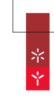

Universidade do Minho
Escola de Direito

Francisco Alexandre Barbosa Andrade de Portugal

Impact of taxes on competition: the legal *status quo* in the European Union

abril de 2015

UMinho | 2015 Francisco Alexandre Barbosa Andrade de Portugal **Impact of taxes on competition: the legal *status quo* in the European Union**

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Abstract

This thesis 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. In the European context, the lack of tax coordination in the internal market is another factor that contributes to distort competition considering that it obliges European firms to compete under different rules and involves high compliance costs. These and other situations where taxes affect competition will be analysed in this study.

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. That is the case e.g., of taxes that foster competition in monopolistic markets, patent boxes and even environmental taxes. Through these and other examples the author will try to sustain that the negative and the positive effects that taxes have on competition are two sides of the same coin.

As taxes are more often a foe than an ally, it is necessary from a competition policy perspective to eradicate the obstacles that taxes create for competition. Therefore in this work the author contributes with a list of recommendations for the EU policymakers, hoping that in the future they will be reflected in European tax law.

Keywords: Distortions of competition, unfair competition, tax aid, tax coordination, market failures.

Resumo

Esta tese demonstra que os impostos são frequentemente um inimigo, mas também um aliado da concorrência. Tradicionalmente, não só a doutrina jurídica mas também a teoria económica, vêm os impostos como um obstáculo à concorrência. A imposição de um imposto interfere com o normal funcionamento do mercado, afectanto a oferta e a procura, uma vez que aumenta os preços do mercado. Impostos alfandegários e auxílios fiscais são exemplos básicos de como os impostos podem restringir a concorrência. No contexto Europeu, a falta de coordenação fiscal no mercado interno é outro factor que contribui para a distorção da concorrência, considerando que obriga as empresas europeias a competir sob diferentes regras e envolve elevados custos de cumprimento. Estas e outras situações em que os impostos afectam a concorrência serão analisados neste estudo.

Apesar dos obstáculos que os impostos frequentemente representam para a concorrência, o autor acredita que os impostos devem também ser considerados um aliado, na medida em que eles podem fomentar a concorrência, assim como ser utilizados para corrigir graves falhas de mercado, alguns dos principais objectivos da política da concorrência. Esse é o caso, por exemplo, de impostos que fomentam concorrência em mercados monopolistas, regimes fiscais próprios para direitos de propriedade intelectual e até mesmo impostos ambientais. Através destes e de outros exemplos, o autor irá tentar sustentar que os efeitos negativos e positivos que os impostos têm na concorrência são dois lados da mesma moeda.

Uma vez que os impostos são mais frequentemente um inimigo do que um aliado, é necessário, de uma perspectiva da política da concorrência, eliminar os obstáculos que os impostos criam para a concorrência. Portanto, neste trabalho o autor contribui com uma lista de recomendações para os decisores políticos da UE, na expectativa de que no futuro elas estejam reflectidas no direito fiscal europeu.

Palavras-chave: Distorções da concorência, concorrência desleal, auxílio fiscal, coordenação fiscal, falhas de mercado.

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Abbreviations

BEPS – Base Erosion and Profit Shifting

CCCTB – Common Consolidated Corporate Tax Base

CFC - Controlled Foreign Company

ECJ – European Court of Justice

EEA – European Economic Area

EFTA – European Free Trade Association

EU – European Union

G20 – Group of the Twenty Major Economies

GATT – General Agreement on Trade and Tariffs

IBFD - International Bureau of Fiscal Documentation

R&D – Research and Development

SCM - Agreement on Subsidies and Countervailing Measures

SME – Small and Medium Enterprise

OECD - Organisation for Economic Co-operation and Development

TEU – Treaty on European Union

TFEU – Treaty on the Functioning of the European Union

UK – United Kingdom

US – United States

VAT – Value Added Tax

WTO – World Trade Organisation

Introduction

Initially, it should be noted that this essay was written with the purpose of the completion of the LL.M. in European and Transglobal Business Law. This is a very comprehensive programme which has tax law, competition law and international trade law as some of its main fields of studies. As a result, this work is also very comprehensive, not having its scope limited to tax or competition law issues. The author will seek to identify key situations in the European context where taxes have a negative and a positive impact on competition. Thus, the scope of this study is intentionally broad.

The main purpose of this thesis is to show that taxes are frequently a foe but also an ally of competition. Traditionally, not only the legal doctrine but also the 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 the 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 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 necessarily 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.

[1] José Ribeiro Brazuna, *"Defesa da Concorrência e Tributação - à luz do Artigo 146-A da Constituição"*, in Instituto Brasileiro de Direito Tributário, Quartier Latin, 2009, page 43.

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. Throughout this piece of research the author will resort to practical examples to give consistency to the approach adopted.

As the OECD notes, "[t]he actual impact of [tax] state aids and subsidies is difficult to assess. On 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" (emphasis added).[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 the society) and that the protection of the free market is just a mean to achieve a superior end (the society 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 consider to be the ultimate goal of competition law, the lack of tax coordination prevailing in the EU cannot let to 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

[2] OECD, "Competition, State Aid, and Subsidies", Competition Policy Roundtables, 2010.

does not preclude the possibility of making sporadic references to other regimes like the WTO, OECD and EFTA when convenient.

Delimitations

Once more, this is intentionally a comprehensive work and has points of connection with several fields of law besides tax law, so it is convenient to delimitate its scope from the beginning. This piece of research is centred on the impact of taxes on competition. Thus, it deals only with distortive measures that have a tax nature. Furthermore, the scope of this study is limited to the European legal context and not to the international context.

Tax aids granted by States can have a significant impact on competition and for that reason will assume particular relevance in this piece of research. State aid is therefore the area of EU competition law that is of most interest for this piece of research. Within the innumerable forms of state aid, tax aids are the only ones relevant. State aids that do not have a tax nature (e.g. direct subsidies or loan agreements) are excluded from the scope of this thesis.

Naturally, the traditional areas of competition law (cartels, abuse of dominant position and mergers and acquisitions) are also excluded from the scope of this work. One section is dedicated to the discussion of some issues related to the abuse of dominant position, but that section is not based in the traditional analysis of Article 102 of the TFEU. Instead, it presents an analysis of how taxes can contribute to increase competition in monopolistic markets.

Another field of law that is related with this topic is international trade law. International trade law deals with several issues that can affect competition, such as custom duties, subsidies (in the broad concept of the WTO) and quantitative restrictions. Only custom duties and subsidies, however, will deserve special emphasis throughout this study as these are the ones that have a tax nature.

As the scope of this study is limited to the analysis of the European legal *status quo,* the international regime of the WTO is also generally excluded. There will be some references to the WTO rules but only because there are some points of contact between

such rules and the European state aid control. Thus, the international rules of the WTO will never be the central object of analysis of this essay.

Finally, it is important to note that this topic goes beyond the legal arena in the sense that it has considerable importance for certain areas of economics, such as, public economics, economic integration theory and international trade theory.[3] Albeit this academic work also includes an economic approach, it is important to note that it does not look at financial calculations.

Methodologies

Regarding the methodologies adopted, this piece of research is essentially based on a legal dogmatic descriptive method, particularly Part I. The following Parts (II, III and IV) are the product of a legal dogmatic descriptive method together with an analytic approach where the author sought to give his opinion whenever it seemed appropriated.

Structure

Clarifying the operative concepts of the topic is of upmost importance before advancing to the analysis of the impact of taxes on competition in detail. Thus, Part I defines such concepts, which include the concept of tax adopted in this study, the definition of the EU competition law purposes, the concept of market failures, an overview of the state aid control and a description of the legal *status quo* in the European Union. The purpose of this Part is to provide the reader an indispensable background to understand the scope of the topic.

Part II and Part III, the core parts of this research, provide factual elements that sustain the thesis i.e., taxes are often a foe but can also be an ally of competition. Whereas Part II discusses the negative effects of taxes on competition, Part III describes the positive effects. In both Parts specific situations of national tax systems as well as

[3] See Hans Friederiszick W., Lars-Hendrik Röller, and Vincent Verouden, *"European State Aid Control: an economic framework"*, Working Paper, 2006, available at https://www.esmt.org/fm/312/European_State_Aid_Control.pdf [02/04/2015], page 11.

situations that concern the European legal framework will be analysed. One can say from this moment that Part II is more extensive than Part III because the negative impact that taxes have on competition is much more palpable than the positive impact.

In the last Part, Part IV, the author makes a critical analysis. As the negative impact that taxes have on competition is more noticeable than the positive impact, it would be important from a competition policy perspective to correct the obstacles that taxes frequently have on competition and emphasize their positive effects. Thus, the author will provide some recommendations in that sense throughout the fourth Part. This Part also includes the final conclusions of the essay.

PART I

GENERAL CONSIDERATIONS ABOUT THE TOPIC

PART I - GENERAL CONSIDERATIONS ABOUT THE TOPIC

1. Outline

The main purpose of this first Part is to provide the reader an indispensable background to understand the topic. Before advancing to the analysis of the impact of taxes on competition properly said, it is necessary to clarify the operative concepts of the topic.

The author will start by clarifying the concept of tax adopted in this piece of research, the types of taxes that will be under scrutiny, the taxes that will be set aside and the concept of tax benefits.

The subsequent section defines the main purpose of EU competition law. In order to evaluate properly the impact of taxes on competition it is paramount to keep in mind the main purpose of EU competition law. Hence, in this introductory Part we will define the main purpose of EU competition law.

In a third moment, the author will analyse the concept of market failures. States frequently charge taxes to correct market failures and thus satisfy the public interest. As this concept will be often invoked throughout this essay, it is important to clarify it in this first Part.

The subsequent section describes the EU state aid control, because this is the best example of the main argument put forward in this thesis i.e., that taxes can have either a positive or a negative impact on competition. On one hand, the general prohibition of state aid established in Article 107(1) of the TFEU reflects that state aids, including tax aids, may affect competition. On the other hand, the exceptions to Article 107(1)[4] are the recognition that sporadically tax aids have positive effects that outweigh the negative effects, being those aids an ally of competition. As tax aids will deserve special emphasis during the course of this essay, in this introductory Part the author will indicate the reasons that justify the state aid control, describe the enforcement of this

[4] Foreseen in Article 107(2) and 107(3) of the TFEU.

regime and clarify the notion of state aid and of tax aid according to the legal doctrine and the ECJ case law.

Finally, as one of the main purposes of this essay is to provide some suggestions to change the legal *status quo* in the EU regarding the impact of taxes on competition (task that is realised in Part IV), the last section of this first Part contains an indispensable description of that legal *status quo*, which demands a significant shift.

2. Taxes Covered

The concept of tax is very flexible and there is no universal definition of tax. Definitions tend to vary according to their context. The economic and legal notions of tax do not strictly coincide with each other. Equally, the concept of tax adopted in the US is not exactly the same that is used in large part of the EU Member States.[5] So, it is important to clarify the concept of tax adopted in this essay from the beginning.

The author follows the OECD working definition of a tax, which establishes that a tax is a "compulsory unrequited payment to the government". Taxes are unrequited or unilateral inasmuch as there is no proportion between the tax paid and the benefits provided by the government to the taxpayer.[6] In other words, there is nothing that the taxpayer receives directly in return of the tax payment (on the contrary of fees, where there is a direct link between the money paid and the good or service obtained).

One other useful definition of tax is the one provided by Thuronyi, which says that taxes can be defined as "a contribution unilaterally imposed under public law which serves to raise revenues and is payable to a public authority (…) [and] where the taxpayer does not receive anything in return for the payment" (emphasis added).[7] Even though taxes are usually paid in cash it is important to note that some statutes foresee the possibility of payment in kind under certain circumstances. The fact that taxes are always imposed by law is a consequence of the principle of legality and means that taxes can only be collected if there is a statute lawfully enacted providing so. Moreover, taxes are always collected by a public authority and go directly to the State coffers so

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[5] Victor Thuronyi, *"Comparative Tax Law"*, Kluwer Law International, 2003, page 48.

[6] European Association of Tax Law Professors**,** *"The Concept of Tax in EU Member States"*, page 20.

[7] Victor Thuronyi, *"Comparative Tax Law"*, *op. cit.,* pages 48 and 49.

that public goals can be realised. Additionally, some taxes also take into consideration the taxpayer's ability to pay, a corollary of the equality principle. That is why the personal income tax is progressive. However, indirect taxes like the VAT are not progressive and so, it cannot be said that all taxes take into consideration the taxpayer's ability to pay. To finish, it is important to note that taxes do not have a criminal nature and so, they are not imposed by way of a penalty or a criminal fine.[8]

There is also no universal classification of taxes. Taxes can be classified with reference to particular criteria. For instance, taxes can be classified by reference to the base on which the tax is levied (such as income, payroll or property), by reference to the method by which the tax is collected (such as, by way of a stamp, withholding, or assessment), or even by reference to whether they are direct or indirect.[9] This panoply of classifications makes very difficult to indicate all the types of taxes that will be included and excluded in this piece of research.

There will certainly be numerous references to direct and indirect taxes. From amongst the direct taxes, the corporate income tax (CIT) is the one that will deserve the most attention. Conversely, the personal income tax, the tax applied on individuals, will rarely be mentioned considering that this tax hardly has a significant impact on competition.

Regarding indirect taxes the VAT, excise duties on gasoline, alcoholic beverages, tobacco, and motor vehicles, as well as registration duties will be part of the analysis made in this academic study. Custom duties, exit taxes collected from legal persons and environmental taxes will also be part of the analysis made.

In spite of the difficulties of enumerating all the taxes that will be excluded from this piece of research there are some that, because of their scarce impact on competition, can be indicated as it is the case of the personal income tax, inheritance taxes and gift taxes. Property taxes and stamp duties will also not deserve a particular reference. In addition to these taxes, the ‘direct cousins’ of taxes, fees and social contributions, are also excluded from the analysis made in this academic work.

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[8] IBFD, ‘*International Tax Glossary*’, Julie Rogers-Glabush, 6th Revised Edition, page 416.
[9] Ibid.

One final concept that is essential to make clear from the beginning is the concept of tax benefit as this concept will be invoked very often throughout this dissertation. The concept of tax benefit covers any tax break granted by the government that relieves the normal tax obligations of the taxpayer, such as, tax exemptions, tax deferrals, tax credits and tax allowances.[10] Tax benefits are usually granted to encourage the development of certain economic activities and they typically confer an economic advantage to their recipients. As it will be noted throughout this piece of research, tax benefits are highly susceptible of creating distortions of competition.

3. The Purpose of EU Competition Law

3.1. The Protection of the European Citizen Welfare

One of the most important considerations that should be made in this first Part of the study is the definition of the main purpose of EU competition law. In order to correctly assess the situations where taxes act as a foe and as an ally of competition (which is made in Parts II and III), it is crucial to be aware of what is the main purpose of EU competition law.

