TILBURG SCHOOL OF LAW

European Commission fiscal State aid approach forcing a tax policy in the fight against harmful tax practices

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PREFACE

This thesis represents the culmination of a difficult year, but quite captivating and substantial for the rest of my life. As my first academic work, I wanted to take the opportunity to thank all teachers I had the pleasure to learn from. You truly make this Master's program and Tilburg University the place to be in the context of international and European tax law. Furthermore, I want to extend special thanks to my supervisor Diheng Xu for her support in times of insecurity and patience during the process of writing my thesis that allowed me to understand many mistakes and get out of the box.

Finally, I would also like to leave a special word for myself. The year 2020 will always be remembered as an atypical year of a pandemic that stopped the world. This thesis has often allowed me to abstract from reality and keep my head up.

17 June 2020,

António R. Mourato

ABBREVIATIONS

The following abbreviations are used throughtout the research paper:

ALP – Arm's Length Principle

APA – Advance pricing agreement

Art. – Article

BEPS – Base erosion and profit shifting

Code - Code of Conduct for Business Taxation

EC – European Commission

CJEU – Court of Justice of the European Union

ECOFIN – Council of Ministers for Economic affairs and Finance

EU – European Union

MNEs – Multinational Enterprises

MSs – Member States

OECD – Organization for Economic Co-operation and Development

OECD Guidelines - OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017

TEU – Treaty on the European Union

TFEU – Treaty on the Function of the European Union

Treaties – Treaty on the European Union and on the Function of the European Union.

ABSTRACT

EU law restrains the potential unlimited taxable power of MSs by establishing limits within their tax competence and how it may be exercised. Those limits include, *inter alia*, the prohibition of fiscal State aid. There is still considerable controversy surrounding the issue this research seeks to address, assuming the antagonistic positions of the EC and MSs on the approach and interpretation of art.107 TFUE. With this in mind, the present paper aims to examine if the EC fiscal State aid investigations are tackling harmful tax practices and selective national tax measures or purposely forcing a European tax policy.

The research starts by introducing the context of the internal market as the theater of operations where the problem in question dwells in conflict with the performance of the EC. Subsequently, it discusses the terms and benchmarks on which the arguments to assess the issue are built on. Based on them, the main research question on the EC application of art. 107 TFUE will be presented. The premise is that State aid law is a limit for MSs tax sovereignty. A broad and unjustified approach may interfere with competences outside the scope of the EC leading to legal uncertainty as a consequence and effect to be considered. The author sums up his conclusions by suggesting a path for progress towards a fairer and sound environment.

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INTRODUCTION

Globalization clashed immaterial borders of the world causing the openness of economies, trade, and the interdependence of states. The EU is founded on the premise that MSs renounce competences to attain common objectives.[1] Policies did not agree explicitly, under the Treaties, remain in the domain of the MSs.[2] Tax policy is an element of the sovereignty of MSs legitimized by democratic power that relies on tax revenue collection and involves both the financing of public expenditures and the redistribution and allocation of resources. The myth of pure tax sovereignty was shattered by the inevitability of each national tax system being conditioned to set tax policies reliant by other tax sovereignties policies. In this context, tax competition between states is unavoidable

Furthermore, the area of international tax law is currently the focus of much debate since everything seems to be allowed in the fight against potential tax planning. Vague definitions and rules that overlap are the cause for insecurity. Policymakers and legislators must find a dynamic balance, and only the judiciary can restore the required certainty and foreseeability concerning MNE's tax burdens.

The topic of this paper is to discuss the fiscal State aid investigations approach as an incresing limit of MS's tax sovereignty. In principle, the two concepts are not in conflict, but due to the new EC application of art. 107 TFEU, tax sovereignty is being eroded in terms of the application of rules related to cross-border transactions and interpretation of the ALP.

After analysing case law and the EC wide use of art. 107 TFEU in the fiscal State aid investigations, it is concluded that State aid law, as a limit, is expanding to an area of competence of the MSs. The EC's approach has the effect of putting legal certainty endanger. The interpretation of the ALP is a good example of how the application of a principle that was not expected and is not implicit in any EU law can disrupt the tax rulings agreed with the tax administrations. A soft non-mandatory law is not expected to be enforced.

EU State aid law is a tool used to tackle solely harmful tax practices and unfair tax competition within the internal market or are the investigations regarding fiscal State Aid concealing the purpose of carrying out a forced tax harmonization in direct taxation? Moreover, striking features of the wave of in-depth open EC fiscal State aid investigations carry the effect of supervising MSs tax competence. The tension created in this unsettled territory creates a conflict between the EC approach on the State aid control and MSs tax sovereignty, not to mention, the rise of legal uncertainty for all parties involved.

[1] Art. 1, Consolidated Version of the Treaty on European Union [2012] OJ C326/01
[2] Arts. 4 and 5, Consolidated Version of the Treaty on the Functioning of the European Union [2012] OJ C326/01

The State aid investigations regarding tax matters as such feature what can be the reaction of a supranational body that supervisions the behavior of MSs when collecting and settle tax procedures. This research project means to assess the concern by all key players in the tax environment, namely, European institutions, MSs, tax advisors, tax lawyers, and MNEs, around the fight to eradicate harmful competition regimes due to the lack of harmonization and certainty in relations with taxpayers.

The importance of preventing a "race to the bottom" or unlawful systems uncoordinated with EU Law is a current interest and one possible solution could be conceived by the transmission of direct taxation powers and deeper tax law harmonization that integrates even further the rules of all MSs. Is the goal of the EC to endorse a "race to the average"? The evolution of the case law on fiscal State aid seems to support the EC current practice.

1.1 - Motivation

Fiscal State aid case law, such as the Belgium excess profit, Starbucks and Fiat interpreted by the CJEU has sustained the EC position. Many questions are still raised,[3] especially regarding the Apple case. There's new ground to break to sustain a framework for State aid review of tax rulings, crucial to arrange needed legal certainty in this area of EU law. Coordinated action is vital to reach an European scheme under which every tax ruling could be subject to *ex-ante* simple review. An essential structure to bring minimal legal certainty to a problematic system due to the overlap between national tax competence in direct taxation and the EC prerogatives in applying State aid rules.

The intent to force harmonized tax law as a measure to reinforce the idea of a solid Single Market, reducing administrative burdens and compliance costs, collapsing tax law systems borders, already distant by language issues, promoting an efficient and fair market for businesses investing in the EU territory. In the fight against harmful tax practices, the EC's approach and use of the State aid ban meant to combat the lack of neutrality and state distortions to competition can be imposing a tax policy and not only a fiscal State aid policy.

1.2 - Research question

The research question proposed is the following: **To what extent are the EC fiscal State aid investigations purely tackling harmful tax practices while eroding a certain degree of MS's tax sovereignty?**

To better understanding the main question, a first sub-question must be answered: **What is the extent of competence and powers the EU has on direct taxation purposes?**

[3] E. (Edouard) Fort, EU State Aid and Tax: An Evolutionary Approach, 57 Eur. Tax n. 9 (2017), Journals IBFD; M.F. de Wilde, On the Future of Business Income Taxation in Europe, 12 World Tax J. (2020), Journal Articles & Papers IBFD.

To challenge the point presented by this research a second sub-question arises: **To what extent are the current system of fiscal State aid investigations and the argued conflict to a certain degree of tax sovereignty on direct taxation capacity in Europe promoting legal uncertainty in the field, and to MNEs?**

Finally to justify the author's position the last sub-question will be answered: **Following the OECD trend regarding BEPS Action 5, is a partial takeover of fiscal sovereignty and enforcing methods for harmonization of direct tax law by the EC, a solution for instituting a truthful and fairly competitive environment diminishing harmful tax practices and avoid legal uncertainty regarding tax rulings in the future?**

1.3 - Benchmark

It is highly relevant to establish the scope of the terms: **Tax sovereignty**, **harmful tax practices**, and **legal certainty**. Correspondingly, the research paper starts with the idea of tax sovereignty as a power for levy taxes. Second, the definition of the external benchmark harmful tax practices in the framework of competition between taxing states. Then, it highlights the use of State aid law as an instrument that aims to establish limits to the state's powers and the EC approach forcing positive integration. Finally, taking into account the context of legal certainty, the EC approach in the fiscal State aid investigations and interpretation of the ALP of art.107 TFEU is going to be tested against the rise of uncertainty.

1.4 – Methodology

The methodology proposed to answer the research question resides on legal analysis and legal research tracing legal sources and case law sustaining a legislative interpretation of EU law like the Treaties and soft law that can assist this research. The methods used to answer the research question and the sub-questions are the review of the relevant legal academic literature, which includes scientific publications and publications of different European and international organizations.

This analysis will be accomplished by sustaining a conjectural reality. Based on factual terms, a hypothesis generated in the fiscal State aid investigations case law. Empirical analysis should only be done in terms of comparative law with other legal instruments that resemble the prospect examined. Economic perspective is important regarding concepts such as Single market, free and open market, harmful tax practices, competition, and distortion of competition.

1.5 – Delimitation

The essential ambition of the proposal is to scrutinize the intention behind the fiscal state aid investigations. Fiscal State aid may assume various forms, but this research focuses

especially on tax rulings granted and investigated by the EC. The analysis will target predominantly if the question surrounding the aim of the EC with the State aid investigations is entirely based on tackling neutrality of the internal market and state distortions to competition or if they hide a European tax-policy endorsed by the EC approach to reform direct taxation.

Considering the wide definition of harmful tax practices and the extent of tax sovereignty as an attribute that is not absolut but that tends to lean on the balance for MSs, politic conceptions are out of the scope of this paper, in matters that relate to analysing comprehensively the correctness of the current international and European tax system.

The main goal is the intention of the EC. This paper will interpret the purposes behind the EC approaches during the evolution that led to the investigations. The argument will oppose the opinion that the EC shouldn't interfere with the MSs tax policy, following the academia that invoked a need to reform the current structure and approach of the EC.

Section I – Background of the fiscal State aid Investigations - The Normative Framework and disputed principles.

1.1 – The Single Market – the legal space where the framework applies.

This section begins by examining a pertinent aspect of the EU, the pledged Single market. Before analysing the main issue of this research paper, the impact and endeavor of EC State aid investigations on the MSs tax rulings, and, more generally, the use of an instrument like EU State aid law in the context of European tax law, few observations must be considered concerning the EU internal market. A brief explanation of the notion is key to appreciate the use of State aid law in European matters.

From the very beginning of the EU, one core goal has been the achievement of economic integration among the MS's.[4] The concept of the EU Single market is the European response to a necessity, in the post-war period, for a stronger economy, legal and political unity between the EU.[5] The establishment of an internal market, formerly known as the common market, is a central objective of the EU.[6]

The CJEU decision on the *Polydor* case was quite clear about establish a common market for the EU zone.[7] The decision confirms the goal to progressively approximate the MSs economic policies, uniting twenty-seven markets into a single market, by having the

[4] On the main objectives of the European Union: Lenaerts, K.; Van Nuffel, P.; Bray, R. *European Union Law*, 3nd ed.; Thomson Sweet & Maxwell: London, 2011, p.108.
[5] Sjaak Jansen, Fiscal Sovereignty of the Member States in an Internal Market – Past and Future, Eucotax Series on European Taxation (volume 28) 2010, Kluwer Law International, p. 52.
[6] Art. 3, nº3 , Consolidated Version of the Treaty on European Union [2012] OJ C326/01
[7] Case 270/80 *Polydor and Others v Harlequin and Others* para.16.

characteristics of a domestic market. This market integration, eliminating differences and obstacles, acting like one single and unique market, sets out the idea that the whole is stronger than the sum of its parts. Building an area defined by the absence of internal frontiers, where goods, persons, services, and capital are free to move.[8] Commonly specified as the four freedoms, one kind of negative integration, setting limits on MSs measures for the greater good.[9] The idea of an internal market is based on the basic principle of an open market economy with free competition.[10] In other words, a market in which activity is determined by market forces, defined by a liberal economic policy.

