

Fiscal Competitiveness versus Harmful Tax Competition in the European Union.

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Issue: Bulletin for International Taxation, 2011 (Volume 65), No. 6

Published online: 10 June 2011

Citation: P. Lampreave, **European Union-Fiscal Competitiveness versus Harmful Tax Competition in the European Union**, 65 Bull. Intl. Taxn.6 (2011), Journals IBFD (accessed 23 Mar. 2012). http://onlines.ibfd.org/document/bit_2011_06_e2_3.

This article analyses the evolution of direct taxation harmonization and harmful tax competition, the latter being a consequence of a lack of harmonization, in the European Union. In this context, it refers to the concept of harmful versus fair tax competition and measures that could be adopted to counter the former.

1. Introduction

Fiscal policy is an element of the sovereignty of Member States that depends on tax collection and involves both the financing of public expenditure and the redistribution of income. It is, therefore, clear that a loss of tax sovereignty on the part of Member States is the cornerstone of the fiscal harmonization undertaken by the EU institutions.

It can be argued that the European Union is a federation of Member State sovereignties. The fact that the diversity of tax systems within the European Union has generated significant debate between the Commission and the Member States, primarily with regard to the establishment of common points that should apply to all Member States, also cannot be ignored.

Since the creation of the European Economic Community (currently, the European Union) the cooperation and adoption of common criteria between the Commission and the Member States has played an important role in economic and monetary policy, but a peripheral one regarding tax policy. In this respect, the lack of consensus on taxation has been evident for decades.

Tax harmonization is not specifically covered, as such, in the Treaty on the Functioning of the European Union (TFEU) (2007). ^[1] ^[2] However, articles 110 to 113 of the TFEU (2007) (previously, articles 90 to 93 of the Treaty establishing the European Community (TEC) (2002)), refer to the "harmonization" of indirect tax:

The Council shall, acting unanimously ... adopt[s] provisions for the harmonisation of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition. ^[3]

The legal basis for Community action in the field of direct taxation can be found in the third Chapter of the TFEU (2007), which is entitled "approximation of the laws", and specifically, in article 115 (previously, article 94 of the TEC (2002)):

The Council shall, acting unanimously ..., issue[s] directives for the approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the internal market.

The reason for the lack of tax harmonization can be found in the Single European Act (SEA) (1986). ^[4] ^[5] The primary objective of the SEA (1986) was to add momentum to the process of constructing the European Union to complete the internal market. However, this objective was difficult to achieve on the basis of the existing treaties, notably because of the decision-making process at the Council, which, following the SEA (1986), imposed a unanimity requirement in respect of the harmonization of legislation.

Within the framework of the TFEU (2007) all tax decisions to be taken at the EU level are subject to unanimity. In other words, all Member States must agree on any measure adopted in the field of taxation.

In contrast, qualified majority voting (QMV) means that an EU law is adopted once a certain threshold of votes in the Council of Ministers is reached. Voting is weighted on the basis of a Member State's population, but corrected in favour of less-populated countries.

Whilst the number of issues that requires unanimity has declined, unanimity continues to apply with regard to policies that are inherently sensitive for the Member States and their citizens. These include the rights of EU citizenship, [6] measures in the field of social security, [7] the state aid regulations, [8] new competences of the European Union not deriving from the TFEU (2007) [9] and financial provisions. [10]

At the Intergovernmental Conference (IGC, 2003/04), the Commission expressed the following views on the need for a move from unanimity to QMV for tax proposals:

... In the draft Constitution, [11] there are still numerous provisions for unanimous voting in the Council or similar decision-making arrangements (consensus within the European Council or agreement by the governments of the Member States). It would be unrealistic to ask for all these to come under "qualified majority voting" and would not moreover be appropriate, given the great diversity of the cases in question. In certain fields, the Constitution will need to be revised to enable the Union to operate effectively.

More precise demarcation of the Union's authority should, in some cases, enable unanimous voting to be dispensed with.

For example:

- taxation in connection with the operation of the internal market (the incompatibility of different Member States' tax systems frequently leads to double taxation),*
- modernising and simplifying existing legislation,*
- administrative cooperation,*
- combating fraud or tax evasion,*
- measures relating to tax bases for companies, but not including tax rates,*
- the aspects of free circulation of capital linked to the fight against fraud,*
- taxation in respect of the environment*

The Commission has emphasized that QMV does not imply harmonization of taxation across the European Union or increased taxation.

Unanimity is considered a "hidden veto" for the Member States, delaying and even paralyzing many tax proposals presented by the Commission. Fiscal policy is perhaps the final instrument that can be used by each Member State to deal with asymmetric shocks. Given this, the author considers that general consensus is required on the need to change the principle of unanimity with regard to tax matters, especially in the current European Union, with its 27 different tax systems. [12]

Despite the slow progress in terms of tax harmonization in general, it can be said that coordination of indirect taxation has progressed more than coordination of direct taxation for corporations. Indirect taxes include taxes on turnover and on the production or consumption of goods and services, which are regarded as components of costs and selling prices that are collected without regard to the realization of profits or, indeed, income, but are deductible in determining profits. Accordingly, indirect taxation requires a greater degree of harmonization, mainly because such taxation affects the free movement of goods and services, thereby benefiting from fairly extensive common fiscal regulation.

VAT directives exist and have achieved a high degree of consensus amongst the Member States. The uniform basis of assessment of VAT has been crucial to removing the fiscal frontiers of cross-border operations, i.e. with regard to the tax base, tax rates, VAT refunds, the regular exchange of information, etc.

Nevertheless, the implementation of a "definitive VAT system" based on the taxation of goods and services in the Member State of origin, as opposed to the current transitional destination regime, has yet to be implemented. A definitive system would have many advantages, would be simple for business and would offer a solution to carousel fraud, although it would not eliminate all types of fraud. The author, therefore, considers that consensus on this topic should be reached to counter tax evasion.

Fiscal harmonization in the field of direct taxation for corporations has, however, failed, as Member States have perceived such harmonization as a restriction on their fiscal sovereignty. Consequently, only a limited number of direct taxation directives have been adopted, i.e.:

- the Parent-Subsidiary Directive (1990): [13] the common system of taxation applying to “profit distributions” between parent companies and subsidiaries of different Member States, which also applies to Switzerland from 2005; [14]
- the Merger Directive (1990): [15] the common system of taxation applying to mergers, divisions, transfers of assets and exchanges of shares regarding companies of different Member States, which also provides for the deferred taxation of capital gains;
- the Arbitration Convention (1990): [16] regarding tax disputes between Member States in respect of the elimination of double taxation in connection with the adjustment of profits of associated enterprises).
- the Savings Directive (2003): [17] regarding the taxation of savings income; and
- the Interest and Royalties Directive (2003): [18] the common system of taxation applying to interest and royalties paid in different Member States between associated companies.

The Commission has not been successful in promoting harmonization measures in the form of directives. Accordingly, other forms of harmonization have become important in the field of direct taxation, as can be seen from the increasing harmonization of the tax systems through the decisions of the European Union Court of Justice (ECJ). [19]

The author agrees with the criticism that has been raised regarding excessive use of the ECJ as a mechanism to compensate for the lack of tax harmonization by way of EU directives. However, it is not possible to ignore the fact that the ECJ was created to ensure the correct application of EU law. Accordingly, through its decisions, the ECJ has helped adapt EU law to the internal market.

