe the serious distortions of competition that several companies, with the assistance of some governments (especially, the Irish, the Luxembourg, and the Dutch), have been creating in the internal market over the last years by resorting to aggressive tax planning, which includes the erosion of tax bases, the shifting of income and agreements between these companies and the national governments, which can consubstantiate into tax aids.

2.2. Custom Duties

Custom duties or tariffs are a simple example of how taxes can have a negative impact on competition and trade. Some authors even consider custom duties as the most evident tax impediment to the functioning of the internal market.[3]

Custom duties are taxes levied on goods imported into one country by the custom authorities. These taxes can be imposed on a specific basis (not based on the value of the imported product but rather on its weight, volume or quantity) or on an *ad valorem* basis (they are calculated based on the value of the imported product i.e., through the application of a tax rate) or as a combination of both.[4]

Custom duties have dual functionality. On one hand, they serve to raise revenues for the State. On the other hand and most importantly for the purpose of this article, custom duties often serve to protect specific domestic industries from foreign competitors.[5] These taxes increase the price of imported goods, thus discouraging their purchase and giving an advantage to locally--produced goods.

3 See for instance, Terra & Wattel, 2005: 7.

4 Guzman & Pauwelyn, 2012: 167.

5 IBFD, 2015: 109.

Custom duties are a tool that allows governments to protect their economy, controlling the flow of goods. Such control of importation may however constitute a serious restriction of competition. Custom duties interfere with the normal balance of the market, affecting the natural supply and demand as they increase the prices of foreign goods. If all the countries massively discourage the importation of goods and services, free trade and economies of scale would not be possible, resulting in less competition and harming the average citizen.

By discriminating domestic and foreign goods, governments ease the production of national products, reducing internal competition with all the problems that it entails, e.g., less innovation as well as more expensive and worst-quality products. Custom duties might therefore be a serious foe of competition.

The European Union plays an important role in the regulation of custom duties. In accordance with Article 28 of the TFEU, the European Union is a Customs Union. As a consequence, Member States are forbidden of imposing custom duties or any charge having an equivalent effect to a custom duty in order to facilitate the free trade of goods and services in the internal market and avoid distortions of competition (Article 30 of the TEU).[6]

Moreover, Article 110 of the TEU prohibits any discriminatory and protective internal taxes. Thus, while Article 30 deals with fiscal barriers to trade levied at the frontiers, Article 110 addresses fiscal rules that apply internally within a Member State, prohibiting aggravated taxes on similar foreign goods. According to Barnard, these provisions are supposed to guarantee the complete neutrality of internal taxation as regards competition between domestic and imported products in order to ensure normal conditions of competition.[7]

The Community Customs Code[8] entered into force in 1992, and was replaced in 2008 by the Modernised Customs Code.[9] Through these legal instruments the European Union gave application to the Treaty provisions and effectively prevented the imposition of custom duties in the internal market,

6 According to Terra and Wattel, "[a] 'charge having an equivalent effect' to a customs duty is any pecuniary charge, under whatever name or scheme, for whatever purpose, however small, levied by a Member State on the occasion of the border-crossing of products". See Terra & Wattel, 2005: 7.

7 Barnard, 2010: 51.

8 Council Regulation (EEC) No 2913/92 of 12 October 1992.

9 Regulation (EC) No 450/2008 of the European Parliament and of the Council of 23 April 2008.

eliminating any restriction of competition that the differentiated tax treatment between national and foreign goods implies.[10]

Contrarily to the WTO, that only establishes that Member States are obliged to keep the applied custom duties rates below an established tariff ceiling,[11] the EU prohibits the imposition of any custom duty on goods crossing the internal market, because those custom duties are regarded as a deterrent for competition and an impediment to the functioning of the internal market.

Therefore, custom duties represent an obvious situation where taxes have a serious impact on competition. And not only taxes that are levied at the frontier may affect competition and international trade. Taxes applied internally, conferring a differentiated treatment between similar national and foreign goods, may also severely affect competition. Nevertheless, the reality is that the imposition of these taxes is stringently regulated at WTO and especially at European level, with the purpose of avoiding the harmful effects that it involves for competition and, consequently, for society.

2.3. Tax Aids

Governments often intervene in the market by granting financial aids to certain sectors or specific companies with the purpose of solving market failures. The problem is that occasionally, either by lack of budgetary discipline, powerful lobbies or due to corruption, governments do not perform such task adequately from a public interest perspective.[12] Sometimes governments grant public money through the tax system (tax exemptions, tax allowances, tax deferrals…) to companies that do not pursue activities of public interest or, even if they do so, the funds are granted in a selective manner whereas they should have been attributed in a general way. The grant of selective tax advantages should be avoided whenever possible from a competition policy perspective, to avoid distortions of the level playing field.

10 In fact, one of the most important objectives of the Modernised Customs Code was to create a level playing field in the single market through the harmonisation of administrative penalties and the replacement of rules based on national law with Community rules. See Terra & Wattel, 2005: 329.

11 Under the WTO rules the imposition of custom duties is not totally prohibited. The WTO merely establishes their gradual reduction. The WTO established tariff ceilings, which each WTO Member must respect. This means that WTO Members are under an obligation to keep their applied custom duties rates at or below the level of the ceiling. See Guzman & Pauwelyn, 2012: 167.

12 Buelens, Garnier, Meiklejohn & Johnson, 2007: 8.

In the same manner that custom duties affect competition and international trade, the same can be said about tax aids granted to the production of certain products. For instance, if one government grants a selective tax advantage to one of its national companies with the aim of stimulating the export of national products, it is distorting competition and international trade. This measure allows the company to sell its products at lower prices and places it in a situation of comparative advantage over its competitors (either national or foreigner), distorting competition and ultimately affecting the normal supply and demand. Subsidies or state aids, in particular tax aids, constitute a typical barrier to trade and create severe distortions of competition.

A tax aid is characterised by always involving a transfer of state resources by public authorities, even if indirectly, in the form of foregone revenue for the State. Also, a tax aid implicates the selective grant of an economic advantage to an undertaking and it is a measure that distorts or at least has the potential to distort competition and trade between Member States.

Provided it is made in selective terms, the adoption of any of the following measures may constitute distortive tax aid: the grant of a reduction of the tax base (through tax allowances or extraordinary amortizations), the grant of a reduction of the amount of tax due (through tax exemptions or tax credits), the grant of tax deferrals or even exceptional rescheduling of the tax debt.[13]

Thus, tax aids may severely affect competition, with all the problems that less competition entails in the long run for the average citizen (less innovation as well as more expensive and worst-quality products). For that reason, tax aids are in principle forbidden by the GATT[14] as well as by EU state aid control.

One case that has attracted much attention and is a good example of how taxes can assume the form of distortive aids concerns the giant of informatics Apple Inc. Recently, Apple's Chief Financial Officer admitted before the US Senate that Apple negotiated with the Irish government a 2% corporate income tax applicable to Apple's subsidiary based in Ireland, whereas the normal corporate income tax in Ireland is 12.5%.[15]

Apple argues that the company did not violate the law since such favourable tax treatment granted by the Irish government cannot be regarded as illegal state aid. The issue in this case is whether this tax treatment granted by

13 Maito da Silveira, 2011: 219 et seq.

14 Article 1 of the Agreement on Subsidies and Countervailing Measures.

15 See Bradshaw, Barker & Houlder, 2014.

the Irish government was selective or not. Even if by law such favourable tax treatment could be granted in favour of any company, it can still be regarded as selective aid if in practice it only applies to that company (*de facto* selectivity). There are no doubts that in this case the remaining conditions for a measure to be considered tax aid are present, since it implies a loss of revenue for the Irish budget (transfer of State resource), confers an economic advantage to Apple and affects trade and competition between Member States.

