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Fiscal Sovereignty or Fiscal Competition in EU Regulation: Theory and Legal Practice Controversy

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ABSTRACT

The actual EU integration status is based on fair social standards for all EU citizens, which implies many areas and dimensions of coherency for the activity of the EU members, both at central states governments policy level and in the everyday life of the people. The functioning of the European Union implies multiples sectors of activity, that have reached different level of integration, with precise features, starting with the most reputable unions (such may be considered the custom union) to the newest one, that are still under construction (as the fiscal union may be). The papers analyses the role of legislation for strengthening the European integration, in the present context. The research starts with the documentation on the legal framework of the EU common market fundamental principles, the functioning and the effects of these principles in theory and also in the Court of the Justice of the European Union (CJEU) resolutions. The impediments that taxation could raise for the optimal function of the common market are explained and the necessity of the fiscal harmonization is emphasized. On one hand, the research focused on the legitimacy of the fiscal common rules in the EU, showing on the other hand the legal possibility for the open competition among the member states fiscal systems. Present ongoing regulatory projects concerning base erosion and profit shifting (BEPS), common corporate taxation base (CCTB) and common consolidated corporate taxation base (CCCTB) are investigated and amendments to the regulatory proposition are formulated. The active role of the CJEU is emphasized and the role of the regulation to develop further integration is explained. The paper conclusions are that the present fight for optimizing the fiscal systems of members states of the EU is one reason more to develop intense actions towards fiscal integration, but there are still important legal, political and social obstacles to overcome in order to built the European fiscal union.

Keywords: EU integration, fiscal union, common taxation

Introduction

The actual EU integration status is based on fair social standards for all EU citizens, which implies many areas and dimensions of coherency for the activity of the EU members, both at central states governments policy level and in the everyday life of the people. The functioning of the European Union implies multiples sectors of activity, that have reached different level of integration, with precise features, starting with the most reputable unions (such may be considered the custom union) to the newest one, that are still under construction (as the fiscal union may be). A high level of competition that evolves in all relevant areas, including the taxation system, characterizes the current economic environment and its effects are not always positive. Being considered usually an economic phenomenon, tax competition also calls for useful legal regulation to limit negative effects, maximizing as much as possible its economic and social benefits.

The economic literature focused on tax competition has witnessed an important dynamic in the recent period, manifested both in academic and political debates. The positive effects of competition have determined states legislative institutions to look for solutions to create attractive tax systems for investors. However, some taxation practices are anti-competitive and undermine fair competition and public confidence in tax systems, situation which requires prompt intervention by the institutions empowered to monitor the competitive environment and to sanction non-compliant practices. The antagonist relationship between fiscal competition, direct result of the governments' self determination right to establish taxation system, and the international fiscal cooperation mechanisms is actual and not easy to be managed.

In the absence of fiscal competition, states fiscal institutions would opt for a monopoly type of behavior, charging excessive taxes. It is fiscal competition the one that leads to low taxation and boosts the discipline of public budget management, proving that tax competition is a determinant of the free character of the economy.

The Concept of Tax Competition

Tax competition is an issue of great interest for researchers, in the context of accelerating the process of globalization. This topic occupies an important place in the investigation and analysis carried out in the European Union, an international actor characterized by a high degree of economic integration, unique currency and freedom of movement of goods, services, persons and capital.

It is important to acknowledge that tax competition cannot be considered competition in the real sense. Competition itself is the situation of free competition where the participants in the economic circuit are able to act on a free economic market, where only the law of supply and demand leads. In the

case of fiscal competition, the competitors are the governments of the states, and their conduct is not tainted by demand and supply, but by political and economic interests. Although tax competition is present in all global markets, it is noted in the literature that there have been few attempts to define this phenomenon.1

Keen, M. defines fiscal competition as a "strategic fiscal context, within the wider framework of non-cooperation among tax jurisdictions (countries, states, or regions of a federation), where each establishes some tax-related parameters according to taxes practiced by the others".2

The "Encyclopaedia of Tax Policy" provides a definition of explicit tax competition as well as a definition of implicit competition. Governments engage in explicit tax competition when establishing tax regulations specifically designed to increase the attractiveness of the jurisdiction for businesses, residents, labor or consumers. Governments engage in implicit tax competition when modifying some fiscal policy goals to mitigate the effects of competition from other governments.3