The increasing use of new sources of law (“soft law”) should also be noted as an innovation with regard to the traditional sources of EU law (“hard law”). Soft law is the term applied to EU measures such as guidelines, declarations and opinions that, in contrast to hard law, are not binding on those to whom they are addressed. Soft law can, however, have legal effect.

Soft law is used where the Member States are unable to agree on the approval of a hard law measure or where the European Union lacks the competence to enact hard law measures. Accordingly, soft law is a temptation for the Commission when faced with resistance from some Member States that threaten to block policy proposals.

It should be noted that soft law is generally considered to be “back door” law. The author, therefore, shares the reservations expressed by Shelton regarding the extent of the legal effect of soft law and its lack of legitimacy, as soft law is developed without the direct or indirect involvement of national parliaments. [20] However, it is undeniable that soft law is more effective with regard to tax coordination than the explicit transfer of tax sovereignty by each Member State, as it is not subject to unanimity.

2. Fair versus Unfair Tax Competition

As noted in section 1., fiscal policy is a part of the sovereignty exercised by each Member State.

It cannot be denied that tax competition between the Member States is inevitable, given the increased integration of new Member States within a European Union with asymmetrical tax systems. The interdependence of each Member State is also patent. Each tax system is unavoidably affected by the other tax systems, especially when another Member State offers tax benefits to attract mobile factors (investment) to its territory. [21]

It should also be appreciated that the blocking of efforts made to realize even limited tax harmonization is nothing more than an attempt to hold on to the last remaining monopoly existing in the internal market. [22] In this context, the existence of harmful tax competition in the European Union must be acknowledged, but the border between fair and unfair tax competition is not easy to identify.

In this respect, The OECD considers that tax competition and the interaction between tax systems can have effects that some countries may view as negative or harmful but others may not. [23]

The Commission in its Communication “A Package to Tackle Harmful Tax Competition in the European Community” [24] considered fair competition in tax matters differently from harmful tax competition, as this relates to those measures that may significantly affect the location of business activities in the European Union.

It is beneficial for the internal market that Member States have adopted a range of policy instruments to improve their competitive position. This also benefits enterprises and entrepreneurs. [25] Nevertheless, it is obvious that some harmonization is required to counter harmful tax competition within the internal market.

As the Commission concluded:

... [T]he need for coordinated action at European level to tackle harmful tax competition in order to help achieve certain objectives such as reducing the continuing distortion in the single market, preventing excessive losses of tax revenue or getting tax structures to develop in a more employment-friendly way [26]

Taxes are not usually a primary factor in the decision of multinational enterprises (MNEs) to engage in cross-border operations. Such a decision is usually based on commercial, economic or even social and political considerations. However, once the initial decision has been made, tax often becomes an important factor. [27]

In the absence of tax coordination within the European Union, if a company decides to undertake cross-border investment, it will consider several jurisdictions. In this regard, it is perfectly legitimate that the final decision will be based on purely fiscal benefits, as there may be a comparative advantage of one jurisdiction over another. [28] Accordingly, some investors may seek to invest in a location with lower tax rates, and, therefore, a greater after-tax return, even if only poor-quality public services are available. In contrast, others may seek to invest in a location with higher-quality public services even if a higher tax burden is imposed to finance those services. [29]

A fact that is clearly evident in recent years is the gradual reduction of tax rates in most Member States, thereby resulting in a possible “race to the bottom” in the European Union. [30] Despite this, the author agrees with the contention that there is no evidence that an approximation of tax rates or a progressive reduction in higher rates in the European Union could result in a “race to the bottom” within the internal market. [31]

Reduced corporate income tax rates have been considered as a way to develop domestic economies and attract new foreign investment. [32] Nevertheless, it should be noted that Member States with healthy economies prefer to maintain an internal budgetary balance rather than reduce taxation significantly. It should also be considered that a lower tax burden can be realized not only by reducing tax rates, but also by reducing the tax base (the higher the value of allowances, the smaller the tax base, etc.). [33]

With regard to tax competition, it has been stated that:

Tax competition is good. It restrains the appetite for higher taxes, it prevents tax cartels, it promotes investment and economic growth. It spurs productivity and innovation. Tax competition creates pressure on States to become more efficient in how they raise and spend taxes. It gives investors the choice between different locations according to the tax levels compared to the benefits provided. [34]

The OECD recognizes that there is no particular reason for two countries to have the same levels of tax and the same tax structures. Although differences in tax systems may have implications for other countries, these are essentially political decisions for national governments. Depending on the decisions taken, the levels of tax may be high or low relative to other countries and the composition of the tax burden may vary. [35]

Consequently, whether or not a country modernizes its fiscal infrastructure (for example, by reducing rates or broadening the base to promote greater neutrality) is principally a matter for domestic policy and must be considered to be lawful tax competition. Countries should be free to design their own tax systems as long as they abide by internationally accepted standards.

Harmful tax competition between Member States is not, however, permitted by the European Union. A clear manifestation of unfair competition is a “ring-fencing strategy”. Under such a strategy, the country with the regime would not be affected by the financial erosion of its own preferential tax base, as the regime would only have an adverse effect on foreign tax bases. Similarly, taxpayers within the regime may benefit from the infrastructure of the country providing the preferential regime without bearing the costs to provide the infrastructure.

Under certain regimes, even an “economic substance or a real business activity” of the enterprise is not required, thereby making it a mere “paper entity”. The author considers that, in such extreme cases, this is closer to tax evasion than harmful tax competition.

It is also necessary to take into account the ECJ decisions that recognize limitations of fundamental freedoms, such as the right of establishment, ^[36] and accept restrictive anti-abuse measures if, disregarding the tax effect, the transaction is “wholly artificial”. The “wholly artificial” doctrine does not apply if a transaction is primarily undertaken for tax reasons, but also has a business purpose.

In this regard, *Halifax plc, Leeds Permanent Development Services Ltd, County Wide Property Investments Ltd v. Commissioners of Customs & Excise*(Case C-255/02) is a very relevant ECJ decision regarding indirect taxation. According to the ECJ, a UK economic operator had no right to deduct input tax as long as the operations giving rise to the right to deduction constituted abusive practices. The ECJ dismissed the taxpayer’s argument that there were commercial explanations for the arrangements other than obtaining a tax advantage and noted that there was no contemporaneous documentation concerning commercial benefits other than the anticipated VAT savings. Specifically, the ECJ stated that:

... [W]here an abusive practice has been found to exist, the transactions involved must be redefined so as to re-establish the situation that would have prevailed in the absence of the transactions constituting that abusive practice. ^[37]

In *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue* (Case C-196/04), the ECJ, following *Halifax* in the field of indirect taxation, applied the same conclusions to direct taxation and reiterated that tax avoidance exists only if the transactions at stake involve:

... wholly artificial arrangements intended to escape the national tax normally payable, by incorporating a company in another Member State only for tax reasons, without any business purpose or substance over form, thus lacking of an economic reality. ^[38]

In this ECJ case, the facts related to the UK controlled foreign company (CFC) legislation, which provided for the inclusion, under certain conditions, of the profits of subsidiaries established outside the United Kingdom in which a resident company holds a controlling stake. The UK tax authorities imputed corporation tax to the parent company of the Cadbury Schweppes group, which was established in the United Kingdom in respect of the profits realized by one of the subsidiaries of the group established in Ireland, where the corporation tax rate was lower.