It is possible to say that EU competition law has a plurality of purposes, namely, economic integration, the maintenance of a level playing field, fostering competition and innovation, safeguard the free market and the free initiative, correcting market failures, and the defence of all market participants (producers, distributers, sellers…), especially the European consumer.[11] These are the most important purposes of competition law.

In spite of this plurality of purposes, one can and must define a hierarchy between them because they can be contradictory sometimes. For instance, one free market can be contradictory to the interest of the European consumer, or better, of the European citizen.

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[10] Ibid. Page 430.

[11] Luís Domingos Silva Morais, *"Empresas Comuns – Joint Ventures no Direito Comunitário da Concorrência"*, Almedina, Coimbra, 2006, page 1549 et seq.

As this piece of research is focused on the European context, it is important to keep in mind the main goals defined in the EU treaties, which establish that free competition and the internal market are nothing more than means to achieve a superior end: the European citizen welfare.[12] According to Professor Froufe, consumer welfare is today one of the main purposes of EU competition policy. Whereas in the past EU competition law was a tool to achieve economic integration in the internal market today, it is mainly focused on safeguarding the European consumer welfare.[13] It is then safe to say that the ultimate and most important purpose of EU competition law is not the protection of a free market *per se* but rather the protection of all market participants, especially the European citizen.[14]

This statement is in line with what is said by Professor Manuel Fontaine who argues that ensuring the society welfare has been one of the most important aims of the States throughout the history.[15] Competition policy is therefore one more instrument that States have at their disposal to achieve such aim. Thus, competition policy is primarily focused on achieving the society welfare.[16]

It would not be reasonable to assume that the European Union could define the protection of a free market as its main goal, because a free market does not necessarily translate into the safeguard of the public interest. A free market can bring significant advantages, but it can also create some problems. In fact, a free market can be prejudicial to the public interest inasmuch as market failures (such as externalities, imperfect information, abuse of dominant position, etc.) are not corrected under a completely free market.

Thus, this thesis is based on the premise that a free market is not an end in itself but rather a means to achieve a superior end, the social welfare. Even though it implies a distortion of competition, a governmental intervention in case of a market failure cannot

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[12] The Preamble of the TEU for instance sets that the Union is "determined to promote economic and *social progress for their peoples* (…) within the context of the accomplishment of the internal market" (emphasis added). See also Article 3(1) of the TEU.

[13] Pedro Froufe, *"A Reforma do Direito Comunitário da Concorrência: O Sentido Descentralizador e/ou Re-Centralizador do Regulamento (CE) Nº 1/2003"*, Escola de Direito da Universidade do Minho, September 2009. pages 51 et seq.

[14] Rodrigo Maito da Silveira, *"Tributação e Concorrência"*, in Instituto Brasileiro de Direito Tributário, Quartier Latin, 2011, page 117.

[15] Manuel Fontaine Campos, "Natureza, origem e exercício do poder político", in Comunicação apresentada no Curso de Ética e Política, Fundação Spes, 2009, page 7.

[16] See also Luis Fernando Schuartz, *"Dogmática Jurídica e Lei 8.884/94",* available at http://www.ie.ufrj.br/grc/pdfs/dogmatica_juridica_e_lei_8884_94.pdf [24/02/2015], page 15.

be regarded as a breach of EU competition law purposes as long as it proves to satisfy the public interest. The correction of market failures in accordance with the public interest and the protection of all market participants, especially the EU citizen in the quality of consumer is therefore the most important and ultimate aim of EU competition law.

3.2. Free Competition as a Means to Achieve a Superior End

If free competition is not the central aim of EU competition law, it is important to define its role under the EU legal framework. It is not the author's intention to deny the positive effects that a free market may bring to the society, rather the contrary. The fact that free competition may bring significant benefits for the European consumer is undeniable. According to the economic theory, free competition in the internal market is expected to bring significant advantages both for the European citizen and for the EU Member States, e.g., costs reduction, specialization, employment, increased efficiency, innovation and better-quality products and services.[17] Accordingly, free competition is one of the most important principles of EU law.

However, this principle has to live together with other equally important principles and goals of EU law like consumer protection, regional development, environmental protection or smart growth. According to Article 7 of the TFEU, the Union shall ensure consistency between its policies and activities, taking all of its objectives into account. As a consequence, market participants may expect to compete freely and under fair conditions, but shall also be aware that when necessary governments will intervene in the market with the purpose of accomplishing other equally important goals of EU law with which free competition has to live.

The history shows that the rules of the market and the Adam Smith's "invisible hand" by themselves are not sufficient to ensure an adequate dynamic of the market as well as a suitable allocation of resources from a public interest perspective. As examples of that we can point the 1929 Wall Street Crash as well as the more recent global

[17] Patrick Ziltener, *"The economic effects of the European Single Market Project: projections, simulations – and the reality"*, in Review of International Political Economy, Vol. 11, Issue 5, page 956.

financial crisis of 2008.[18] As a completely free system does not serve the public interest, governmental actions in the market are sometimes required.

Such actions, it is important to reinforce, are often made through the tax system. For example, governments frequently grant tax benefits for the production of goods that the society needs but that are not normally provided by the market. Even though this measure affects free competition, it cannot be regarded as having a negative impact from a competition policy perspective inasmuch as it benefits the European citizen.

Hence, free competition is one of the most important principles of EU competition law. There are, however, some deviations to this principle that can be justified on grounds of public interest.

To identify the situations where these deviations are legitimate, it is necessary to make a judgement of proportionality between the positive effects of the governmental action (usually, the correction of a market failure) and the negative effects (affecting free competition).[19] If the benefits of the governmental measure outweigh its costs, then the impact of such measure cannot be considered negative from a competition policy perspective. In the European context, these governmental interventions are commonly called state aid. Before advancing to the topic of state aid, however, there is another concept that is important to clarify, which is the concept of market failures.

4. Market Failures

The correction of market failures in accordance with the public interest is one of the most important purposes of competition policy and is one of the main reasons that justify governmental interventions in the market through the tax system.[20] Thus, the concept of market failures will be invoked very often throughout this academic work. For that reason, it is important to discuss this concept in this introductory Part.

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[18] José Ribeiro Brazuna, *"Defesa da Concorrência e Tributação - à luz do Artigo 146-A da Constituição"*, *op. cit.,* page 25.
[19] Hans Friederiszick W., Lars-Hendrik Röller, and Vincent Verouden, *"European State Aid Control: an economic framework", op. cit.,* page 8.
[20] Ibid. page 13.

The concept of market failures derives from the economic field. A market failure occurs essentially when a free market does not allocate the resources efficiently.[21] More specifically, the amount of products supplied does not correspond to the amount of products demanded by consumers. This problem may occur due to the absence of some economic factors. Market failures are likely to occur, for instance, when market participants are exclusively focused on achieving their own interests. When suppliers are only focused in maximizing their profits, the outcome of the market will probably be inefficient from the public perspective.

From the vast number of types of market failures there are some that should be mentioned in this piece of research. First of all, market failures can be originated by negative externalities. Negative externalities occur when market participants impose a cost on third parties and do not have to pay for that.[22] That would be the case of pollution through industrial activity. In a market without governmental actions, market participants in the industrial sector could impose a cost to the society (the detriment of the environment) and not have to pay for it.

Positive externalities can also be the origin of market failures. In some cases, market participants are not able to pick the full benefits of their action.[23] That is the case of R&D. R&D can bring major benefits for the society. Sometimes, the positive effects collected by the society (the so-called spill-over or free rider effects) are even bigger than the benefits collected by the entity developing the R&D activities (that would be the case, for instance, of R&D activities in the field of medicine). The free rider effects create a reluctance on firms to invest in R&D since they are not able to pick the full benefits of their activities, which makes that the amount of money invested in R&D lower than what would be socially desirable.

Market failures may also be originated by imperfect information. When one of the parties of a transaction has more information than the other, it may lead to unfair transaction and agency costs, resulting in inefficient market outcomes from the public

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[21] State Aid Action Plan (2005), page 7. See also Christian Buelens, Gaëlle Garnier, Roderick Meiklejohn and Mattheu Johnson, *"The economic analysis of state aid: Some open questions", in* Economic Papers, 2007, page 10.
[22] José Ribeiro Brazuna, *"Defesa da Concorrência e Tributação - à luz do Artigo 146-A da Constituição"*, *op. cit.,* page 68.
[23] State Aid Action Plan (2005), page 7.

interest point of view. For instance, regarding the financial market, start-up firms frequently have problems in finding a reasonably-priced funding.[24]

Significant market power can also create market failures. When a firm obtains significant market power in a free market, it is able to charge excessively high prices, reduce the levels of supply or exclude trading partners, which translates into an inefficient allocation of resources. The abuse of dominant position is a market failure that has serious consequences for all market participants.

One other market failure that can occur in a free market concerns the provision of public goods.[25] Public goods are goods that are needed by the society but that are not normally provided by the market because, since it is not possible to exclude anyone from its use, it is impossible to charge its use individually. National defence and illumination are examples of public goods that are not normally provided by the market.

More factors can originate market failures, such as, geographical location and the volatility of products. Nevertheless, all market failures can be corrected through two approaches. The first approach concerns the use of regulatory instruments, e.g., prohibiting the production of certain products or requiring licenses for their production. The other approach to correct market failures is made through governmental interventions in the market, known as state aids in the EU context. In this case, governments modify the natural allocation of financial resources in the market with the purpose of eliminating market failures. There is an extensive variety of schemes that can be regarded as state aid, which include the grant of subsidies, tax benefits, loan agreements, etc. This thesis however will only give special attention to state aids with a tax nature, which might be particularly distortive.

5. The State Aid Control

Tax aids will deserve special emphasis in the following Parts of this piece of research because, these are particularly distortive measures. For that reason, it is

[24] Ibid.
[25] Ibid.

convenient to make some previous considerations about the state aid control in this introductory Part.

5.1. State Aid as a Valuable Instrument

As it was previously observed, free competition is not a guarantee that the public interest will be safeguarded and that is why sometimes governments must intervene. Governments usually grant financial aids to certain sectors or specific companies with the purpose of solving market failures and thus serve the public interest.

When governmental actions, in particular the ones that are made through the tax system, successfully solve market failures taxes shall be regarded as an ally of competition. The basic example is one tax measure that promotes competition in monopolistic market or taxes that encourage the development of R&D activities. These and other situations where taxes act as an ally of competition are discussed in detail in Part III of this essay.

5.2. The Negative Side of State Aid

In spite of what is said in the previous section, due to lack of budgetary discipline, powerful lobbies or corruption, governmental interventions may also lead to an inefficient allocation of financial resources. When it occurs, a governmental failure is deemed to exist.[26]

In fact, the State can be a major player responsible for distorting competition. Through the tax system, national, regional and even local governments occasionally leave certain firms in a stronger position than its competitors without any good reason. Granting public money to certain undertakings without ensuring the satisfaction of the

[26] Christian Buelens, Gaëlle Garnier, Roderick Meiklejohn and Mattheu Johnson, *"The economic analysis of state aid: Some open questions", op. cit.,* page 8.

public interest is a flagrant distortion of fair competition and of market efficiency.[27] When it occurs, taxes shall be considered a foe of competition.

5.3. The Need for a State aid Control

Through the state aid control, the European Commission ensures that state aids are granted in accordance with the public interest and avoids undue distortions of competition.

Whereas in the past this field was seen as the 'poor relative' of competition law, that is not the case anymore.[28] The number of state aid cases reaching the General Court of the European Union during the last five years is superior to the number of cases of other areas of competition law considered all together.[29]

The system of state aid control makes the European Union the most transparent and coherent jurisdiction in the world regarding the grant of state aid. Indeed, it is not possible to find a similar system of state aid control in almost any other jurisdiction. Only in the EFTA there is an identical regime, which draws inspiration from the EU due to the need to coordinate competition law in the EEA.

The state aid control operates in similar terms as the WTO subsidy control, but the state aid control is even more stringent, much due to the active role performed by the European Commission. While the WTO subsidy control only occurs *ex post,* the European Commission operates the state aid control both *ex ante* and *ex post* i.e., before and after the state aid has been granted.[30]

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[27] Ben Terra and Peter Wattel, *"European Tax Law",* Kluwer, 4th Edition, 2005, page 19.

[28] Hansen, M. A. Van Ysendyck, and S. Zhulke, *"The coming of Age* of EC State Aid Law: A Review of the Principal Developments in 2002 and 2003", *in* European Competition Law Review, 2004, page 182.

[29] See Pablo Colomo, *"State Aid Litigation Before the EU Courts (2004 – 2012): A Statistical Overview"*, Oxford University Press, Journal of European Competition Law & Practice, 2013, Vol.4, No.6. page 4650.

[30] Additionally, the WTO only exercises the subsidy control if a WTO Member makes a complain, whereas the European Commission acts *ex officio,* having the possibility to impose the withdraw of any illegal state aid even of the ones that were not notified.

State aid is an area with a strong political component. On the contrary of other fields of competition law, state aid control is directed to the States, not to firms.[31] Additionally, the central role is performed by a political institution, the European Commission, which acts as a supranational supervisor authority.[32]

One can identify four goals of state aid control. Firstly, state aid control seeks to ensure the maintenance of the level playing field in the internal market. Since competition is regarded as a useful instrument to promote EU citizen welfare, this regime attempts to guarantee that competition will not be distorted by Member States, unless there is a major reason of public interest.

Secondly, state aid control has a redistributive rationale.[33] Even though state aid has the potential to distort competition, the European Commission is aware that state aids may also have positive impacts in the market. The most efficient way to produce positive effects is by correcting market failures. A state aid that corrects a market failure and improves the social welfare is regarded as "good aid".

Thirdly, state aid control seeks to reduce the harmful effects of subsidy races within the internal market. As that will be described later (Part II, section 7) subsidy races occur when Member States compete with each other in an individual rationale with the intention of collecting a large share of international profits. Since almost all Member States adopt this strategy, the result is a collective waste of public resources.[34] By controlling the tax aids permitted, the European Commission reduces the possibility of subsidy races to the bottom.[35]

Finally, the state aid control can also be seen as an instrument responsible for restricting governmental failures. Due to several reasons (lack of budgetary discipline, powerful lobbies, corruption, etc.), sometimes governments spend public money

[31] The political feature of state aid control is also denoted by the different perspectives that Member States adopt about the use of this public instrument. For instance, whereas the UK, the Netherlands and Estonia rarely grant state aids, France, Germany, Denmark, Sweden and Poland frequently make use this instrument. For further developments see Christian Buelens, Gaëlle Garnier, Roderick Meiklejohn and Mattheu Johnson, *"The economic analysis of state aid: Some open questions", op. cit.,* page 2.

[32] See Blauberger, *"Of 'Good' and 'Bad' Subsidies: European State Aid Control through Soft and Hard Law",* West European Politics, vol. 32, No. 4, July 2009, page 724.

[33] See Hans Friederiszick W., Lars-Hendrik Röller, and Vincent Verouden, *"European State Aid Control: an economic framework", op. cit.,* page 15 et seq.

[34] Ibid. page 22.