The economist *Adam Smith* proposed the removal of artificial obstacles, intending to allow competition to thrive, given that the 'invisible hand' would achieve the efficient allocation of resources by itself.[11] MSs and the EU must act by this principle, favoring an efficient allocation of resources.[12] This efficient allocation supports the objectives of improving and maximizes welfare from the citizens of Europe[13] by opening the internal borders of MS's while setting competition rules which guarantee the free operation of market forces.[14] The competence to draft EU competition laws is explicitly stated in the EU exclusive competence to establish "competition rules necessary for the functioning of the internal market".[15] The EU has to "adopt measures with the aim of establishing or ensuring the functioning of the internal market".[16] EU State aid law is included in the competition law section of the TFEU and should be considered, under a systematic interpretation argument approach, as a central element of competition law. Effectiveness of free trade is sustained by the assumption that the peak of productivity is reached with little, or no public interference, making the market more efficient by encouraging economic agents to shift towards higher productivity.[17]

The Single Market, as a whole, and the corresponding twenty-seven markets, are committed to the principle of open competition, which also applies to competition in tax systems.[18] Taxation has a relevant part in the overall grand scheme of the EU Single market. In order to compete with economies like the US or China, the EU must be capable of

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[8] Art. 26, nº2, Consolidated Version of the Treaty on the Functioning of the European Union [2012] OJ C326/01
[9] For studys about the four freedoms as a negative integration see: art. 26, nº2 TFEU; Gianluigi Bizioli, Balancing the Fundamental Freedoms and Tax Sovereignty: Some Thoughts on Recent ECJ Case Law on Direct Taxation, European Taxation (volume 48), No 3, 133 et seq., March 2008, Journals IBFD, p. 133. See also; Terra/Wattel, European Tax Law, Vol. 1 General Topics and Direct Taxation, Fed fiscal studioserie, 7th edition, 2018, p.45-53.
[10] Arts. 119 and 120, Consolidated Version of the Treaty on the Functioning of the European Union [2012] OJ C326/01
[11] Jones, A.; Sufrin, B. E.; Dunne, N. Jones and Sufrin's Eu Competition Law: Text, Cases, and Materials, Seventh: Oxford University Press: Oxford, United Kingdom, 2019, p.1-20.
[12] Art.120, Consolidated Version of the Treaty on the Functioning of the European Union [2012] OJ C326/01
[13] Whish, R.; Bailey, D. Competition Law, Ninth; Oxford University Press: Oxford, United Kingdom, 2018, p.3-19.
[14] Kemmeren, E., The CJEU and the internal market concept in direct taxation. In EU Tax Law and Policy in the 21st Century (2017), (Vol. 35, pp. 3-50), Kluwer Law International.
[15] Art. 3, nº1, b), Consolidated Version of the Treaty on the Functioning of the European Union [2012] OJ C326/01
[16] Ibid, art. 26 nº1.
[17] For a detailed study: Krugman, Paul, et al. International Economics: Theory and Policy, Global Edition, Pearson Education Limited, 2014.
[18] W. Schön, *Tax Competition in Europe—The Legal Perspective*, (2000), 9 EC Tax Review p.91.

optimizing market conditions to survive in the international competition of tax systems.[19] Therefore, a Single market is a decisive conception to reach the integration of national economies, i.e. market integration.

The EU objectives alone do not impose obligations on MSs.[20] The responsibility to pursue its objectives rests on the EU by employing appropriate means according to the competences given by the Treaties.[21]

EU competence is based on the principle of conferral, i.e. the Union has no original competence, and MSs voluntarily confer all its competences in the founding treaties.[22] Thereby, a tension between the objectives of the Union as a whole, and the sovereignty of MSs to make decisions and follow policies autonomously comes up. This research measures the degree of autonomy that MSs have, in terms of assessing its limits, namely through EU State aid rules.

1.2 – Negative Integration – State aid rules

The purpose of this research paper, taking into consideration the use of EU State aid rules, a brief presentation about the relationship between negative integration and State aid rules should be presented.[23] In the context of tax law, integration may be obtained positively and negatively. Positive integration is accomplished employing tax harmonization using EU legislation where MSs agree on common regulation, or at minimum, with policy coordination. Negative integration is enforced over legal prohibitions on discriminatory measures and restrictive provisions of MS's national tax systems.[24]

Unlike indirect taxes, direct taxation has fewer considerable provisions referred to in the Treaties.[25] The majority of MSs deems direct taxation as the last remnant of sovereignty, and continues to be reluctant to transfer competence to the EU level in the area of direct taxation.[26] Thence, a huge and rapidly expanding body of case law is often observed, commonly regarding a MS tax measure that violates the TFEU free movement rights or EU State Aid rules, forms of negative integration.

For the Union to achieve its objectives, it must necessarily constrain the competence of all MSs individually. This in no way implies the EU has unlimited tax competence, and

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[19] Ibid, p.105.

[20] Case C-339/89 *Alsthom Atlantique* para. 9; Case C-9/99 *Échirolles Distribution* para.25; Case C-484/08 *Caja de Ahorros y Monte de Piedad de Madrid* paras.46-47.

[21] Art. 3, nº6, Consolidated Version of the Treaty on European Union [2012] OJ C326/01.

[22] Ibid, arts. 4, nº1, and 5, nº1.

[23] For studies on positive market integration see: Terra/Wattel, European Tax Law, Vol. 1 General Topics and Direct Taxation, Fed fiscal studioserie, 7th edition, 2018, p. 14-18, 44-49.

[24] Hans Gribnau, Soft Law and Taxation: EU and International Aspects, (2008), Legisprudence, 2:2, 67-117.

[25] For a study on Treaty provisions for matters of Direct and Indirect taxation: Terra/Wattel, European Tax Law, Vol. 1 General Topics and Direct Taxation, Fed fiscal studioserie, 7th edition, 2018, p.14-18.

[26] M. Lsenbaert, EC law and the Sovereignty of the Member States in Direct Taxation, (The Netherlands; IBFD Doctoral Series, 2010).

that MSs give up all their powers. It is easier to understand EU State aid law as a limit or boundary, to a potential free discretionary absolute power to levy taxes by the MSs. Direct tax competence of the MSs is limited, as the research paper illustrates, like sides of a box. Defining in detail some walls of this box, fiscal State aid, is discovering the potential of what is inside it. A logical benchmark is to start by the limit, rather than trying to define, point by point, the potentially infinite MSs possibilities of direct taxation competence.

For the present case, EU State aid prohibitions are an example of a prominent negative market integrator. Within this framework, the case law of the CJEU is of major importance.[27] The consequence of the lack of legal basis in the Treaties for positive integration in respect of direct taxation, together with the resistance of MSs for giving up tax sovereignty is the emerging of deficiencies due to insufficient detailed direct EU tax laws.

On the other hand, EU State aid rules are in the process of becoming, in the author's opinion, the strongest engine for negative integration of direct taxes leading to a positive integration solution.

Despite that, negative integration such as constraining domestic direct tax policies, hence applying EU State aid law, has its limitations. Examining particular tax measures is not the same as harmonizing tax systems. Not all tax rulings are harmful, and even if some are classified as harmless, that doesn't guarantee that it involves no State aid within the meaning of art. 107(1) TFEU. The same can be stated in reverse. Defining limits through negative integration is not the same as defining policies. Nor is the concept of harmful tax practices the same as EU State aid law. The overlap of rules is just appearing over the misconception of one to be broader than the other.

1.3 – The concept of Tax Sovereignty

A benchmark of this research is the concept of tax sovereignty. In order to answer the question of whether the EC fiscal State aid investigations are eroding MSs tax sovereignty, it's fundamental to grasp where does the power of taxation comes from.

The definition of Sovereignty since *Bodin* described it has become boundless.[28] The concept is instinctively perceived by the average person as the power of a country to rule its government and determine policies autonomously. Sovereignty, from a legal point of view, can be defined as a state's inherent right of self-determination within a specific territory and

[27] Kemmeren, E., The CJEU and the internal market concept in direct taxation. In EU Tax Law and Policy in the 21st Century (2017), (Vol. 35, pp. 3-50), Kluwer Law International.
[28] Bodin, J. (1992). Bodin: On Sovereignty (Cambridge Texts in the History of Political Thought) (J. Franklin, Ed.). Cambridge: Cambridge University Press.

political community.[29] In a nutshell, sovereignty expresses the supreme authority of a state over a territory and its citizens from an international law perspective.[30]

With the foundation of the EU, MSs limited their sovereignty by means of a cooperation agreement to attain common objectives.[31] As a supranational entity, the EU has competence based on the principle of conferral.[32] For this reason, MSs have voluntarily transferred part of their sovereignty, granting and sharing competences with the EU, because otherwise, the EU would not be able to pursue the objectives it is supposed to achieve.[33]

According to the aim of this paper, the investigation is limited to one manifestation of sovereignty in a broad sense: tax sovereignty. In this context, it is important to examine afterwards the degree of sovereignty, that is, competence, MSs have delegated to the EU in matters of direct taxation. Traditionally, tax policy is perceived as part of the domain of national sovereigns.[34] An important notion to mention when talking about sovereignty is jurisdiction. Is the way to turn sovereignty into reality,[35] as an expression of the state power, and the capacity to decide and impose decisions, like taxes, related to legislative competences: The limitation for the exercise of that power in a certain circumscribed area. Therefore, jurisdiction falls into the concept of sovereignty, and the latter sets the boundary for the former.[36] **Tax sovereignty is an inherent right to levy taxes in its territorial jurisdiction**.[37]

Generally speaking, national citizens accept government decisions expecting the benefit of society as a whole.[38]. Levying taxes finances mainly public expenditures of goods and services, e.g. health, education, infrastructure, and defense. Higher taxes mean, in principle, more, or at least, better public goods and services. Citizens authorize the state to act on their behalf, collecting tax revenue. Due to this democratic society system, payment of taxes gives the taxpayer the right to participate and to have a saying in the design of the tax system[39], to hold the government accountable in respect of the decision-making process and policies. This doctrine is significant considering the EU is a supranational entity. The consent

[29] Sjaak Jansen, Fiscal Sovereignty of the Member States in an Internal Market – Past and Future, Eucotax Series on European Taxation (volume 28) 2010, Kluwer Law International, p.233.
[30] Otto Marres, The Principle of Territoriality and Cross-Border Loss Compensation, Intertax, (volume 39 issue 3), 112 et seq., 2011 Kluwer Law International, p.112.
[31] Art.1, Consolidated Version of the Treaty on European Union [2012] OJ C326/01
[32] Ibid, arts. 4º, nº1, and 5º, nº1.
[33] Nigel Foster, EU Law Directions, Oxford University Press, 4th edition, p.79.
[34] Not so very long ago, a BEPS Report indicated: "Tax policy is not only the expression of national sovereignty but is at the core of this sovereignty, and each country is free to devise its tax system in the way it considers most appropriate". OECD (2013), *Addressing Base Erosion and Profit Shifting*, OECD Publishing, Paris, 28.
[35] L.E. Schoueri, Tax Treaty Override: A Jurisdictional Approach, 42 Intertax 11, p.691 (2014).
[36] F.D. Martínez Laguna, Abuse and Aggressive Tax Planning: Between OECD and EU Initiatives – The Dividing Line between Intended and Unintended Double Non-Taxation, 9 World Tax J. (2017), Journals IBFD.
[37] Sjaak Jansen, Fiscal Sovereignty of the Member States in an Internal Market – Past and Future, Eucotax Series on European Taxation (volume 28) 2010, Kluwer Law International, p.58.
[38] J. Rawls, Political Liberalism, New York: Columbia University Press (1993) and M. Weber, The Theory of Social and Economic Organization, Talcott Parsons (ed.), New York: Free Press (1964).
[39] T. Dagan, Tax, law and development, Y. Brauner & M. Stewart (eds.), Edward Elgar Publishing, 2013, p.62.

of every European citizen is legitimized through national democratic mechanisms[40], put differently, each MS joining the EU is required to ratify admission using whatever domestic constitutional procedure legitimizing European sovereignty.[41]

The principle of “no taxation without representation”[42] has survived throughout the 18th century to the present day, providing a guarantee against arbitrary taxation and discretionary tax measures. The prerogative of a government that exercises the function of levying taxes is legitimized by democratic representation, parliamentary majorities. One intention of the BEPS project is to support “the effective fiscal sovereignty of countries over the design of their tax systems”.[43] Tax legislative competence of governments is widely accepted by all key players in the EU, i.e. tax legislation adopted by governments is valid.[44] However, those who strongly advocate the principle of representation, must take into account that a citizen of a MS can take advantage of the EU fundamental freedoms and exit the MS of citizenship mostly or exclusively for tax reasons, as long as the move is not artificial. Thus, paying taxes in one MS and holding voting rights in another MS.

1.3.1 - War on tax Sovereignty – EU current power and competence on direct taxation.

In this section of this research paper, the negative integration through State aid rules is considered to limit MS’s tax sovereignty. The functioning of the internal market presented previously depends on EU competence and legislation, which is not necessarily competent in direct tax matters. Before the author of this research paper can infer to a conflict in the EC application of art. 107 TFEU State aid creating a climate of legal uncertainty, an analysis must be carried out that deconstructs legitimacy and competence to legislate on direct taxation within the EU. The first sub-question must be answered: **What is the extent of competence and powers the EU has on direct taxation purposes?**

Tax sovereignty raises one fundamental aspect when the prohibition of fiscal State aid is discussed: the conflict between the power conferred on the MS to tax income arising in their territory and the EC competence conferred to avoid distortions to the EU market. In principle, both are legitimate and do not conflict. The problem begins when the EC approach establishes the imposition of rules and principles that are interpreted autonomously without authorization from the MSs. This gives rise to a tension between two systems and a need to

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[40] A.van Staden, The Right to Govern: The Democratic Legitimacy of the European Union, Study 20, (Clingendael Institute 2003) p.20. See also R. Keohane, S. Macedo & A. Moravcsik, Democracy-Enhancing Multilateralism (2009), International Organization, 63, at 25.

[41] Art. 49, nº2, Consolidated Version of the Treaty on European Union [2012] OJ C326/01

[42] A quote attributed generally to James Otis around 1761, which reflected the resentment of American colonists at being taxed by the British Parliament with no elected representatives by them and became an anti-British slogan before the American Revolution; in full, “Taxation without representation is tyranny.”

[43] OECD (2014), *Countering harmful tax practices more effectively, taking into account transparency and substance*. Paris.