Thus, the European Commission has to scrutinise if this aid was granted selectively and if it falls under any exception to the general prohibition of state aid foreseen on Articles 107(2) and 107(3). If the Commission considers this measure as prohibited tax aid, such a decision would imply the reestablishment of the situation that previously existed, i.e., the recovery of the illegally granted state aid (about 10.5% of Apple's turnover during the past ten years, since the agreement dates back to 1991, but the powers of the Commission to order the recovery of unlawful state aid are limited to a period of ten years) and the respective interest.

Thus, one must conclude that tax aids represent another situation where taxes can be a serious foe of competition, making the competitive process truly unfair. Tax aids granted to certain undertakings can distort the level playing field in the internal market inasmuch as they put their recipients in a comparative advantage over their competitors, causing damages to the average European citizen in the long run.

2.4. The Lack of Tax Coordination

The lack of tax coordination in the EU and the consequent existence of 28 different tax systems in the internal market also creates significant obstacles to competition, at various levels.

Firstly, European firms compete under different rules. These different rules do not only involve the application of different tax rates, but also different administrative procedures (different temporal requirements and different financial costs to satisfy the tax obligations) and different accounting rules. This opinion is supported by Terra and Wattel, who unreservedly say that "[d]ifferences between Member States' domestic laws and administrative practices may cause serious distortions to the conditions of competition within the internal market".[16]

16 Terra & Wattel, 2005: 21.

A company that is allowed to satisfy one specific tax obligation in one year is certainly in advantage facing a company that is obliged to satisfy the same tax obligation in one month. During that one-year period the first company has at its disposal financial resources that may result in a better performance in the market whereas its competitor had to deliver those financial resources to the State coffers by the end of the one-month period. So, not only the different tax rates applicable across the EU, but also the different administrative procedures and the different accounting rules, make the competition process unfair.

Another example that illustrates how different tax rules in the internal market distort competition can be found in the excise duties applied on gasoline across the EU territory. Even though excise duties were supposed to be harmonised at European level due to the imposition made by Article 113 of the TFEU,[17] the truth is that the Directive[18] giving application to such provision is not stringent enough to effectively coordinate the application of excise duties on gasoline. Due to the level of dependence on this good, the price of gasoline plays a key role in several industries, such as distribution companies, car rental and trucking. The application of different excise duties on gasoline across the internal market changes significantly the price of this good, distorting competition in those industries. For instance, since the beginning of the year 2015, taxes (which include excise duties, a new road contribution, a new carbon fee and VAT) are responsible for a relative increase of the price of gasoline in Portugal by 13.7% (€0.19 per litre) when compared to the neighbouring country Spain. This makes it very difficult for Portuguese companies whose economic activity highly depends on gasoline to be as efficient and competitive as their neighbouring competitors.

This variance of the tax rules within the internal market has the additional disadvantage of harming companies that exercise economic activities across the internal market. Companies exercising activities throughout the internal market must be aware of the tax rules applicable in all jurisdictions where they perform an economic activity and they also have to deal with the tax administration of each Member State. Thus, a company that performs an economic activity in all Member States must be aware of the specificities of each of the

17 Article 113 of the TEU provides that "[t]he Council shall (...) adopt provisions for the harmonisation of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition".

18 Council Directive 2008/118/EC of 16 December 2008.

28 tax systems of the European Union, in order to satisfy its tax obligations. Furthermore, it also has to deal with 28 tax administrations. This involves high compliance costs and heavy administrative burdens for that company.[19] As a consequence, the lack of tax coordination makes EU-based companies less efficient and less competitive. The adoption of common standards applicable throughout the internal market is fundamental from a competition policy perspective, in order to make European companies more competitive and efficient.

European firms have to face extra difficulties when compared to their American, Japanese or Chinese competitors, who only have to deal with one tax system and one tax administration, even though they exercise economic activities throughout their whole respective territory.[20] Facing European firms, the foreign counterparts can be more competitive and have a better performance in the worldwide market, because they have less compliance costs and less administrative burdens. In the long run, the European economy is not able to accompany the growth of its rival economies, which has negative consequences for European citizens.

Therefore, one concludes that the lack of tax coordination in the internal market represents a strong obstacle to competition. On the one hand, it results in unfair competition because it obliges European firms to compete with each other under different tax rules, affecting the level playing field. On the other hand, the lack of tax coordination makes companies exercising economic activities throughout the internal market less competitive due to the high compliance costs that they have to support to fulfil their tax obligations. The fact that European companies are less competitive is something that is against the main objectives of EU competition policy.

1.5. Harmful Tax Competition

Harmful tax competition is another problem that reflects the negative impact that taxes have on competition. First of all, it is important to note that harmful tax competition is a problem that affects not only EU Member States, but all countries in the world.[21]

It is a given that competition is an economic phenomenon that does not only exist between market actors. In fact, countries also compete between

19 See Spengel & Wendt, 2007: 8.

20 European Commission, 2011: 6.

21 See Schön, 2003: 38.

themselves with the purpose of attracting the maximum amount of businesses and capital possible to their jurisdictions by granting tax benefits to that effect. However, the exaggerated use of these incentives can lead to serious problems.

Globalisation and the consequent reduction of barriers to trade, especially in the EU due to the fundamental freedoms, have increased firms' options to establish their businesses in low tax jurisdictions. Being aware of this reality, during the last three decades, countries all over the globe have increasingly granted tax benefits and reduced the corporate income tax rates with the intention of attracting foreign capital to their jurisdictions.[22] This governmental behaviour has serious consequences from a competition policy perspective.

One could think that the substantial reduction of corporate income tax rates in an extensive number of jurisdictions of the globe is a positive outcome for competition, because when taxation is reduced companies have more financial resources at their disposal so they can be more efficient and competitive. The supporters of tax competition say that tax competition encourages operational efficiency and makes States responsive to citizen preferences. Further, they argue that tax competition leads to coordination through the reduction of taxation.[23]

Not denying that a certain degree of tax competition can have positive effects, one cannot neglect the negative effects that an intensive and reckless tax competition may originate, as shown by the following example.

If a country grants one tax benefit to attract foreign companies to its territory, the neighbour country may feel under pressure because it does not want to lose capital in favour of the first, and so grants an equivalent tax benefit. Ultimately, the tax benefits granted do not increase the relative benefit to invest and both countries lose their fiscal revenues. Both countries would be better off without the grant of the tax benefits.[24] This measure has a negative effect as it is a waste of public fiscal revenues as well as resulting in a reduction of social welfare. Further, this behaviour may originate a vicious circle where countries grant tax benefits just to accompany their neighbours in the hope of not losing capital in their favour, which may lead to "fiscal degradation" and a "race to the bottom", where the bottom is the critical point in which the costs

22 OECD, 1998: 13.

23 See Bratton & McCahery, 2001: 680.

24 See Bal, 2014: 64.

of granting the tax benefits become superior to the benefits that they were supposed to generate. In the end is the society that will suffer.[25]

From a competition policy perspective, it is fundamental to keep in mind that harmful tax competition does not only affect countries' budgets, but also all market participants' performance, as it promotes unfair conditions of competition. Tax competition prevents the realisation of one of the most important goals of EU law, the maintenance of a level playing field.[26] Whereas some companies are subject to high corporate income tax rates, their direct competitors are taxed in the low tax jurisdictions of the Member States that joined the harmful tax competition process.