[35] Christian Buelens, Gaëlle Garnier, Roderick Meiklejohn and Mattheu Johnson, *"The economic analysis of state aid: Some open questions", op. cit.,* page 6.

incorrectly by offering state aids in an inefficient manner. In cases where States control funds, powerful companies frequently allocate resources to lobby for it.[36] Through state aid provisions the European Commission is able to ensure that public money is adequately invested.

5.4. The Enforcement of the State Aid Control

Under Article 108(3) of the TFEU, all new state aids must be notified to the European Commission before being implemented.[37] This is the first and indispensable step that all Member States must take in order to lawfully grant state aids.[38] If Member States grant a state aid without complying with the notification obligation, the Commission will act in accordance with its *ex officio* powers and require the recovery of the unlawfully granted aid.

The procedure of notification is regulated on the Procedural Regulation.[39] Under Article 2 of the Procedural Regulation "(…) any plans to grant new aid shall be notified to the Commission in sufficient time by the Member State concerned". Even though Article 108(3) of the TFEU does not explicitly refer it, it is settled case law that the obligation to notify the Commission belongs to the Member State concerned, not to the firm or firms receiving the state aid.[40]

To help Member States determine the situations in which a measure constitutes state aid and must be notified, the European Commission developed a complex legal framework, encompassing secondary regulations, guidelines, frameworks and notices. The legal instrument that regulates the grant of tax aids is the 1998 Commission Notice on fiscal state aid.[41]

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[36] Ibid. page 8.
[37] Ben Terra and Peter Wattel, *"European Tax Law", op. cit.,* page 19.
[38] It is opportune to note that there are some exceptions to the obligation of notify the Commission, which are set out in the General Block Exemption Regulation.
[39] Regulation 659/1999.
[40] See Joined Cases C-442/03 P and C-471/03 P, Judgment of the Court, 1 June 2006, P & O European Ferries (Vizcaya) SA and Diputación Foral de Vizcaya v. Commission of the European Communities, paragraph 103.
[41] Commission Notice on the application of the State aid rules to measures relating to direct business taxation (98/C 384/03).

Article 3 of the Procedural Regulation, foresees the "standstill obligation". According to such provision, until the Commission's approval Member States must refrain themselves from granting any state aid. After notifying the Commission, Member States shall wait for a positive, conditional or negative decision.[42]

If one Member State grants a state aid without prior approval of the European Commission, such aid is considered unlawful and must be recovered. The purpose is to re-establish the situation that previously existed.[43]

There are no specific rules at supranational level regarding the recovery procedure. Instead, according to Article 14(3) of the Procedure Regulation, the recovery of unlawful aid shall be administrated according to national law.[44]

Finally, it is convenient to note that the powers of the Commission to recover unlawful state aid are limited to a period of ten years counting from the day on which the aid was conceded.[45] After that ten-year period, the Commission is not legitimated to require the recovery of the unlawfully granted state aid.

5.5. The Concept of State Aid

On the topic of the concept of state aid, the regulatory framework, the case law and the literature are fairly extensive, surely because the European Commission has not issued yet an official and legally binding definition of state aid. Article 107 of the TFEU is the basic provision regarding state aid and should be the starting point to define its concept.

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[42] It is convenient to note that the decisions issued by the European Commission may be appealed before the ECJ and that the standstill obligation has direct effect, which means that it can be invoked by direct competitors before national courts. For further developments see Lisa Paterno, *"State Aid and Fiscal Protectionism in the European Union from the Perspective of Competitors"*, in Bulletin for International Taxation, IBFD, June 2011.

[43] The ECJ does not consider the recovery of state aid as a penalty, but rather as the "logical consequence" of the finding that the aid is unlawful. See Case C-70/72, Judgment of the Court, 12 July 1973, Commission of the European Communities v. The Federal Republic of Germany, paragraph 66. To re-establish the situation that previously existed, in addition to the unlawful state aid granted the respective interests also have to be recovered [Article 14(2) of the Regulation 659/1999].

[44] This position was confirmed by the ECJ in *Netherlands v. Commission (*Case C-382/99).

[45] Article 15 of the Regulation 659/1999.

Article 107(1) defines state aid as "(…) any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods (…) in so far as it affects trade between Member States". Through the text of this provision, considered together with the jurisprudence of the European Courts, one can identify four conditions that a measure must fulfil to be considered state aid.

Firstly, a state aid always involves a transfer of state resources by public authorities. The transfer does not have necessarily to be made by the central government. It can also be made by regional or local governments, as well as other institutions controlled by the State, e.g., public banks.[46] The concept of transfer of state resources includes not only direct transfers (for instance, subsidies or loans) but also the attribution of indirect benefits that affect the public budget, such as, tax exemptions.[47] It is fundamental to keep this in mind to comprehend part of the scope of this thesis.

The second characteristic of a state aid is the grant of an economic advantage to an undertaking. The concept of undertaking applicable here is the same that is used in other areas of competition law, which covers "any entity engaged in an economic activity, regardless of its legal status and the way in which it is financed".[48] Thus, non-profit entities such as charities and universities are covered by this concept and subject to state aid control. State aids to non-profit entities are also regarded as potentially distortive. As the former Commission Vice President in charge of competition policy said, even though non-profit entities sometimes play an important social role, it is fundamental to ensure that they do not benefit from an undue advantage when they operate in the same markets as commercial players.[49]

Thirdly, a state aid is a measure that is always selective. This means that the state aid is only available for certain undertakings, sectors, products, regions or types of firms. The opposite of a selective measure is a general measure i.e., a measure that is available to all types of businesses. A general measure applies without excluding

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[46] See Begoña Pérez Bernabeu, *"R&D&I Tax Incentives in the European Union and State Aid Rules"*, IBFD, European Taxation, May 2014, page 183.
[47] Ibid.
[48] Case C-288/11 P, Judgment of the Court (Eighth chamber), 19 December 2012, paragraph 50.
[49] European Commission Press release available at http://europa.eu/rapid/press-release_IP-12-1412_en.htm

sectors, products, regions, or firms and cannot be regarded as state aid.[50] As Friederiszick et al.[51] note, it is important to pay special attention to measures that are *de jure* general but *de facto* selective. These are measures that theoretically have general applicability but in practice apply selectively. For instance, a measure shall be regarded as selective when one government is aware that only one company in its jurisdiction employs more than 1000 workers and designs a statute establishing that all businesses that employ more than 1000 workers may benefit of a 10% reduction of the corporate income tax rate. Such measure is not *de jure* selective but is *de facto* selective, because it was *a priori* projected to favour only one company in that jurisdiction. Such measure shall therefore be regarded as satisfying the characteristic of selectivity.

Finally, state aid is a measure that distorts or at least has the potential to distort competition and trade between Member States. This condition is usually divided in two parts. It is settled case law that the potential to distort competition does not have to be significant or substantial.[52] This condition is satisfied even if small amounts of aid and minor market shares are at stake. It is common practice to consider that all selective measures distort competition. In order to consider that a measure affects trade between Member States it is enough that the undertaking receiving the aid operates in a market in which there is trade between Member States. Since nowadays there is trade between Member States in almost every market, practically all measures are liable to affect trade between Member States.

It is convenient to note that is possible to find a European influence in the concept of subsidy used at WTO level. The EU is a WTO Member and there is an obvious similarity between the concept of state aid under EU law and the concept of subsidy under the WTO rules. Subsidy is the equivalent term for state aid at WTO level and such concept is defined in Article 1 of the Agreement on Subsidies and Countervailing Measures (SCM). According to this provision, a subsidy is deemed to exist if there is "a financial contribution made by a government or any public body".[53] The different forms of financial contributions include (i) direct transfers of funds, including potential transfers, such as loan guarantees, (ii) foregone revenues that are

[50] Ben Terra and Peter Wattel, *"European Tax Law", op. cit.,* page 166.
[51] Hans Friederiszick W., Lars-Hendrik Röller, and Vincent Verouden, *"European State Aid Control: an economic framework", op. cit.,* page 6.
[52] See the Judgment of the Court of First Instance, Case T-55/99 of 29th September 2000, *Confederación Española de Transporte de Mercancías v Commission of the European Communities*, paragraph 94.
[53] Article 1.1(a)(1) of the SCM.

otherwise due (for instance, tax benefits), (iii) goods and services provided by the government other than general infrastructure and (iv) payments by a government to a funding mechanism. Thus, one may conclude there is a clear parallelism between this criterion and the criterion of "transfer of state resources" foreseen in the EU state aid control. In addition to financial contributions by a government, Article 1.1(b) of the SCM establishes that in order to a subsidy be deemed to exist, the financial contribution must confer a benefit to the recipient. Likewise, there is an obvious parallelism between this criterion and "the grant of a selective economic advantage" established in the EU state aid control.

To conclude, there is no doubt that the notion of state aid is extremely broad and includes an endless number of measures. This concept covers any measure that selectively relieves the normal expenses of an undertaking, e.g., capital injections, loans guarantees, tax benefits and preferential interest rates. A proper definition of state aid is thus crucial to increase legal certainty. In the sequence of the 2012 State Aid Modernisation initiative, the European Commission is expected to publish a Notice containing accurate guidelines to define the concept of state aid and each of its characteristics based on the legal framework that the Commission has created as well as on the ECJ case law. While an official version of such Notice is not published, one can define state aid as the grant either direct or indirect by the State or any other public authority controlled by the State through public resources of an economic advantage only in favour of one entity or one group of entities engaged in an economic activity.

5.6. The Concept of Tax Aid

"*We need a full picture of the tax rulings practices in the EU to identify if and where competition in the Single Market is being distorted through selective tax advantages."*[54]

Margrethe Vestager, Commissioner in charge of competition policy.

It was already observed that there are two approaches that governments can adopt to grant state aid. Governments can grant state aid directly, which implies giving

[54] European Commission - Press release, Brussels, 17 December 2014 available at http://europa.eu/rapid/press-release_IP-14-2742_en.htm [10/03/2015].

funds to firms, such as, subsidies or loans.[55] Alternatively, governments can grant state aid indirectly, by abdicating of revenues that are otherwise due. That is the case of tax benefits. By reducing the tax obligations of certain companies, governments may be granting a state aid, since they are relieving the normal expenses of those companies. This last type of state aid, tax aid, will deserve particular highlight in the following Parts of this thesis and that is why we should clarify this concept.

Based on what was described in the previous sections, it is not difficult to imagine situations where taxes configure a situation of state aid. Tax statutes that involve a loss of revenue that would otherwise be due, confer a selective economic advantage to an undertaking or a group of undertakings, and affect competition and trade between Member States, constitute a situation of state aid.[56] This is what is established in the 1998 Commission Notice on fiscal state aid.[57]

For instance, when a central government grants a reduction of tax rates in favour of a specific firm, such situation might constitute state aid. This measure implies an indirect transfer of state resources inasmuch as involves a loss of revenues that was otherwise due,[58] confers an economic advantage to an undertaking that does not follow from the natural course of its business, can be selective and is likely to affect competition and trade between Member States.

The same can be said when a government grants a tax benefit to the exportation of a certain good, for instance bananas. Such measure involves a transfer of State resources, confers an economic advantage, is selective because it just benefits the producers of bananas and affects trade and competition between Member States.[59]

The notion of tax aid encompasses any kind of tax that is susceptible of conferring an economic advantage to certain taxpayers, such as, reductions of the tax base (allowances and extraordinary amortizations), reductions of the amount of tax due

[55] For further developments see Aleksandra Bal and René Offermanns, *"R&D Tax Incentives in Europe"*, IBFD, European Taxation, April 2012, page 167.
[56] See IBFD, '*International Tax Glossary*', *op. cit.,* page 417.
[57] Commission Notice on the application of the State aid rules to measures relating to direct business taxation (98/C 384/03).
[58] See Kees van Raad, *"Materials on International an EU Tax Law"*, International Tax Center of Leiden, Vol. 2, 2013/2014, page 2849.
[59] It is convenient to refer that under the WTO rules such tax benefit would also be regarded as a forbidden subsidy inasmuch as there is a financial contribution made by a government (foregone revenues that are otherwise due) and such financial contribution confers a benefit to the recipient.

(tax exemptions and tax credits), tax deferrals or even exceptional rescheduling of the tax debt.[60] The ECJ has already held, for instance, that a rebate on energy consumption taxes only benefiting certain undertakings manufacturing goods constitutes tax aid.[61] Lenience in the recovery of tax claims from undertakings was also considered to constitute tax aid.[62]

Therefore, one may accept that the concept of state aid is so broad that covers a significant number of tax measures. Since it covers so many tax measures, the question that can arise is whether the control of such measures exercised by the European Commission does not constitute an undue restriction of EU Member States' tax sovereignty.

It is the author's opinion that the tax aid control does not imply any illegal restriction of Member States' power to tax. First of all, whether it is true that Member States maintain tax sovereignty, it is also true that such sovereignty must be exercised consistently with EU law. Secondly, the TFEU confines the scope of action of the EU in tax matters to a very limited number of situations, but among those matters we can find competition issues in the form of tax aid.[63] Through the European Treaties, Member States gave the European Commission the competence to control such measures so, the tax aids control cannot be regarded as an undue restriction of Member States' tax sovereignty. The truth is that currently EU Member States already do not have full fiscal sovereignty. Today, tax sovereignty is more apparent than real[64] and the restrictions imposed by the tax aid control is just one example of that as well as indirect tax coordination.

It is important to note that not only tax aids can be an ally or a foe of competition. As it will be shown in the subsequent Parts of this thesis, taxes that do not fulfil all the conditions of state aid may have also a positive or a negative impact on

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[60] Rodrigo Maito da Silveira, "Tributação e Concorrência", *op. cit.,* page 219 et seq.
[61] Case C-143/99, Judgement of the Court of 8 November 2001, *Adria-Wien Pipeline GmbH.* Originally cited in Ben Terra and Peter Wattel, *"European Tax Law", op. cit.,* page 165.
[62] Case C-276/02, Judgement of the Court of 14 September 2004, *Commission v Italy.* Originally cited in Ben Terra and Peter Wattel, *"European Tax Law", op. cit.,* page 165.
[63] The remaining areas where the EU has scope of action concerning tax issues are matters of multilateral surveillance, the proper functioning of the internal market, tax discrimination, and ad hoc tax measures to attain specific objectives of the Union. For further developments see Gaëtan Nicodème, "Corporate tax competition and coordination in the European Union: What do we know? Where do we stand?", in Economic papers of the European Commission Directorate-Generale for Economic and Financial Affairs, June 2006, nº 250, pages 8 et seq.
[64] Ana Paula Dourado, *"Lições de Direito Fiscal Europeu"*, Coimbra Editora, 2010, page 223.

competition. The fact that some taxes do not comply with all the conditions of state aid simply means that they are out of the scope of the Commission's state aid control. Taxes with general applicability, for instance, do not fall under the Commission's control, but can be responsible for affecting (either positively or negatively) competition. Thus, the author will not only focus the analysis on tax aids, but also on taxes that, even though not being state aid, can perform the role of an ally or of a foe of competition.