[44] Brokelind, C. Principles of law: Function, Status and Impact in EU tax law, 2014, p. 205.

establish equilibrium in the allocation of competences between the MSs and the EU, or at minimum, explicitly delimit the border for the exercise of MSs fiscal competence in direct taxation, and avoid a vague application of EU State aid law inconsistently. MSs have to exercise their tax sovereignty at a national level, and in parallel ensure those tax systems comply with the European legal framework.[45]

The current situation in reference to the EC open fiscal State aid investigations can only be understood in the context in which competence in the field of direct taxes does not belong directly to the EU. Shortcomings in form, insuperable legality, or political reasons that lead exactly to force MSs to comply throughout negative integration. The EU State aid regime seems so often incomprehensible, as a result of the insufficient understanding of its core in fighting the lack of neutrality and state distortions of competition.

From the standpoint of the principle of conferral, without a policy agreement, competencies remain in the domain of the MSs. Few powers in the field of direct taxation are conferred to the EU in terms of positive integration. Thus, the EU Single market is divided into twenty-seven different tax systems, with different rules and often different languages that in no way help an EU international competition as whole vis-à-vis other economies. EU institutions are unable to propose their own taxes or to establish their own tax policy. In solid terms, the powers and competence of the EU and the EC in direct taxation are limited to legal prohibitions on discriminatory and restrictive provisions of the MS's tax systems, which include the prohibition of fiscal State aid.

For clarification of any doubts, consistently supported by case law, "*direct taxation falls within the competence of the MS's, but MS's must exercise their competence on direct taxation consistently with EU law"*. [46]

The CJEU has made clear that direct taxation sovereignty rests with the MSs, [47] more particularly, the right to allocate taxing power between them and thus, the right to define their income tax system.[48] This is almost *Acte Clair* doctrine at this point. In *Gilly*[49] the CJEU has

[45] C. Micheau, State Aid, Subsidy and Tax Incentives Under EU and WTO Law, Kluwer Law International, 2014, p.476.
[46] Case C-279/93 *Finanzamt Köln-Altstadt v. Roland Schumacker* para.21; Case C-80/94 *G.H.E.J. Wielockx v. Inspecteur der Directe Belastingen* para.16; Case C-264/96, *Imperial Chemical Industries (ICI) v. Kenneth Hall Colmer* para.19; Case C-311/97, *Royal Bank of Scotland plc v. Elliniko Dimosio* para.19; Case C-35/98, *Staatssecretaris van Financiën v. B.G.M. Verkooijen* para.32; Joined Cases C-397/98 and C-397/98, *Metallgesellschaft Ltd and Others, Hoechst AG and Hoechst (UK) Ltd v. Commissioners of Inland Revenue and HM Attorney General* para.37; Case C-319/02, *Petri Manninen* para.19, Case C-446/03, Marks & Spencer plc v. David Halsey (Her Majesty's Inspector of Taxes), para. 29; Case C-196/04, *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue* para. 40, Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation* para.36; and Case C-524/04, *Test Claimants in the Thin Cap Group Litigation v. Commissioners of Inland Revenue* para. 25.
[47] Case C-204/90 *Bachmann v Belgium*
[48] Sylvia Elwes, The Internal Market versus the Right of Member States to Levy Direct Tax-A Clash of Fundamental Principles, Intertax (volume 41 issue 1), 12 et seq., 2013 Kluwer Law International, p.18
[49] Case C-336/96 *Gilly* para.24

distinguished the exercise of fiscal competence, such as determine taxation methods, taxable incomes, and the allocation of fiscal competence.[50]

Prohibitions can be, not only EU State aid law, the subject of our study, but also freedom of establishment, free movement of persons, services, and capital. Also, it is unlawful any discrimination or restriction, barrier, except if justified. In *Säger*[51], the CJEU considered the free movement provisions require not only the elimination of all discrimination on grounds of nationality but also the abolition of any restriction when it is liable to prohibit or otherwise inhibit economic activities. The coexistence of twenty-seven tax systems results in disparities or variations.[52] Nonetheless, distortions resulting from mere disparities between tax systems do not fall within the scope of the EU provisions in the TFEU at all time.[53] This is reasonable since, an advantage or a disadvantage for a taxpayer should be attributable to a MS, otherwise, the MS would be accused of something out of its competence. This is also true in the area of EU State aid law.[54] Logically, disadvantages resulting from applying other rules in other tax jurisdictions are ineffective. Tax sovereignty is, hence, restricted by negative integration, i.e. **MS's fiscal sovereignty is restricted by EU State aid law**.

1.3.2 – Tax Competition: wielding tax power.

The CJEU clarified the question around who has the power to legislate and levy taxes by retaining extensive competences in direct tax matters.[55] On the other hand, the theory that different MSs are endowed with exclusive tax legislative powers as rule-makers in the area of taxation, ideally aiming of maximizing welfare to a point of maximal efficiency, and redistributing resources fairly strictly linked to the nationality of their constituents must be abandoned. Economic globalization has reduced the sovereignty of nations, as it was previously known. The loss of tax sovereignty takes the form of market-induced pressure to lower taxes and difficulty in applying existing tax rules, over legal prohibitions on discriminatory measures and restrictive provisions of MS's national tax systems like State aid rules.

The central problem involves inevitably the internal market. It is impossible to discuss the workings of the EU Single market without mention competition. One basic assumption underlying the conceptualization of competition on a free and open market is the

[50] Ibid, para.30.
[51] Case C-76/90 *Säger* para.12; See also Case C-55/94 *Gebhard* para.37; Case C-298/05 *Columbus Container Services*, para.34.
[52] Opinion AG Geelhoed in Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation* para.43.
[53] Case C-403/03 Schempp, para.45.
[54] Case 57/65 *Lütticke*, para.31.
[55] Opinion of AG Poiares Maduro in Case C-446/03 *Marks & Spencer,* paras 23-24.

highest efficient production of goods and services for the benefit of the consumers.[56] At an international level, 200 or so states compete with one another for investments, residents, and tax revenues. Competition has transformed a world of sovereign fiscal policies with the increased mobility of MNEs and capital investments. MSs act as recruiters to attract residents and investments, leaving aside the idea of tax patriotism, paying taxes as an obligation to a national, in order to promote the collective goals and common good of a given group. Also, tax patriotism is illusory in a global world focused on efficiency and cutting costs: companies, entrepreneurs, and even individual people, consider low tax costs a substantial factor in deciding where to set up undertakings and invest capital. Aware of this, MSs build competitive tax systems and measures to attract economic activities from other countries. Tax competition, as consequence, shapes the behaviour of economic agents and public institutions.

In a short review of the literature regarding the quarrel tax competition vs tax harmonization[57] *Schön* compares the economic pros and cons of tax harmonization versus tax competition.[58] As *Schön* successfully puts it: "*the difference between tax harmonization and tax competition in Europe boils down to the difference between consensus and dissensus among the MSs of the EU"*.[59]

Tax competition between European domestic tax systems, leads to budgetary and tax efficiency, favouring an efficient allocation of resources, beneficial to all in principle.[60] Competitiveness prevents theoretically improper conduct regarding excessively high and unjustified taxes and, puts pressure to reach more efficient ways on how to raise and spend taxes collected.[61] However, tax competition may be economically counterproductive often producing harmful effects caused by tax measures and systems designed solely to undermine competition. In accordance with a review of the last two decades, there is a gradual reduction of statutory tax rates in most MSs. Even so, there is no evidence to support the claim that an approximation of tax rates or a progressive reduction in higher rates might outcome in a "race to the bottom" within the internal market.[62]

The existence of harmful tax competition in the EU must be acknowledged, but the line between fair and unfair tax competition needs to be identified. The question of assessing what is harmful or not is not yet a consolidated concept, if it will ever be. There is no

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[56] Hans Gribnau (2008) Soft Law and Taxation: EU and International Aspects, Legisprudence, 2:2, p.75.
[57] For a detailed study see: Schon, W. Tax Competition in Europe - General Report. Tax Competition in Europe, (2003).
[58] Ibid, p.6.
[59] Ibid, p.39.
[60] Terra/Wattel, European Tax Law, Vol. 1 General Topics and Direct Taxation, Fed fiscal studioserie, 7th edition, 2018, p.110. See also, F Vanistendael, "Fiscal Support Measures and Harmful Tax Competition" (2000) 9 EC Tax Review 152-61.
[61] European Parliament, Report on the Commission Communication on Tax Policy in the EU, 22 Feb 2002 / 14 Mar 2002, A5-0048/2002, par.G.2/3.
[62] R. Griffith & A. Klemm, What Has Been the Tax Competition Experience of the Last 20 Years?, Institute for Fiscal Studies, Working Paper 04/05 (2005), available at http://ideas.repec.org/s/ifs/ifsewp.html.

consensus on the definition of harmful tax competition and measures and even "empirical evidence is somewhat disputed by both economists and political scientists."[63]

1.4 - The principle of legal certainty

Theoretically, casting doubt on the EC fiscal State aid policy creates *a priori* a feeling of uncertainty. Later on, the research paper discusses uncertainty in the fiscal State aid investigations, but it is noteworthy to define the principle of legal certainty previously.

Research on the principle of legal certainty has a long tradition.[64] Previous studies[65] and case law have shown legal certainty as fundamental for EU law,[66] even though, the principle of legal certainty is not written in the Treaties. In an attempt to construct a definition, the application of the law must be predictable to a specific situation. However, the aim of this research paper is not to define the precise concept of legal certainty. Prior research questions whether it can be defined at all.[67]

Assuming a legal positivistic approach, there are as many conceptions of legal certainty as to the legal systems that define them. The practical problem in a literal approach is the temptation to consider that MSs have a different concept of legal certainty than the one the EU law legal order has. The cases Van Gend en Loos[68] and Costa v Enel[69] verified the intimate connection between national legal systems and EU law. On the grounds of the CJEU, legal certainty can be classified as a general principle of EU law.[70]

The CJEU mentions that legal rules must be clear and precise to ensure predictability in the legal relationship covered by EU law. So, **foreseeability appears to be the benchmark**. In any case, a legal definition of the principle in EU law would be well received, since the CJEU mentions it ambiguously.

Analysing legal certainty requires considering the principle of protection of legitimate expectations.[71] Legal certainty provides MNEs with conscious and rational decisions and planning their activities with predictability. Taxation is a breach in the right to property and the tax burden should be foreseeable, to be capable of adjusting their conduct with certainty.

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[63] C M Radaelli, "The Code of Conduct against Harmful Tax Competition: Open Method of Coordination in Disguise?", (2003) 81 Public Administration 522.

[64] For an exhaustive overview of the different definitions given for the concept of legal certainty throughout the literature see Mark Fenwick, Mathias Siems, and Stefan Wrbka, The Shifting Meaning of Legal Certainty in Comparative and Transnational Law (Bloomsbury 2017) 1-17.

[65] Raitio J. (2003) Legal Certainty in the Framework of Other General Principles of EC Law. In: The Principle of Legal Certainty in EC Law. Law and Philosophy Library, vol 64. Springer, Dordrecht

[66] C-323/88 *Sermes*

[67] Braithwaite, John. "Rules and principles: A theory of legal certainty." Austl. J. Leg. Phil. 27 (2002): p.47

[68] Case 26/62 *Van Gend en Loos*

[69] Case 6/64 *Costa*

[70] Case 63/93 *Duff and others v Minister for Agriculture Fisheries and Food*

[71] *General Principles of Eu Law and European Private Law*; Bernitz, U., Groussot, X., Schulyok, F., Eds; European Monographs, 84; Kluwer Law International: Alphen aan den Rijn, The Netherlands, 2013. See also: Humberto Avila, Certainty in Law (Springer, 2016), p.195-197.

Hereupon, uncertainty arises with the EC approach in relation to the antagonistic interpretation of tax rulings assembled. Foreseeability is far from guaranteed at this point. So, at this moment, MNEs are at a crossroads.

1.5 – Harmonizing Tax sovereignty – positive integration possibility

The general legal basis provision for the internal market of art.115 TFEU enables an oportunity to legislate under a special legislative procedure if there is a unanimous vote.[72] Bare in mind that, tax decision-making process at the EU level requires this unanimity, i.e. all MSs must agree on any measure adopted in the field of taxation. Unanimity is regarded as a "hidden veto", delaying and even paralyzing many tax proposals presented.[73] Although it is not easy to reconcile twenty-seven MSs to reach such a vote, as all have the power to veto any proposal in that field, it is not impossible.[74]

The mindset seems to be gradually changing. This results from political pressure, budgetary and economic issues, public outrage against tax evasion, and precisely, tax avoidance caused by unsustainable tax competition.[75] Limited positive integration through harmonization was achieved, in direct taxation, by a handful of vital directives e.g, Parent-Subsidiary Directive, Mergers Directive, Interest and Royalty Directive and the Anti-Tax-Avoidance Directive I and II, outside of the scope of this research paper.[76]

Section II - The fight against Harmful tax practices.

There is a generally accepted use of the terms "harmful tax practices", "harmful tax competition" or "harmful tax measures" as if they were one of the same things. Regardless, these concepts sustain broad understandings that need to be contemplated into the legal framework context examined. If the purpose is to fight something, we need to know exactly what are we fighting.