The author, therefore, considers that the fundamental freedoms have been used as a safe-harbour rule to try to justify tax avoidance and, in certain cases, have benefited tax shelters.

Within the framework of the European Union, the author also considers that it is very important to standardize tax avoidance provisions, but the problem is, as usual with regard to the European Union, deciding on the means by which such provisions could be agreed. This topic is, however, outside of the scope of this article and, in the following sections, reference is only made to the harmful tax practices of the Member States.

The OECD and EU thinking on harmful tax practices is useful in understanding what constitutes such practices, as both the OECD and European Union have identified several key factors in this regard. In particular, the OECD has postulated the following five factors with regard to harmful tax practices: ^[39]

- (1) low effective tax rates;
- (2) ring-fencing, as a consequence of which certain preferential tax regimes are partly or fully isolated from the domestic markets of the country with the regime;
- (3) a lack of transparency in the operation of a regime, which makes it harder for home countries to adopt defensive measures;

- (4) a lack of effective exchange of information, which is evidenced by the failure to notify foreign tax authorities of a regime granted to its taxpayer; and
- (5) the absence of a “real business activity” or an “economic substance” requirement.

The Commission’s six criteria in identifying potentially harmful tax measures are: ^[40]

- (1) an effective level of taxation considerably lower than the general level of taxation in the country concerned;
- (2) tax advantages that are granted only to non-residents;
- (3) tax incentives for activities that are isolated from the domestic economy and, therefore, have no effect on the national tax base;
- (4) the granting of tax advantages without any real economic activity and substantial economic presence;
- (5) a basis for the profit determination for companies that departs from internationally accepted rules, particularly those approved by the OECD; and
- (6) a lack of transparency.

Accordingly, taking these criteria into account, harmful tax competition can be defined as a fiscal policy implemented on the initiative of a country that offers a wide range of tax incentives and advantages to attract mobile factors (investment) to that country in the absence of transparency and the effective exchange of information with other countries.

In contrast, fair tax competition can be defined as a decision by a country to reduce the tax burden, either by lowering tax rates or by granting tax credits to both resident and non-resident entities. The exchange of information with other tax authorities and full transparency in respect of the tax system are also required.

3. Measures to Eradicate Harmful Tax Competition

3.1. Introductory remarks

A variety of measures have been adopted to eradicate harmful tax competition. These can be classified as unilateral, bilateral and multilateral measures and are considered in sections 3.2., 3.3. and 3.4., respectively.

3.2. Unilateral measures

Unilateral measures, currently, are adopted by countries that wish to protect their tax base against harmful tax competition. The way in which these measures are applied, however, varies greatly from country to country.

In this regard, a country can incorporate anti-abuse measures into its domestic legislation, such as regulations on fiscal transparency, transfer pricing regulations, or regulations that penalize tax havens or countries without effective exchange of information. It is also possible to establish fiscal measures comparable to those that have resulted in the relocation of mobile factors to a jurisdiction to encourage the return of lost investment.

The OECD recommends the adoption of various domestic measures, including: ^[41]

- CFC rules;
- foreign investment fund regulations;
- regulations regarding restrictions on participation exemptions and other systems for exempting foreign income in the context of harmful tax competition;
- regulations regarding the reporting of international transactions and the foreign operations of resident taxpayers;
- tax rulings;
- transfer pricing rules; and
- regulations regarding access to banking information.

Unilateral measures are the simplest for a county to adopt, as they do not require the agreement of other countries. However, in general, such protectionist measures are not particularly effective in countering harmful tax competition.

3.3. Bilateral measures

Bilateral measures are agreements between two countries (for example, tax treaties) that establish anti-abuse provisions to prevent the incorrect use of these agreements, including:

- the amended article 26 of the OECD Model (2010); ^[42]
- a limitation-on-benefits clause;
- making domestic anti-abuse rules compatible with a tax treaty;
- an anti-treaty shopping clause;
- mutual assistance in the recovery of tax claims; and
- a refusal to conclude tax treaties with tax havens.

One Commission initiative, which is referred to as a priority by the current Commissioner (Mr Sêmeta, the Commissioner for Taxation and Customs Union, Audit and Anti-Fraud), ^[43] relates to problems of double taxation and incompatibilities with EU law that are not addressed by bilateral tax treaties. ^[44] In this respect, the Commission has assessed the problem of double taxation, including the question of the equal treatment of EU residents and the application of bilateral tax treaties when more than two countries are involved (triangular situations). ^[45]

One option would be to develop an EU Model Treaty, based on the OECD Model (2010), but taking into account the TFEU (2007). Another, less practical, option would be the conclusion of a multilateral tax treaty between all of the Member States. ^[46]

The author would argue that an EU Model Treaty, with articles based on the TFEU (2007), would greatly assist the Member States in future treaty negotiations with each other and with third countries. It would also resolve the differences between tax treaties and the treaties regarding the internal market.

3.4. Multilateral measures

Multilateral measures are coordinated actions that can be regarded as a response to a globalized market. Multilateral measures can also be regarded as an attempt by the countries concerned to apply the principles of collaboration and joint coordination. In this regard, both the OECD and the Commission have implemented relevant measures. Accordingly, section 4. analyses the relevant aspects of the EU Code of Conduct (1997). ^[47] This section considers the similar OECD project.

In 1998, the OECD published a report with 19 recommendations to counter what it regarded as harmful tax competition. ^[48] Subsequently, the OECD created the Forum on Harmful Tax Practices (the "Forum") to oversee the implementation of the recommendations. The recommendations were adopted by 28 of the (then) 30 OECD Member countries.

The first result of this work was published in June 2000. Two forms of harmful tax practice were identified, essentially by examining the preferential regimes that existed in OECD Member and non-Member countries. In 2000, the OECD published the *Framework for a collective memorandum of understanding on eliminating harmful tax practices*. This report listed separately cooperative and non-cooperative jurisdictions, the later being regarded as "potentially harmful".

In June 2003, the Forum verified whether or not the OECD Member countries had eliminated the harmful regimes. In 2004, the Forum reviewed the preferential regimes and stated that there were only three regimes on which the Forum could not reach a conclusion, i.e. the proposed Belgian coordination centre regime, the Swiss "50/50 practice" and the Luxembourg 1929 holding company regime, all of which were subsequently abolished.

The OECD reports of 2004 and 2006 were especially relevant. Both incorporated a mechanism to ensure a level playing field in the implementation of the standards of transparency and information exchange that permits fair competition between all countries.

The year 2009 was important in connection with full effective exchange of information between countries. ^[49] In the run-up to the G20 summit held in London on 2 April 2009, the standards on transparency and exchange of information developed by the OECD were endorsed by all key territories, including jurisdictions that had been opposed to exchanging bank information. ^[50]

It should be noted that the OECD reports have never suggested that all preferential tax regimes are harmful. If a preferential tax regime gives rise to little incidental harm to another country but has substantial benefits to the host country, the preferential tax regime may be justifiable. Nevertheless, the author agrees that the OECD's definition of harmful tax competition is rather subjective. [51]

Section 4. focuses on the EU Code of Conduct (1997). The EU Code of Conduct (1997) and the OECD guidelines are broadly compatible and reinforce each other, particularly with regard to the criteria used to identify potentially harmful tax regimes, but the scope and operation of the two differ. The OECD guidelines are clearly limited to financial and other service activities, whereas the EU Code of Conduct (1997) considers business activities in general, although with an emphasis on mobile activities (investment).