Tax aids deserved a previous note firstly, because these are particularly distortive tax measures. Secondly, for the reasons explained above, the European tax aid control is the perfect illustration of the main argument adopted in this thesis i.e., that taxes can be an obstacle but also an ally of competition. Lastly, tax aids will deserve a particular highlight in the subsequent Parts and so, it was necessary to clarify this regime in this introductory Part, which aims to provide the reader an indispensable background to understand the following Parts of the thesis.

6. The Legal *Status Quo* in the European Union

As the following Parts will prove, the legal *status quo* in the European Union regarding taxation involves significant problems from a competition policy perspective. For that reason, one of the main purposes of this study is to provide some recommendations to change the legal *status* quo (task that is realised in Part IV). Keeping in mind the aim of this introductory Part, this is the right place to make some previous considerations about the legal *status quo* in the EU.

The legal *status quo* in the EU regarding taxation is characterised by a large diversity, because each Member State has its own tax system. This vast diversity in the internal market shall be seen as a factor that has a severe impact on competition because European firms are subject to different tax rates, different administrative costs and different accounting rules. Substantial differences in overall tax burdens between undertakings from different Member States operating within the same market frustrate

free competition.[65] The lack of tax coordination is therefore an extremely serious problem from a competition policy perspective.

The debate regarding the problems that the lack of tax coordination in the EU entails is not new. In fact, the lack of tax coordination is one of the most debated topics in the European Union. The first proposal to coordinate tax systems in Europe was made in 1962 by the Committee chaired by prof. Fritz Neumark.[66] However, the progress made since then is very limited.

It is important to make clear from the beginning that the author does not advocate that full tax harmonisation should be defined as an immediate goal by EU policy makers. That would not be reasonable. Past initiatives have proved that any attempts to establish full tax harmonisation in the European Union are condemned to failure. Member States are not willing to abdicate of their tax sovereignty because, after having had renounced to other important instruments, especially the monetary policy, tax policy is the last instrument on their possession to control public finances.[67] The different cultures that prevail in the European Union are another issue that makes very difficult to achieve full tax harmonisation in the short term.

Thus, the author argues that the focus should rather be in attempting to coordinate just certain aspects of national tax systems that are essential to ensure the maintenance of the level playing field in the internal market. Raising the bar too high can easily defraud the expectation and lead to the immediate failure of political initiatives on that sense. Conversely, concentrate all efforts in a restricted number of key issues may lead to success.

One reason that justifies the absence of significant progresses on direct taxation is the unanimity rule foreseen on Article 115 of the TFUE, which establishes that the adoption of any tax decision in the EU has to be accepted by all Member States.[68] Whereas the number of matters that require unanimity has decreased during the last years, such rule has been maintained in relation to tax matters.[69] The unanimity rule

[65] Ben Terra and Peter Wattel, *"European Tax Law", op. cit.,* page 240.
[66] See Gaëtan Nicodème, "Corporate tax competition and coordination in the European Union: What do we know? Where do we stand?", *op. cit.,* page 22.
[67] Ibid.
[68] See Ana Paula Dourado, *"Lições de Direito Fiscal Europeu"*, *op. cit.,* page 223.
[69] See also Patricia Lampreave, *"Fiscal Competitiveness versus Harmful Tax Competition in the European Union"*, IBFD, Bulletin for International Taxation, 2011 (Volume 65), No. 6.

makes the legislative procedure really difficult because, since taxation is a very sensitive matter, there is always at least one Member State that disagrees with the legislative proposal.

As a consequence of the difficulties imposed by the unanimity rule, the achievements on direct taxation at the European level regard discrete matters, namely, the Parent-Subsidiary Directive[70], the Merger Directive[71], the Interest and Royalties Directive[72], the Savings Directive[73] and the Arbitration Convention[74].

The need to create some convergence on tax systems among the 28 Member States so that European firms can compete under equivalent conditions is evident. This is a vital step to advance in the single market integration process. If the internal market is supposed to be a market without internal borders, European firms should not receive differentiated treatments depending on the territory in which they have their headquarters established. And it is convenient to keep in mind that such differentiated treatments relate not only with the applicable tax rates but also with administrative and accounting rules, which make the conditions of competition unfair.

Tax coordination can be achieved by two ways. One way is through positive integration which requires positive actions at Community level such as, common policy making as well as the adoption of directives and regulations. The other way to achieve tax coordination is through negative integration which is made through legally enforceable prohibitions on certain measures of Member States or undertakings that violate the fundamental rules of the internal market, such as distortions of competition.[75]

In fact, the biggest achievements in European tax law especially in what concerns direct taxation are due to the decisions of the European Court of Justice. The

[70] Directive 2014/86/EU of the Council of 8 July 2014 amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.
[71] Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States.
[72] Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States.
[73] Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments.
[74] Convention 90/436/EEC of 23 July 1990 on the elimination of double taxation in connection with the adjustment of profits of associated enterprises.
[75] Ben Terra and Peter Wattel, *"European Tax Law", op. cit.,* page 28.

need to coordinate tax rules to avoid injuries in the internal market has been confirmed by the ECJ which has been making use of the fundamental freedoms and other Treaty provisions (in particular, the state aid provisions and the non-discrimination principle) to harmonise certain aspects of direct taxation through its decisions. The traditional example is the *Marks & Spencer*[76] case, perhaps the most relevant case regarding corporate taxation in the internal market. In this case the ECJ held that the prohibition imposed by the UK tax authorities to offset the losses of Marks & Spencer's subsidiaries in Belgium, France and Germany constituted an unjustified breach of the freedom of establishment inasmuch as the subsidiaries had exhausted the possibilities available in their States of residence of having the losses taken into account and no possibilities remain for those losses to be taken into account in their States of residence in future accounting periods.[77]

Some authors have been criticising the approach adopted by the ECJ saying that the Court has made an excessive use of this behaviour in order to offset the lack of tax coordination by way of EU legislation. However, even assuming that the decisions of the ECJ are not the most adequate method to harmonise tax matters it is not possible to ignore the fact that the ECJ was created to guarantee the correct application of EU law.[78] The author believes that while Member States are not able coordinate certain matters of direct taxation, it is preferable to have the ECJ with this approach, interpreting and adapting EU law to the main goals of the internal market. One cannot forget that Member States' tax sovereignty must be exercised in accordance with EU law and the ECJ is the European institution responsible for ensuring the proper application of EU law.

The high compliance costs of having to deal with 28 tax systems when exercising economic activities across the internal market is one reason that makes European firms less competitive and less efficient. The need to know the provisions of each tax system, together with the need to deal with the tax authorities of each Member State where a company exercises its economic activities, represent striking obstacles for

[76] Case C-446/03, Judgment of the Court (Grand Chamber) of 13 December 2005, Marks & Spencer plc v. David Halsey (Her Majesty's Inspector of Taxes).
[77] See Frank Barry and Rosemary Healy-Rae, *"FDI Implications of Recent European Court of Justice Decisions on Corporation Tax Matters"*, European Business Organization Law Review, vol. 11, 2010, page 134.
[78] See Patricia Lampreave, *"Fiscal Competitiveness versus Harmful Tax Competition in the European Union", op. cit.*

European firms that develop intra-EU operations.[79] These obstacles imply heavy financial costs and significant bureaucratic work, which makes European firms less competitive and efficient, breaching one of the most important purposes of competition policy (see section 3.1).

Another problematic consequence that the lack of coordination on tax matters involves is harmful tax competition. Due to the fundamental freedoms, companies are able to design their tax planning strategies through the establishment of their businesses in the legal system that better serves their tax purposes. Thus, the tendency in the European Union during the last two decades has been that Member States have lowered the corporate income tax rates.[80] Member States that offer the lowest corporate income tax rates are able to attract more businesses and mobile factors to their jurisdictions. This behaviour is really problematic from a competition policy perspective because it affects the level playing field in the internal market as there is an enormous disparity between the tax treatments conferred to the actors of the same single market.

To summarize, an increased coordination of tax rules at European level would definitely make competition in the internal market fairer. Even though full tax harmonisation is an overly ambitious goal to be pursued at the moment, at least it would be expectable to achieve some convergence on matters that significantly influence the conditions of competition like administrative tax rules, accounting rules and exit taxation. As we will see in the subsequent Parts of this piece of research, tax coordination is an indispensable step to reduce the negative effects that taxes have on competition.

The question is how the EU can implement any type of tax coordination in the absence of a formal power to do that. The answer may imply the use of soft law instruments. In the past, there was an initiative in the European Union involving the adoption of a soft law instrument, which allowed creating some convergence for the first time on an area of direct taxation, which was the Code of Conduct for Business Taxation. The Code of Conduct marked an historical moment where the representatives of EU Member States were able to, for the first time, discuss and reach an agreement on

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[79] Christoph Spengel and Chistiane Malke, *"Comprehensive Tax Base or Residual Reference to GAAP or Domestic Tax Law?"*, Series on International Tax Law, University Prof. Dr Michael Lang, vol. 53, page 65.

[80] See Mario Monti, *"A New Strategy for the Single Market"*, Report to the President of the European Commission, 9 May 2010, page 80.

matters of direct taxation. Later, the Code was converted into hard-law. A re-launch of this initiative taking into account the latest developments on international taxation and broadening its scope to other areas of direct taxation could produce interesting results.

Another instrument that would certainly be very useful to reduce the negative impact that the lack of tax coordination in the EU has on competition is the Common Consolidated Corporate Tax Base. This proposal has the aim of coordinating certain rules regarding corporate income taxation in the internal market, without implying the harmonisation of tax rates. These and other pertinent initiatives to change the legal *status quo* are discussed in the last Part of this essay.

PART II

TAXES AS A FOE OF COMPETITION

PART II - TAXES AS A FOE OF COMPETITION

1. General Context

After having clarified the operative concepts of the topic, it is time to advance to the analysis of the impact of taxes on competition properly said. This second Part of the thesis is focused on demonstrating the negative impact that taxes have on competition.

As previously noted, competition can be a really valuable tool to improve the European citizen welfare. Increased competition can lead to higher efficiency, innovation, and cheaper and better products. As a consequence, the competition process shall remain undistorted, unless there is a valid reason of public reason 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 competition 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.

Furthermore, in the European context the lack of tax coordination represents one of the main obstacles to competition. First of all, the lack of tax coordination makes that companies of the same single market compete under different and unfair tax rules. Secondly, the lack of tax coordination also reduces economic efficiency as it involves high compliance costs for companies exercising economic activities throughout the internal market. Hence, taxes are a foe and represent serious obstacles for competition.

In the present Part of this academic work the author analyses numerous situations where taxes affect competition. It will be initially explained the negative impact that custom duties and tax aids can create 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 of the application of different tax rules in the internal market, the impossibility of cross-border relief, the re-registration process of cars and exit taxation.

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, obscurity in national tax systems and affecting international trade. 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 really 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.

The final section contains the main conclusions of this Part.

2. Custom Duties

Custom duties or tariffs (these terms are usually used interchangeably) 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.[81]

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.[82]

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 thesis, custom duties often serve to protect specific domestic industries from foreign competitors.[83] These taxes increase the price of imported goods, thus discouraging their purchase and giving an advantage to locally-produced goods.

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, which results in less competition 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.

Several international agreements have been celebrated in order to prevent the massive charge of custom duties and the consequent distortions of competition. The most important and thus briefly referenced in this work is the General Agreement on Trade and Tariffs (GATT). The GATT, established in 1948, was both an international organisation and a multilateral treaty. The first goal of the GATT is to liberalise global

[81] See for instance, Ben Terra and Peter Wattel, *"European Tax Law", op. cit.,* page 7.
[82] Andrew Guzman and Joost Pauwelyn, *"International Trade Law"*, Wolters Kluwer Law & Business, 2nd Edition, 2012, page 167.
[83] IBFD, '*International Tax Glossary*', *op. cit.,* 109.

trade and deals with several international trade problems, e.g., countervailing duties, custom duties, quantitative restrictions and subsidies.[84] Moreover, the GATT led to the creation of the WTO in 1994, currently the larger institution at international level with 160 members, including some of the major economies of the world like the EU, the US, Russia, China and Japan.[85] The WTO plays a very active role, ensuring that free competition and free trade exist at international level.

One of the most important cases at WTO level is the *Japan – Taxes on Alcoholic Beverages* case.[86] This case concerns not exactly the levy of custom duties (taxes levied at the frontier) but rather the imposition at internal level of taxes that confer a differentiated treatment between similar national and foreign goods, which are equally distortive. Giving application to the national treatment principle, the WTO bodies settled for the first time that similar domestic and foreign products must receive an equal tax treatment, in order to safeguard free competition and international trade. This case was marked in the history of international trade law as the most important cases regarding the strict relationship that should exist between taxation and competition.

Regarding EU law, the European Union also plays an important role on the regulation of custom duties. In accordance to the 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).[87]

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 (like the *Japan – Taxes on Alcoholic Beverages* case). According to Barnard, these provisions are supposed to

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[84] Ibid, page 498.
[85] For further developments see Andrew Guzman and Joost Pauwelyn, *op. cit.,* page 79 et seq.
[86] The Panel Report is available at https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S006.aspx?Query=%28@Symbol=%20wt/ds8/r*%20not%20rw*%29&Language=ENGLISH&Context=FomerScriptedSearch&languageUIChanged=true# [20/01/2015].
[87] According to Ben Terra and Peter 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 Ben Terra and Peter Wattel, *"European Tax Law", op. cit.,* page 7.

guarantee the complete neutrality of internal taxation as regards competition between domestic and imported products in order to ensure normal conditions of competition.[88]

The Community Customs Code[89] entered into force in 1992, and was replaced in 2008 by the Modernised Customs Code.[90] 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, eliminating any restriction of competition that the differentiated tax treatment between national and foreign goods implies.[91]

Contrarily to the WTO, that only establishes that Member States are obliged to keep the applied custom duties rates below an established tariff ceiling,[92] 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.

To conclude, 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. So, taxes levied either at the frontier or internally that confer a differentiated treatment between similar national and foreign goods can be a strong foe of 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 the society.

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[88] Catherine Barnard, "*The Substantive Law of the EU: The four freedoms"*, 3rd Edition, Oxford University Press, 2010, page 51.

[89] Council Regulation (EEC) No 2913/92 of 12 October 1992.

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

[91] 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 Ben Terra and Peter Wattel, *"European Tax Law", op. cit.,* page 329.

[92] 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 Andrew Guzman, Joost Pauwelyn, *"International Trade Law"*, page 167.

3. Tax Aids

Even though this topic was debated in detail above, the present Part would not be complete without a reference to the distorting aids (or subsidies) in particular, the ones that are granted through the tax system. Selective tax aids may be particularly distortive.

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. Sometimes governments grant public money through the tax system (tax exemptions, tax allowances, tax deferrals…) to companies that do not prosecute activities of public interest or, even though they do it, 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 always as possible from a competition policy perspective to avoid distortions of the level playing field.