MSs often design their tax policy to become attractive targets for foreign investment. Tax policies vary from establishing systems with special preferences for certain industries to a well-designed tax system based on principles of sound tax policy. The *Neumark-Report*[77] proposed an integrated economic area where economic agents determine the allocation of resources based upon physical, technical, or other strictly economic parameters. An early proposal of neutrality, an economic concept, embracing the idea that tax shouldn't be part of

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[72] Terra/Wattel, European Tax Law, Vol. 1 General Topics and Direct Taxation, Fed fiscal studioserie, 7th edition, 2018, p.35.
[73] European Economic and Social Committee, Opinion of the European Economic and Social Committee on 'Taxation in the European Union: common principles, convergence of tax laws and the possibility of qualified majority voting', 2004/C 80/33, OJ C 80/139 (30 Mar. 2004).
[74] Directives: 77/779 EEC; 90/434 and 435 EEC; and 2003/48 and 49 EEC.
[75] Terra/Wattel, European Tax Law, Vol. 1 General Topics and Direct Taxation, Fed fiscal studioserie, 7th edition, 2018, p.45.
[76] A remarkable number of cases on the interpretation of these directives by the CJEU can be examined in the last few years.
[77] Report of the Fiscal and Financial Committee on Tax Harmonization in the Common Market, Report 21, Doc. SD-32 (EEC Commission, 1962).

the business decision-making process, neither encouraging nor discouraging personal or business decisions.[78] Full neutrality is a utopian idea and cannot be realized but, as a principle, should shape the performance of the parties.[79] The Single market favours an efficient allocation of resources preventing distortions from domestic law-making, advocating an efficiency objective of undistorted decision-making[80], backing up the concept of neutrality as part of the EU law.[81]

The concept of harmful tax practices is influenced by many circumstances. Being an open dynamic concept based on effects, and indifferent to stable criteria, classify an actual or potential effect of a tax practice, or measure, as harmful depends on the overall assessment of relevant factors, which leads to conflicting interpretations. Although harmful tax practices are associated with tax competition, not all tax competition goes hand in hand with harmful tax practices. Tax competition based on sound economic principles, such as neutrality, simplicity, transparency, and stability, contributes to more foreign investment and economic growth.

2.1 - BEPS action plan – Action 5 Harmful tax practices.

The key to understanding the debate on harmful tax measures is to consider the perspective of states who increasingly need revenue to cover their debts and operating costs as public goods and services and the prospect of a taxpayer more and more specialized estimates the "cost-benefit-ratio" of his tax burden and necessarily wants to pay as little as possible within the legal limits. These are recognized positive economic effects of tax competition. When the equilibrium disappears and the taxpayer is indifferent to the level of public goods and services offered by a state, for instance, skilled labour or great infrastructure, or when a decision to attribute a tax benefit has no effect on the budget as a whole, leads to a "beggar-thy-neighbour" policy.

Action 5 Report is one of the four BEPS minimum standards to restore confidence in tax systems ensuring the fight against harmful tax practices Thus, acknowledging that tax competition and the interaction between tax systems can have harmful effects, the OECD developed a standard framework under the 1998 Report for determining whether a regime is, or not, a harmful preferential regime.[82] According to the report, specific tax practices are considered harmful, i.e. the OECD identified elements of a tax regime that might be regarded

[78] A. Auerbach, The Theory of Excess Burden and Optimal Taxation in: Handbook of Public Economics, vol. 1 ch. 2, p. 61 et seq. (A. Auerbach & M. Feldstein eds., Elsevier1985) and The Deadweight Loss from "Non-Neutral" Capital Income Taxation, 40 J. Pub. Econ., p. 1 (1989).
[79] D. Weisbach, The Use of Neutralities in International Tax Policy, U. of Chicago, Coase-Sandor Inst. L. & Econ. Working Paper No. 697 (2014).
[80] W. Schön, Tax Competition in Europe: The Legal Perspective, 9 EC Tax Rev. 2, p. 97 et seq. (2000) and E.C.C.M. Kemmeren, Double Tax Conventions on Income and Capital and the EU: Past, Present and Future, 21 EC Tax Rev. 3, p.158 et seq. (2012).
[81] W. Schön, Neutrality and Territoriality – Competing or Converging Concepts in European Tax Law? 69 Bull. Intl. Taxn. 4/5 (2015), Journals IBFD.
[82] OECD (1998), Harmful Tax Competition: An Emerging Global Issue, OECD Publishing, Paris, para.45

as “harmful”[83]. These factors have been revised by the FHTP[84]. Consequently, the FHTP has reviewed preferential regimes to ensure the absence of measures that could negatively impact the tax base of other jurisdictions. The list now consists of five key factors and five other factors.[85]

The conclusions of the OECD, while important, still raise doubts and fuel the international debate. Prior research with an economic background suggests that from the position of a stand-alone state, specific tax incentives for foreign investment or certain sectors of the economy might prove far more efficient than general changes in the tax system.[86] Even tax haven practices can be considered the only way for very small countries, otherwise insignificant, to compete with other countries given their lack of infrastructure and conditions. These features can balance the scale in the quest for fairness if not ostensibly affect other jurisdictions, proving to be more effective for development and economic growth than a “normal” tax system.[87] National governments different political choices may constitute disparities between tax systems that might be able to have external implications. Decisions on the tax level may imply a high or low tax value relative to other countries and the composition of the tax burden may vary. Therefore, a tax incentive may be a way of maintaining a certain balance. Lower tax burdens can be obtained not only by reducing tax rates but also by reducing the tax base. The current situation is more of a “race to the average”.[88]

In the context of this research paper, the use of the harmful tax practices definition, provided by the OECD, will be considered utmost when applicable, along with other instruments mentioned.

2.2 - EC and Fiscal State aid – Tackling harmful tax practises.

The so-called guardian of the treaties, tackles harmful tax measures executing art. 107 TFUE. The article aims to maintain a level playing field inside the EU. Even though the first tax related case dates back to 1974[89], EU State aid law has received much attention over the last two decades, when the notion of fighting harmful tax practices first arose. An EC initiative prompted a discussion for coordinated action at EU level to tackle harmful tax

[83] Ibid, para.29
[84] Forum on Harmful Tax Practice.
[85] OECD (2019), Harmful Tax Practices - 2018 Progress Report on Preferential Regimes: Inclusive Framework on BEPS: Action 5, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, p.13.
[86] Easson, Tax Incentives for Foreign Direct Investment, Part II: Design Considerations, IBFD-Bull. 2001, p.365 et seq.
[87] Bracewell-Milnes, Tax Competition – Harmful or Beneficial?, Intertax 1999, p.86 et seq.; Bracewell-Milnes, Uses of Tax Havens, Intertax 2000, p.406 et seq.; Pires, Quo Vadis International Tax Law?, Intertax 2001, p.394 et seq.; Ellis, Are Measures to Curb Harmful Tax Competition necessary?, European Taxation 1999, p.78 et seq.
[88] M.P. Devereux et al., Do Countries Compete over Corporation Tax Rates?, Institute for Fiscal Studies, Working Paper 02/10 (2001)
[89] Case 173/73, *Italy v. Commission*

measures.[90] In this area, the EC is free to determine its policy, subject to CJEU review, and it's independent for its enforcement.

The CJEU have always been vigilant about any measure that could distort competition.[91] Literature review shows that State aid rules are rather short and ambiguous set side by side into their noted significance to the functioning of the internal market.[92] The concept of State aid is determined through the interpretation of the EC and controlled by the CJEU.[93]

The new State aid policy on business taxation is interesting since it was the EC "package to tackle harmful tax competition", the "Monti Package"[94], that encouraged change. Interestingly, the EC quickly communicated[95], at that time, the application of State aid rules to measures relating to direct business taxation following the resolution.[96] This was the starting point of a new era, considering this EC 1998 Notice set the stage for a number of new State aid cases opened.[97]

The CJEU clarified in time that the concept of State aid could potentially include tax measures.[98] They cover any transfer of public resources from the government to a specific beneficiary or to several beneficiaries.[99] State aid rules assure that MSs do not selectively give to a particular company an economic advantage. This aid can distort competition by favouring certain companies over their competitors. Under art. 107 of the TFEU four cumulative conditions need to be satisfied to identify a State aid violation. If one is not met, the article doesn't apply:

1 - A transfer of public resources to an organization involved in an economic activity;

2 - The measure confers an advantage on an organization that it would not have received in the normal course of business;

3 - The measure is selective;

4 - The measure distorts or has the potential to distort competion and influence trade within the internal market.

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[90] Commission communication, *A package to tackle harmful tax competition in the European Union,* Brussels, 05.11.1997 COM (97) 564 final.

[91] State aid was defined in the decision DE: ECJ, 23 Feb. 1961, Case C-30/59, De Gezamenlijke Steenkolenmijnen in Limburg v. Haute Autorité de la Communauté europeénne du charbon et de l'acier.

[92] Peters, Cees. 2019. "Tax Policy Convergence and Eu Fiscal State Aid Control: In Search of Rationality." Ec Tax Review p.28

[93] Forrester E. 2018. "Is the State Aid Regime a Suitable Instrument to Be Used in the Fight against Harmful Tax Competition?" Ec Tax Review 27 (1): p.19

[94] Commission communication, *A package to tackle harmful tax competition in the European Union,* Brussels, 05.11.1997

[95] European Commission, Commission Notice on the Application of the State Aid Rules to Measures relating to Direct Business Taxation, 98/C 384/03, OJ C 384/3, (12 Oct. 1998).

[96] Resolution, annexed to the ECOFIN Council conclusions of 1 December 1997, O.J. No. C2 January 1998.

[97] Terra/Wattel, European Tax Law, Vol. 1 General Topics and Direct Taxation, Fed fiscal studioserie, 7th edition, 2018, p.883.

[98] De gezamenlijke Steenkolenmijnen in Limburg, 30/59, Judgment, EU: C: 1961:2; Italy v Commission, C-173/73, Judgment, EU: C: 1974:71; Banco Exterior de España v Ayuntamiento de Valencia, C-387/92, Judgment, EU: C: 1994:100.

[99] P. Lampreave Márquez, Harmful Tax Competition and Fiscal State Aid: Two Sides of the Same Coin? (2019), Journals IBFD

In the final notice on the notion of State aid,[100] the EC aims to provide clarification to public authorities of MSs and MNEs operating in the EU.[101] Additionally, the notice[102] contains guidelines on how to define State aid by analysing each condition step-by-step present in art. 107 TFEU.[103] The EC position enforces the cumulative aspect that must be present for a measure to be determined incompatible with the internal market.

Selectivity is normally the main focal point of fiscal State aid investigations and generally also the most controversial aspect. The selectivity criterion is formally and in practice split into two questions: determining the existence of advantage and whether such advantage is selective. A three-step approach for determining whether a tax measure is selective was formulated by case law, the so-called "**selectivity test**".[104] The method of a three-step analysis is in line with the 2016 Notice.[105] The interpretation of the CJEU is plausible given that appreciates and compares the circumstances of the beneficiary of the alleged advantage with the position of any other undertaking in a factual and legal situation that is comparable targeting the system of reference. The first step is to identify the **reference system**. As a gold standard, the broader the system of reference, the sooner a derogation from this reference framework leads to a potential selective advantage. In accordance with the case *Paint Graphos*, the system of reference for cases involving tax measures is the general corporate tax system of the MS concerned. Furthermore, if a derogation is established, it must be determined whether the measure is nevertheless justified against the presentation of the nature and general scheme of the reference system.

2.3 – EU third way solution – Soft Law.

In terms of the positive integration of direct taxation, options are limited. Even in terms of negative integration, fiscal State aid is not the creator of tax law. The EU found a "third way" as a solution: the EU Code of Conduct for Business Taxation.[106]

Just before the turn of the century, the ECOFIN adopted the resolution[107] concerning the Code of Conduct on business taxation. The Code was a major step forward in the fight

[100] Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, OJ C 262, pp. 1-50 (19 July 2016).
[101] European Commission Press Release IP/16/1782, State aid: Commission clarifies the scope of EU State aid rules to facilitate public investment (19 May 2016).
[102] Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, OJ C 262, pp. 1-50 (19 July 2016).
[103] The conditions listed in the 2016 Notice: (1) the existence of an undertaking; (2) the imputability of the measure to the State; (3) its financing through state resources; (4) the granting of an advantage; (5) the selectivity of the measure; and (6) its effect on competition and trade between Member States.
[104] At an early stage, the CJEU stated that the comparison should be made 'with other undertakings which are in a legal and factual situation that is comparable in the light of the objective pursued by the measure in question.' Case C–143/99 *Adria-Wien-Pipeline* para.41; Later the CJEU ruled that it should be defined whether the measure 'differentiates between economic operators who, in light of the objective assigned to the tax system of the MS concerned, are in a comparable factual and legal situation.' Joined Cases C–78/08 to C–80/08 *Paint Graphos* para.49
[105] Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, OJ C 262, pp. 1-50 (19 July 2016).
[106] Conclusions of the ECOFIN Council meeting on 1 Dec. 1997 concerning taxation policy DOC 98/C2/01, OJ C 2 (1998) (EU Code of Conduct).

against harmful tax practices. The choice for soft law is not innocent.[108] It reflected the existing tension whenever the issue of direct taxation is addressed and the reluctance of MSs in relation to their tax sovereignty.