4. The EU Code of Conduct (1997)

4.1. Introductory remarks

As a result of studies undertaken by the Commission and the fact that tax coordination is limited by the principle of unanimity, the Member States agreed to adopt a package of measures in respect of EU fiscal policy. The package was signed in 1999 by all of the Member States during the mandate of Commissioner Mario Monti and included proposals to adopt a code of conduct on business taxation, for a savings income directive, and for a directive to regulate the taxation of EU-source royalties and interest payments by companies. [52]

The Commission, aware of its limitations in adopting legislation, decided on the form of a code of conduct signed by all of the Member States with the objective of countering harmful tax practices within the European Union. The compromises accepted by the Member States included, on the one hand, a standstill clause that prevented the Member States from introducing new measures and, on the other, a rollback clause that obliged the Member States to abolish existing harmful measures.

A Code of Conduct Group (the "EU Group") was created to dismantle unfair practices in the Member States. [53] The EU Group decided to divide the initial list into the following five categories: (1) intra-group services; (2) financial services and offshore companies; (3) other sector-specific regimes; (4) regional incentives; and (5) other measures. This also covered dependent and associated territories.

Finally, the initial list of 271 potential unfair tax measures was reduced to 66 measures to be dismantled (40 in Member States, three in Gibraltar and 23 in dependent or associated territories). The final date for the adoption of the rollback clause was initially 2003, but for certain regimes this was subsequently extended to 2010. [54] With regard to the Member States, the Commission decided that 31 measures (after reviewing 52 measures) should be abolished. [55]

An essential point to note is the connection between the EU Code of Conduct (1997) and the state aid regulations. In this respect, the Commission has the power to request the withdrawal and repayment of any state aid, including state aid granted in the form of a preferential tax regime.

Mr Mario Monti stated that some of the tax measures covered by the EU Code of Conduct (1997) could fall within the scope of the provisions on state aid in the TEC (2002). [56] In this regard, the TEC (2002), prohibited a measure that "distort[s] or threatens to distort competition, by favouring certain undertakings or the production of certain goods ... insofar as it affects trade between Member States". [57] According to this definition, a tax measure would be considered to be state aid [58] if the following conditions were met: [59]

- the measure is funded by state resources;
- the measure provides an economic advantage;
- the measure distorts competition and trade within the European Union; and
- the advantage is selective.

The most important issue is to determinate whether or not a tax measure that provides advantages but limits its scope to intra-group transactions could be considered a selective advantage. With regard to all of the categories established by the EU Code of Conduct (1997), this article examines intra-group financing activities, financial services and holding company regimes due to their effects on international tax planning. [60]

4.2. Financial services for third parties and intra-group financing activities

MNEs have traditionally encountered very strict regulations in relation to exchange controls with regard to international operations. This has given rise to serious financial and tax difficulties for MNEs. Consequently, during the 1960s, US MNEs began to centralize the management, financing and administration of the companies within a group in a single company to minimize financial and tax costs.

For the purposes of the EU Fourth Directive (1978), [61] a “financial holding company” is a company incorporated with the sole purpose of acquiring participations in other undertakings without involving itself, directly or indirectly, in the management of those undertakings with no prejudice to its rights as a shareholder. The limitations imposed on the activities of such companies mean that compliance with the basic rules can be supervised by an administrative or judicial authority.

Financial centres are defined as entities that are wholly owned by one or more companies of the same group. Usually, an MNE incorporates a finance company in another Member State. The primary activity of such a company is to borrow funds from the headquarters [62] or outside the group and to onlend the funds to affiliates. A finance company is usually established in a low-tax jurisdiction or in a state with a favourable treaty network to minimize withholding tax on interest. [63]

Measures relating to financial services were penalized by the EU Code of Conduct (1997) if they related, in whole or in part, to providing exemptions or reduced levels of taxation to such business. Once the EU Group had reviewed all of the relevant measures, they considered eight to be harmful. In this regard, the International Financial Service Centre (IFSC) in Dublin should be noted as being one of the most aggressive regimes in this category due to its frequent use in international tax structuring.

The assessment of measures relating to intra-group financing activities was subject to similar considerations as measures regarding financial services. A negative evaluation was given to measures affecting intra-group financing when:

- the regime provided for a substantially lower effective tax rate;
- the regime permitted the application of fixed margins in respect of “pass-through financing” without a regular review of those margins in light of normal commercial criteria;
- the regime allowed for the creation of substantial reserves that were in excess of the real underlying risks and reduced taxable profits;
- the regime permitted profits to be allocated between a headquarters and a subsidiary in a way that was contrary to the arm’s length principle;
- the cost-plus and resale-minus methods were used in circumstances in which a comparable uncontrolled price might reasonably be obtained; and
- the regime required the company concerned to be part of an international group.

With regard to intra-group services, the EU Group noted the importance of the arm’s length principle as set out in the OECD Transfer Pricing Guidelines (1995). [64] The objective of the EU Group was to prevent the transfer of profits between countries by under- or overvaluing transfer prices. The arm’s length principle envisages that the taxable profits deriving from cross-border transactions between associated enterprises should be computed as if the transactions were carried out between parties acting at arm’s length.

The EU Group penalized six intra-group regimes. Special attention, however, should be paid to the “intra-group finance activities”, “international financial activities and finance branch” in the Netherlands and “finance companies” in Luxembourg, as the most aggressive regimes in this category due to their frequent use in tax planning.

In relation to the IFSC, [65] the primary conclusion drawn was that the abolition of the regime was a positive step in countering harmful tax competition. However, the subsequent approval by the Commission of a general rate (12.5%) in Ireland applied to all companies with “active income”, which is much lower than the rates applied in other Member States, could still be considered to be a harmful measure. Although a low tax rate, in itself, should not be regarded as unfair competition, the author believes that, in the case of Ireland, this could be considered to be a harmful measure. This is because it is understood that the key factor that attracted a large number of MNEs to operate in Ireland was the low Irish general corporation tax rate.

With regard to Luxembourg financial companies, it is arguable that the dismantling of the requirements (fixed margin and the obligation to be part of an international group) for companies to benefit from this tax regime, was a major advance in the fight against harmful tax competition. However, Luxembourg has not lost its position in the financial international market. It is currently one of the primary territories in which to locate a finance company due to the different financing vehicles [66] or hybrid financial instruments [67] that are offered. With regard to the latter, it should be noted that some hybrid financial instruments are still very harmful and have never been penalized by the Commission.