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 exportation of national products it is distorting competition and international trade. This measure allows such company to sell its products at lower prices and places it in a situation of comparative advantage over its competitors (either nationals or foreigners), 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 for always involving a transfer of state resources by public authorities, even though indirectly, considering that it represents 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 (see Part I, sections 5.5 and 5.6).

Provided that 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.[93]

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[94] as well as by the 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 the Apple's subsidiary based in Ireland, whereas the normal corporate income tax in Ireland is 12.5%.[95]

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 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 in favour of 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 decision implies the reestablishment of the situation that

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[93] Rodrigo Maito da Silveira, "Tributação e Concorrência", *op. cit.,* page 219 et seq.

[94] Article 1 of the Agreement on Subsidies and Countervailing Measures.

[95] See Tim Bradshaw, Alex Barker and Vanessa Houlder, *"Apple Hit by Brussels finding over illegal Irish tax deals"*, Financial Times, 28th September 2014, available at http://www.ft.com/intl/cms/s/0/ae979ad0-4708-11e4-8c50-00144feab7de.html#axzz3TuUWGZ5S

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 recover unlawful state aid are limited to a period of ten years) and the respective interests.

Based on as well as in section 5 of the previous Part, one must conclude that tax aids represent another situation where taxes can be a serious foe of competition, making the competition 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, damaging the average European citizen in the long run due to the problems that the reduction of competition involves.

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 create significant obstacles at various levels to competition.

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".[96]

One company that is allowed to satisfy one specific tax obligation in one year is certainly in advantage facing a company that it 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

[96] Ben Terra and Peter Wattel, *"European Tax Law", op. cit.,* page 21.

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 distorts 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,[97] the truth is that the Directive[98] giving application to such provision is not stringent enough to effectively coordinate the application of excise duties on gasoline. Due to the high dependence of 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 increasing the price of gasoline in Portugal in 13.7% (€0.19 per litre) when compared to the neighbouring country Spain. This makes very difficult for Portuguese companies whose economic activity highly depends of gasoline to be as efficient and competitive as their neighbour 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. So considering a company that performs an economic activity in all Member States, it must be aware of the specificities of each of the 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.[99] As a consequence, the lack of tax coordination makes EU-based companies less efficient and less competitive. The adoption of common standards

[97] 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".

[98] Council Directive 2008/118/EC of 16 December 2008.

[99] See Cristoph Spengel and Carsten Wendt, *"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 2007/17, page 8.

applicable across 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.[100] 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 the European citizen.

Therefore, one shall conclude that the lack of tax coordination in the internal market represents a strong obstacle for competition. On 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 purposes of the EU competition policy.

5. The Impossibility of Cross-Border Relief

The impossibility of cross-border relief constitutes another situation where taxes act against competition. Under the current European regulatory framework, cross-border relief for losses incurred by associated companies located in different Member States is not allowed. In other words, one group of companies exercising activities across the internal market is not allowed to consolidate their profits and losses. Each affiliated company of a group is taxed separately by the country in which it operates (the so-called, separate-accounting allocation method).

[100] Memo/11/171 Questions and Answers on the CCCTB, Brussels, March 2011 available at http://europa.eu/rapid/press-release_MEMO-11-171_en.htm?locale=en [02/03/2015] page 6.

As a consequence, if the group's losses in one Member State are superior to all its profits made elsewhere in the EU, the group still has to pay taxes in the Member States where profits were made.[101] Thus, the tax burden that one group of companies has to support can be much superior than it was suppose in a market without internal borders. For that reason, groups of companies see their economic efficiency restricted, which makes them less competitive.

The most important case regarding the impossibility of cross-border relief is the already referred *Marks & Spencer* case.[102] As the ECJ noted in this case, the impossibility of offsetting profits and losses goes against the ideals of the internal market. In a market without internal borders as the internal market is supposed to be it would be important to find a solution where consolidation was allowed, recognising the cross-border activities of European firms across the EU territory.[103]

Moreover, the impossibility of cross-border relief also translates into the need for the expensive transfer pricing system that is currently in place. The goal of the current transfer pricing system is to prevent that companies shift their profits between Member States through intra-group transfers with the purpose of reducing their taxable profits. Thus, 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.

The transfer pricing system is very complex and costly because companies are required to demonstrate that they established their transfer prices on an arm's length basis by supplying documentary proof, which also reduces their economic efficiency and competitiveness in the internal market.[104] If groups of companies were allowed to consolidate their profits and losses, they would not need to transfer their profits, meaning that the transfer pricing system would not be necessary and European firms would have less compliance costs, resulting in more economic efficiency and competitiveness.

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[101] Memo/11/171, Questions and Answers on the CCCTB, Brussels, March 2011 available at http://europa.eu/rapid/press-release_MEMO-11-171_en.htm?locale=en [02/03/2015] page 3.
[102] Case C-446/03, Judgment of the Court (Grand Chamber) of 13 December 2005, Marks & Spencer plc v. David Halsey (Her Majesty's Inspector of Taxes).
[103] Today there is one proposal in that sense, the Common Consolidated Corporate Tax Base.
[104] For further developments see Cristoph Spengel and Carsten Wendt, *"A Common Consolidated Corporate Tax Base for Multinational Companies in the European Union: some issues and options"*, *op. cit.,* page 8.

In summary, the separate-accounting allocation method that is currently in place is also a foe of competition. Firstly because groups of companies pay more taxes than it was supposed in a single market due to the impossibility of cross-border relief, reducing their economic efficiency and competitiveness in the internal market. Then again, this same impossibility of cross-border relief leads to the necessity of the transfer pricing system, implying substantial costs for companies fulfilling their tax obligations and making them less competitive and less efficient. Therefore, we may conclude that the impossibility of cross-border relief creates significant obstacles from a competition policy perspective.

6. The Re-registration Process of Cars

The automotive industry is another situation that illustrates the fact that taxes may be a serious obstacle for competition in the internal market. Under the existing legal framework there are major administrative and tax restrictions on the automotive industry that affect competition and go against the ideals of the internal market. The current regulatory framework does not allow moving permanently one car from one Member State to another without having to pass by a costly process of re-registration and the respective payment of a tax. This situation comprises substantial problems.[105]

First of all, it implicates double taxation because the car which has already paid one tax to be registered when it was originally bought has to pay another tax to be registered again in another Member State.

The second problem relates to the complex administrative procedure that this process involves. The financial cost of dealing with the competent administrative authorities is highly significant, and these extra costs should not exist in a market without internal borders.

Thirdly, the re-registration process of cars moving from one Member State to another represents an unjustified restriction of the free movement of goods. This process harms cars sellers, which see the free movement of their products restricted. From a competition policy perspective, as Mario Monti notes, the re-registration process

[105] See Mario Monti, *"A New Strategy for the Single Market"*, *op. cit.,* page 40.

prevents the car industry from fully exploiting economies of scale, because trade in the automotive industry is not as free as it was supposed to.[106] Market participants of the automotive industry see their efficiency restricted by the registration tax. And this restriction of competition cannot be justified by reasons of public interest because it will not bring any benefit for the European citizen. Quite the opposite, the re-registration process harms the European citizens because it implies extra-costs for who intends to buy one car in another Member State, preventing them from exploiting the advantages of the internal market.

Additionally, the re-registration process of cars increases the unfair conditions of competition, driving companies to comparative different situations. For instance, a Portuguese trucking company wishing to upgrade its automotive fleet by buying a (usually more cheap) truck in Germany has to pass through the costly process of re-registering the truck in Portugal, whereas if a German competitor buys the exact same car it does not have to support such burden. This puts the two companies of the same single market in different conditions, which results in unjustified distortions of competition.

As Terra and Wattel note, in addition to the re-registration tax, systems of vehicle taxation highly differentiated cause the same problems from a free movement of goods perspective[107] as well as from a competition policy perspective. For that reason, approximation of vehicle taxes should also be encouraged.

Thus, we must conclude that the re-registration process of cars moving permanently from one Member State to another is another situation where taxes distort competition. This process distorts competition in the automotive industry, because it restricts free trade of automobiles in the internal market, preventing car sellers from totally exploiting the economies of scale. In the author's opinion, the re-registration process of cars is one custom duty disguised or at least a charge having an equivalent effect to a custom duty, which, as previously noted, is prohibited by Article 30 of the TFEU (see section 2). Hence, the re-registration process of cars represents an obvious breach of the basic EU law rules. On the other hand, the re-registration process of cars results in the imposition of different costs on actors of the internal market, particularly

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[106] Ibid.

[107] Ben Terra and Peter Wattel, *"European Tax Law", op. cit.,* page 448.

on those whose economic activities highly depends of an automotive fleet, making the conditions of competition unfair.

7. 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 one problem that does not only affect the EU Member States, but all countries in the world.[108]

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

Taxes are not the first factor that companies consider when deciding to establish a new business. In a preliminary phase, companies attribute more importance to other factors, such as, the market characteristics (market structure, number of potential consumers and latest statistical data relating to the economic growth of such market), political and social issues (such as, the regulatory framework, political stability, labour costs and education levels) as well as geographical location (access to appropriate infrastructures, climate, etc.).[109]

Nevertheless, after considering these preliminary issues, taxes appear right next on the list of factors that companies value the most when deciding to establish a new business.[110] Thus, if one company finds two countries that grant the preliminary issues in the same terms, such company will opt to establish its business in the country that confers a more favourable tax regime.

In the European Union Member States are generally able to grant access to similar preliminary conditions, so tax issues assume particular relevance in the

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[108] See Wolfgang Schön, *"Tax Competition in Europe - General Report"*, Max Planck Institute, page 38.
[109] See Patricia Lampreave, *"Fiscal Competitiveness versus Harmful Tax Competition in the European Union", op. cit.*
[110] Ibid.

companies' choice. Due to single market integration, the economies of the EU have become more and more integrated, which translates into a satisfactory convergence between the 28 Member States concerning political and social questions. In consequence, when companies are facing decisions of establishing new businesses in the internal market, taxes are a factor that assumes particular importance.

Globalisation and the consequent reduction of barriers to trade, especially in the EU due to the fundamental freedoms, have increased firms' availability to establish their businesses in low tax jurisdictions. Being aware of that availability 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.[111] 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 as 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.[112]

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.[113] This measure has a negative effect as it is a waste of public fiscal revenues as well as it

[111] OECD Forum on Harmful Tax Practices, page 13.
[112] See William W. Bratton and Joseph A. McCahery, *"Tax Coordination and Tax Competition in the European Union: Evaluating the Code of Conduct on Business Taxation"*, page 680.
[113] See Aleksandra Bal, *"Tax Incentives: III-Advised Tax Policy or Growth Catalyst?"*, IBFD, European Taxation, February/March 2014, page 64.

will result in a reduction of the social welfare. Further, this behaviour may originate a vicious cycle where countries grant tax benefits just to accompany their neighbours in hope to not lose capital in their favour, which may lead to a "fiscal degradation" and a "race to the bottom" where the bottom is the critical point in which the costs 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.[114]

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.[115] 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

[114] See João Sérgio Ribeiro, *"Distributive Justice Through Taxation: European Perspective"*, Jurisprudencija, 2006, page 87.
[115] See the OECD Forum on Harmful Tax Practices, page 9.

reduces legal certainty and transparency.[116] The lack of legal certainty is prejudicial for businesses since companies do not know in 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.

Finally, harmful tax competition affects international trade in the sense that, as tax benefits are designed to attract foreign direct investment, they strongly affect the allocation of mobile factors across the globe.[117] Therefore, there is the risk of a large share of the most mobile factors, especially capital, be concentrated in a small number of jurisdictions. This is prejudicial from a perspective of competition policy because, if the majority of capital is concentrated in the hands of few entities, they might be able to reduce competition, misbalancing the adequate and fair distribution of capital across the globe.

In conclusion, harmful tax competition is a serious problem from a competition policy perspective, as it affects the level playing field, the international trade, and the States' budgets, 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 pass through the creation of rules coordinating the grant of tax benefits in the internal market.

As this problem does not only affect EU Member States, but also all countries in the world, many attempts have been made to solve this problem by the several international organisms. Amongst the organisms that sought to provide solutions for this problem, the OECD is the one that has devoted the most serious efforts. The OECD started the debate in 1998 through the Forum on Harmful Tax Practices.[118] Several reports were issued from this Forum and the consequence was the elimination of numerous harmful tax measures.[119] In the European context there was an attempt to solve the problem of harmful tax competition, involving the creation of the Code of

[116] See Aleksandra Bal, *"Tax Incentives: III-Advised Tax Policy or Growth Catalyst?", op. cit.*, page 65.
[117] See the OECD Forum on Harmful Tax Practices, page 56.
[118] OECD, *"Harmful tax competition: an emerging issue"*, available at http://www.oecd.org/tax/transparency/44430243.pdf [05/12/2014].
[119] The OECD identified 47 "potentially harmful regimes" and of those 47 "potentially harmful" regimes, 19 were abolished, 14 were amended to remove their potentially harmful measures, 13 were found not to be harmful and only one was found to be harmful. http://www.oecd.org/ctp/harmful/committeeonfiscalaffairsreleasesoutcomeofreviewofpreferentialtaxregimesinoecdcountries.htm [08/12/2014].

Conduct for Business Taxation, a soft law instrument that also allowed identifying and eliminating several harmful tax measures in the internal market. Nevertheless, tax competition continues to exist in the internal market and additional efforts should be made.

8. Exit Taxes

According to Diana Silva, exit taxes are pecuniary contributions required, either to individuals or legal entities that transfer their residence from the home State to the host State.[120] Exit taxes can thus be levied on both individuals and legal entities, however, only the latter will be focused on this essay.

When there is a transfer or residence of legal entities from the home State to the host State, the home State will lose the power to tax the income generated during the period of residence in its territory. Thus, in order to preserve the latent tax revenue, the home States charge exit taxes, which aim taxing that income, ensuring the tax revenue that the home State hoped to receive.[121]

The problem is that the rules on exit taxation frequently set a less favourable treatment for the entities that transfer their residence to the host State when compared to the ones that stay in the home State. In order to dissuade companies from re-establishing their businesses, the home State usually levies disproportionate taxes. Thus, exit taxes have a strong dissuasive effect and restrict the freedom of establishment foreseen in the TFEU.[122]

With this biased treatment for the entities that transfer their residence to the host State when compared to the ones that stay in the home State, exit taxes make competition unfair. Companies re-establishing their businesses into other jurisdiction have to support extra-costs when compared to their competitors that stay in the home State. Thus, exit taxes distort competition. Additionally, exit taxes prevent European firms from fully exploiting the advantages that the internal market is supposed to

[120] Diana Silva, *"Impostos de Saída: Fundamento e Limites"*, Escola de Direito da Universidade do Minho, page 21.
[121] Ibid. page 69.
[122] Ibid., page 131.

confer. Exit taxes dissuade companies to re-establish their businesses in jurisdictions that confer more favourable conditions (political, social, geographical, etc.) for the development of their economic activities, preventing them to become more competitive. Hence, exit taxes reduce competition in the internal market, being a foe.