The Code *"is a political commitment and does not affect the MSs rights and obligations or the respective spheres of competence of the MSs and the Community resulting from the Treaty"*[109] proves the difficulty that exists to harmonize since MSs have great difficulty in delivering control in this matter. In the report, there is an evident preoccupation not to interfere in the MSs direct taxation competence. The effort of this non-binding political agreement to tackle distortions on tax competition between MSs is illustrated by the coordinated action from all that contributed to removing harmful tax measures. Thus, an improvement in tax transparency through the exchange of information and the evaluation of potential tax measures. The Primarolo Group[110] presented its final report[111] on harmful tax regimes in the EU containing a list of 66 harmful tax measures, that represents a peculiar resemblance to nowadays contested fiscal State aid investigations tax practices. Although, after a further look, there is evidence, as the Netherlands delegation has highlighted, that the report appears to suggest "pseudoharmonisation".[112]

The notion of harmful tax practises is described using broad criteria demanding a case-by-case interpretation. Some of the same criticism is mentioned and could be applied regarding the use of tax State aid rules currently.[113] The criteria for identifying potentially harmful measures include:[114]

(i) An effective level of taxation that is significantly lower than the general level of taxation in the country concerned;

(ii) Tax benefits reserved for non-residents;

(iii) Tax incentives for activities that are isolated from the domestic economy and, therefore, have no impact on the national tax base;

(iv) Granting of tax advantages even in the absence of any real economic activity;

[107] Resolution, annexed to the ECOFIN Council conclusions of 1 December 1997, O.J. No. C2 January 1998, p.1

[108] OECD definition of soft law: Co-operation based on instruments that are not legally binding, or whose binding force is somewhat "weaker" than that of traditional law, such as codes of conduct, guidelines, roadmaps, peer reviews. Available here: https://www.oecd.org/gov/regulatory-policy/irc10.htm.

[109] Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee on the work of the EU Joint Transfer Pricing Forum in the field of business taxation from October 2002 to December 2003 and on a proposal for a Code of Conduct for the effective implementation of the Arbitration Convention (90/436/EEC of 23 July 1990).

[110] The Council confirmed the establishment of the Code of Conduct Group on 9 March 1998. It was presided over by Mr. Primarolo (the then UK paymaster general) and the first meeting was held in May 1998.

[111] Report from the Code of Conduct Group (Business Taxation) to the ECOFIN Council on 29 November 1999 on the Code of Conduct (Business Taxation), SN 4901/99 (1999).

[112] Ibid, p.2

[113] E. (Edouard) Fort, EU State Aid and Tax: An Evolutionary Approach, (2017) Journals IBFD.

[114] Conclusions of the ECOFIN Council Meeting of 1 Dec. 1997 Concerning Taxation Policy – Resolution of the Council and the Representatives of the Governments of the Member States, Meeting within the Council of 1 Dec. 1997 on a Code of Conduct for Business Taxation – Taxation of Saving, OJ C 2/01 (1998).

(v) The basis of profit determination for companies in a multinational group departs from internationally accepted rules, in particular those approved by the OECD;

(vi) Lack of transparency.

The Code established a Code of Conduct Working Group.[115] Over the years, the Group has evaluated more than 400 tax regimes, and around 100 tax regimes have been removed or amended.[116]

The purpose of the Code of Conduct is to produce two types of effects: roll back existing tax measures that constitute harmful tax practices and to refrain from adopting similar tax measures in the future ("standstill"). The EC clearly stated that tax systems should not contain harmful tax measures but also had to be in line with EU State aid law. Furthermore, it is noted that some of the tax measures covered by the Code could fall within the scope of the State aid provisions.[117]

2.4 – The Code vs art. 107 TFEU

The notion of State aid within the meaning of art. 107 TFEU and harmful tax measures within the meaning of the Code of Conduct differ. The latter instrument is related to State aid rules due to its intention to tackle harmful tax measures. A tax measure classified as harmful by the Code of Conduct does not necessarily entail State aid. Conversely, a tax measure classified as harmless does not guarantee that it involves no State aid within the meaning of art. 107 TFEU. Similarly tackling harmful tax practices is the goal in the OECD 1998 Report[118], signifying a possible correlation between all of them. The parallel between the Code and a new EU tax State aid policy on business taxation is interesting if we recall it was the EC "package to tackle harmful tax competition" that urged for a change, pointing already a drive for harmonization.

Despite having the same goal, avoid measures that affect competition, cornerstones of the Union project, qualifications are distinct.

From one's point of view, it is understood that there is an apparent overlap between the Code of Conduct adopted to eradicate harmful tax measures and the EU State aid rules, that doesn't actually exist. Fiscal State aid investigations endeavors to eradicate the distortion in "competition between companies" preventing states through their tax policies to favour

[115] T. O´Shea, Ensuring Fair Taxation: 20 Years of the EU's Code of Conduct Group, Tax Notes Intl, p.717-722 (2018).
[116] Council, Report by the Code of Conduct Group to the Council of 12 June 2018, Overview of the preferential tax regimes examined by the Code of Conduct Group (Business Taxation) since its creation in March 1998, Doc. 9639/18.
[117] Report from the Code of Conduct Group (Business Taxation) to the ECOFIN Council on 29 November 1999 on the Code of Conduct (Business Taxation) (1999) para. J.
[118] OECD (1998), Harmful Tax Competition: An Emerging Global Issue, OECD Publishing, Paris.

certain economic operators over others, in a comparable legal and factual situation. The Code seeks to fight harmful tax practices and eradicate distortions of "competition between MSs".

2.5 - The EC 'New' Approach

An overview of the substantial case law is necessary to make a brief assessment and present common points of relevance. State aid law itself is not wrong. The critical focus is the EC approach is the application of art.107 TFEU, interpretation of the ALP, tax selectivity criteria, and the definition of the reference system. The relevant literature mentioned above and the analysis of the case law below is decisive to determine and develop the terms on which the EC is eroding MS's direct taxation competence and the hypothesis of infringement the principle of legal certainty.

At the moment, the facts point out that: tax sovereignty is an inherent right to levy taxes in its territorial jurisdiction, direct taxation falls within the exclusive tax competence of MSs, but MSs must exercise their competence on direct taxation consistently with the EU law. Therefore, State aid law restricts MS's fiscal sovereignty as a EU law limit. Additionally, the fiscal State aid investigations should be eradicating the distortion in "competition between companies" from a selectivity perspective.

To test the theory supported by this research and the proposed hypothesis of endangered legal certainty, the argument will be based on the case law analysed below and evaluated in light of the normative framework developed above. The evaluation of the court's merit decisions is outside the scope of this research, as well as a detailed explanation of the concept of ALP within the framework of the transfer pricing area. The EC lost at trial in both the Belgium Excess Profit and the Starbucks case, whereas it won only in the Fiat case.

2.5.1 - Belgium Excess Profit.

The EC investigation on the Belgium excess profit scheme was sustained on a misapplication of the Belgian income tax code and the ALP that allowed deducting excess profits from the beneficiaries company's tax base. Entities part of an MNE could reduce their tax base through the deduction of excess profits from their actual profits.

Tax rulings under EU State aid rules are not an issue if they merely establish tax arrangements complying with the applicable legislation. The aid granted normally consists of income that belongs to the State that it's not collected,[119] "the absence of a gain for the State in question".[120] The EC expressed concerns about tax rulings ratified unilateral downward adjustments of the beneficiary's tax base, without any legal basis. Moreover, the EC was

[119] R. Bondrager et al., The Impact of Fiscal State Aid Recovery Risks on Share Purchase Agreements, 56 Eur. Taxn. 10 (2016), Journals IBFD

[120] Opinion of Advocate General Léger in Case C-159/01 *Netherlands v. Commission* para.84

worried that issuing excess profit rulings in favour of certain companies may discriminate against certain Belgian companies, which did not, or could not, receive the same treatment or rulings.

The EC believed these rulings allowed erroneously those companies to pay substantially less tax.[121] The excess profit exemptions granted constituted an aid scheme and such scheme was illegal under EU State aid regulation. The EC considered the article of Belgium tax code provided for a selective advantage[122]and argued that the advantage was selective because it is only available for companies' part of MNEs and there was no justification for the selective treatment by the nature or general scheme of the Belgium tax system. Commissioner Margrethe Vestager said regarding this case that*:* "*the Belgian "excess profit" tax system granted substantial tax reductions only to certain multinational companies that would not be available to companies in a comparable situation."*[123]. The adjustments were done pro-actively and unilaterally regardless of any actual risk of double taxation.

Be that as it may, it is not part of the scope of this investigation to assess the merits of the court's decisions deeply. However, the CJEU did not pronounce on whether or not the "excess profit" tax exemptions gave rise to illegal State aid.

The case is substantial to demonstrate, once again, and reinforce the author's position regarding direct taxation. As EU law currently stands, this is an exclusive competence that falls within the competence of the MSs. Nonetheless, they must exercise that competence consistently with EU law.[124] The CJEU also confirmed the research stating that although MSs enjoy fiscal autonomy in the field of direct taxation, any fiscal measure adopted must comply with the State aid rules of EU law.[125] The CJEU goes even further and spells out a standstill rule inherent to that fact.[126] Also, it is undisputed that the EC is the competent body to ensure compliance with art. 107 TFEU.[127] For the EC's approach in the field of State aid to be systematic, logical, and consistent with art.107 TFEU, the identification of the reference system, the first step, is very important. Although this specific case has not yet been evaluated in material terms, the reference system, domestic tax code, implemented an article that replicated explicitly the internationally accepted ALP inspired by the OECD transfer pricing guidelines.[128] A key aspect of this case concerns the selection of the most appropriate transfer

[121] European Union; Belgium - European Commission: Belgian excess profit scheme constitutes incompatible State aid (11 Jan. 2016), News IBFD.
[122] B.J.M. Terra & J. Kajus, Investigations into individual "excess profit" tax rulings granted by Belgium to 39 multinational companies (23 Sep. 2019), News IBFD.
[123] State aid: Commission opens in-depth investigations into individual "excess profit" tax rulings granted by Belgium to 39 multinational companies, Press release, 16 September 2019, Brussels.
[124] Joined Cases T-131/16 and T-263/16, *Kingdom of Belgium and Magnetrol International v European Commission* para.62.
[125] Ibid, para.61
[126] Ibid, para.63
[127] Ibid, para.62
[128] The arm's length principle was introduced into Belgian tax legislation by the addition of a second paragraph to Article 185 of the CIR 92, based on the text of Article 9 of the Model Tax Convention on Income and Capital of the OECD. See OECD

pricing method. The application of a one-sided method is taxed (or untaxed) by a different country is the natural consequence of applying these methods and is, therefore, not against the proper application of the ALP.

2.5.2 - Starbucks Case.

The EC scrutinized an APA celebrated between the Dutch tax authorities and Starbucks concerning the deductibility of Starbucks payment of a specific level of royalties to a related entity, resulting in a reduction in the tax base of Starbucks.[129] The existence of illegal State aid due to the identification of a derogation from the reference system of Dutch tax rules that could not be justified was concluded. The derogation arose from the fact that the valuation method chosen in support of the APA did not reflect normal market conditions.

According to the EC, the application of ALP is erroneous, refusing to consider the Dutch Decree as a reference base, as well as, to compare the Dutch treatment of Starbucks only with the Dutch treatment of other multinationals.[130] The more circumscribed the reference system is, the more complicated it will be for the EC to demonstrate the existence of a selective advantage or a different tax treatment that integrates State aid pursuant to art. 107 TFEU.

However, the most notable part of the decision of the CJEU is the confirmation of an EU ALP, a transfer pricing principle developed autonomously and, thus, imposing substantive rules of tax law to MS's.[131] As a result, a European ALP is now supposed to be part of the art. 107 TFEU. This EU ALP is part of EU competition law and is needed to test the application of the ALP standard. An ALP that is not the same as the national and international tax law. To justify the existence of this principle the CJEU rely strongly on the argument that art.107 TFEU presupposes a principle of equal treatment.[132] The assumption of foreseeability is inconceivable when the scope of a single article is so broad that everything fits inside. Following *Wattel's* definition, this principle is "aimed at protecting a level playing field for all economic operators in the internal market, i.e. at protecting free competition, rather than at tax base protection or prevention of double taxation".[133]

Pursuant to the Notice of 2016, the reference system is composed of "*a consistent set of rules that generally apply — on the basis of objective criteria — to all undertakings falling*

(2017), *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017*, OECD Publishing, Paris.

[129] Commission Decision 2017/502 (Oct. 21, 2015) on state aid implemented by the Netherlands to Starbucks, 2017 O.J.

[130] R. Mason, "State Aid Special Report – Part 6 : Arm's Length on Appeal", p. 771, 776

[131] Joined Cases T-760/15 and T-636/16, *Kingdom of the Netherlands and Starbucks vs. European Commission* para.131ss

[132] Ibid, para.158

[133] P. Wattel, Stateless Income, State Aid and the (Which?) Arm's Length Principle, Intertax, 2016, volume 44, issue 11, p.791.

within its scope as defined by its objective”[134] Identify the reference system represents the benchmark the EC, within its State aid assessment, shall demonstrate the existence of a derogation caused by the fiscal measure under its scrutiny. In every case, this step is of major significance. Particularly, both parties disagreed with the determination of the reference framework. The CJEU upholds the EC position of identifying the reference system by stressing out that, in order to reach such a conclusion, domestic law shall not distinguish between integrated companies and stand-alone companies as regards their corporate tax liability. The decision did not perform a substantial analysis as to whether stand-alone and integrated companies are, in fact, comparable.