In order to move forward with the single market integration process and ensure that a true level playing field is reached, it is fundamental to coordinate the rules regarding the grant of tax benefits and reduce tax competition. Such coordination should reduce the divergence of tax treatments conferred in the internal market and allow European firms to compete under equivalent and fair conditions.

Harmful tax competition can create significant distortions of competition even at national level considering that it encourages a differentiated tax treatment between national and foreign businesses. As tax competition aims to attract foreign investment, governments grant a more favourable tax treatment to foreign businesses when compared to nationals. This discriminatory treatment between national and foreign businesses distorts competition internally. Additionally, it represents a violation of one of the cornerstones of the EU, the non-discrimination principle between nationals and foreigners.

Harmful tax competition also creates obscurity in national tax systems. The intense attribution of tax benefits increases the complexity of national tax systems and reduces legal certainty and transparency.[27] The lack of legal certainty is prejudicial for businesses since companies do not know on which ground they will step in the future. Moreover, the complexity of national tax systems increases the companies' administrative costs, which makes them less efficient and less competitive.

In conclusion, harmful tax competition is a serious problem from a competition policy perspective, as it affects the level playing field, the States' budgets,

25 See Ribeiro, 2006: 87.

26 See OECD, 1998: 9.

27 See Bal, 2014: 65.

instigates lack of legal certainty and promotes obscurity. The reckless use of tax benefits constitutes a serious obstacle to fair competition. As a consequence, tax policy makers should be focused on reaching a solution to solve this problem, which will certainly require the creation of rules coordinating the grant of tax benefits in the internal market.

2.6. Base Erosion Profit Shifting and Tax Aid Cases

Currently, there are more than a few cases under European Commission scrutiny that can be a good example of how certain tax measures can breach competition policy purposes, involving the erosion of tax bases, shifting of income and tax aids.

For years, multinational companies like Apple, Amazon, Facebook, Google, Starbucks and hundreds of others have developed complex tax planning, involving the creation of holding companies and subsidiaries in the European Union,[28] in order to minimise their tax obligations and consequently obtain a comparative advantage over their competitors.

Only recently, however, have these cases received proper attention by the competent authorities, much as a result of the financial crisis lived in the EU, which increased the need for Member States to consolidate their budgets. Recent investigations made by the International Consortium of Investigative Journalism also drew attention by leaking a vast number of documents that prove that Member States of the European Union, like Luxembourg and Ireland, have celebrated illegal tax agreements with some of the world's largest multinational companies (the so-called Luxembourg Leaks).

Countries like the US, the UK and France supported for years the process of globalisation as it promotes economic growth, creates jobs and fosters innovation. However, such countries are now recognising that global operations have been used by a vast number of multinational companies as a way to substantially reduce their tax obligations, increase their profits and acquire an illegitimate advantage over their competitors, thus affecting competition.[29]

Multinational companies have established their international headquarters in Member States of the EU that confer a much more favourable corporate income tax when compared to their original country. The 12.5% corporate

28 See Örberg, 2013: 5 et seq.

29 BMR Advisors, 2013.

income tax applicable in Ireland, for instance, is much more attractive than the 35% corporate income tax rate applied in the US.[30]

Additionally, these multinational companies earn profits in several countries, for instance in the UK or France, and then transfer the revenues to their headquarters, which are based in low-tax jurisdictions like Ireland, Luxembourg and the Netherlands. Thus, the profits made by these multinational companies are only taxed (at low tax rates) in the Member States where such companies established their headquarters.

These multinational companies take advantage of the existing loopholes of bilateral tax treaties to shift their profits to low tax jurisdictions, which results in double non-taxation or less than single taxation.[31] By evading taxes, these companies reduce their normal costs and obtain an unfair advantage over their competitors that adequately satisfy their tax obligations.

The UK and France are the Member States that have express most concern about the aggressive tax planning adopted by those companies. Actually, the UK is considering the creation of the so-called "Google tax", a tax which aims at preventing the losses of UK tax revenues caused by the aggressive tax planning practiced by such multinational companies, by targeting intra-group payments.[32]

While such aggressive tax planning can be disapproved of from a moral point of view, it is important to note that it is not illegal under the current legal framework, supposing that the companies established in the EU actually perform genuine economic activities in the jurisdiction where they have their headquarters established.[33] These multinational companies usually perform small activities of their businesses like marketing, for example, in low-tax jurisdictions and argue that they perform a genuine economic activity and therefore should be taxed accordingly to the tax system of such jurisdiction.

The aggressive tax planning practiced by several multinational companies does not only involve the shifting of income and the erosion of tax bases, but also tax agreements with Member States where they established their headquarters to reduce the applicable taxes. It is here that the "tax optimisation" practiced by these multinational companies may have become illegal, as such

30 See Örberg, 2013: 5.

31 OECD, 2013: 10.

32 Winning, 2014.

33 See Örberg, 2013: 6. For further developments see also Russo, 2007: 55 et seq.

individual negotiation of the applicable taxes with the competent authorities may constitute prohibited tax aid in the meaning of Article 107(1) of the TFEU.

The cases that have attracted most attention are the tax rulings applied by Ireland to Apple, the tax rulings applied by Luxembourg to Fiat and Amazon and the tax rulings applied by the Netherlands to Starbucks. All these Member States are under Commission state aid investigations to analyse if they granted prohibited tax aid.

The European Commission is investigating the transfer pricing agreements, also known as advanced pricing agreements, established between the Member States and the referred multinational companies, which are liable to confer a selective economic advantage to the latter. Under the present method of transfer pricing using an arm's length principle, intra-group transfers of values have to be priced in the same manner as independent companies would do in the market. The transfer prices are normally calculated under a pre-determined set of criteria. The advanced pricing agreements allegedly celebrated between the multinational companies and the EU Member States establish the application of a more favourable set of criteria for the determination of the prices of intra-group commercial transactions.[34] These transfer pricing agreements involve the low or non-taxation of royalties, intellectual property rights, and loan interests. Such agreements confer a selective economic advantage to these companies as the prices established for these intra-group transactions will automatically be accepted by the tax authority of the country that adopts the transfer pricing agreement.[35] The taxes paid by such companies are thus much lower than they would be under normal conditions, which creates considerable distortions of competition.