Therefore, one can conclude that exit taxation represents another situation where taxes act against the main goals of competition policy. This is one problem that derives from tax competition. In order to avoid losing capital to their neighbours, Member States usually seek to dissuade companies from re-establishing their businesses by charging heavy taxes. As a consequence, exit taxes go against the main purposes of EU competition law. Firstly, exit taxes imply unfair competition, because they make companies that want to re-establish their businesses have to support extra-costs when compared to their competitors that remain in the home State. On the other hand, by dissuading European firms from re-establishing their businesses in the jurisdictions that could grant more favourable conditions for the development of their economic activities, exit taxes prevent European firms from being entirely competitive, reducing competition in the internal market.

9. Base Erosion Profit Shifting and Tax Aid Cases

Currently, there are more than a few cases under the 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,[123] in order to minimise their tax obligations and consequently obtain a comparative advantage over their competitors.

Only recently, however, these cases have received proper attention by the competent authorities, much as a result of the financial crisis lived in the EU, which

[123] See Sabina Örberg, *"Tax Planning with Holding Companies for US Investors in Europe - A Comparative Study of Holding Regimes in Sweden and Switzerland"*, Lund University, 2013, pages 5 et seq.

increased the need for Member States to consolidate their budgets. Recent investigations made by the International Consortium of Investigative Journalist also drawn attention by leaking a vast number of documents that prove that Member States of the European Union like the 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, affecting thus competition.[124]

Multinational companies have established their international headquarters in Member States of the EU that confer a much more favourable corporate income tax when compared than their original country. The 12.5% corporate income tax applicable in Ireland, for instance, is much more attractive than the 35% corporate income tax rate applied in the US.[125]

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 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.[126] By evading taxes, these companies reduce their normal costs and obtain an unfair advantage over their competitors that adequately satisfy their tax obligations.

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[124] BMR Advisors, *"Base Erosion and Profit Shifting ("BEPS") – Intangibles"*.

[125] See Sabina Örberg, *"Tax Planning with Holding Companies for US Investors in Europe - A Comparative Study of Holding Regimes in Sweden and Switzerland"*, *op. cit.*, page 5.

[126] OECD Action Plan on Base Erosion and Profit Shifting, page 10.

The UK and France are the Member States that have revealed more 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 preventing the losses of the UK tax revenues caused by the aggressive tax planning practiced by such multinational companies, by targeting intra-group payments.[127]

While this aggressive tax planning can be disapproved 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.[128] 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 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 received more 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 the Commission state aid investigation 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

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[127] Nicholas Winning, *"U.K. Details 'Google Tax' Plans"*, Wall Street Journal, 10th December 2014, available at http://www.wsj.com/articles/u-k-details-google-tax-plans-1418239699.

[128] See Sabina Örberg, *"Tax Planning with Holding Companies for US Investors in Europe - A Comparative Study of Holding Regimes in Sweden and Switzerland"*, *op. cit.*, page 6. For further developments see also Raffaele Russo, *"Fundamentals of International Tax Planning"*, IBFD, Amsterdam, 2007, pages 55 et seq.

advantage to the latter. As it was noted earlier, 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.[129] 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 celebrates the transfer pricing agreement.[130] The taxes paid by such companies are thus much lower than 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 practice 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 practice under EU state aid rules to cover all Member States. The Commission will ask Member States to provide detailed information about their tax rulings practice, 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.[131]

The fact the current President of the European Commission, Jean Claude Juncker, was the responsible for the numerous tax rulings provided by the Luxembourg during the last two decades, however, raised some suspicious about the European

[129] See Covington & Burling LLP, *"European State Aid and Investigations into Tax Rulings"*, available at http://www.cov.com/files/Publication/ec609066-95f4-4933-ac9e-d45a12d1d60e/Presentation/PublicationAttachment/68adacee-8813-4124-99db-d493494263f6/European_State_Aid_and_Investigations_into_Tax_Rulings.pdf [04/01/2015], pages 1 et seq.

[130] Ibid.

[131] European Commission Press release available at http://europa.eu/rapid/press-release_IP-14-2742_en.htm [05/01/2015].

Commission integrity to really solve this problem. Further developments to maintain the level playing field are expected.[132]

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 IV.

10. Interim Conclusions

This second Part of the study clearly states how taxes can be a strong foe of competition. Taxes are a tool that governments have at their disposal to influence the market participants' behaviour.

In some cases taxes can be used to protect certain domestic companies, as it is the case of custom duties and tax aids. The downside of these taxes is that they may severely restrict competition and international trade. Therefore, the use of these two instruments is rigorously regulated both at WTO and EU levels in order to avoid their harmful effects.

[132] 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.[132] 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 Press release available at http://europa.eu/rapid/press-release_IP-14-1073_en.htm [05/01/2015].

Conversely, most of the remaining situations analysed here, like the application of different tax rules throughout the internal market, the impossibility of cross-border relief, the harmful tax competition, exit taxes and the aggressive tax planning that results in base erosion and profit shifting are issues that are not adequately regulated at EU level and significantly affect competition. In all these cases, taxes act as a serious foe of competition, preventing the achievement of some of the most important goals of competition policy. All these situations exist due to the lack of political consensus in the European Union regarding the coordination of national tax provisions.

Therefore, a major political effort must be made in order to achieve some coordination on direct taxation. Otherwise, taxes will continue to represent a strong obstacle to competition in the internal market, harming European companies, the European economy and ultimately the European society. All the efforts should be concentrated in the adoption of new solutions that can change the legal *status quo*. However, it is important to bear in mind that the success of such solutions will require a strong political commitment.

Even at national level, each Member State can individually implement measures that contribute to reduce the obstacles that taxes imply on competition. The core examples would be the elimination of national provisions imposing the re-registration process of cars and the end of individual tax rulings in favour of certain companies. The elimination of the re-registration process of cars would immediately increase competition in the automotive industry. On the other and, the end of individual tax rulings in favour of multinational companies would contribute to balance the level playing field in the internal market. None of these measures is dependent of the unanimity rule or of any political consensus.

There are numerous situations where taxes are a foe and a strong obstacle from a competition policy perspective. The European economy demands a shift where taxes are not responsible for making its companies so less competitive, efficient and innovative on one hand, and where equality of conditions of competition is fostered. Accordingly, in the last Part of this essay the author will indicate the path that in his opinion should be pursued in order to correct the situations where taxes constitute an obstacle for competition. The obstacles that taxes represent for competition can and should be reduced.

PART III

TAXES AS AN ALLY OF COMPETITION

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1. General Context

This third 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 elaborated analysis is necessary to find situations where taxes act as an ally. Still, throughout this third Part the author will show some evidences of how taxes must not always be considered a foe of competition, as sometimes they are truly 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 their disposal to satisfy the main purposes of competition policy, specially, 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 overrated.

Taxes can indeed act as a true ally of competition. That is the case, for instance, of taxes that foster competition in monopolistic markets, a well targeted imposition of custom duties, the transfer pricing rules, tax regimes that encourage R&D and innovation (e.g., patent boxes), environmental taxes and taxes that stimulate the creation of new jobs. 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 the VAT coordination brought. 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 really 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.

2. Taxes That Foster Competition in Monopolistic Markets

Taxes that foster competition in monopolistic markets are a good example that taxes can be a valuable ally of competition. The equivalent term used for monopoly in EU competition law is dominant position. Companies may obtain a dominant position in a given market. According to the ECJ, "the dominant position referred to [in Article 102 of the TFEU] relates to a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by giving it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers".[133]

It should be mentioned that Article 102 covers the dominance of the market by a single firm (monopoly) but also collective dominance, i.e., oligopolistic markets under the head of collective or joint dominance by more than one firm. Dominant position is thus one situation in which one company, or a group of companies acting together, own all or nearly all of the market resulting in the absence of competition. Some indicators that a company has dominant position are the percentage of market share (usually a market share of 50% is synonym of significant market power but this presumption is rebuttable), vertical integration and developed distribution systems, product differentiation, superior technology, the ownership of intellectual property rights, economic performance and previous findings of dominance.

It is important to bear in mind that a dominant position is not forbidden under EU competition law inasmuch as it is not an anti-competitive practice on its own. What is forbidden is the abuse of dominance. Unfair prices (predatory prices or selective price cutting), limited production (reduction of the output to increase the prices above the competitive level), inferior products and exclusion of trading partners (exclusive dealing agreements or refusals to supply) are all examples of practices that characterise an abuse of dominant position.[134] Therefore, the abuse of dominant position creates serious problems for the society.[135]

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[133] Case 27/76, Judgment of the Court, 14 February 1978, United Brands v. European Commission, paragraph 65.

[134] For further developments see Richard Whish and David Bailey, *"Competition Law",* Oxford University Press, 7th Edition, 2012, pages 201 et seq. See also José Ribeiro Brazuna, *"Defesa da Concorrência e Tributação - à luz do Artigo 146-A da Constituição"*, *op. cit.,* pages 95 et seq.

[135] There are several reasons that can prevent other companies from joining the dominated market, such as, the dominant company being protected by the State ,the fact that the dominant company practices

Governments may intervene to prevent free markets from being dominated by one single company. The number of measures available to solve this problem is relatively broad, but keeping in mind the scope of the thesis, the author will only refer the ones that have a tax nature.

Through the tax system, governments can intervene and promote the entrance of new competitors or strengthen the position of small competitors in dominated markets, changing the market structure in order to avoid the harmful effects that the absence of competition in such market has for all market participants.

Taxes can be a really useful tool in the process of adjusting the market structure in accordance with the public interest. For a given market, if 70% of the market share is held by a single company whom abuses of its dominant position, and there are two other companies with 15% of market share each, it can be important from a competition perspective to grant tax incentives to the smaller companies. This measure would promote their efficiency and growth, allowing them to absorb part of the market share of the dominant company. The dominant company would no longer act independently in the market and perform abusive practices that harm other market participants like producers, distributors, sellers and consumers. In this case, the tax system acts as an ally, fostering competition, encouraging the defence of all market participants as well as the correction of a market failure.

There are different tax measures that governments can adopt to prosecute that task such as granting tax exemptions, tax deferrals, tax credits or tax allowances in favour of the smaller companies. In the given example tax allowances would probably be the best measure that one government could adopt because tax allowances are the incentive that better suits small companies. According to the OECD, tax credits are only a good incentive for companies that have major tax liabilities. Since smaller companies in principle do not have significant tax liabilities they may benefit more from the reduction of their tax base (through allowances) than from the reduction of their tax liabilities.[136]

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prices so low that one competitor could not accompany, the lack of access to the necessary resources or even the absence of required licenses.

[136] OECD, *"Tax Incentives for Research and Development: Trends and Issues"*, available at http://www.oecd.org/science/inno/2498389.pdf [04/04/2015], page 28.

It is true that such governmental conduct could be regarded as tax aid in the meaning of Article 107(1) of the TFEU. However, such tax aid would certainly be allowed by the European Commission in the context of the exceptions to the general prohibition of state aid established in Articles 107(2) and 107(3), since such aid would guarantee the satisfaction of the public interest, in particular, the defence of all market participants, including the European citizen.

The present description makes evident that taxes can be a true ally of competition. By fostering competition in monopolistic markets through the tax system, governments can reduce the market power of dominant firms that perform abusive practices, preventing them from acting independently in the market, safeguarding the interest of all market participants. Taxes are indeed an ally of competition.

3. Custom Duties

Without prejudice of what was said in Part II and keeping in mind that the irresponsible use of custom duties might constitute a serious obstacle to competition, they might also perform the role of an ally.

As previously discussed, custom duties are a tool that allows governments to control the flow of goods. Whether 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.

A wise and well targeted imposition of custom duties may have positive effects 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[137] (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 balance competition in the internal market.

[137] 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 Magdalena Bernaciak, in *"Social Dumping and the EU integration process"*, Working Paper 2014.06, European Trade Union Institute.

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.[138] For that reason, it is very difficult for European firms to compete with foreign players that do not obey such standards and aim to sell their products in the internal market. Those external companies do not guarantee the adequate conditions to their workers, so they have lower production costs and can practice extremely low prices. Social dumping results therefore in unfair competition.

To avoid European firms and competition in the internal market being harmed by social dumping, a well targeted imposition of a custom duty on products coming from those external countries is a measure that has a positive impact from an EU competition policy perspective as it can balance competition.

It is true that in that case 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 the social welfare) and simultaneously make them compete with foreign companies that have very low production costs due to social dumping, which results in unfair competition. 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

[138] As a result of the imposition made by Article 153 of the TFEU.

policy perspective. Conversely, the indiscriminate imposition of custom duties on any good that comes from the outside of 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 II (section 2). Thus, we shall conclude that custom duties might also be an ally of competition.

4. The Transfer Pricing Rules

The 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.[139] 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.[140]

Today, the majority of cross border trade that occurs is between related companies, which constitutes a huge concern for tax authorities.[141] Companies frequently use transfer prices as an allocation method. Since the 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.[142]

[139]http://ec.europa.eu/taxation_customs/taxation/company_tax/transfer_pricing/index_en.htm[07/04/2015]

[140] Maria João Maurício, *"Transfer Pricing and the arm's length principle in the European Union law and domestic law",* Escola de Direito da Universidade do Minho, 2013, page 1.

[141] Hubert Hamaekers, *"Arm's length – How long?"*, International Transfer Pricing Journal, 2001, page 39.

[142] http://ec.europa.eu/taxation_customs/taxation/company_tax/transfer_pricing/index_en.htm [07/04/2015]

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 advantage over their competitors. Hence, transfer pricing mechanism is a tool that corporations use in order to avoid high taxation in certain jurisdictions.[143]

The transfer pricing rules that are currently in place appear as a solution to avoid that companies unlawfully reduce their tax obligation and consequently obtain 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.[144] Rules and procedures applicable to transfer pricing are usually found in the domestic law of many countries.[145] By setting the prices to be applied between intra-group transfers and making affiliated enterprises treat themselves as independent, tax administrations avoid that companies allocate their profits to low tax jurisdictions. In other words, the transfer pricing rules ensure that all market actors pay their due taxes, preventing certain companies from shifting their profits to low tax jurisdictions, ensuring fair competition.

Therefore, we can conclude that the transfer pricing system is one ally of competition. By enforcing that all companies pay their rightfully due taxes, it avoids distortions of competition. The transfer pricing rules prevent that certain companies acquire a tax advantage over their competitors by allocating their profits to low tax jurisdictions, ensuring the maintenance of the level playing field in the internal market. Thus, even though the transfer pricing system involves high compliance costs both for EU-based firms and tax administrations, the reality is that it ensures fair competition.

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[143] Maria João Maurício, *"Transfer Pricing and the arm's length principle in the European Union law and domestic law", op. cit.,* page 2.

[144] 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."

[145] In many cases these reflect the OECD Transfer Pricing Guidelines. IBFD, '*International Tax Glossary*', *op. cit.,* page 449.