2.5.3 - Fiat Case

The EC examined a tax ruling granted to an entity providing financing and treasury services to Fiat. The ruling approved a valuation method allowing a profit distribution favourable to the Fiat group.[135] The EC argued that the reference base included the general Luxembourg corporate tax system and found a derogation from the reference system of Luxembourg tax rules in the form of a deficient choice of method-of-assessment. Stand-alone companies could not achieve the reduced tax base in the same way.[136]

Without considering the national tax framework, and rather judge the case by applying its own independent ALP originated in art.107 TFUE, not from MSs adoption of the ALP in domestic law[137], the EC finds that Fiat received a selective advantage from the Luxembourg tax administration, unlawful State aid.[138] Luxembourg follows the author’s opinion and claimed that the EC was engaging in tax harmonisation in disguise, despite direct taxation falling within the exclusive competence of the MSs.

Once again, the CJEU reinforced the imperative exercise of direct taxation competence consistently with EU law, thus, confirming the scope of State aid rules to areas that have not been harmonised in the EU, such as direct taxation.[139] In that context, art. 107(1) TFEU allowed the EC to verify whether the pricing of integrated undertakings corresponds to the pricing under market conditions in order to determine if a selective advantage may have been granted.

The tool of the EU ALP as applied by the EC in the context of art. 107 TFEU is an instrument or benchmark for making that comparison. Likewise, the EC formulation of the EU ALP introduces legal uncertainty and confusion as to when a tax ruling might breach the rules on State aid law. Despite the fact that requirements already mentioned earlier demand

[134] Art 133 of 2016/C 262/01 (EC notice 2016); EC decision 2016/2326 p.193; 2017/502 p. 231.
[135] Commission Decision 2016/2326 (Oct. 21, 2015) on state aid Luxembourg granted to Fiat, 2016 O.J. (L 351)
[136] Ibid, paras 198 and 199
[137] Ibid, para.228
[138] Ibid, para.311ss
[139] Case T-755/15, *Grand Duchy of Luxembourg and Fiat Chrysler Finance Europe v European Commission* para.104.

that legal rules are clear and precise, aiming to ensure that situations and legal relationships governed by EU law remain foreseeable[140], the CJEU decided it was illegal State aid and that the legal rule that led to the adoption of the contested decision, art. 107 TFEU and the four conditions for a finding of such aid, which are are clear and precise fulfilling the principle of legal certainty.[141]

"*The EC does not, at this stage of the EU law, have the power autonomously to define the normal taxation of an integrated undertaking, disregarding national tax rules"*[142]. - The EC disregards the domestic reference framework, which also contains a proper ALP within its national legislation. The *sui generis* nature of the ALP was confirmed, the most criticized assumption.

The CJEU, again, did not perform a fundamental substantial analysis as to whether stand-alone and integrated companies are comparable, also missing in the Starbucks case. The determination of the reference system seems to be a big problem. Things don't look great if the first step is constantly expanded. This means not only that MS's competence to grant an APA does not escape from the scrutiny of EU fiscal state aid control but also the great wide scope of art.107 TFEU to catch everything that may fit there. The EC broad approach to the objective comparability analysis confirmed tacitly by the CJEU puts all the undertakings in a MS in a comparable situation, making the first step of the selectivity test rather automatic and formal.[143]

2.5.4 – Apple Case – The smoking gun

Similarly to the other cases mentioned above, this is also a case of a tax ruling raising profit allocation issues. The legal conumdrum starts with the questionable Irish rulings and the allocated profits to the Irish branches of Apple's Irish-incorporated subsidiaries in accordance with the ALP.[144] Regarding the interpretation of the selectivity criteria and more specifically the first step concerning the definition of the reference system, opinions differ.

Overall, the EC claims that the tax rulings granted to Apple did not reflect the economic reality of the transactions. The method of allocation of profits chosen allowed the group to be tax exempt by virtue of a former mismatch between Irish and tax residence rules. The EC assumed that the reference system should include all the companies taxed in Ireland,

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[140] Case C-63/93, *Duff and Others v Commission* para.20.
[141] Case T-755/15, *Grand Duchy of Luxembourg and Fiat Chrysler Finance Europe v European Commission* para.406
[142] Ibid, para.112
[143] See Ivan Lazarov and Svitlana Buriak, *Luxembourg - Is Fiat's Tank Half-Full or Half Empty? The General Court's Decision in Luxembourg v. Commission (T-755/15)*, International Transfer Pricing Journal, Vol. 27, 2020. The authors make a comparison between the Fiat case and the *Gibraltar* case (C-106/09 P). As regards Gibraltar, they believe it was a highly unusual situation where the totality of the domestic reference framework conferred a selective advantage to offshore companies and, therefore, the CJEU had to come up with a new approach regarding comparability. "*This new approach required comparing all companies and was the natural result of the fact that the tested measure was the whole system of corporate taxation introduced in Gibraltar, which was allegedly de facto selective*". This was not the case in Fiat, where the tested measure was the APA derogating from the specific rules on transfer pricing under the domestic law of Luxembourg.
[144] R. Mason, "Special Report on State Aid- Part 3: Apple", Tax Notes, 6th February 2018, p.735, 737.

the resident ones and non-resident ones. The determination of the taxable profit should ensure "that integrated companies are taxed on an equal footing to non-integrated companies under the ordinary rules of taxation of corporate profit".[145]

The ALP was not incorporated in the Irish domestic tax law. There was no guidance on how to determine the liable profit of an Irish branch. The ALP was incorporated in the Irish law in 2010, and even then, the relevant provision only applied to related companies and not in case of allocation of profits within a single company. The EC argues that Ireland should have applied the ALP in the granted tax rulings as in the OECD guidelines, because it reflects a 'general' or 'independent' standard in fiscal State aid law, avoiding to mention and debate the absense of the principle in the domestic tax legislation, the supposed reference system. The EC, once again, states that the application of the ALP *"flows from Article 107 of the Treaty, as interpreted by the Court of Justice, which binds the MS and from the scope of which national tax rules are not excluded. That principle therefore applies independently of whether the MS in question has incorporated the arm's length principle in its national legal system"* [146]

Section III – The hidden tax policy - Tackling harmful tax practices or something else?

A well-known problem with State aid law is the EC approach restricting the competence of MS's in matters of direct taxation causing a political debate on the level of EC tax competence and interference with MS's tax sovereignty[147]. This turns out to be even more problematic because the undeterminated EC approach leads to uncertainty, particulary to MNEs. When it comes to tax measures, the scope of art. 107 TFEU is still unclear since, for instance, there are still uncertainties on how the reference framework of the general tax system and the relevant comparison should be established.[148]

The EC seems to be using its powers in the area of State aid as an instrument for carrying out not only fiscal State-aid policy but also a genuine hidden tax policy. An intended path of harmonization by negative integration. Through EU State aid control, a form of negative integration, as an alternative to harmonization and coordination via secondary law instruments, positive integration, which the EC is unable to get under the unanimity rule and the resistance of the MSs.

In the author's opinion, the EC investigations regarding State Aid rules point out the shift from preferential tax regimes whose selectivity results from criteria contained in MS's

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[145] Commission Decision 2017/1283 (Aug. 30, 2016) on state aid implemented by Ireland to Apple, 2017 O.J. (L 187) para. 230.
[146] Ibid, para.257
[147] Dennis Weber, EU Law and the Building of Global Supranational Tax Law: EU BEPS and State aid, 2017, p.37-40.
[148] Peters, C. Tax Policy Convergence and Eu Fiscal State Aid Control: In Search of Rationality. Ec Tax Review 2019, 28 (1), p.6

tax systems to administrative decisions and rulings on the application of general rules or principles whose effects are to validate complex, international tax-planning schemes set up by MNE's. Tackling harmful tax measures comes up nowadays as not merely a side effect of State aid law, a form of negative integration, but also its pretended public main driver. International doctrine points State aid rules as "backdoor rules" to fight harmful tax practices.[149] State aid rules control the tax sovereignty of MSs by limiting their power to attract companies via harmful selective fiscal measures.

Nonetheless, it is not suitable for tackling harmful tax competition. Two arguments that support this position are the wording of art. 107 TFEU and the approach case-by-case nature of State aid law, restricted to the territory of one MS without considering the practices of other MS's.[150] At the same time, a general tax measure, no matter how harmful it may be, shall not be declared illegal State aid if it applies generally to all companies operating in that state without exception or if the exception is justified by the nature of the tax system, reference tax system.

EU State aid rules and the EC aim to eradicate the distortion in "competition between companies" preventing states through their tax policies to favour certain economic operators over others, in a comparable legal and factual situation. Tackling harmful tax practices means eradicate distortions of "competition between MS's". Therefore, the aim is similar enough to be confused but sufficiently different not to overlap. conducts upon the rule of law.

State aid law demands prior notification of all new aid measures to the EC even though notifications are relatively few, as MS's considered that incorporating new measures is within their tax sovereignty and it is not necessary to notify them. That is changing since the EC has sent a powerful signal to the MS's employing fiscal State-aid policy and pushing MS's to follow its interpretation in fiscal policy. Thus, hiding a European tax-policy.

3.1 – Eroding tax sovereignty – MS's arguments

There seems to be no doubt as to whether EU State aid law restricts MS's competence, namely, tax sovereignty. For this reason, it is necessary to confirm whether State aid investigations are increasing this limit, i.e. gently eroding tax sovereignty. Moreover, as already said, the CJEU's competence is not to create EU law, but to interpret it. The Starbucks and Fiat decisions, which determine the existence of a EU ALP principle based on the interpretation and decision of the EC that until now its existence was unknown, strengthens the thesis that there is a EC fiscal policy, and that the policy is accepted by the CJEU. The

[149] Edoardo Traversa & Alessandra Flamini, Fighting Harmful Tax Competition through EU States Aid Law: Will the Hardening of Soft Law Suffice? 2015 Eur. St. Aid L. Q. 323, 325 (2015)

[150] Eu Tax Law and Policy in the 21st Century; Haslehner, W., Kofler, G., Rust, A., Eds.; Eucotax, Series on European Taxation, 55; Wolters Kluwer: Alphen aan den Rijn, The Netherlands, 2017, p.127

Apple case turns out to be even more serious to prove the eroding of tax sovereignty since MSs are required to use an ALP without a legal basis in the reference system. Is time to answer the question: **To what extent are the EC fiscal State aid investigations purely tackling harmful tax practices while eroding a certain degree of MS's tax sovereignty?**

The debate at this point is based on EC's application of State aid law and interpretation of the ALP. The purpose of this paper, at this stage, is to demonstrate that EC investigations in fiscal State aid are, to some extent, interfering with MS's competence in direct taxation. The premise is again the State aid rules as a limit to that sovereignty. Let's imagine that MSs potentially have all the tax sovereignty inside a box. The walls of that box are the limits, in this case, one of them is State aid law. Taking into account the assessed case law, the vague EC approach, and wide use of article 107 TFUE, the limit is sort of "expanding" pressing the space inside the box, i.e. eroding tax sovereignty.

A conclusion that can be drawn from the case law studied is a hypothetical obligation to apply the ALP. The EC's approach on using a *sui generis* ALP when testing tax rulings is derived from the idea that individual and group companies are in similar legal and factual circumstances. This approach is aware of the fact that, from an economic perspective, the idea of group companies is to benefit from group integration, so that their mutual transactions are motivated by synergy and not arm's length transactions. Even though the ALP is transposed into domestic law, inherently recognized in the MS reference tax systems, and inspired by the OECD transfer pricing guidelines, which could be used as a benchmark to determine the existence of selective advantage in the State aid cases, there is no EU law provision requiring MSs to have any ALP or other transfer pricing legislation. Therefore, when it is not expressly agreed, it remains in the competence of MSs.

If MSs are in no way required to incorporate these standards, there's also no requirement on a mandatory applying of any specific adjustment method as seems to be the idea of EC in Starbucks and Fiat case. Now, if this obligation does not exist in case the MSs have incorporated the ALP in their national legislation, on what basis can the EC apply an ALP in the Apple case, taking into account the steps to determine an illegal aid, since the system of reference does not have an ALP.

Allocate profits has always been recognized as a sovereign choice.[151] Broadening upon the scope of fiscal State aid through the description of a 'normal' or 'general' tax system erodes MS's tax sovereignty.

[151] R. Mason, "Tax Rulings as State Aid- Part 4: Whose Arm's Length Standard?" p.947-956

The existence of a EU ALP confirmed in the case law of Starbucks and Fiat, that art.107 TFEU amounts to a "general principle of equal treatment in taxation that would allow no different treatment of the profits of stand-alone companies and integrated companies."[152]The decision makes clear that the so-called EU ALP should oversee the application of transfer pricing law. But how is this possible if the MS has no transfer-pricing article incorporated in its domestic reference system framework. It does not exist in art. 107 TFEU an obligation to use ALP to define the allocation of profits. It is not the only method available. For instance, the Common Consolidated Corporate Tax Base determines the application of the formulary apportionment method through an allocation key.

Furthermore, the EC claimed in Starbucks that the Dutch use of the transactional net margin method violated the ALP, granting a selective advantage. The proper method to be used in this case was the comparable uncontrolled price method. However, the absence of EU legislation that forces a MS to give priority to one transfer pricing method over the other is contrary to that position. There is no paragraph in art. 107 TFEU that indicates the best method, or the preferred method for allocating profits. Therefore, the fact that the EC simply has a different opinion regarding the results of the method used does not mean it is the incorrect method to apply. Even if it's the wrong method, it is a mistake, not illegal State aid.