There are also researchers considering that tax competition generates so many effects on economy and in social life so the concept should be defined as "tax war". There are two main reasons to support this renaming process of the concept. First, the competition between governments is completely different from the competition between companies, in terms of effects, general features and means of action. Second, the effect of tax competition at global level is destructive for all countries but it is even worse for the developing countries.4 On the contrary, there are opinion saying it is just a myth that tax competition hurts countries and public revenue. In reality, developed economy countries are not in competition with offshore area, the institution of tax credit being functional and efficient in order to prevent double taxation.5

The nowadays major opinion is not in accordance with Charles Tiebout model, which considered voters are acting as consumers and that people would always move in lower tax jurisdiction.6 There are six intense arguments based on pure economic theory, justifying that the model is working only at local level, where the flexibility of workforce is easily manifested, and it is not validated in the context of the current global economy.7 Still, this

[1]Ioan TALPOŞ, Alexandru O. CRÂŞNEAC – Efectele concurenței fiscale, in Revista Economie teoretică și aplicată, vol. XVIII (2010), no. 8(549), pp. 38-54.

[2]Keen, M., „Tax competition", The New Palgrave Dictionary of Economics, 2008, Ed. Steven N. Durlauf and Lawrence E. Blume, Palgrave Macmillan.

[3]Tannenwald, R., „Tax Competition", The Encyclopaedia of Tax Policy, Washington: the Urban Institute, 1999, pp. 367-371.

[4]Tax Justice Network – Tax Competition, Aug 26, 2016, available at http://www.taxjustice.net/tax-competition/, retrieved 26 May 2019.

[5]IFC Forum – Tax Competition, available at https://www.ifcforum.org/myths-v-reality/, retrieved 26 May 2019.

[6]Tiebout, C. (1956), "A Pure Theory of Local Expenditures", Journal of Political Economy, 64 (5): 416–424, doi:10.1086/257839.

[7]Tax Competition – Was Charles Tiebout Joking? Fools Gold Blog, April 23, 2015, available at http://foolsgold.international/competitiveness-was-charles-tiebout-joking/, retrieved 20 May 2019.

phenomenon, known as tax competition, has led to important changes in tax policy everywhere.8

Wilson and Wildasin have proceeded in a different way, defining the tax competition according to its ways of performance.9 Broadly speaking, fiscal competition can be defined as any fiscal context in which different independent governments do not coordinate fiscal policies. In a narrow sense, fiscal competition can be defined as any fiscal context in which different independent governments do not coordinate their fiscal policies, and each government's fiscal policy affects the way in which tax revenue is allocated between them. We note in these definitions that there is a distinction between horizontal tax competition present among state governments and vertical tax competition, which is manifested at different levels of fiscal decision-making in accordance with the organization of that state. Vertical tax competition exists when tax authorities located at different levels of government (central, regional, local) share the same taxable items.

Tax competition may take several forms of manifestation, depending on the purposes pursued by the authorities, but also depending on the fiscal instruments that are used. Considering the goals pursued by the authorities, competition between governments takes place to attract:

- Foreign direct investments, portfolio investments and high-performing financial capital.
- Internal financial flows from multinational companies that can track revenue or profits, targeting the parent company for tax optimization purposes.
- Buyers from abroad, in particular those who are interested in taxable products and excise duties, when there are significant differences between them.
- Highly qualified workforce, considered to have a higher degree of mobility.

Considering the tax instruments used by the authorities, there are different forms of tax competition:

- Competition through tax rates, when governments set lower rates of taxation than those established in other states.
- Competition using tax bases, when facilities are provided for the establishment of taxable items (deductions, preferential treatment of tax losses, accounting for depreciation, etc.).
- Public expenditure competition, when authorities spend a significant amount of the revenue to provide public services that increase business productivity (such as excessive public spending on infrastructure).

[8]Daniel Mitchell - Tax Competition, in: The Encyclopedia of Libertarianism, edited by: Ronald Hamowy, DOI: http://dx.doi.org/10.4135/9781412965811.n307, retrived 20 May 2019.
[9]Wilson, J. D., Wildasin, D., „Capital Tax Competiton: Bane or Boon”, Journal of Public Economics, nr. 88, 2004, pp. 1065-1091.

Evaluating the positive effects of fiscal competition and the negative impact of this phenomenon on the global market, in general, and of the European level, in particular, there is a strong need to balance the two, without eliminating none of them. This equilibrium could be insured using responsible and updated regulation.

Tax Competition versus Tax Harmonization within the EU

The European Union today's performance is the direct effect of integration, the unique and complex process that necessarily involves legislative approximation and includes fiscal harmonization. In line with the fundamental principles of freedom of movement that characterize the common market, there has always been noticed a certain need for uniform rules, with mandatory power in all Member States. Equally, the sovereign right of the states to self-determination and the fundamental subsidiarity principle of EU law have created the context of adopting country-specific rules. In the field of taxes and duties, Member States still enjoy sovereignty, while imperative rules at EU level are being adopted only with the unanimous vote of the members. However, the current state of European integration has also imposed particular uniformity in the fiscal regulation.