5. Tax Incentives to Research and Development

Research and Development (R&D) activities can be defined as "creative work undertaken on a systematic basis in order to increase the stock of knowledge, including knowledge of man, culture and society, and the use of this stock of knowledge to devise new applications".[146]

The development of R&D activities is fundamental from a competition policy as it results in more innovation, increased productivity and consequently more competition. Accordingly, Article 179(1) of the TFEU establishes that R&D is one objective of common interest. Further, R&D activities are closely connected with the Europe 2020 strategy,[147] which intends to increase growth in the EU by making it a smart, sustainable and inclusive economy.

However, without governmental actions, the market alone will not invest what is desirable in R&D. The society collects significant benefits from R&D activities even though it is the company investing in R&D that has to support all the costs involved. These spill-over effects make companies reluctant to invest in R&D activities because the company has to support alone all the costs associated to R&D, whereas the society collects the major benefits.[148] In spite of companies investing in R&D can expect to collect some benefits (such as lower production costs and increased revenues) private investors are reluctant to invest in R&D, particularly when there is uncertainty about the success of such investments.[149]

Ergo, in the absence of governmental actions, the level of investment in R&D is below what is desirable, resulting in less innovation and less competition. To correct this market failure, governments had to find solutions. One of the most efficient solutions is to encourage the investment in R&D activities through the tax system. By relieving the tax liability of undertakings developing R&D activities, governments

[146] OECD, Frascati Manual, Proposed Standard Practive for Surveys on Research and Experimental Development, 2002, available at http://www.tubitak.gov.tr/tubitak_content_files/BTYPD/kilavuzlar/Frascati.pdf [3/10/2014], page 30.
[147] Available at http://ec.europa.eu/eu2020/pdf/COMPLET%20EN%20BARROSO%20%20%20007%20-%20Europe%202020%20-%20EN%20version.pdf [1/102014].
[148] See Aleksandra Bal and René Offermanns, *"R&D Tax Incentives in Europe"*, *op. cit.*, page 167.
[149] European Commission, Competition Policy Brief, *"Supporting R&D and innovation in Europe: new State aid rules"*, available at http://ec.europa.eu/competition/publications/cpb/2014/005_en.pdf [04/04/2015], page 2.

stimulate them to keep investing in R&D, which results in more competition, innovation, better products, increased efficiency and more jobs, some of the most important goals of the competition policy.

One strategy adopted by several Member States of the European Union is the patent box. The patent box, also known as innovation box, is a special tax regime that stimulates R&D offering a substantially reduced corporate tax for income derived from patents and other forms of intellectual properties.[150] This way, patent boxes stimulate competition and innovation, being a true ally of competition.

Belgium, Cyprus, France, Hungary, Liechtenstein, Luxembourg, Malta, the Netherlands, Portugal, Spain and the United Kingdom are some of the Member States that created patent boxes. It is possible to find some differences between country practices. Some exempt part of the income or allow for a notional deduction of part of the IP income, whereas others explicitly stipulate a separate tax rate for IP income.[151] But in spite of the differences, the reality is that all of them grant a tax break to intellectual property revenues, stimulating innovation and competition in the internal market.

Therefore, one must conclude that taxes can be indeed a valuable ally to stimulate R&D and consequently competition and innovation in the internal market. The patent boxes that are currently in force are one excellent example of that. By offering substantially reduced corporate tax for income derived from R&D, patents and other forms of intellectual property rights, governments stimulate competition and innovation, which proves that taxes may be an ally of competition.

6. Tax Benefits for the Creation of Jobs

The financial crisis lived in the EU during the last years increased substantially the unemployment rates in several Member States.[152] High unemployment rates are against the main purposes of competition policy because they make national economies

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[150] Lisa Evers, Helen Miller, and Christoph Spengel, "Intellectual Property Box Regimes: Effective Tax Rates and Tax Policy Considerations", Centre for European Economic Research, Discussion Paper No. 13-070, November 2013, page 1.
[151] Ibid. Page 6.
[152] Especially in Cyprus, Croatia, Italy, Greece, Portugal, Slovakia and Spain.

weaker, reducing competitiveness, efficiency and innovation. Thus, the creation of new jobs is now one of the top priorities of the European competition policy.

Recently, the European Commission announced a €315 billion Investment Plan to be applied in the 2015-2017 period, aiming to get Europe growing and get more people employed.[153] This plan is expected to create 1.3 million jobs in the internal market, fostering competition and innovation. The money is supposed to be invested in strategic areas for Europe like, energy, transport, broadband, education, research and innovation. Tax benefits may play a key role in the execution of this project as they may be used as a channel to inject financial resources in the economy.

The grant of tax benefits is probably the most efficient and transparent way to channel the investment into the economy. Such tax benefits however must be carefully designed to avoid undue distortions of competition by ensuring that they are granted in the most transparent and equitable way possible.

Tax benefits for the creation of new businesses and for companies hiring new employees are suitable incentives to reduce the unemployment rates across the EU and consequently increase productivity, efficiency and competition in the internal market. In fact, the receivers of those tax benefits may get a selective economic advantage over their competitors within the meaning of Article 107(1), but this tax aid can be justified by reasons of public interest. A judgement of proportionality will lead us to the conclusion that the positive effects of this governmental intervention (creation of new jobs, increased productivity, competitiveness and innovation in the internal market as well as the development of strategic areas for Europe like, energy, transport, broadband, education, research and innovation) outweigh the negative effects (affecting free competition). Such tax aid would certainly fall within the exceptions to the general prohibition of state aid foreseen on Article 107(2) and 107(3).

To sum up, the tax system can be a very useful tool to put the new Investment Plan in practice. Granting tax reliefs, such as tax exemptions or tax allowances, in favour of companies hiring new employees is an efficient way to channel the money of

[153] See the 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 final available at http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52014DC0903&from=EN [14/01/2015]

the Investment Plan. Therefore, there is no doubt that in this case the tax system can also act as a true ally of competition, contributing to create more jobs and consequently making the European economy more dynamic, efficient, competitive and innovative, some of the fundamental aims of competition policy.

7. Environmental Taxes

Environmental taxes represent another situation where taxes can act as an ally of competition. Firstly, environmental taxes can balance competition in the internal market by eliminating an unfair comparative advantage that certain external competitors have when compared to European firms. On the other hand, environmental taxes help attain the ultimate purpose of competition policy, the society welfare, through the correction of a market failure.

Primarily, 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.[154] 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 confers 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,

[154] Article 3.3 of the TEU.

there is a valid reason to protect European firms because, whereas they have to support the natural costs of protecting the environment, their external competitors play under different rules that allow them to reduce their production costs. As this competitive advantage is totally unfair from an EU competition policy perspective, it is adequate to increase the price of goods coming from those external countries through environmental taxes, ensuring that European firms are not harmed by environmental dumping.

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 dumping. Therefore, there is no doubt that in this case taxes are a true ally of competition because they guarantee that the competition in the internal market is not distorted by the environmental dumping practiced outside the EU, ensuring the maintenance of the level playing field.

On the other hand, environmental taxes can help attaining the ultimate purpose of competition policy, the society welfare, through the correction of a market failure. By taxing the emission of carbon dioxide, giving application to the polluter pays principle, environmental taxes correct a market failure because in the absence of such tax, the polluter would impose a cost on the society (the detriment of the environment) and would not pay for it.[155]

In addition to taxing environmentally harmful actions, the tax system can also be used to encourage environmentally beneficial actions. For instance, the grant of a tax benefit in favour of electric car producers is a measure that has a positive impact because it protects the environment and additionally stimulates innovation in the automotive industry.

In conclusion, environmental taxes are a strong ally of competition. First and most importantly, they guarantee the maintenance of the level playing field in the internal market by ensuring that European firms are not harmed by the environmental dumping practiced by their external competitors. On the other hand, environmental taxes help attain the ultimate purpose of competition policy that is the society welfare, through the correction of a market failure. Additionally, environmental taxes can stimulate (green) innovation, which is another important purpose of competition policy.

[155] OECD, *"Environmental Taxation: A Guide for Policy Makers"*, available at http://www.oecd.org/env/tools-evaluation/48164926.pdf [15/01/2015], page 2.

For all these reasons, one must conclude that environmental taxes are a true ally of competition.

8. Excise Duties on Alcoholic Beverages and Tobacco

Excise duties on alcoholic beverages and tobacco deserve a special mention because their effects are controversial. There is no consensus among specialists about whether excise duties on alcohol and tobacco have a positive or negative impact. Even though excise duties are not a pure ally of competition, because they do not foster competition, the truth is that these excise duties are in line with the ultimate purpose of competition policy, inasmuch as they correct a market failure.

Excise duties are taxes that increase the original price of the respective goods. As a consequence, excise duties on alcoholic beverages and tobacco modify the natural consumer behaviour, discouraging the purchase of such goods. Some authors consider that excise duties have a negative impact because they interfere with the normal balance of the market, affecting the law of supply and demand in the industries of alcoholic beverages and tobacco.

The author, however, does not think that excise duties represent an undue distortion of competition. It is true that excise duties on alcoholic beverages and tobacco affect the freedom of the market in the respective industries. Still, such restriction of competition shall not be regarded as negative if we think either from a legal or from a social perspective.

The consumption of alcohol and tobacco creates a negative externality because it originates harmful effects for public health. In the absence of excise duties on alcohol and tobacco there would be a market failure because the consumers of these goods would be able to impose a cost on the society (reducing public health) without having to pay for it. Thus, excise duties serve to correct this market failure and safeguard the society welfare, the ultimate goal of competition policy.

Furthermore, it is convenient to note that the imposition of excise duties on alcoholic beverages and tobacco is coordinated at European level.[156] Article 113 of the TEU establishes indirect taxes in the European Union, including excise duties, shall be harmonised in order to avoid distortions of competition. Thus, in 1992 the EU adopted the Horizontal Directive,[157] which coordinates the application of excise duties on alcoholic beverages and tobacco in the internal market, preventing substantial modifications of the prices of these goods.

Even though excise duties on alcohol and tobacco affect free competition and the supply and demand of the respective goods, one must conclude that they are totally in line with the ultimate purpose of EU competition law, in particular, the correction of a market failure in accordance with the public interest. Excise duties on alcohol and tobacco are expected to reduce the negative effects that the consumption of these goods creates for the society in general. Therefore, even though these excise duties are not a pure ally of competition, they are not a foe inasmuch as they are in line with the ultimate purpose of competition policy.

9. The VAT Coordination

As it was previously referred (Part I, section 6), 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 Indirect taxation is the exception to that rule.[158] 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" (emphasis added). Thus, indirect taxation is the one of the few areas of European tax law that can be characterised by a satisfactory degree of

[156] Catherine Barnard, "*The Substantive Law of the EU: The four freedoms", op. cit.,* page 55.
[157] Directive 92/12/EEC.
[158] See João Sérgio Ribeiro, *"Distributive Justice Through Taxation: European Perspective"*, *op. cit.,* page 82.

coordination[159] 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 granting that all of them are subject to the same tax burdens we can say that taxes do not affect competition. Thence VAT coordination being a good example that taxation in the internal market does not have to be a synonym of distortions of 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.[160] In other words, the most important aspects of indirect taxation are properly coordinated in legally binding instruments. It should be noted that this also means that EU Member States already do not have total fiscal sovereignty.

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 coordination is fundamental from a competition policy perspective because indirect taxes may be a more visible obstacle to competition than direct taxes. 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 imposition 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

[159] See Gaëtan Nicodème, "Corporate tax competition and coordination in the European Union: What do we know? Where do we stand?", *op. cit.,* page 10.
[160] See Ben Terra and Peter Wattel, *"European Tax Law", op. cit.,* page 9.

State.[161] For that reason, VAT coordination is extremely positive from a competition policy perspective.

Corporate income taxation is equally important to make competition fairer. As it has been described above, the lack of tax coordination in the internal market, especially in what concerns the corporate income tax, is one of the factors that contribute most for the existence distortions of competition. Thus, in the author's opinion the achievements on VAT coordination should function as an inspiration for direct taxation.

Even though up to date it was not possible to reach significant agreements about direct taxation, this is an indispensable step to ensure the maintenance of the level playing field in the internal market. It is well known that it is not possible to achieve full tax harmonisation immediately,[162] especially in what concerns the applicable tax rates, but there are other aspects that should be coordinated to promote fair conditions of competition in the internal market, such as administrative and accounting rules.

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. Thus, the VAT coordination shows that taxation in the internal market does not have necessarily to be a synonym of distortions of competition.

10. Interim Conclusions

The analysis made so far shows that taxes shall not only be regarded as a foe of competition. Throughout this Part several situations were presented where taxes

[161] 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 II, section 3). This situation is avoided under the VAT system that is currently in force. For further developments see Ben Terra and Peter Wattel, *"European Tax Law", op. cit.,* page 9.

[162] See Gaëtan Nicodème, "Corporate tax competition and coordination in the European Union: What do we know? Where do we stand?", *op. cit.,* page 8.

perform the role of a true ally, helping attain some of the most important goals of competition policy.

Firstly, it was observed that taxes can play a decisive role in stimulating competition in monopolistic markets, helping to prevent the harmful effects that an abuse of dominant position can originate for all market participants.

Then it was seen that a precise imposition of custom duties might be fundamental to avoid the harmful effects that the social dumping practiced outside the internal market can originate from an EU competition policy perspective. The imposition of custom duties on goods coming from those countries is vital to eliminate the unfair advantage that foreign companies have over European companies.

It was also discussed how the transfer pricing rules currently in force are fundamental to ensure fair competition, preventing that certain market participants acquire an unfair advantage over their competitors by reducing their tax obligations through the allocation of their profits to low tax jurisdictions.

Fourthly, it was concluded that taxes are an essential tool in making the European economy more prosperous, competitive, innovative and efficient, whether it is through the stimulation of R&D activities like the patent box regimes or through the creation of new jobs.

It was also noted that environmental taxes can play a key role to avoid the harmful effects that the environmental dumping practiced outside the internal market may originate from an EU competition policy perspective. Charging environmental taxes on goods coming from those countries is essential to eliminate the unfair advantage that foreign companies have over European companies. Furthermore, by protecting the environment, environmental taxes help to achieve the ultimate purpose of competition policy, the society welfare and stimulate (green) innovation.

Finally, we observed that even though excise duties on alcoholic beverages and tobacco are frequently pointed out as having a negative impact, they truly are in line with the ultimate purpose of competition policy inasmuch as they correct a market failure in accordance with the public interest and for that reason they cannot be considered a foe of competition.

With the exception of excise duties, all the remaining situations analysed throughout this Part show that taxes foster competition, ensure the maintenance of the level playing field, protect market participants and correct serious market failures, some of the most important goals of competition law. Accordingly, one shall conclude that taxes can be a true ally of competition.

As a final point, it was stressed how VAT coordination is an excellent example that taxation in the internal market does not have to be a synonym of obstacles to competition. Tax coordination ensures that European companies compete under more homogeneous conditions, which is fundamental to maintain the level playing field in the internal market. In the author's opinion VAT coordination should function as an inspiration for the challenges that direct taxation is currently facing, especially corporate taxation, which requires an urgent shift.