Finally, if a MS has explicitly incorporated and acknowledged the OECD transfer pricing guidelines, it will form a benchmark independently on whether the ALP is part of that reference system itself. The CJEU states that the EC cannot simply put aside the OECD Transfer Pricing Guidelines in order to give a more explicitly autonomous interpretation to the EU ALP.[153] However, the result is arguable if there is no such explicit reference to the OECD transfer pricing guidelines in the domestic law or administrative practice. Besides, it is legally wrong to accept the OECD transfer pricing guidelines as a benchmark just because they "reflect the international consensus achieved with regard to transfer pricing".[154] They must be present in the reference system.

The pending Apple case is the one that most strikingly demonstrates the eroding of the sovereignty of MSs. Under the EC approach of art.107 TFUE, the new EU ALP recognized by the CJEU, and the new role given to the OECD transfer pricing guidelines, the ALP is part of the EC's assessment of aid, even though the ALP is not incorporated in the

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[152] Joined Cases T-760/15 and T-636/16, *Kingdom of the Netherlands and Starbucks vs. European Commission* paras.167-168
[153] Ibid, para.155
[154] Ibid.

Irish domestic tax law. This is an unacceptable result, which does not follow the State aid law set out in art.107 TFEU, since it totally disregards the first step, the reference system.[155]

MSs are not required by EU law to include in national legislation any transfer pricing legislation, let alone any specific method of transfer pricing adjustment. The only reference to an OECD soft law arm's length principle in documents connected to the EU is the Code of Conduct that is, also, not binding. Lastly, the recent EC notice on State aid, which is dated from 2016, is soft law as well. If a policy area is not cited in a Treaty, the EC cannot propose a law in that area, for this reason, MSs are not required to use an EU ALP that is not typified in any EU law. More than that, MSs are not even given options for what method to use when it comes to cross-border transactions or how to perform a comparability analysis.

In the meantime, sounds clear that with the lack of definition established, MSs will, more and more, require the EC to approve and confirm national tax rulings before they take effect. On one hand, this calls for more stringent legislation. On the other hand, it succeeds to demonstrate a substantial tax sovereignty limitation, contradicting the tax sovereignty that MSs have as regards direct taxation, resulting in the EC's acting as an informal second supranational tax administration.[156]

3.2 – The EC "secret explanatory memorandum" written between the lines.

The first exhibited sign of intention to harmonize the field of direct taxation can be seen by the new approach in 1996, in light of the "tax competition" notion being addressed for the first time.[157] The EC recognizes the impact competition in tax matters has on Europe in a document called "Taxation in the European Union"[158]. The intention is to accomplish the objective of a better internal market and stabilizing national tax systems. The Monti Package offered an initial real prospect of an agreement.[159] The use of State aid rules to fight harmful tax practices was an instrument used since the beginning as demonstrated by the State Aid Business Tax Notice following the adoption and as a complement to the Code of Conduct.[160] The MSs did not reveal promptitude in the implementation of the package against harmful tax competition. Thus, for the first time, the EC acted in a way that represents the theme that this investigation tries to defend. This refers to the launch of investigations into fifteen regimes

[155] P.J. Wattel 2016 "The Cat and the Pigeons: Some General Comments on (TP) Tax Rulings and State Aid After the Starbucks and Fiat Decisions" Springer-Verlag Berlin Heidelberg 2016.
[156] Ibid, p.187 and 194, Such EU-wide clearing house system has indeed already been called for in 2015 by the Special Committee on Tax Rulings and Other Measures Similar in Nature or Effect.
[157] Monti, The Single Market and Beyond, EC Tax Review 1997, p.2 et seq.; Bolkestein, Taxation and Competition: The Realization of the Internal Market, EC Tax Review 2000, p.78 et seq.
[158] See European Commission, Taxation in the European Union – Report on the Development of Tax systems, 22 Oct 1996 COM (96) 546 final; Cnossen, Monti's ECOFIN Discussion Paper, Intertax 1996, p.228ss
[159] Communication from the Commission to the Council: Towards Tax Coordination in the European Union – A Package to Tackle Harmful Tax Competition in the European Union, (1997) para.6
[160] Commission Notice on the application of the State aid rules to measures relating to direct business taxation OJ C 384, 10.12.1998 p.3–9. Para. 2

identified by the Primarolo Group as potentially harmful on the basis of the criteria laid down in the Code of Conduct in July 2001.[161]

In 2004 the aspirations of the EC were threatened in the *Gibraltar*[162] case. The tax measure appreciated did not meet the selectivity criterion within the classic assessment used to identify a selective advantage. Also, the comprehensive use of State aid rules has been called into question.[163] However, the CJEU backed the EC position and ruled that the tax measure constituted selective aid given that "its very application resulted in a different tax burden for different undertakings"[164] and declared to be incompatible with EU State aid law.

Commissioner Vestager shows no intention of giving up and wants enforcement of EU State aid rules intended to protect fair competition in the EU's Single market.[165] The position of the EC is expressed in an interview stating the use of the State aid ban due to the failure of MSs to coordinate their national taxing systems.[166]

For the author, the EC's position and policy are no longer hidden when recently Vestager states without a doubt: "*the ultimate goal that all companies pay their fair share of tax can only be achieved by a combination of efforts to make legislative changes, enforce State aid rules and a change in corporate philosophies".*[167]

The EC has broadened the concept of 'selectivity' exploiting the powers of interpretation to be able to enforce a tax policy even when the State aid rules would not apply, despite the notion of harmful tax measures developed in the Code of Conduct. From the interpretation of the ALP, to the broad criterion of art.107 TFUE applied even more widely in the EC approach an incidental effect of the State aid investigations on tax rulings is the contribution to more transparency which in turn indirectly contributed to restoring the level playing field.

The EC hoped that, despite being soft law, the Code of Conduct would make the MSs through an attitude of, at least standstill, avoid measures that would jeopardize the internal market and refrain from creating externalities that only a horizontal coordination policy can

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[161] European Commission Press Release, 11 July 2001: 'Commission Launches Large Scale State Aid Investigation into Business Taxation Schemes', http://europa.eu/rapid/press-release_IP-01-98 2_en.htm.
[162]Joined Cases T-211/04 and T-215/04 *Government of Gibraltar v Commission*
[163] Opinion of the Advocate General of the Court of Justice: "harmful institutional or tax competition between Member States clearly does not fall within the mechanism for controlling State aid established by the Treaty'… 'If the tax system is of a general character, it falls outside the application of Article [107 TFEU]'. *Commission and Spain v Government of Gibraltar and UK*, Joined Cases C-106/09 P and C-107/09 P, AG Opinion, paras.134 and 140
[164] Joined Cases C-106/09 P and C-107/09 P *Commission and Spain v Government of Gibraltar and UK* para.93
[165] Letter of EU Commissioner Vestager to Secretary Lew of the US Department of the Treasury (29 Feb. 2016)
[166] See: https://www.theguardian.com/world/2017/sep/17/margrethe-vestager-people-feel-angry-about-tax-avoidance-european-competition-commissioner.
[167] European Commission - Statement by Commissioner Margrethe Vestager following Court judgments on two tax State aid cases (Fiat in Luxembourg and Starbucks in the Netherlands), Brussels, 24 September 2019

avoid.[168] Thus, the EC uses State aid control to force MSs to eliminate these allegedly harmful measures. There is a shift to the use of hard law, even if it is not the proper instrument for tackling harmful practices in the context of the Single market due to the failure of the MSs to coordinate a solution that eliminates these externalities.[169] With the difficulty that exists in harmonizing in matters of direct taxation, and uniting the unanimity of the MSs, the position of the EC is somewhat understandable. Paradoxically, the uncertainty that EC brings into State aid law by introducing the ambiguous ALP distinct from the OECD guidelines, will motivate MSs to bring more certainty on the EU and international level.[170]

As already ascertain in this research, the EU Code of Conduct and the Code of Conduct Group is monitoring, above all, general tax measures, while the EC when dealing with State aid law considers imperatively selective measures. Despite this, their work is not mutually exclusive.[171] Although harmful tax measures for the Code's criteria may be unlawful State aid, it was also mentioned above that measures regarded as harmful comply with the State aid rules, and vice versa.[172] The consequence of the EC using State aid standards in this wide way is an interference in the competence in direct taxation of MSs that creates legal uncertainty whose benchmark is foreseeability to adopt conducts upon the rule of law.

There is widespread belief among several authors, like us, that the EC is increasingly interfering in fiscal matters reserved for MSs under current legislation that should be left outside the framework of the State aid regulations.[173] The point is that the rules of art. 107 TFEU has a scope that is restricted to selectivity. This selectivity has been extended in a way that does not allow foreseeing the result, i.e. generating a state of uncertainty that harms MNEs, and companies in general.

Section IV – Issues for multinational companies– urge for legal certainty.

To test the effect of the EC's approach a second sub-question must be discussed: **To what extent are the current system of fiscal State aid investigations and the argued conflict to a certain degree of tax sovereignty on direct taxation capacity in Europe promoting legal uncertainty in the field, and to MNEs?**

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[168] W. Bratton & J. McCahery, Tax Coordination and Tax Competition in the European Union: Evaluating the Code of Conduct on Business Taxation, 38(3) Common Mkt. L. Rev. 718 (2001).

[169] D. Kyriazis, From Soft Law to Soft Law through Hard Law: The Commission's Approach to the State Aid Assessment of Tax Rulings, 15(3) Eur. St. Aid L. Q. 436 (2016).

[170] Vos B. 2018. "State Aid, Taxation & Transfer Pricing: Illegal Fiscal State Aid Granted to Starbucks?" Ec Tax Review 27 (2) p.113 and A. Miladinovic & R. Petruzzi, The Recent Decisions of the European Commission on Fiscal State Aid: An Analysis from a Transfer Pricing Perspective, 26 Intl. Transfer Pricing J. 4 (2019), Journal Articles & Papers IBFD p.252.

[171] A. Easson, State Aid and the Primarolo List, The EC Tax J. 5, p.111 (2001).

[172] C. Pinto, EC State Aid Rules and Tax Incentives: A U-Turn in Commission Policy? (Part I), 39 Eur.Taxn. 8 (1999), Journals IBFD.

[173] R.H.C Luja, EU State Aid Rules, Tax Competition and Its Limits, 76 Tax Notes Int'l (2014), the author stated the following: "If we start abusing the State aid regime to cover situations where the founders of the EU aimed at using the instrument of legal harmonization, then political wishful thinking could turn into harmful tax policy" and "As state aid focuses on the national tax system for reference and selective benefits within that system, it is not suited to deal with large parts of tax avoidance in the international arena although, admittedly, the opening of formal state aid investigations can serve to bring the BEPS project forward within the EU".

The author follows the debate about legal certainty in fiscal State aid by the EC.[174]One of the debated topics concerns the alleged breach of the Rule of Law, a founding value of the EU.[175] In particular, such principle comprises the principle of legality, and guides decision maker's actions, such as the EC, to resolve disputes by applying legal rules that have been declared beforehand, and not to alter the legal situation retrospectively by discretionary departures from established law.

A thorough analysis of the full economic impact regarding legal uncertainty is outside of the scope of this research. However, the argument claiming that legal certainty is endangered, followed by the author, seems naturally noticeable with the EC's approach in targeting tax rulings, the interpretation of the ALP, and to apply EU State aid standards broadly and, perhaps, discretionarily.

If, in principle, MSs have the power to legislate and celebrate tax agreements with companies operating in their territory, jurisdiction, the application of EU fiscal State aid, as an obviously necessary mean of limiting national measures to protect the internal market, creates indeterminacy to the conduct MNEs must adopt when is descretionary. The approach of the EC concerning State aid rules is not clarified, nor the essence of their application seems clear. Thus, the problem underlying is arbitrariness, since it is not possible to predict decisions promoting vagueness and uncertainty.

Taxpayers celebrate individual tax rulings for the sake of legal certainty to undertake costly business transactions. Fiscal State aid investigations are tackling precisely instruments providing legal certainty. Indeed, MNEs are now obliged to turn into the EC to get that required legal certainty. This reality grants powers to the EC not only referred to the "automatic notification" of national tax rulings, for example, using one transfer pricing method, in particular, ensured in a tax ruling, is not equivalent to illegal State aid, but with the power to determine how the proper allocation of profits among MSs should occur. Understandably, MNEs and tax authorities are confused.[176]

The new approach of the EC based on the method of a general standard or rule is applied in a MS tax system that involves great uncertainty. Unlawful State aid exists in any situation where the EC may identify any wrong application of tax rules by tax administrations, which is natural in complex matters such as an intercompany allocation of cross-border

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[174] Verhagen T.H.J. 2018. "Conference: New Perspectives on Fiscal State Aid: Legitimacy and Effectiveness of Fiscal State Aid Control." Ec Tax Review 27 (6): p.440.

[175] Art. 2, Consolidated Version of the Treaty on European Union [2012] OJ C326/01See also: The rule of law is defined in the Oxford English Dictionary as: " The authority and influence of law in society, especially when viewed as a constraint on individual and institutional behavior; (hence) the principle whereby all members of a society (including those in government) are considered equally subject to publicly disclosed legal codes and processes".