Since June 2013, the Commission has been investigating under state aid rules the tax ruling practices of seven Member States (Belgium, Cyprus, Ireland, Luxembourg, Malta, the Netherlands and the UK). Further, by the end of 2014 the Commission enlarged the enquiry about tax ruling practices under EU state aid rules to cover all Member States. The Commission will ask Member States to provide detailed information about their tax ruling practices, in particular to confirm whether they provide tax rulings and a list of all companies that have received a tax ruling from 2010 to 2013.[36]

34 See Covington & Burling LLP, 2014: 1 et seq.

35 Ibid.

36 European Commission, 2014 Press release.

The fact the current President of the European Commission, Jean Claude Juncker, was responsible for the numerous tax rulings provided by Luxembourg during the last two decades, however, raised some suspicions about the European Commission's motivation to really solve this problem. Further developments to maintain the level playing field are expected.[37]

The analysis made in this section shows that certain multinational companies have been taking advantage of national tax systems resorting to aggressive tax planning in order to reduce their tax burdens and obtain an economic advantage over their competitors. This situation represents serious distortions of competition. For that reason, it is essential from a competition policy perspective to reduce the possibilities that these companies have to evade taxes, by reducing the number of loopholes in tax legislations and increasing transparency and tax cooperation. The G20 has already granted support to the OECD initiative on base erosion profit shifting (BEPS), which will be further explained in Part 4.

3. TAXES AS AN ALLY OF COMPETITION

3.1. General Context

This Part is not as extensive as the previous one, possibly because the positive impact that taxes have on competition is not as palpable as the negative impact. Whereas we can easily find situations where taxes represent an obstacle to competition, a more elaborate analysis is necessary to find situations where taxes act as an ally.

Even though taxation frequently constitutes an obstacle to competition, it is also true that the tax system is a valuable tool that governments have at

37 Since October 2013, the European Commission is also investigating whether the new Gibraltar corporate tax regime (introduced in 2011) selectively favours certain categories of companies as previously occurred with Azores and the Basque Country. The new Gibraltar income tax act foresees a tax rulings practice that allows companies to ask for advance confirmation of whether certain income generated by companies incorporated in Gibraltar or that carried out an activity which generates income, are subject to taxation in Gibraltar. Based on documentation obtained, the Commission has concerns that the assessed rulings may contain state aid as the Gibraltar tax authorities appear to have granted tax rulings without effectively evaluating whether the companies income has been accrued in or derived from outside Gibraltar. In fact, this is not the first time that the Gibraltar tax system is under the Commission scrutiny under the state aid rules, before the investigation of 2001 in respect of a specific tax regime exempting companies without any trade or business in Gibraltar and not owned by Gibraltar residents from corporate tax. Also in 2004 the Commission concluded that a proposed tax reform by the UK applicable to all companies in Gibraltar consisting of a payroll tax, a business property occupation tax and a registration fee was in breach of state aid rules. See the European Commission 2014c Press release.

their disposal to satisfy the main purposes of competition policy, particularly to foster competition, ensure the maintenance of the level playing field, correct market failures and protect all market participants. The value that taxes can have from a competition policy perspective must not be overlooked.

Taxes can indeed act as a true ally of competition. That is the case, for instance, of a well targeted imposition of custom duties, the transfer pricing rules and environmental taxes. Each of these taxes will be analysed in terms of the positive effects that they can bring from a competition policy perspective.

After that, the author will conclude that tax coordination is the key to reduce the obstacles that taxes often constitute for competition by observing the advantages that were achieved thanks to VAT coordination. This is an excellent example that shows how taxation in the internal market does not have to be a factor responsible for distorting competition. VAT coordination had a very positive impact from a competition policy perspective because, as this tax is imposed on the sale of every product, it has a high potential to influence the supply and demand and, consequently, competition.

3.2. Custom Duties

As previously discussed, custom duties are a tool that allows governments to control the flow of goods. While it is true that the massive imposition of custom duties on imported goods affects competition and international trade, it is also true that a precise imposition of custom duties may have a positive impact, from an EU competition policy perspective. Namely, charging custom duties on goods produced outside the internal market, in particular in countries that practice social dumping[38] (like China, India, Mexico, etc.) is a measure that can contribute to make competition fairer. Even though this measure affects international trade, actually it contributes to balancing competition in the internal market.

As the European Union is built on a social model, it has high standards in what concerns workers' protection, such as minimum wages and limits of weekly working hours.[39] For that reason, it is very difficult for European firms to compete with foreign players that do not obey such standards and aim to

38 Social dumping can be defined as "the practice, undertaken by self-interested market participants, of undermining or evading existing social regulations with the aim of gaining a competitive advantage". See Bernaciak, 2014.

39 As a result of the imposition made by Article 153 of the TFEU.

sell their products in the internal market. Those external companies do not guarantee adequate conditions to their workers, so they have lower production costs and can practice extremely low prices. Social dumping results, therefore, in unfair competition.

It is true that if custom duties are used in these cases, European firms are being protected from foreign competitors. However, it would be legitimate to do so because, whereas European firms have to support the normal costs of granting an adequate treatment to their workers, their external competitors play under different rules that allow them to reduce their production costs by treating their workers poorly. This competitive advantage is unfair from a European perspective and it is adequate to impose custom duties on goods produced in those foreign countries.

It would not be fair, nor reasonable, for European firms to be obliged to respect high standards of workers' protection (which must be maintained to ensure social welfare) and simultaneously make them compete with foreign companies that have very low production costs due to social dumping. Thus, custom duties can make competition fairer and ensure that European firms are not harmed by the foreign competitors that do not respect the minimum legal standards of the internal market.

Therefore, one must conclude that a precise imposition of custom duties on certain goods produced outside the internal market has positive effects from an EU competition policy perspective. What distinguishes a wise from a thoughtless imposition is the reason underlying such imposition. If the purpose is avoiding unfair competition, social dumping and ensuring the protection of the workers' rights, the imposition of custom duties must be considered wise and positive from a competition policy perspective. Conversely, the indiscriminate imposition of custom duties on any good that is imported into the internal market, irrespectively of whether the country of origin of such goods obeys the minimum standards of the internal market, constitutes a serious obstacle and a restriction of competition as we have observed in Part 2.

3.3. Transfer Pricing Rules

Transfer pricing rules that are currently in force represent another situation where the tax system acts as an ally of competition. Even though this system implies high administrative costs for EU-based companies (due to the documentary proof that it requires), the truth is that it promotes fair competition. Transfer pricing refers to the terms and conditions surrounding transactions (of goods, services and capital) within a multinational company. It concerns the prices charged between associated enterprises established in different countries for their intra-group transactions.[40] Due to globalisation and expansion of international trade, multinational companies have been adopting business strategies that involve the creation of subsidiaries and branches throughout different countries. As a rule, each affiliated company is taxed separately by the country in which it operates.[41]

Today, the majority of cross border trade that occurs is between related companies, which constitutes a huge concern for tax authorities.[42] Companies frequently use transfer prices as an allocation method. Since transfer prices are set by non-independent associates within the multinational, multinational entities may set transfer prices on cross-border transactions to reduce taxable profits in their jurisdiction.[43]

As the main purpose of companies is to maximise their overall profits, they frequently try to allocate their profits through transfer prices to low tax jurisdictions so as to reduce their tax obligations, thus acquiring an advantage over their competitors. Hence, the transfer pricing mechanism is a tool that corporations use in order to avoid high taxation in certain jurisdictions.[44]

Transfer pricing rules that are currently in place are aimed at preventing companies from unlawfully reducing their tax obligations and obtaining a comparative advantage over their competitors that rightfully fulfil their tax obligations, distorting competition.

Under the present transfer pricing system, intra-group transfers of values have to be priced in the same manner as independent companies would do in the market, using an arm's length principle.[45] Rules and procedures applicable to transfer pricing are usually found in the domestic law of many coun-

40 http://ec.europa.eu/taxation_customs/taxation/company_tax/transfer_pricing/index_en.htm.