In relation to the intra-group finance activity undertaken in the Netherlands, once the scheme was abolished due to it being considered harmful tax competition, it was replaced by a regime referred to as the "interest group box", which is not yet in force. This regime provides for lower taxation and/or the deduction of interest received and/or paid in the context of intra-group transactions. The Commission reviewed this regime to determine whether or not it constituted state aid under the TEC (2002). [68] The Commission concluded that, following several amendments by the Netherlands, the regime did not constitute state aid, as it did not involve selective advantages for certain companies since it can be applied equally to all companies receiving interest from related companies. [69]

One of the significant concerns regarding the group interest box regime is whether or not a second level of de facto selectivity arises. This would mean that the regime would provide for an advantage to a multinational group of companies when the lender is resident in the Netherlands and the borrower resides in a country the legislation of which allows for the full deduction of interest. It is true that the group interest box regime does not de jure give rise to international selectivity, but the regime can be considered to be de facto selective, as it, in fact, gives rise to this advantage. [70]

Another regime considered to be harmful by the Commission applies to intra-group services provided by Belgian coordination centres. The dismantling of this regime was very controversial, as these centres were frequently used in tax planning compared to other less used centres that were also penalized (in Luxembourg and Spain). The regime was penalized not only for being harmful, but also as some of its inherent elements were considered to be state aid. [71]

Belgium coordination centres levied tax on a fixed markup, which was applied to a reduced tax base, as only certain operating expenses were taken into consideration. A coordination centre could only conduct a limited number of authorized activities, which were restricted to intra-group transactions and had to be part of a multinational group with a high consolidated capital and turnover. A further condition was that the group had to have subsidiaries in at least four different Member States, other than the country of origin. Accordingly, the conditions for incorporating a coordination centre were limited not only in respect of the activity of the centre, but also in respect of the size of the group. [72]

The coordination centre regime was amended in 2003 to make the regime compliant with the EU Code of Conduct (1997). The regime was subsequently replaced in 2006 by a new regime, referred to as a "notional interest deduction". This regime, which was reviewed by the Commission, was not considered to be harmful.

From this, it can be concluded that, despite the fact that there have been positive developments in relation to the dismantling of the measures considered, Ireland, Luxembourg and the Netherlands continue to exercise a dominant position with regard to the location of financial activities. In this respect, it must be remembered that MNEs have, for many years, chosen Belgium, Ireland, Luxembourg and the Netherlands as part of their international tax structuring. However, the global recession and the fact that certain recently acceding Member States offer corporate income tax rates that are much lower than those applied in Belgium, Ireland, Luxembourg and the Netherlands have resulted in these Member States incorporating changes into their tax system to remain competitive in terms of international corporate structuring. It should, however, not be forgotten that Member States such as Cyprus, Hungary and Malta were also viewed, before acceding to the European Union, as locations with strong tax benefits with regard to international finance.

It is also arguable that, despite the changes it has made, Switzerland continues to benefit from the restrictive policy applied in the European Union, resulting in major relocations to the country for the purpose of undertaking financial activities. [73] It should, therefore, be emphasized that what is required in the short term is an agreement between the European Union and Switzerland, with a view to abolishing harmful tax regimes. However, such an agreement would have to be negotiated and not imposed, as Switzerland is not a Member State.

4.3. Holding companies

The primary purpose of holding companies is to hold shareholdings in other companies. A distinction can be made between companies that hold significant shareholdings in other companies and those that hold a diversified portfolio of shares for a group of investors (portfolio holding companies). In general, holding companies can benefit from privileged tax treatments, such as a reduction in or complete exemption from withholding tax on dividends received and capital gains derived.

The concept of a holding company varies between Member States. In general, a holding company is a corporation that owns sufficient voting shares in one or more other companies to exercise control over the companies. A corporation that exists solely for this purpose is referred to as a "pure holding company", [74] whilst a holding company that also engages in a business of its own is referred to as a "holding-operating company".

Holding companies are also widely used by MNEs for tax planning purposes to structure complex projects and separate out what is a productive activity (to be carried out by subsidiaries) from management and development activities (to be undertaken by the holding company). In addition, a holding company often provides support services to subsidiaries, such as legal advice, human resources and accounting services.

With regard to holding companies, the EU Group considered that the assessment of measures relating to holding companies was particularly complex and difficult. The discussion between Member States and the EU Group regarding holding companies was, therefore, more problematic than in respect of other categories.

The EU Group recognized that there may be commercial reasons for an MNE to have a particular holding company within its corporate structure. However, the EU Group also noted that many holding companies are established wholly or mainly for tax planning reasons. In particular, holding companies are often used as a tax-efficient holding vehicle for profits or as a tax-efficient conduit.

The EU Group determined that participation exemptions that permitted the exemption of foreign-source dividends, in circumstances where the profits giving rise to the dividends were taxed at a significantly lower level in the source country than they would have been if they had arisen in the Member State, fell within the scope of holding regimes. The EU Group also penalized situations where a company located in the source country was a "passive income company" that lacked a real economic activity. Such structures permit income from tax havens and low-tax territories to be received by the holding company free of tax. [75]

As well as receiving dividends from subsidiaries, holding companies usually realize capital gains and losses on the sale of subsidiaries. In some Member States such capital gains are tax exempt, in others they are taxable (with a credit given for foreign taxes) and in yet others special rates apply. The EU Group considered that if capital gains were tax exempt, the capital losses should not be tax deductible. Accordingly, asymmetrical treatments of capital gains and/or losses or the lack of anti-abuse provisions in Member States to counter tax avoidance and tax evasion were penalized.

Some Member States, such as Denmark, [76] Ireland, Luxembourg and the Netherlands, were opposed to the holding company category being included in the EU Code of Conduct (1997), as they were of the opinion that the measures adopted under the Code would adversely affect the location of holding companies in the European Union. In this context, it should be remembered that the Netherlands delegation was of the opinion that there were two schools of thought with regard to holding companies in the European Union. One school favoured the exemption method and the other, the credit method. Both systems were, and still are, an acceptable way of dealing with a parent-subsidiary relationship. If the existence of the two different schools results in friction, bilateral or unilateral measures can be used to resolve this, but the Netherlands felt that this should have been outside the scope of the EU Code of Conduct (1997).

The Irish delegation also did not agree with the criteria established in the EU Code of Conduct (1997). The fact that participation exemption regimes did not fit in easily within the criteria of the EU Code of Conduct (1997) was, in Ireland's view, not a justification for entirely new criteria that went far beyond the Code. A participation exemption regime should not have been considered to be a harmful measure without an exhaustive analysis of the regime. The author agrees with this.

The EU Group, after reviewing all holding regimes in the European Union, penalized seven regimes. The most relevant were the 1929 Luxembourg holding companies regime and the Austrian, Danish, Maltese and Netherlands holding company regimes.

There is no doubt that the 1929 Luxembourg holding companies regime was very damaging, as it did not even fall within the provisions of the tax treaties concluded by Luxembourg. Consequently, the regime for these holding companies was amended with effect from 1 July 2005. Under the amended rules, companies that receive at least 5% of their dividend income from companies that are not fully subject to a tax comparable to Luxembourg corporate income tax may lose their tax-exempt 1929 holding company status. Since 2006, no new 1929 holding companies could be incorporated, but, inexplicably, the existing ones could continue to benefit for a transitional period until December of 2010, despite being considered one of the most aggressive tax regimes in the European Union.

Since 2007, Luxembourg has enacted a new regime to replace the 1929 holding companies regime, which is referred to as a "private asset management company" (*société de gestion de patrimoine familial*, SPF), which has not yet been reviewed by the Commission. An SPF cannot undertake commercial activities, but can hold shares in a subsidiary that carries on such operations. The tax benefits are very attractive, as there is a total exemption from income and communal tax. Consequently, this regime is also excluded from all of Luxembourg's tax treaties.

It is important to distinguish SPFs from *sociétés de participations financières* (Soparfis). A Soparfi is a type of holding company that is based on common tax law and enables any Luxembourg company, which is resident and fully subject to corporate income tax, to benefit from tax relief on dividends received from a major shareholding to prevent the income from being taxed several times (economic double taxation). Accordingly, a Soparfi is fully eligible for treaty benefits. A Soparfi may have a pure holding activity, but may also carry on commercial activities that are fully subject to taxation. The Soparfi regime was thoroughly reviewed within the context of the EU Code of Conduct (1997) and was found not to constitute unfair competition.