[176] P.J. Wattel 2016 "The Cat and the Pigeons: Some General Comments on (TP) Tax Rulings and State Aid After the Starbucks and Fiat Decisions" Springer-Verlag Berlin Heidelberg 2016.

profits of large MNEs, even without any intention to confer a selective advantage on the relevant taxpayer.

4.1 – Legal certainty: benchmark to test the EC fiscal State aid investigations.

Primary, the CJEU Fiat case law raises the violation of the principle of legal certainty due to an unprecedented and undefined concept of ALP.[177] The Court decision is contrary to Fiat's plea mainly because of two reasons. First, Luxemburg's national tax law objective is to tax integrated undertakings and stand-alone undertakings equally, "*It was foreseeable that the Commission would be able to verify [under art 107 TFEU] ... whether the methodology for determining transfer pricing accepted on the tax ruling deviated from pricing that would have been set under market conditions*".[178] Second, of major importance, the sentence estimates that the EC specified in the contested decision the definition, scope, and legal nature of the ALP correctly.[179] The CJEU accepted the EU ALP described by the EC instead of interpreting, specify, and thus justify this concept adequately and independently.

After analysing and comparing Starbucks and Fiat decisions, the controversial EC approach of art.107 TFEU and the interpretation of the EU ALP boils down to two main points: all undertakings, independent or group companies, are equally taxed on their profits; the nature of the EU ALP.

Taking into consideration the nature of the EU ALP, the principle of legal certainty comes into play. The EC did not provide any reference points or guidelines as to how to apply the ALP in practice, neither before these tax rulings nor after them. Without the existence of clear and precise rules, even if the OECD Guidelines are implemented or incorporated into the national domestic legislation, tax administrations of MSs are "sailing in uncharted waters". The legal uncertainty is not relieved by EC's comment that if OECD guidelines are followed the result is "unlikely" to be illegal State aid.[180]Again, this research does not question the EC legality to tackle selective tax rulings, however, more guidelines and insight on the EC methodological approach is needed when calculating deviations from the reference system.

The State aid ban has come with a price of legal uncertainty, uncertainty motivated by the vague scope of art. 107 TFEU connected with the growing economic interdependence

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[177] Joined Cases T-755/15 and T-759/15, *Grand Duchy of Luxembourg and Fiat Chrysler Finance Europe v European Commission,* para. 96. According to the case-law, the principle of legal certainty, which is a general principle of EU law, requires that legal rules be clear and precise, and aims to ensure that situations and legal relationships governed by EU law remain foreseeable (Case C 63/93 *Duff and Others v Commission* para.20).

[178] Case T-755/15, *Grand Duchy of Luxembourg and Fiat Chrysler Finance Europe v European Commission* para.183.

[179] Ibid, para.185 – 186

[180] Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, OJ C262 (2016) para.172-173

between MS's.[181] However, this does not seem to be the CJEU understanding.[182] The Court does not consider EC's interpretations to be unforeseeable. So, the conclusion appears to be that the uncertainty, which MNEs are experiencing, is not an unlawful breach of legal certainty within the meaning of EU law for the CJEU.

This unforeseeable approach of the EC that can be seen in the fiscal State aid investigation cases is even more reprehensible where one considers the legitimate purpose of such agreements between MSs and MNEs[183], namely to ensure group companies "*legal certainty and predictability on the application of general rules"*.[184] For instance, as mentioned above, the selectivity test seems to result in a 2 steps-test, thereby contradicting the well-established approach of the EC in the EU State aid law. That said, the issue is intrinsically linked to legal certainty, normally tied to legal determinacy.

The author disagrees with the CJEU interpretation. Just consider the Apple case where a EU ALP is applied without the reference system incorporating either an ALP or the OECD guidelines. Indeed, this lack of foreseeability runs counter to the target pursued by the MNE's when they choose to enter on such agreements with MS's. Instead, the EC aims to push MS's to surrender tax sovereignty, harmonizing rules concerning direct taxation on a EU level. The EC is not concerned about legal certainty at this point. It is a sacrifice the EC is willing to make. It employs a negative integration instrument to force positive integration.

The EC investigations over tax State aid are an instrument to supervise tax sovereignty employing a negative integration method politically motivated, representing an opportunity for EU institutions to interfere in a field that is highly protected by MSs. These investigations call into question agreements with MNEs and expectations created by norms that would be within the scope of MSs. Questioning the taxes collected, or not collected, with interest and retroactive effects by the MSs to these companies, there is a sense of uncertainty due to the inability to predict and foresee appropriately the total cost of the tax is such a weakness in the face of the challenge of State aid regulations.

Section V – A new framework - proposed solution.

In the next section of this research paper, justifing the author's position the last sub-question will be answered: **Following the OECD trend regarding BEPS Action 5, is a partial takeover of fiscal sovereignty and enforcing methods for harmonization of direct tax law by the EC, a solution for instituting a truthful and fairly competitive**

[181] Peters, C. Tax Policy Convergence and Eu Fiscal State Aid Control: In Search of Rationality. Ec Tax Review 2019, 28 (1), p.6.
[182] Joined Cases T-755/15 Luxembourg v Commission and T-759/15 Fiat Chrysler Finance Europe v Commission, par. 412.
[183] The 2016 EC notice regards administrate tax rulings as a "*specific issue concerning tax measure*". Arts. 169-173 specifically provided for such agreements reached between the tax administration and the taxpayer.
[184] Art.169, EC Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union.

environment diminishing harmful tax practices and avoid legal uncertainty regarding tax rulings in the future?

In light of the objective proposed in this paper, following the infringement of the MS's tax sovereignty, and the endangered legal certainty a centralized approach could improve the current regime. Cooperating to achieve a multilateral solution that substantially reduces the uncertainty of the current system, and is more advantageous and practical for the taxpayer. The Ruding committee[185] already mentioned a long time ago the need of an action at a European level, since it is unlikely differences distorting the functioning of the internal market are reduced significantly through independent action by MSs. The current system motivates MSs to accept CCTB, but it is unlikely that EC would have the technical and human resources to perform such a clearing system.[186] Some sort of minimal tax harmonization could, in fact, prove to improve the regime not only in terms of certainty but also in efficiency and justice for all parts considered. At this point, the EC has two potential options: Continue to increase the already wide scope of application of art.107 TFEU to include as much harmful tax measures as it can with a concept of selectivity *de facto* almost absolute; Fighting for the binding harmonization of an instrument that already exists is just not mandatory. I have the impression that the previous option will lead to this solution.

Based on the findings concluded in this research, it seems more than valid a solution that involves making the Code of Conduct a mandatory instrument. The problem that can be identified in the EC approach using art.107 TFEU is that it was designed for selective realities of distortions of competition between companies caused by the European countries in their jurisdictions.

The investigations allow to conclude that the EC tries to fight harmful tax practices that have an external effect more than properly internal. The introduction of this new ALP in art.107 TFEU represents the concern that exists to fight against practices that affect competition between states.

The question of the reference system and the selectivity test are extremely important for this purpose and that is why it is essential to understand the difference between a practice that can be harmful but is not illegal State aid. It is not by chance that these investigations arise in the context of structures that allow MNEs to reduce their tax burden, but through harmful measures and, in some cases, non-selective practices.

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[185] Ruding, Onno. Report of the Committee of Independent Experts on company taxation Executive summary. March 1992.

[186] P.J. Wattel 2016 "The Cat and the Pigeons: Some General Comments on (TP) Tax Rulings and State Aid After the Starbucks and Fiat Decisions" Springer-Verlag Berlin Heidelberg 2016, p.187 and 194, Such EU-wide clearing house system has indeed already been called for in 2015 by the Special Committee on Tax Rulings and Other Measures Similar in Nature or Effect.

For distortions of "competition between MSs", there is a suitable instrument, which, although not binding, is the valid instrument: the Code of Conduct. The Code itself already refers to an ALP and it is much more focused on cross-border transactions. If we want to make progress together, we have to do it in the right way. A small change, that can make all the difference, is to build, based on the Code of Conduct, a European directive – **Directive for Harmful Business Taxation Practices**, harmonizing behaviors that seem to be accepted by MSs, tax authorities, tax lawyers and advisors, after consulting the Code of Conduct Group in accordance with BEPS action 5. Materialize a definition and guidelines for a true European ALP and, why not, EU profit allocation methods. The Group has been involved in designing coordinated tax policy, so just twist to mandatory what it is "quasi-legislation".[187]

MSs already effectively implement the vast majority of the Group's conclusions. Turning the avoidance of harmful predictable behaviors binding and thus activate mechanisms provided to act according to arts. 258 to 260 of the TFEU in case of disobedience. A superficial analysis to the Apple case allows us to recognize immediately factors that are preponderant to define harmful practices: Key factors: The regime imposes no or low effective tax rates on income from geographically mobile financial and other service activities; The regime fails to require substantial activities; Other factors: An artificial definition of the tax base; Failure to adhere to international transfer pricing principles; Foreign source income exempt from residence country taxation.

Both parties have to give in eventually. A centered solution emanated from European secondary law, both the EC gains more powers in direct taxation, as the MSs and MNEs can define with certainty and, in a way that they are not caught by surprise. BEPS Action 5 is working on delivering a level playing field, including ensuring substantial activities requirements are in place in no or only nominal tax jurisdictions contributing to a more fair and coherent international taxation framework.[188]

As advocated above, defending the harmonization of part of direct taxation competence stealing as minimal as necessary some fiscal sovereignty from MSs and offering it to the EU is one idea. Multilateral cooperation sustains the goal to provide justice and fairground for the European zone. In order to accomplish a fair competitive environment, competition should be maintained. Whatever standard harmonizes the concept of harmful tax practices, the limit must be established, so that there is a competitive margin.

Creating a level playing field must also avoid cartelistic behavior by MSs. *Peters* claims "the need for a "light regime" of EU fiscal state aid control that provides for

[187] Terra/Wattel, European Tax Law, Vol. 1 General Topics and Direct Taxation, Fed fiscal studioserie, 7th edition, 2018, p.931.
[188] OECD (2019), Harmful Tax Practices - 2018 Progress Report on Preferential Regimes: Inclusive Framework on BEPS: Action 5, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, p.33.

substantial guarantees for the autonomy of the MSs".[189] In the author's opinion, this regime should replace this broad and discretionary application of State aid rules with the commitment of EC and MSs, while maintaining not only the MS's direct taxation autonomy majority but also a competitive frame.

Taking into account the success of the Code of Conduct in a European environment as an open method of coordination, MS's tax regimes and the tax scenery of the internal market have a lot to benefit in a harmonized definition of harmful tax practices and institutionalizing the roll-back of those measures in a new directive. This could be one more step towards an internal market based on real economic activity, horizontal tax efficiency, and policy coordination. Keeping tax competition at some level is fundamental to promote efficiency, building the solid foundations on what should not be done, to let MSs operate within the legal framework. A so-called standardized international tax regime as *Dagan* argues.[190]

It seems clear the intention of forcing the yield of MSs through the State aid ban as a "tax harmonization through the backdoor".[191] From this point of view, is just a matter of seeing what takes longer: the persistence of the EC to applying State aid rules in taxation matters challenging tax sovereignty of MSs, as long as the CJEU supports it, or MSs giving up rowing against the current, reaching the unanimity required by art. 105 TFEU. Tax policy convergency and harmonization is consistent with the fundamental purpose of the EU and shall not be undermined. MSs should surrender some autonomy to solve the European Tax Paradox.[192] The question arises as to whether the current domestic tax competition within the EU reveals the selfishness and distrust among MSs and the European project, or can we move forward to attain common objectives?

[189] Peters, C. (2019). Tax policy convergence and EU fiscal state aid control: In search of rationality. EC Tax Review, 28(1), p.17.
[190] Dagan, T. (January 01, 2017). Tax Sovereignty in an Era of Tax Multilateralism. Eu Law and the Building of Global Supranational Tax Law: Eu Beps and State Aid, p.37-47.
[191] D. Kyriazis, From Soft Law to Soft Law through Hard Law: The Commission's Approach to the State Aid Assessment of Tax Rulings, 15(3) Eur. St. Aid L. Q. 436 (2016).
[192] Peters, Cees. 2019. "Tax Policy Convergence and Eu Fiscal State Aid Control: In Search of Rationality." Ec Tax Review 28 (1): p.15. - "This paradox implies that the Member States would need to surrender some of their autonomy to the European level in order to retain the power to tax those (powerful) taxpayers that are able to escape the control of the Member States".

APPENDIX

Table 1.1 Criteria for assessing preferential tax regimes. [193]

Five key factors
The regime imposes no or low effective tax rates on income from geographically mobile financial and other service activities.
The regime is ring-fenced from the domestic economy.
The regime lacks transparency.
There is no effective exchange of information with respect to the regime.
The regime fails to require substantial activities.[194]

Five other factors
An artificial definition of the tax base.
Failure to adhere to international transfer pricing principles.
Foreign source income exempt from residence country taxation.
Negotiable tax rate or tax base.
Existence of secrecy provisions

[193] Table based on the OECD (2019), Harmful Tax Practices - 2018 Progress Report on Preferential Regimes: Inclusive Framework on BEPS: Action 5, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, p. 13. Table 1.1.

[194] This includes the 2015 Action 5 Final Report (OECD, 2015), the 2017 Progress Report (OECD, 2017), and any guidance on substantial activities agreed by the Forum on Harmful Tax Practice and Inclusive Framework thereafter.

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