41 Maurício, 2013: 1.

42 Hamaekers, 2001: 39.

43 http://ec.europa.eu/taxation_customs/taxation/company_tax/transfer_pricing/index_en.htm.

44 Maurício, 2013: 2.

45 This arm's length principle is found in article 9 of the OECD Model Tax Convention: "[When] conditions are made or imposed between … two [associated] enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly."

tries.[46] By setting the prices to be applied between intra-group transfers and making affiliated enterprises treat themselves as independent, tax administrations avoid companies allocating their profits to low tax jurisdictions. In other words, transfer pricing rules ensure that all market actors pay their due taxes, preventing companies from shifting their profits to low tax jurisdictions, ensuring fair competition.

Therefore, we can conclude that the transfer pricing system is an ally of competition, even though it involves high compliance costs both for EU-based firms and tax administrations.

3.4. Environmental Taxes

Environmental taxes represent another situation where taxes can act as an ally of competition. Environmental taxes can promote fair competition in the internal market by eliminating the comparative advantage that certain external competitors have when compared with European firms for not having to respect the minimum standards of environmental protection established in EU law.

Environmental protection is currently one of the most important concerns of the European Union. The Treaty on the European Union establishes that Member States shall promote a sustainable use of the environment.[47] As a consequence, EU-based firms have to respect high standards of environmental protection, which naturally increases their production costs.

The fact that certain foreign companies that sell their products in the internal market do not have to fulfil the same environmental standards makes competition in the internal market unfair. As those companies do not have to obey the same standards, they have lower production costs, which gives them a comparative advantage. Therefore, environmental dumping results in unfair competition.

Just like custom duties, environmental taxes can be used to ensure that European firms are not harmed by foreign competitors that practice environmental dumping. Here, there is a valid reason to protect European firms.

It would not be reasonable to make European firms respect high environmental standards and simultaneously make them compete directly with companies that are able to produce extremely cheap products due to environmental

46 In many cases these reflect the OECD Transfer Pricing Guidelines. IBFD, 2015: 449.

47 Article 3.3 of the TEU.

dumping. Therefore, there is no doubt that in this case taxes are a true ally of competition, ensuring a level playing field.

3.5. VAT Coordination

As was previously mentioned, the legal *status quo* in the European Union is characterised by a problematic lack of tax coordination that involves serious problems from the perspective of competition policy. Still, indirect taxation is the exception to that rule.[48] Article 113 of the TEU provides that "[t]he Council shall (…) adopt provisions for the harmonisation of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market and <u>to avoid distortion of competition</u>" (emphasis added). Thus, indirect taxation is one of the few areas of European tax law that can be characterised by a satisfactory degree of coordination[49] and is an excellent example that taxation does not have to be a factor responsible for distorting competition in the internal market.

Tax coordination is fundamental to maintain the level playing field in the internal market. Only by giving European firms the possibility to compete under the same conditions and by ensuring that all of them are subject to the same tax burdens can we say that taxes do not affect competition.

The current legal framework encompasses several Directives on VAT which regulate, among other things, the range of tax rates permitted, the procedure of VAT refund and the determination of the tax base.[50] In other words, the most important aspects of indirect taxation are properly coordinated in legally binding instruments.

VAT coordination represents a major step in the single market integration process and brought significant advantages for competition, in particular, the promotion of equal conditions of competition and the facilitation of the free movement of goods within the internal market, which is essential to make the internal market more competitive.

VAT performs a decisive role in the competition process because, as it is imposed on the sale of all products, it can seriously influence the supply and demand of certain goods as well as of its complementary goods. The impo-

48 Ribeiro, 2006: 82.

49 See Nicodème, 2006: 10.

50 Terra & Wattel, 2005: 9.

sition of different VATs across the internal market would represent a strong obstacle to fair competition as the price of all products across the internal market would be artificially modified by each Member State.[51] For that reason, VAT coordination is extremely positive from a competition policy perspective.

Corporate income taxation is equally important to make competition fairer, and lack of coordination in this area is one of the factors that contribute most for the existence of distortions of competition. Thus, in the author's opinion, the achievements on VAT coordination should be an inspiration for direct taxation.

Any type of tax coordination is fundamental and represents a major step to promote fair competition, considering that tax coordination allows European firms to compete under equivalent conditions in what is expected to be a market without internal borders. If the market does not have internal borders, companies acting in such market cannot receive a differentiated tax treatment accordingly to the jurisdiction where they have their headquarters established.

4. CONCLUSIONS AND RECOMMENDATIONS

4.1. General Context

The analysis made so far shows that even though taxes have the potential to be an ally of competition, they are much more often a foe. The negative impact of taxes on competition is much more palpable than the positive impact.

Therefore, it is fundamental, from a competition policy perspective, to correct the situations where taxes constitute an obstacle and to reinforce their positive impact. Accordingly, some recommendations will now be provided with that goal in mind.

The lack of tax coordination in the internal market is the main cause for tax based distortions, as it makes European firms compete under different tax rules, which significantly affects the level playing field. Companies competing in the same single market are treated differently and have to support different tax burdens, accordingly to the jurisdiction where they have their headquarters established, which makes the competitive process very unfair. Furthermore, the lack of tax coordination implies heavy financial costs for companies exercising economic activities throughout the internal market, which makes European

51 For instance, in the absence of VAT coordination, Member States would have the possibility of hiding export subsidies in arbitrary refunds upon exportation, with all the problems that export subsidies entail for competition (see Part I). This situation is avoided under the VAT system that is currently in force. For further developments see Ben Terra & Wattel, 2005: 9.

firms less efficient and less competitive. For those reasons, the legal *status quo* should be altered.

Tax coordination is the key solution. In order to ensure the maintenance of a level playing field in the internal market, it is crucial to coordinate certain aspects of national tax systems so that European firms can compete under more homogenous conditions. VAT coordination proves that taxation in the internal market does not have to imply distortions of competition. A high level of tax coordination is the solution.

There are some initiatives, both at European and international level, which are in line with the necessary shift, namely, the European proposal for a Common Consolidated Corporate Tax Base and the OECD action plan on BEPS. The advantages that each of these initiatives can bring from a competition policy perspective will be analysed in the following sections.

However, these initiatives are not sufficient to tackle all the obstacles that taxes create for competition, analysed in Part 2. For that reason, the author will recommend the adoption of additional measures that, in his opinion, might contribute to correcting those obstacles.

4.2. Common Consolidated Corporate Tax Base

As was previously noted, it is urgent to reach some tax coordination in the internal market to correct the obstacles that taxes frequently create for competition. It is well-known that the harmonisation of tax rates will not occur in the near future, due to Member States' continued lack of political willingness to give the Union total fiscal sovereignty. Nonetheless the harmonisation of tax rates is not the only means of fostering fair competition in the internal market. As Terra and Wattel note, "[d]ifferences between Member States' administrative practices may cause serious distortions to the conditions of competition within the internal market".[52]

A company that can meet its tax obligations in a year is in clear comparative advantage over its competitors who have to comply with their tax obligations in just one month. Thus, it is crucial to coordinate the administrative and accounting practices in the internal market to ensure the maintenance of the level playing field.