A further example of a holding regime that is not considered to be harmful, following review by the EU Group, is the Spanish holding companies regime (*entidad de tenencia de valores extranjeros*, ETVE), which is still in force. ETVEs are ordinary Spanish companies that engage in the administration and management of participations in the equity of non-resident companies. They may also engage in other activities.

If a Spanish company complies with the ETVE criteria, [77] it is not subject to Spanish corporate income tax on the foreign-source dividends it receives or on the capital gains arising from the sale of its participation in a foreign subsidiary. [78] A further important feature of the regime is that an ETVE can distribute to its shareholders its profits from non-taxable income (as defined) free of any Spanish withholding tax, provided that the shareholders are not resident in a country that is designated as a tax haven by Spain.

However, the particularly strict requirements in the Spanish regulations, the numerous tax inspections of ETVEs and the excessively restrictive decisions of the Spanish courts in relation to the required "valid economic reason" for their establishment make the ETVE regime less competitive compared to other holding company regimes in the European Union. [79]

Other regimes examined by the EU Group included the Netherlands holding companies regime and the participation exemption regime. The Netherlands has, for many years, been one of the Member States that has attracted international operators for fiscal reasons, either by incorporating a conduit holding company or a headquarters in its territory.

The EU Group found that the "participation exemption regime" permitted the exemption of foreign-source dividends in circumstances in which the profits giving rise to the dividends had been taxed at a significantly lower level in the source country than they would have been if they had arisen in the Netherlands. The regime was also penalized on account of the asymmetrical treatment of capital gains and/or losses. In addition, the Commission considered that the "tax rulings" provided by the tax authorities should be modified. Specifically, tax rulings should only be given in certain circumstances and following a case-by-case review to prevent tax evasion.

Offshore companies, exempt companies and the tax rulings policy of Aruba and the Netherlands Antilles were also penalized by the EU Code of Conduct (1997). These jurisdictions are referred to, as they

were frequently used together with a Netherlands holding company in international tax planning to minimize tax.

In 2007, the Netherlands participation exemption regime was amended and the regime now only applies when the participation has complied with an “assets test” [80] and a “subject-to-tax test”. [81] In 2009, the participation exemption regime was again revised. These changes were intended to remove administrative obstacles and simplify the application of the exemption regime for taxpayers. Under the new regime, the participation exemption automatically applies where the Netherlands intermediate holding company performs a “linking function” between the business operations of its parent and/or subsidiaries or when a Netherlands top holding company performs essential functions for the business operations of the group. [82]

The competitiveness of a tax system depends not only on purely tax matters, but also on the flexibility of the tax authorities, which may not fully counter tax evasion. In this respect, the Netherlands has always recognized that mutual cooperation between the state and the private sector is beneficial. It is important that all institutions have a clear position with regard to special tax regimes. [83] A particularly restrictive policy does not benefit the domestic market and discourages foreign investment. This is an issue that the tax authorities should consider in increasing competitiveness, as it is not the way to counter tax evasion.

The author concludes that the EU Group has been successful with regard to tax coordination in respect of holding companies, especially regarding the tax advantages that were considered to be harmful. The author also believes that the use of holding companies can be considered to be fair competition, but only within a regulated framework. However, if one holding regime is more favourable than others or if one tax authority is more flexible than others, this should not necessarily be regarded as harmful tax competition.

In relation to this, a fact that the author considers to be very negative is the lack of an exhaustive study undertaken by the OECD on holding companies. An OECD study that is wider in scope than the EU Code of Conduct (1997) would have a greater effect on the eradication of certain types of holding company regimes incorporated for the sole purpose of tax evasion.

5. Conclusions

As a general conclusion, it can be stated that clear regulation with specific standards that must be met by all of the Member States, uninfluenced by political considerations, is necessary to eradicate harmful tax competition.

A possible solution could involve adopting a legally binding directive to regulate harmful tax competition within Member States, based on the principles already established by the EU Code of Conduct (1997) (which is not legally binding), and updating it by accommodating new measures that have not yet been reviewed, such as hybrid instruments. The directive could be extended by agreement to third countries.

This would undoubtedly limit the tax sovereignty of the Member States and the freedom to adopt the most appropriate tax system for their circumstances. It would also limit tax planning within the European Union, but without prejudice to the fundamental freedoms. There is no doubt that such a policy could ultimately benefit all of the Member States that currently suffer from the steady erosion of their revenues and could also positively affect the drive against tax evasion. The question then is what form of harmonization Member States are willing to undertake and whether they prefer to act in an open and competitive market or a regulated market supervised by EU institutions.

A directive would also have benefits for the Commission, as it would no longer have to constantly review the effective abolition of penalized regimes or control the implementation of new regimes created by Member States that have not yet been reviewed by the Commission. In this context, it is important to note that the agreement adopted by the Member States included a “standstill clause” and the Commission does not have sufficient resources to control all of the existing regimes in the European Union. However, in the author’s opinion, common interest should prevail over the interests of individual Member States.

It is difficult to ignore the fact that the European Union, through the actions of its institutions, has not always had the support of all of the Member States and their citizens, as is evidenced by the failed

attempt to adopt a European Constitution and the difficulties in ratifying the Lisbon Treaty. This illustrates the conflict between Member States (through their political representatives) and EU institutions.

It could be argued that the EU institutions have failed to sufficiently communicate with Member States (and the Member States with their citizens with regard to EU policies). The author considers the work of the Commission to be valid and its decisions generally correct, but they could be in danger of excessive dogmatism.

It should not be forgotten that invasive action against the tax sovereignty of the Member States is not, a priori, well received. This simply implies that ad hoc discussions between the Member States could establish a common tax policy with regard to harmful tax competition, as fair competition is beneficial because it reduces government waste and disciplines politicians.

Finally, an understanding between Member States and the EU institutions (more than simple tax coordination and less than full tax harmonization) is necessary to turn the situation into a clear benefit for all, not just for individual Member States, but also for the enterprises and entrepreneurs of the European Union. "Soft" harmonization would not harm competitiveness and economic growth in the European Union, as only an approximation of the 27 tax systems can eradicate harmful tax competition. A European Union with coordinated policies would, therefore, make the Union a reference point in the global economy.

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1.

TFEU (2007): Treaty on the Functioning of the European Union of 13 December 2007, OJ C 115 (2008), EU L. IBFD.

2.

The Treaty of Lisbon amended the European Union's two core treaties, the TEU (1992): Treaty on European Union of 7 February 1992, OJ C 1919 (1992), EU L. IBFD and the TEC (2002): Treaty establishing the European Community, OJ C 325 (2002), EU L. IBFD. The latter has been renamed the TFEU (2007). Several protocols and declarations have also been appended to the TFEU (2007).

3.

Art. 113 TFEU (2007).

4.

SEA (1986): Single European Act of 28 February 1986, OJ L 169 (1987), EU L. IBFD.

5.

The SEA (1986), which was signed in Luxembourg on 17 February 1986 by nine Member States and on 28 February 1986 by Denmark, Greece and Italy, was the first major amendment of the Treaty establishing the European Economic Community. It entered into force on 1 July 1987.

6.

Arts. 22 and 25 TFEU (2007).

7.

Arts. 48 and 160 TFEU (2007).

8.

Arts. 108 TFEU (2007).

9.