We can analyze tax harmonization in the European Union starting with 1996, when the European Commission initiated actions for a common system for ruling value added tax (VAT) for all Member States. This common regulation envisages compliance by the Member States with the general principles of VAT, that are definition of subjects of this tax, the possibility of co-existence for standard and reduced rates, the general criteria to identify taxable persons and the most frequent exceptions. The first VAT legislation at European level also addressed the place of taxation, prioritizing the principle of taxation at the place of origin, which indirectly fueled the phenomenon of tax competition. Although the idea of VAT taxation in the country of origin of goods and services is a strategic priority of the EU, it has been proved that it is very difficult to find consensus among Member States in this regard.

The harmful tax competition was a concern at European level since the adoption of the Code of Conduct for business taxation, set out in the conclusions of the Council of Economics and Finance Ministers (ECOFIN) of 1 December 1997. This Code is not a piece of regulation itself, it has no binding force but it certainly has political force. By adopting the Code, the Member States willingly assumed the standstill conduct, meaning that they have undertaken to abstain the adoption of tax rules that stimulate harmful tax competition and refrain from introducing any such measures in the future. When adopting the Code, the Council acknowledged the positive effects of fair competition, which may be beneficial for the market. In view of this, the Code was designed for the purpose of detecting the measures that unjustifiably affect the location of economic activity within the EU territory, by targeting the rules for non-residents, when they benefit of the more favorable tax treatment than

the generally available fiscal treatment in the Member State. For the purpose of identifying such harmful measures, the Code sets out the criteria on the basis of which any potentially harmful measures should be tested. Since then, the Code of Conduct Group has been monitoring standstill conduct and the implementation of rollback and it has reported regularly to the Council.10

An example of the small-scale evolution of the tax harmonization process in the field of direct taxation is the taxation of companies, as there is a strong risk that very low tax rates in a country or various tax cuts may unfairly attract firms from competing countries, with effects on the erosion of tax bases in their countries of origin. In this respect, it is worth mentioning the efforts to approximate the regulatory or administrative provisions in the Member States to establish a Common Consolidated Corporate Tax Base (CCCTB) that applies to the entire activity of a company regardless of where it operates within the European Union.

Hence, the relationship between harmonization of regulation in the EU and tax competition is antagonistic and difficult to manage. Tax harmonization involves a certain coordination among the legislatives of all member states and several types of joint actions, from the establishment of uniform rules, namely single rates and identical tax bases, to the observance of the right of governments to decide, but within a predefined framework and within predetermined taxation limits. At least from strictly theoretical point of view, ideal tax harmonization is the one that eliminates the differences between national tax systems until the benefits of tax competition are abolished. Therefore, there is no unanimity with regard to tax harmonization, the main disadvantages being:

- The elimination of fiscal competition, with all its advantages that primarily involve attracting liquidity to the economy.
- The differences among tax rates, in order to fully justify other technical considerations (optimal fiscal pressure).
- Competition between national regulatory systems is a wider phenomenon than fiscal competition, with more implication on the economy.
- The efficiency of tax systems is not judged abstractly but on the basis of theoretical indicators and in precise terms, by direct reference to material factors (such are living standards) and behavioral factors (such is purchasing behavior).
- The violation of the fiscal sovereignty of the states.

Depending on the type of tax that we mainly refer to and analyze, the stringency of harmonization is appreciated differently, for instance:

[10]https://ec.europa.eu/taxation_customs/business/company-tax/harmful-tax-competition_en, retrived 20 May 2019.

a) The highest degree of harmonization is necessary in the field of indirect taxes because the differences between them determine different prices for the consumer, thus indirect taxes segmente national markets, which is a result incompatible with the Single Internal Market general objectives (complete and functional integrated markets).
b) Direct taxes generally require limited harmonization, aimed at avoiding discrimination, double taxation or unintentional taxation.
c) There is, however, a certain sub-category of direct taxes, such as those applied to flexible tax bases, for which it is considered that closer coordination is needed to counteract the distortions induced in the allocation of resources within the Single Internal Market.
d) Taxation of personal income does not require harmonization with the exception of the Regulatory Agreements to remove any restrictive effects on the free movement of persons, to avoid double unintentional taxation and to prevent the unwanted effects of the measures introduced at national level to prevent tax avoidance.