Currently, there is a proposal on the table that aims at coordinating the administrative and accounting rules in the internal market: the Common

52 Terra & Wattel, 2005: 21.

Consolidated Corporate Tax Base (CCCTB).[53] In the author's perspective, this proposal can contribute to correcting some of the obstacles that taxes frequently imply for competition, and for that reason deserves some considerations.

One of the most important goals of the CCCTB proposal is the creation of one single set of tax rules applicable throughout the whole internal market. This single set of tax rules can even be materialised into a tax code that coexists with the tax laws of each of the Member States.[54] Thus, the aim of this proposal is independent from the harmonisation of tax rates. It relates only to administrative and accounting rules. Allowing European firms the possibility to compete under the same administrative and accounting rules is paramount, in order to make competition fairer. Even if tax rates were fully harmonised, it would still be necessary to coordinate administrative and accounting rules to achieve fair conditions of competition.

In addition, under the CCCTB proposal, groups of companies would be able to consolidate their individual tax bases. The consolidated tax base would then be apportioned between the different Member States through a formula.[55] Thus, the adoption of the CCCTB could bring significant advantages from a competition policy perspective.

It would also facilitate the exercise of economic activities in the internal market and, consequently, increase competition. Under the CCCTB, European firms exercising economic activities throughout the internal market would only have to deal with a single set of tax rules and a single tax administration. As a result, European firms, particularly SMEs,[56] would find it easier to expand their business to other Member States, increasing competition in the internal market.[57]

53 The proposal can be consulted at http://ec.europa.eu/taxation_customs/resources/documents/taxation/company_tax/common_tax_base/com_2011_121_en.pdf.

54 See Ribeiro, 2012: 732.

55 This formula is based in three factors, namely, assets, sales and labour. The purpose of the formula is to distribute the tax base between the Member States where the company concerned exercises its activities in an equitable manner. For further developments see Maurício, 2013: 64 et seq.

56 The European Commission expects that SMEs of a medium sized enterprise expanding within the EU could be reduced by 67% with the CCCTB proposal. See European Commission, 2011a: 5.

57 A third advantage that the CCCTB would bring is that it would make tax competition between Member States much more transparent. As the factors that constitute the tax base would be standardised it would be enough to look at the different rates. For further developments see Ribeiro, 2012: 733.

Therefore, we must conclude that the adoption of the CCCTB would certainly contribute to changing the legal *status quo* and remove some of the obstacles that taxes imply for competition. The CCCTB would allow achieving some level of tax coordination in the internal market, which is fundamental to make competition fairer.

Considering the high value of the CCCTB proposal and because it could be so useful to correct some of the obstacles that taxes constitute for competition, one may wonder why a Directive was not yet adopted. The main justification is the unanimity rule. The CCCTB proposal needs to be agreed to by all Member States in the Council. As this is a very sensitive matter, no agreement has been reached so far.[58] Still, as stated by Professor João Sérgio Ribeiro, given the significant advantages of adopting this system, there are good chances that the CCCTB may come to be successfully implemented.[59]

4.3. OECD Action Plan on Base Erosion and Profit Shifting

Another initiative that seeks to reach a notorious degree of tax coordination and, therefore, might contribute to reducing the obstacles that taxes often constitute to competition, is the OECD action plan on base erosion and profit shifting.

Recently, the OECD published an action plan that aims to achieve some international tax coordination in order to combat the erosion of tax bases and the shifting of income.

According to the action plan, base erosion and profiting shifting occurs when companies resort to tax planning and take advantage of the different tax rules across jurisdictions in order to reach double non-taxation or less then single taxation. The concept of base erosion and profit shifting also includes arrangements that achieve no or low taxation by shifting of profits away from jurisdictions where the economic activities creating those profits take place.[60]

As explained in Part 2, the erosion of tax bases and the shifting of profit illegitimately allow multinational companies to reduce their tax burdens, increase their profits and obtain an unfair tax advantage over their competitors that adequately fulfil their tax obligations. Therefore, the erosion of tax bases and

58 Especially in what concerns the apportionment formula.

59 Ribeiro, 2012: 733.

60 OECD, 2013: 10.

the shifting of income is a huge problem from a competition policy perspective that should be tackled.

In 2012 the G20 leaders declared the necessity to reform international tax rules in order to combat the erosion of tax bases and the shifting of income and also declared support to the OECD efforts. Hence, international tax coordination is currently at the top of tax policymakers' agenda.

As the OECD notes, the process of globalisation does not allow for domestic policies, including tax policies, to be designed in isolation.[61] Otherwise, gaps and loopholes in tax legislations will continue to exist, creating room for double non-taxation and distortions of competition.

Reaching further tax coordination in the digital economy is one of the top priorities of the action plan. According to the OECD, the growing importance of digital products that can be delivered over the Internet has made it much easier for businesses to locate many productive activities in locations that are distant from the physical location of their customers.[62] Multinational companies active in the digital economy are presumed to be especially apt at optimising their corporate structures by crossing national tax systems, given their strong reliance on the sale of intangibles.[63] Accordingly, the OECD action plan sustains that it is vital to coordinate international tax rules to ensure that these companies do not evade their taxes and consequently do not distort competition.

The action plan also indicates that countries should adopt measures such as designing new international standards to be adopted in bilateral tax treaties, adopt strict anti-abuse provisions, strengthen the CFC rules,[64] and create a multilateral instrument designed to provide an innovative approach to international tax matters.[65] The purpose of these measures is to reduce the loopholes in national tax systems, increase international tax cooperation and attain a satisfactory amount of tax coordination.

61 OECD, 2013: 15.

62 OECD, 2013: 7.

63 See Lee-Makyiama & Verschelde, 2014: 2.

64 In order to prevent the creation of affiliated non-resident taxpayers and routing the income of a resident enterprise through the non-resident affiliate.

65 See OECD, 2013:13 et seq.

Thus, the action plan suggests significant modifications to the current principles of international corporate taxation. Drastic measures are required to change the legal *status quo*.

The tax coordination suggested by the action plan can prove to be truly efficient to tackle the new challenges of international tax law. Accordingly, European politicians should remain alert to the OECD's efforts, as they might prove useful to eliminate some of the distortions of competition that tax systems frequently originate.

4.4. Recommendations

A proposal must now be made about what should additionally be done to reduce the negative impact that taxes have on competition and foster their positive impact.

Despite the fact that the CCCTB proposal and the OECD action plan on BEPS can bring positive results from a competition policy perspective due to the tax coordination that they seek to achieve, unfortunately these initiatives would not suffice to correct all the situations where taxes act as a foe of competition.

The recommendations that follow are meant as a set of guidelines that could inspire European policymakers. Being an initial approach, this proposal is not exhaustive and is opened to additional developments when the political willingness for strong commitments is greater. The purpose of these recommendations is to contribute with some fundamental orientations that the author believes could contribute to change the legal *status quo*.

The first and indispensable measure would be the creation of a group of experts specifically responsible for finding solutions to reduce the obstacles that taxes create for competition and to foster their positive effects. Previous experiences show that the creation of a group of experts in charge of the discussion of specific matters can be a truly proficient mechanism to lead to important results. That was the case of the Primarolo Group[66], the group of experts formed in 1998 to ensure the administration of the Code of Conduct for Business Taxation. This group, composed by a tax expert from each Member State, was able to reach a notorious degree of convergence on a sensitive matter of direct taxation, the combat of harmful tax competition. This was the first time that tax policy makers of the EU Member States reached a proper agreement on

66 The Group was named after Mrs Dawn Primarolo, the UK Paymaster General, who chaired the group.

corporate taxation.[67] The results achieved by this group were remarkable from a tax policy perspective.