Art. 352 TFEU (2007).

10.

Arts. 312 and 322 TFEU (2007).

11.

Treaty Establishing a Constitution for Europe, OJ C 310 (2004), EU L. IBFD.

12.

Some Member States are clearly against any weakening of the principle of unanimity in relation to tax matters.

13.

EU Parent-Subsidiary Directive (1990): Council Directive 90/435/EEC of 23 July 1990 on the Common System of Taxation Applicable in the Case of Parent Companies and Subsidiaries of Different Member States, OJ L 225 (1990), EU L. IBFD.

14.

C. Brokelind ed., *Une Interpretation de la Directive Sociétés Mères et Filiales du 23 juillet 1990* (Bruylant 2000).

15.

EU Merger Directive (1990): Council Directive 90/434/EEC of 23 July 1990 on the Common System of Taxation Applicable to Mergers, Divisions, Partial Divisions, Transfers of Assets and Exchanges

of Shares Concerning Companies of Different Member States and to the Transfer of the Registered Office, of an SE or SCE, Between Member States, OJ L 225 (1990), EU L. IBFD.

16.

Arbitration Convention (1990): Convention 90/436/EEC of 23 July 1990 on the Elimination of Double Taxation in Connection with the adjustment of Profits of Associated Enterprises, OJ L 225 (1990), EU L. IBFD.

17.

EU Savings Directive (2003): Council Directive 2003/48/EC of 3 June 2003 on Taxation of Savings Income in the Form of Interest Payments, OJ L 157 (2003), EU L. IBFD.

18.

EU Interest and Royalties Directive (2003): Council Directive 2003/49/EC of 3 June 2003 on a Common System of Taxation Applicable to Interest and Royalty Payments Made Between Associated Companies of Different Member States, OJ L 157 (2003), EU L. IBFD.

19.

R. Falcón y Tella, *El Papel de la Jurisprudencia en la Armonización Fiscal Europea*, in *Sistema Fiscal Español y Armonización Europea* p. 33 (various eds., Marcial Pons 1995).

20.

D. Shelton, *Law and Not Law and the Problem of Soft Law*, in *Commitment and Compliance: The Role of Non-Binding Norms in the International Legal System* pp. 1-21 (D. Shelton ed., Oxford University Press 2003).

21.

See R. Griffith & A. Klemm, *What Has Been the Tax Competition Experience of the Last 20 Years?*, Inst. for Fiscal Stud., Working Paper 04/05 (2005), available at <http://ideas.repec.org/s/ifs/ifsewp.html>, at p. 4, who state "... By capital mobility we mean that productive activity can be shifted at low cost across countries. It is important to note that capital need not actually move, the possibility that it can is sufficient. This means that it can be difficult to find evidence for capital mobility. One indirect way is to compare rates of return across countries, the idea being that corporate mobility will equalise these ...".

22.

J. Malherbe, *Harmful Tax Competition and the European Code of Conduct*, 21 *Tax Notes Intl.* 2, p. 151 (10 July 2000).

23.

OECD, *Harmful Tax Competition. An Emerging Global Issue* p. 15 (1998), available at www.oecd.org/dataoecd/33/0/1904176.pdf.

24.

European Commn., *Towards Tax Co-ordination in the European Union: a package to handle harmful tax competition*, COM(1997) 495 (1 Oct. 1997).

25.

P. Lampreave Márquez, *EU Tax Commissioner Semeta's Tax Policy May Spell Success*, 58 *Tax Notes Intl.* 6, p. 465 (10 May 2010).

26.

EU Code of Conduct (1997): Conclusions of the ECOFIN Council meeting on 1 December 1997 concerning taxation policy DOC 98/C2/01, OJ C 2 (1998).

27.

R. Rohatgi, *Basic International Taxation*, 2nd ed. (Richmond Law & Tax 2005).

28.

P. Lampreave Márquez, *Competencia Fiscal Desleal Entre los Estados Miembros de la Unión Europea* p. 44 (Aranzadi 2010).

29.

OECD, *supra* n. 23, at p. 17, where it is stated that "The Committee recognises that some investors may seek to invest in a location with lower rates (and greater after tax return) even if only low public services are available, while others may seek to invest in a location with higher public services even if they have to endure a higher tax burden to finance them".

30.

B. Gurtner & J. Christensen, *The Race to the Bottom: Incentives for New Investment*, *Tax Just. Network*, p. 5 (2008), who state that "[t]he advantage gained by one country from lowering its taxes is often short term because it is quickly offset by similar moves in neighbouring countries. This beggar-thy-neighbour process of undercutting has been observed in a number of regions, with some tax havens in the European region, e.g. the islands of Guernsey, Jersey and the Isle of Man, leading the way by offering zero tax rates to both resident and non-resident companies." Available at www.taxjustice.net/cms/upload/pdf/Bruno-John_0810_Tax_Comp.pdf.

31.

M.P. Devereux & R. Griffith, *The impact of corporate taxation on the location of capital: A review*, *Swedish Econ. Policy Rev.* 9, pp. 79-102 (2002), available at <http://spot.colorado.edu/~utar/DevereuxGriffith.pdf>.

32.

Les Impôts en Europe (Y. Blaise et al. eds., Dalloz 2004).

33.

See M.P. Devereux, B. Lockwood & M. Redoano, *Do Countries Compete over Corporation Tax Rates?*, Inst. for Fiscal Stud. working papers (W02/10) (2001), available at <http://ideas.repec.org/s/ifs/ifsewp.html>.

34.

See www.efd.admin.ch.

35.

J. Owens, *Curbing harmful tax practices, Recommendation by the Committee of Fiscal Affairs*, 26 Intertax 8/9, pp. 230-234 (1998).

36.

Art. 49 TFEU (2007), previously art. 43 TEC (2002).

37.

UK: ECJ, 21 Feb. 2006, [Case C-255/02, Halifax plc, Leeds Permanent Development Services Ltd, County Wide Property Investments Ltd, v. Commissioners of Customs & Excise](#), para. 98, ECJ Case L. IBFD.

38.

UK: ECJ, 12 Sept. 2006, [Case C-196/04, Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue](#), para. 1 of the Judgement Summary (referring to paras. 50, 51 and 55 of the decision), ECJ Case L. IBFD. This case concerned the application of the UK CFC legislation to the Irish finance subsidiaries of a UK parent company.

39.

OECD, *supra* n. 23, at pp. 26-30.

40.

ECOFIN, *supra* n. 26, at p. 3.

41.

OECD, *supra* n. 23, at pp. 40-45.

42.

OECD Model Tax Convention on Income and on Capital (22 July 2010), Models IBFD.

43.

Lampreave Márquez, *supra* n. 28, at p. 94.

44.

L. De Broe, *International Tax Planning and Prevention of Abuse: A Study Under Domestic Tax Law, Tax Treaties and EC Law in Relation to Conduit and Base Companies* (IBFD 2008), Online Bks. IBFD.

45.

European Commn., *Co-ordinating Member States' Direct Tax Systems in the Internal Market*, COM(2006) 823 final (19 Dec. 2006), EU L. IBFD and *Tax Treatment of Losses in Cross-Border Situations*, COM(2006) 824 final (19 Dec. 2006), EU L. IBFD.

46.

M. Lang et al. eds., *Tax Treaties and EC Law* (Kluwer Law International 2007).

47.

EU Code of Conduct (1997), *supra* n. 26.

48.