PART IV

CONCLUSIONS AND RECOMMENDATIONS

PART IV - CONCLUSIONS AND RECOMMENDATIONS

1. General Context

In the present Part the author will analyse what should be done to change the legal *status quo* and remove the obstacles that taxes often imply for competition as well as stand out their positive impact.

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 stand out their positive impact. Accordingly, throughout this last Part of the essay, the author will provide some recommendations in that sense.

As discussed previously, the lack of tax coordination in the internal market is the main cause for taxes being so distortive. The lack of tax coordination 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 turns the competition process really unfair. Furthermore, the lack of tax coordination implies heavy financial costs for companies exercising economic activities throughout the internal market, which makes European firms less efficient and less competitive. For those reasons, the legal *status quo* asks for a shift.

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 homogeneous conditions. The VAT coordination proves that taxation in the internal market does not have to imply distortions of competition. Thus, a high level of tax coordination is the solution to correct the obstacles that taxes frequently imply for competition.

There are some initiatives both at European and international level that 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 II. For that reason, the author will recommend the adoption of additional measures that in his opinion might contribute to correct those obstacles.

Throughout this Part the author will make a critical analysis about what should be done to reduce the obstacles that taxes often bring for competition as well as to stand out the situations in which taxes act as an ally.

This Part is finalized with the main conclusions of this essay.

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 the lack of political willingness that Member States maintain in giving the Union total fiscal sovereignty. Nonetheless the harmonisation of tax rates is not the only thing necessary to foster 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".[163]

According to what was said in Part II (section 4), administrative rules have a significant impact on competition. A company that can meet its tax obligation in a year is in clear comparative advantage over its competitors who have to comply with their tax obligations in just one month. This is because during this period of one year the first company has a certain amount of financial resources that can ensure better market

[163] Ben Terra and Peter Wattel, *"European Tax Law", op. cit.,* page 21.

performance than its competitors. 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 one proposal on the table that aims to coordinate the administrative and accounting rules in the internal market, the Common Consolidated Corporate Tax Base (CCCTB).[164] In the author's perspective this proposal can contribute to correct 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.[165] Thus, the aim of this proposal is independent of the harmonisation of tax rates. It relates only with the administrative and accounting rules, which is also very important to balance competition in the internal market. Allowing European firms the possibility to compete under the same administrative and accounting rules is paramount to make competition fairer. Even if tax rates were fully harmonised, it would still be necessary to coordinate the administrative and accounting rules to achieve fair conditions of competition.

In addition, under the CCCTB proposal groups of companies would be able to consolidate the individual tax bases. The consolidated tax base would then be apportioned between the different Member States through a formula.[166]

Thus, the adoption of the CCCTB can bring significant advantages from a perspective of competition policy. First and foremost, it would make competition fairer because it gives European firms the possibility to compete under the same administrative and accounting rules. In order to ensure the maintenance of the level playing field it is essential to have homogeneous tax rules applicable throughout the

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[164] 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 [04/04/2015].

[165] See João Sérgio Ribeiro, *"Tributação das Sociedades de Acordo com uma Base Comum Consolidada na União Europeia", op. cit.,* page 732.

[166] 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 Maria João Maurício, *"Transfer Pricing and the arm's length principle in the European Union law and domestic law", op. cit.,* pages 64 et seq.

whole internal market. Accordingly, the tax coordination proposed by the CCCTB is fundamental to balance competition.

Additionally, another advantage that the CCCTB would bring from a competition policy perspective is that it would 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 one single set of tax rules and one single tax administration. Thus, the CCCTB would ease the exercise of economic activities in the internal market, meaning that for European firms, particularly SMEs,[167] there would be greater availability to expand their business to other Member States, increasing competition in the internal market.[168]

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

The CCCTB would not only ensure that European firms compete under the same set of administrative and accounting rules, but would also ease the exercise of economic activities throughout the internal market, thus resulting in increased competition and more innovation, two of the most important goals of competition policy. For these reasons, the author argues that the adoption of this system is essential from a competition policy point of view.

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 adopted yet. The main justification is the unanimity rule. The CCCTB proposal needs to be agreed by all Member States in Council. As this is a very sensitive matter no agreement was achieved yet.[169] Still, as stated by Professor

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[167] 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 Memo/11/171 Questions and Answers on the CCCTB, Brussels, March 2011, page 5.

[168] 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 João Sérgio Ribeiro, *"Tributação das Sociedades de Acordo com uma Base Comum Consolidada na União Europeia", op. cit.,* page 733.

[169] Especially in what concerns the apportionment formula.

João Sérgio Ribeiro, given the high advantages of adopting this system, there are great chances of the CCCTB being successfully implemented.[170]

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 reduce the obstacles that taxes often constitute to competition is the OECD action plan on base erosion and profit shifting. For that reason, it also deserves some considerations.

Recently, the OECD published one 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 takes place.[171]

The OECD argues that companies frequently reduce their tax burdens by taking advantages of the different rules in national tax systems. As explained in Part II (section 9), 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 the shifting of income is one huge problem from a competition policy perspective that should be tackled.

In 2012 the G20 leaders declared the necessity to reform the international tax rules in order to combat the erosion of tax bases and the shifting of income and also

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[170] João Sérgio Ribeiro, *"Tributação das Sociedades de Acordo com uma Base Comum Consolidada na União Europeia",* page 733.
[171] OECD Action Plan on Base Erosion and Profit Shifting, page 10.

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 that domestic policies, including tax policies, be designed in isolation.[172] Otherwise, gaps and loopholes in tax legislations will continue to exist, creating room for double non-taxation and distortions of competition. For that reason, it is urgent from a competition policy perspective to reach international tax coordination.

Reaching further tax coordination on 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 much easier for businesses to locate many productive activities in locations that are distant from the physical location of their customers.[173] Multinational companies exercising activities 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.[174] 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 like design new international standards to be adopted in bilateral tax treaties, adopt strict anti-abuse provisions, strengthen the CFC rules,[175] and create one multilateral instrument designed to provide an innovative approach to international tax matters.[176] 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, so as to avoid the harmful effects caused by base erosion and profit shifting.

Thus, the action plan suggests significant modifications on the current principles of international corporate taxation. But drastic measures are required to change the legal *status quo*. Accordingly, the adoption of those measures can prove to be truly efficient

[172] Ibid. page 15.
[173] Ibid. page 7.
[174] See Hosuk Lee-Makyiama and Bert Verschelde, in *"OECD BEPS: Reconciling Global Trade, Taxation Principles and the Digital Economy"*, page 2.
[175] In order to prevent the creation of affiliated non-resident taxpayers and routing the income of a resident enterprise through the non-resident affiliate.
[176] See the OECD Action Plan on Base Erosion and Profit Shifting, pages 13 et seq.

to effectively tackle the erosion of tax bases, the shifting of income and the distortions of competition that it originates.

The OECD action plan let us conclude that it is essential from a perspective of competition policy to reach further international tax coordination. Otherwise, certain multinational companies, especially the ones exercising activities in the digital economy, will continue to resort to complex and artificial tax schemes in order to take advantage of loopholes, shift their profits, reduce their tax burdens and acquire an advantage over their competitors, distorting competition. 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 efforts as they might be really useful to eliminate some of the distortions of competition that the tax systems frequently originate.

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 excel the 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 analysed situations where taxes act as a foe of competition. Thus, the author will make its own recommendations to correct the obstacles that taxes frequently imply for competition.

These recommendations aim to constitute 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 superior. The purpose of these recommendations is to contribute with some fundamental orientations that the author believes that can contribute to change the legal *status quo.*

1. The first and indispensable measure would be the creation of one group of experts specifically responsible for finding solutions to reduce the obstacles that taxes

create for competition. Previous experiences show that the creation of one group of experts in charge for the discussion of specific matters can be a truly proficient mechanism to present important results. That was the case of the Primarolo Group[177], the group of experts formed in 1998 to ensure the administration of the Code of Conduct for Business Taxation. This group, composed by one 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 corporate taxation.[178] The results achieved by this group were remarkable from a tax policy perspective. For that reason, the author suggests that the competent European institutions should create one group of experts specifically responsible for finding adequate solutions to reduce the obstacles that taxes frequently create for competition and excel their positive effects.

2. European politicians should refocus the work of the Code of Conduct for Business Taxation simultaneously with its application. This Code was adopted in 1998 as a soft law instrument and established a set of features that allowed define and eliminate several harmful tax measures.[179] 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

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

[178] See Claudio M. Radaelli, *"The Code of Conduct Against Harmful Tax Competition: Open Method of Coordination in Disguise?",* Public Administration Vol. 81 No. 3, 2013, pages 521 et seq.

[179] 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;
- 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).

income".[180] 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.

3. The harmonisation of the applicable tax rates in the internal market is a measure that would represent a major step to balance 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 the 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 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 applicable in the internal market is 17% and the maximum is 27%. This would not fully take fiscal sovereignty from Member States and would significantly reduce the massive gap and disparity of tax treatments granted throughout the internal market and consequently balance competition.

If such agreement could be reached and there was still ambition for further progress, Member States could additionally agree that over the years, or even decades, this gap should be progressively reduced until corporate income tax rates become fully harmonised, ensuring thus the maintenance of an adequate level playing field in the internal market.

4. The harmonisation of the applicable tax rates would not be sufficient to achieve totally fair conditions of competition and even that harmonisation was accomplished, it would still be necessary to coordinate the administrative and accounting rules in the internal market. For that reason, it is vital to adopt one single set of tax rules applicable throughout the internal market, and that is where the CCCTB proposal can prove to be really useful.

[180] OECD Action Plan on Base Erosion and Profit Shifting, page 17.

5. 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 from the tax aid control exercised by the European Commission due to not meeting the four characteristics of a state aid (see Part I, section 5.5). Thus, the tax aid control is not 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.

6. The re-registration process of cars must be also be abolished by all Member States. The re-registration process of cars represents a clear violation of the basic EU law rules as it hinders the free movement of this good and distorts substantially competition, especially, in the automotive industry. The elimination of this process and of the payment of the respective tax would allow the automotive industry to fully exploit the economies of scale. It is true that the elimination of the re-registration process of cars would represent a loss of tax revenues for certain Member States. However, this is an indispensable measure from a competition policy perspective. For the same reasons, approximation of vehicle taxes should also be encouraged.

7. 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. It is fundamental from a competition policy perspective 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.

8. Exit taxation on legal persons should also be redesigned so that it does not discriminate companies exiting the home State when compared to companies that stay there. This discriminated treatment results in unfair competition. Further, by dissuading

European firms to join the jurisdictions that better suit the exercise of their economic activities (the host State), exit taxes prevent European companies from fully exploiting the advantages of the internal market, making them less competitive. Thus, EU policymakers should redesign exit taxes, removing their dissuasive effect, ensuring that they do not confer a less favourable treatment to companies exiting the home State when compared to companies that stay there, which would simultaneously make competition fairer and foster competition in the internal market.

9. The New Horizontal Directive,[181] which is supposed to coordinate the application of excise duties in the internal market, should be made more stringent. This Directive replaced the already referred 1992 Horizontal Directive, though it does not establish the maximum tax rates applicable. By not establishing the maximum tax rates, the New Horizontal Directive gives room so that distortions of competition continue to exist as it is the case that we have previously analysed regarding excise duties on gasoline (Part II, section 4). Thus, the author proposes that the New Horizontal Directive should be revised and set the maximum tax rates of excise duties applicable in the internal market, increasing tax coordination and reducing distortions of competition.

10. 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 intend to grant are in line with the competition policy aims, avoiding situations where they grant illegal tax aids.

11. The 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.

[181] Council Directive 2008/118/EC of 16 December 2008.

12. The creation of a sub-division inside the European Commission or even of an autonomous with the sole responsibility of controlling the grant of tax aids is another measure that can make the tax aid control more efficient and reduce the distortions of competition that the grant of tax aids frequently originates. One 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 that one single institution can effectively control the grant of all types of state aids. Thus, the creation of one body specifically responsible for controlling just this type of state aid, tax aid, would contribute to make the tax aid control much more efficient and to avoid situations where Member States unduly distort competition through tax aids.

13. Additionally, giving more power to the national competition authorities to control the grant of tax aids can 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 contribute to make the tax aid control more efficient. Accordingly, they should receive more power to collaborate with the European Commission in the tax aid control.

14. Last but not least, EU policymakers should agree on the substitution of the unanimity rule by the qualified majority voting. It is due to the unanimity rule that the internal market is so underdeveloped about tax matters. Under the qualified majority voting, which is the rule used under the ordinary legislative procedure, a law is adopted once a certain threshold of votes in the Council of Ministers is obtained. This would simplify the legislative procedure on tax matters and allow achieving the shift that the current legal framework so urgently requires. EU Member States shall not be afraid of adopting this measure because, it is important to reinforce, the 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.[182]

[182] Patricia Lampreave, *"Fiscal Competitiveness versus Harmful Tax Competition in the European Union", op. cit.*

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 only aim to provide some fundamental orientations that could guide EU policymakers when the political commitment in the EU is superior. It is the author's belief that the adoption of the majority of these recommendations is in the future of European tax law.

5. Final Conclusions

The main conclusion of this essay is evidently that taxes can be a foe and an ally of competition. This was the thesis stated and explained in the course of this work by means of examples that confirm its truthfulness.

Throughout this analysis it is possible to conclude that taxes are responsible for making competition unfair and for making European companies less competitive and less efficient. As 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, the re-registration process of cars, 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 seen the high compliance costs that the lack of tax coordination involves as well as the problems created by the impossibility of cross-border relief and exit taxation. 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, fostering competition and innovation, ensure the maintenance of the level playing field, the protection of all market participants and the correction of market failures in accordance with the public interest. That is the case of taxes that foster competition in monopolistic markets, a precise imposition of custom duties, tax regimes that promote R&D and innovation (like patent boxes), taxes that stimulate the creation of new jobs and environmental taxes. In all these cases taxes act as an ally of competition. Furthermore, if tax coordination is achieved, European

companies are able to compete under fair conditions, as we have seen through the VAT coordination. Thus, one shall conclude that taxes can also be an ally of competition. The negative and the positive impact that taxes may have on competition are thus two faces of the same coin.

Finally, although taxes may be an ally of competition, the analysis made shows that they are usually a foe rather than an ally. The negative impact of taxes on competition is much more perceptible than the 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 standing out their positive impact. The European proposal for a CCCTB as well as the OECD plan on BEPS can contribute to change the legal *status quo,* as they seek to attain a notorious degree of tax coordination. Still, that is not enough to correct all the situations where taxes act as a foe of competition. In fact, there are more measures that European policymakers can adopt to reduce the negative impact of taxes on competition. Their adoption though requires a strong political commitment by part of all EU Member States, something that will only be proved with time. But 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 the European citizen welfare, the ultimate purpose of EU competition law.

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