European politicians should revisit the Code of Conduct for Business Taxation. This Code was adopted in 1998 as a soft law instrument and established a set of features that allowed defining and eliminating several harmful tax measures.[68] Meanwhile in 2001, when Mario Monti became the EC Commissioner for Competition, the Code was converted into a hard law instrument. Many years have passed since the Code was created and it is not properly designed to tackle the new challenges of international tax law. As the OECD notes "today the 'race to the bottom' often takes less the form of traditional ring-fencing and more the form of across the board corporate tax base reductions on particular types of income".[69] Thus, the author suggests that the Code should be redesigned in order to make it a more efficient instrument to tackle the new challenges of international tax law in particular, the erosion of tax bases and the shifting of income. The OECD action plan should obviously be an influence.

The harmonisation of applicable tax rates in the internal market is a measure that would represent a major step to balancing competition in the internal market. However, there is still resistance from EU Member States to take that step. Still, in the impossibility of fully harmonising applicable tax rates in the internal market, EU Member States should be able to define the minimum and maximum corporate income tax rates applicable in the internal market, similarly to what it set out in the VAT directives. Nowadays, a massive gap between corporate income tax rates exists in the internal market, varying between 12.5% (applied in Ireland) and 33% (applied in Belgium and France). Member States should reach an agreement to reduce this gap, i.e. to reduce this discrepancy and make the competitive conditions in the internal market more equitable. Member States could define e.g., that the minimum CIT appli-

---

67 See Radaelli, 2013: 521 et seq.

68 The features are: a level of taxation which is suggestively lower than the general level of taxation in the country concerned; tax benefits attributed exclusively in favour of non-residents; tax incentives for activities which are isolated from the domestic market and so do not have impact on the national tax base; granting of tax advantages even in the absence of any real economic activity and substantial economic presence within the Member State offering such tax advantages; the basis of profit determination for companies in a multinational group departs from internationally accepted rules, notably the rules approved by the OECD; and lack of transparency. Further, the Code of Conduct also establishes that EU Member States should eliminate the harmful tax measures identified accordingly to that set of features (Paragraph C of the Code) as well as refrain themselves from introducing new tax measures that can be considered harmful (Paragraph D of the Code).

69 OECD, 2013: 17.

cable in the internal market is 17% and the maximum is 27%. This would not fully take fiscal sovereignty away from Member States, but would significantly reduce the massive gap and disparity of tax treatments granted throughout the internal market and consequently balance competition.

If such an agreement could be reached, and if further progress were sought, Member States could additionally agree that, over the years, or even decades, this gap should progressively be reduced, until corporate income tax rates become fully harmonised.

Even with full harmonisation of applicable tax, it would still be necessary to coordinate the administrative and accounting rules in the internal market. For that reason, it is vital to adopt a single set of tax rules applicable throughout the internal market, and that is where the CCCTB proposal can prove to be very useful.

A Directive or a Regulation coordinating the grant of tax benefits throughout the internal market must also be adopted to avoid the distortions of competition that tax competition between Member States originates. Certain tax benefits escape the tax aid control exercised by the European Commission, due to not meeting the four characteristics of state aid. Thus, tax aid control cannot prevent the harmful effects of tax competition. Consequently, it would be very important, from a competition policy perspective, to have a piece of legislation that defines a ceiling of tax benefits for each industry, reducing tax competition between Member States. By coordinating the grant of tax benefits in the internal market, it would be possible to avoid the harmful effects that tax competition between Member States can originate.

Even though the European Union already forbids the imposition of custom duties on imported products, it would be important to strengthen these rules in a way that Member States could not resort to artificial schemes, like the re-registration process of cars to impose disguised custom duties and affect competition in the internal market.[70] It is fundamental to ensure that the only custom duties or charges having an equivalent effect charged in the internal market are the ones imposed on goods coming from external countries that practice social and environmental dumping.

The New Horizontal Directive,[71] which is supposed to coordinate the application of excise duties in the internal market, should be made more stringent.

70 Monti, 2010: 40.

71 Council Directive 2008/118/EC of 16 December 2008.

This Directive replaced the already mentioned 1992 Horizontal Directive, though it does not establish the maximum tax rates applicable. By not doing so, the New Horizontal Directive allows distortions of competition to continue, as is the case previously noted, regarding excise duties on gasoline. Thus, the author proposes that the New Horizontal Directive should be revised, setting the maximum tax rates of excise duties applicable in the internal market.

The soft law instruments (guidelines, frameworks and notices) used by the European Commission to assess the legality of the tax aids granted by the EU Member States should be converted into hard law instruments, especially the 1998 Commission Notice on fiscal state aid. This is another measure that would contribute to reduce the negative impact of tax aids on competition. Such conversion would increase legal certainty, giving Member States the possibility to be sure that the tax aids they intend to grant are in line with competition policy aims, avoiding situations where they grant illegal tax aids.

European institutions should also increase the Member States' responsibility in the grant of tax aids. Heavily fining Member States that grant illegal tax aids would certainly reduce the number of situations where Member States unjustifiably grant tax aids that distort competition.

The creation of a sub-division inside the European Commission, or even of an autonomous body with the sole responsibility of controlling the grant of tax aids, is another measure that can make tax aid control more efficient and reduce the resulting distortions of competition. A body specifically focused on controlling the grant of tax aids would certainly be more efficient than a supranational authority that is responsible for controlling all types of state aid. As we have seen, the concept of state aid is so broad that it is very difficult for a single institution to effectively control the grant of all types of state aids.

Additionally, giving more power to national competition authorities to control the grant of tax aids could also help to avoid situations where Member States distort competition through the tax system. National competition authorities are more easily aware of any change in their national tax system than the European Commission. Thus, national competition authorities can give a very useful contribution to making tax aid control more efficient. Accordingly, they should receive more power to collaborate with the European Commission in tax aid control.

Last but not least, EU policymakers should agree on the substitution of the unanimity rule by qualified majority voting. It is due to the unanimity rule that the internal market is so underdeveloped in tax matters. Qualified majority voting would simplify the legislative procedure on tax matters and allow achieving the shift that the current legal framework so urgently requires. EU Member States should not be afraid of adopting this measure because, it is important to reinforce, qualified majority voting does not entail the harmonization of taxation in the European Union. It simply eliminates the "hidden veto" that each Member State has under the unanimity rule.[72]

To conclude, the adoption of these measures is crucial to correct the obstacles that taxes frequently constitute for competition. Some of these recommendations might have a broad scope and be too ambitious, but they are only aimed at providing some fundamental orientations that could guide EU policymakers. It is the author's belief that the adoption of the majority of these recommendations is in the future of European tax law.

4.5. Final Conclusions

The main conclusion of this essay is, evidently, that taxes can be a foe and an ally of competition.