Lampreave Márquez, *supra* n. 28, at p. 100.

49.

A. Gurría, *G20: Cleaning Up the World Economy*, The Guardian (31 Mar. 2009): "... Good intentions are one thing, however, and action is another ...".

50.

R.T. Kudrle, *The OECD's Harmful Tax Competition Initiative and the Tax Havens: From Bombshell to Damp Squib*, 8 Global Econ. J. 8 (2008).

51.

Lampreave Márquez, *supra* n. 28, at p. 114.

52.

See European Commn., *Taxation in the European Union*, SEC(1996) 487 (20 Mar. 1996). See also European Commn., *Report from the Commission on the Development of Tax Systems*, COM(1996) 546 (22 Oct. 1996).

53.

The Code of Conduct Group was established by the Council to assess the tax measures that could fall within the scope of the Code and to oversee the provision of information on those measures. This Code of Conduct Group was presided over by Ms Primarolo (the then UK paymaster general) and the first meeting was held in May 1998. See the EU Code of Conduct (1997), *supra* n. 26. See also the *Primarolo Report*, SN4901/99 (1999).

54.

For the Group's progress, see Doc. 13563/00 FISC 193; Doc. 8789/01 FISC 83; Doc. 14467/01 FISC 249; Doc. 8848/02 FISC 129; Doc. 7018/1/03 FISC; and Doc. 14361/03 FISC 173.

55.

Doc. 13213/03 (May 2003).

56.

In European Commn. Press Release, IP/03/182 (23 Feb. 2000), Commissioner Mario Monti stated that the Directorate General for Competition would examine all the relevant cases of fiscal state aid with regard to business taxation to allow the Commission to comply fully and promptly with its own institutional obligations.

57.

A. Easson, *State Aid and the Primarolo List*, 2 The EC Tax J. 5, p. 111 (2001).

58.

With regard to state aid, see C. Pinto, *EC State Aid Rules and Tax Incentives: A U-Turn in Commission Policy?*, 39 Eur. Taxn. 8 (1999).

59.

C. Pinto ed., *Tax Competition and EU Law* (Kluwer Law International 2003).

60.

Lampreave Márquez, *supra* n. 28, at p. 240.

61.

Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54(3)(g) of the Treaty on the annual accounts of certain types of companies, OJ L 222 (1978).

62.

Where tax planning is particularly aggressive, intra-group financing is frequently obtained by a "back-to-back loan" with the consequential double deduction of interest.

63.

International Tax Glossary (J. Rogers-Glabush ed., IBFD 2011), Online Bks. IBFD.

64.

OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD 1995).

65.

IR: Irish Finance Act, 1987.

66.

See, for example, the investment funds regime, the venture capital company, as well as certain securitization vehicles.

67.

Hybrid financial instruments are defined as instruments with economic characteristics that are inconsistent in whole or in part with the classification implied by their legal form. Hybrid financial instruments normally contain elements of equity, debt and/or derivatives, the advantages of which are combined in the same instrument. In a cross-border situation, this normally gives rise to a mismatch in the tax characterization and treatment of the income by the various tax jurisdictions involved.

68.

As noted in the EU Code of Conduct (1997), *supra* n. 26, at p. 5 the Commission considers that there is a link between state aid and harmful tax competition.

69.

The Commission argued that it must be demonstrated that a measure does not provide an advantage to any company compared to others in a comparable legal and factual situation. With regard to the Netherlands, the measure is symmetric and would transfer the tax burden between the taxpayers' companies. Accordingly, a purely domestic group that opted for the group interest box would compensate for the advantage of reduced taxation of the interest received by a Netherlands financing company by way of a lower deduction in respect of the interest paid at the level of a Netherlands finance company.

70.

Lampreave Márquez, *supra* n. 28, at p. 259.

71.

J. Malherbe & M. Wathelet, *Pending Cases Involving Belgium: The Belgian Coordination Centres Cases: C-182/03, C-217/03, C-399/03; C-176/03 and C-433/04*, in *ECJ Recent Development in Direct Taxation* (various eds., Kluwer Law International 2006).

72.

J. Malherbe & O. Neiryck, *National Report Belgium*, in *Tax Competition in Europe* pp. 187-188 (W. Schön ed., IBFD 2003).

73.

X. Oberson & H. Hull, *Switzerland in International Tax Law* (IBFD 2006), Online Bks. IBFD.

74.

For the concept of pure holding companies, see the law concerning 1929 Luxembourg holding companies. Tax-exempt 1929 holding companies are Luxembourg resident companies whose exclusive purpose is the acquisition of participations, in any form whatsoever, in other Luxembourg or foreign companies, and the management and development of these participations.

75.

Lampreave Márquez, *supra* n. 28, at p. 148.

76.

Whilst some legislative restrictions under Danish tax law make Denmark less attractive as a location for a holding company, in May 2009, the participation exemption regime was amended to attract

foreign investment. See N. Bjornholm & M.B. Klemp, *Denmark Advantages as a Holding Company Jurisdiction*, 57 Tax Notes Intl. 2, p. 173 (11 Jan. 2010).

77.

The participation of an ETVE in the foreign company paying the dividends must amount to at least 5% of the foreign company's equity or, in respect of the acquisition of the foreign participation, have a value of a minimum of EUR 6 million. The participation must be held for at least one year. The foreign company in which the participation is held must be subject and not exempt in the country where it is resident to a tax similar to the Spanish corporate income tax (the presumption can be rebutted) and must not be resident in a territory classified as a tax haven. At least 90% of the foreign company's income, out of which dividends are paid to the ETVE, must arise from active business activities. The participation in the capital of the ETVE is nominative. Capital gains realized on the disposal of a participation in a foreign company are not included in the Spanish holding company's taxable income, provided that these conditions are satisfied.

78.

In order to claim ETVE status, the Spanish holding company must have the necessary substance to accomplish its corporate purpose. Although "substance" is not defined in the Spanish legislation, it is defined by way of a resolution of the tax authorities. This requirement can be considered to be met if the company acted as an administrator of daily management. See P. Lampreave Márquez, *Entidades de Tenencia de Valores Extranjeros (ETVE regime)*, 6 Impuestos 119 (2000).

79.

ES: TEAC, 25 June 2009, Res. 656/2007.

80.

Under the assets test, no more than 50% of the direct or indirect assets of the subsidiary may consist of non-business-related investments. Consolidated annual financial statements are insufficient for the assets test and, instead, a separate "allocation balance sheet" must be drawn up. Certain assets, such as group receivables, are generally considered to be non-business-related investments.

81.

If the assets test cannot be met, a subject-to-tax test of at least 10% applies as a safe harbour. In order to calculate the 10% effective rate of taxation, the foreign (i.e. non-Netherlands) tax base, as ascertained from the foreign profits tax return, must be converted into the tax base in accordance with Netherlands standards. Divergences between the Netherlands and the foreign tax bases – which, for example, arise in practice with regard to the participation exemption, the depreciation of real estate and interest deductions – give rise to onerous administrative burdens in relation to the subject-to-tax test.

82.

P. Flipsen & O. Burgers, *The Netherlands*, 35 Intl. Tax J. 6, p. 23 (Nov.-Dec. 2009).

83.

Lampreave Márquez, *supra* n. 28, at p. 186 and P. Lampreave Márquez, *Régimen Fiscal de las Entidades Holandesas (Dutch Holding Regime)*, 6 Quincena Fiscal 47 (2010).