We have shown that taxes are responsible for making competition unfair and for making European companies less competitive and less efficient. As examples of situations where taxes promote unfair conditions of competition, we have seen the harmful effects caused by custom duties, tax aids, the application of different tax rules in the internal market, tax competition and the erosion of tax bases and shifting of income. As situations where taxes make European companies less competitive and efficient, we have mentioned the high compliance costs inherent in the lack of tax coordination. In all these situations taxes act as a foe of competition.

Nonetheless, it is also evident that taxes can be an ally of competition. Taxes can perform a key role in the achievement of some of the most important goals of competition policy, namely, to foster competition, ensure the maintenance of the level playing field and protect all market participants. That is the case of a precise imposition of custom duties, environmental taxes and transfer pricing rules. In all these cases, taxes act as an ally of competition. Furthermore, if tax coordination were achieved, European companies would be able to compete under fair conditions, as we have seen through VAT coordination. Thus, one should conclude that taxes can also be an ally of competition. The

72 Lampreave, 2011.

negative and the positive impact taxes have on competition are thus two faces of the same coin.

Finally, although taxes may be an ally of competition, our analysis shows that they are more frequently a foe than an ally. The negative impact of taxes on competition is much more perceptible than their positive impact. Thus, it is vital from a competition policy perspective to change the legal *status quo*, by correcting the situations where taxes constitute an obstacle to competition and fostering their positive impact. The European proposal for a CCCTB as well as the OECD plan on BEPS can contribute to changing the legal *status quo,* as they seek to attain a significant degree of tax coordination. Still, that is not enough to correct all the situations where taxes act as a foe of competition. There are more measures that European policymakers can adopt to reduce the negative impact of taxes on competition. But their adoption requires a strong political commitment from all EU Member States, something that may only come to be reached with time. However, if Member States are willing to adopt those measures, the obstacles that taxes bring for competition will surely be eradicated, making competition fairer, European firms more competitive, the European economy more prosperous and, ultimately, improving European citizens' welfare, the ultimate purpose of EU competition law.

REFERENCES

BAL, Aleksandra
2014 *Tax Incentives: III-Advised Tax Policy or Growth Catalyst?*, IBFD, European Taxation.

BARNARD, Catherine
2010 *The Substantive Law of the EU: The four freedoms*, 3.ª ed., Oxford University Press.

BERNIACK, Magdalena
2014 "Social Dumping and the EU integration process", Working Paper 2014.06, European Trade Union Institute.

BMR Advisors
2013 "Base Erosion and Profit Shifting ("BEPS") – Intangibles", Vol. 1, n.º 9.2.

BRATTON, William W. & MCCAHERY, Joseph A.
2001 "Tax Coordination and Tax Competition in the European Union: Evaluating the Code of Conduct on Business Taxation", *Common Market Law Review*, 38.

BRAZUNA, José Ribeiro
2009 "Defesa da Concorrência e Tributação – à luz do Artigo 146-A da Constituição", Instituto Brasileiro de Direito Tributário, Quartier Latin.

BUELENS, Christian, GARNIER, Gaëlle, MEIKLEJOHN, Roderick, JOHNSON, Mattheu
2007 "The economic analysis of state aid: Some open questions", *Economic Papers*.

COVINGTON & BURLING LLP
2014 *European State Aid and Investigations into Tax Rulings*.

EUROPEAN COMMISSION
2011a Memo/11/171, "Questions and Answers on the CCCTB", Brussels, available at http://europa.eu/rapid/press-release_MEMO-11-171_en.htm?locale=en.

2011b Proposal for a Council Directive on a Common Consolidated Corporate Tax, available at http://ec.europa.eu/taxation_customs/resources/documents/taxation/company_tax/common_tax_base/com_2011_121_en.pdf.

2014a Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European and Social Committee, the Committee of the Regions and the European Investment Bank, An Investment Plan for Europe, COM/2014/0903 available at http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52014DC0903&from=EN.

2014b European Commission Press release, "State aid: Commission extends information enquiry on tax rulings practice to all Member States", available at http://europa.eu/rapid/press-release_IP-14-2742_en.htm [15/01/2015].

2014c European Commission Press release, "State aid: Commission extends in-depth investigation into Gibraltar corporate tax regime to include tax rulings practice", available at http://europa.eu/rapid/press-release_IP-14-1073_en.htm [15/01/2015].

2014d "Supporting R&D and innovation in Europe: new State aid rules", Occasional papers by the Competition Directorate–General of the European Commission, Issue 5.

Guzman, Andrew & Pauwelyn, Joost

2012 *International Trade Law*, 2.ª ed., Wolters Kluwer Law & Business.

IBFD

2015 *International Tax Glossary*, 6.ª ed., Julie Rogers-Glabush.

Lampreave, Patricia

2011 "Fiscal Competitiveness versus Harmful Tax Competition in the European Union", IBFD, *Bulletin for International Taxation*, Volume 65, No. 6.

Lee-Makyiama, Hosuk & Verschelde, Bert

2014 "OECD BEPS: Reconciling Global Trade, Taxation Principles and the Digital Economy", *Ecipe Occasional Paper* No. 4.

Maurício, Maria João

2013 *Transfer Pricing and the arm's length principle in the European Union law and domestic law,* Escola de Direito da Universidade do Minho.

Monti, Mario

2010 *A New Strategy for the Single Market*, Report to the President of the European Commission.

Nicodème, Gaëtan

2006 "Corporate tax competition and coordination in the European Union: What do we know? Where do we stand?", *Economic papers of the European Commission Directorate-Generale for Economic and Financial Affairs*, n.º 250.

OECD

1998 "Harmful tax competition: an emerging issue", available at http://www.oecd.org/tax/transparency/44430243.pdf.

2010 "Competition, State Aid, and Subsidies", *Competition Policy Roundtables*.

2011 "Environmental Taxation: A Guide for Policy Makers", available at http://www.oecd.org/env/tools-evaluation/48164926.pdf.

2013 "Action Plan on Base Erosion and Profit Shifting", available at http://www.oecd.org/ctp/BEPSActionPlan.pdf.

Örberg, Sabina

2013 *Tax Planning with Holding Companies for US Investors in Europe – A Comparative Study of Holding Regimes in Sweden and Switzerland*, Lund University.

Radaelli, Claudio M.

2013 "The Code of Conduct Against Harmful Tax Competition: Open Method of Coordination in Disguise?", *Public Administration*, Vol. 81, No. 3.

Ribeiro, João Sérgio

2006 "Distributive Justice Through Taxation: European Perspective", *Jurisprudencija*, n.º 2 (80).

2012 "Tributação das Sociedades de Acordo com uma Base Comum Consolidada na União Europeia", in *Estudos em Homenagem ao Professor Doutor Alberto Xavier*.

Schön, Wolfgang

2003 *Tax Competition in Europe – General Report*, Max Planck Institute.

Silveira, Rodrigo Maito da

2011 "Tributação e Concorrência", Instituto Brasileiro de Direito Tributário, Quartier Latin.

Spengel, Cristoph & Wendt, Carsten

2007 "A Common Consolidated Corporate Tax Base for Multinational Companies in the European Union: some issues and options", *Oxford University Centre for Business Taxation Working Paper* 17.

Terra, Ben & Wattel, Peter

2005 *European Tax Law,* 4.ª ed., Kluwer.

Winning, Nicholas

2014 "U.K. Details 'Google Tax' Plans", Wall Street Journal, available at http://www.wsj.com/articles/u-k-details-google-tax-plans-1418239699.