Tax competition can be perceived as a method to achieve global competitiveness. States compete with each other to attract capital, and direct competition has encouraged efforts to create attractive tax systems for investors. However, some tax practices are anti-competitive and undermine fair competition and the confidence of contributors in the regulatory system of taxation.

In September 2004, the Commission adopted a Communication on preventing and combating financial and corporate malpractice (COM (2004) 611), which provides the strategy for a coordinated action in the fields of financial services and company law, in order to reduce the risk of financial malpractice. In the tax area, the Commission suggests more transparency and exchange of information in the field of corporate taxation so that tax systems are better prepared to cope with complex corporate structures. The Commission also wants to ensure coherent EU policies on offshore financial centers to encourage these jurisdictions to move towards transparency and effective information exchange.

On 28 April 2009, the Commission adopted a Communication identifying actions that EU Member States should take to promote "good governance" in the tax area (i.e. more transparency, exchange of information and fair tax competition).11 The Communication identifies how good governance could be improved within the EU. It also lists the tools that the EU and Member States have at their disposal to ensure that the principles of good governance are applied internationally. Finally, it calls on the Member States to adopt a more coherent approach to the principles of good governance in their bilateral relations with third countries and international community. The Communication builds on

[11]https://ec.europa.eu/taxation_customs/business/company-tax/harmful-tax-competition_en, retrieved 20 May 2019.

the current EU policy on good governance and the G20 conclusions of 2 April on non-cooperative tax jurisdictions.

At EU level, the complexity of the integration process and the collaboration that Member States develop are necessarily enforcing harmonized tax rules, particularly with a view to the smooth functioning of the European single market. Thus, a form of tax harmonization becomes inevitable, and a number of issues can be argued for tax harmonization, such as:

- Eliminating discrimination and the risk of double taxation.
- Preventing tax evasion for transactions between member states contributors.
- Preventing revenue losses associated with tax competition scenarios.
- Reducing the costs for non-residents' employment under the provisions of several tax systems.
- Non-use of the benefits of a single market by the Member States.
- The international distribution of tax revenues.
- Distorting the constitution and implicitly the allocation of budgetary resources, with negative consequences on the level of the financing of the public expenditure financing.

Competition between governments has the same beneficial effects as competition in the business environment. States that promote fewer restrictive and protectionist fiscal policies will enjoy the most new jobs and will benefit of large investments. Tax competition is another aspect of open competition between countries, with increased importance in the context of increased mobility of capital and labor. Taxpayers, workers and investors are equally pursuing the highest return after tax, so they leave the home country for the one who is offering the most exciting taxation system.

In this context, it is natural that in states with high rates of taxation the authorities' representatives criticize the phenomenon of tax competition because it limits their ability to use fiscal policy to achieve high public revenues and maintain excessive spending. These states criticize their more competitive neighbors, which attract economic activity and increased workforce. Tax competition exists both between different European tax systems and between countries belonging to the same tax models. It is most pronounced amongst the Eastern model states and less among the northern model states. It also manifests itself more strongly between the eastern and the continental models. Instead, the Nordic system is the most resilient to tax competition (which may be said to be somewhat "frozen") due to the existence of dual taxation, as well as the fact that countries are geographically more isolated and do not interact with the rest of Europe.12

[12]Maria Felicia Chirculescu – Advantages and Disadvantages of Tax Competition in the European Union, in Annals of the „Constantin Brâncuşi" University of Târgu Jiu, Economy Series, Issue 1/2018, p. 191.

It is pertinent to note that liberal low-tax regime were encouraged by high levels of economic, financial and monetary regulation and high taxes in other countries, and the competition provided by these regimes helped to spur international liberalization which has generally been beneficial.13

The action plan adopted by the Commission on 17 June 2015 for fair and effective corporate taxation in the EU also addressed issues related to harmful tax practices and the work of the Code of Conduct Group.

The Tax Avoidance Package adopted on 28 January 2016 is part of the ambitious Commission agenda for a fairer, simpler and more efficient taxation of companies in the EU. The package contains concrete measures to prevent aggressive fiscal planning, to increase tax transparency and create a level playing field for all EU businesses.

We note that the preferred instrument of harmonization of the EU taxation is the directive, as it respects the right of the state to decide on the procedure and means to respect it, still achieving a certain level of uniformity of the regulation.

The TFEU Provisions on Competition and Tax Harmonization

Although competition and tax harmonization are considered to be opposite concepts, the TFEU regulates in Title VII common imperative rules on competition, taxation and legislative harmonization. After dealing with the competition rules applicable to enterprises and the State aid issue in Chapter 1, Chapter 2 regulates the fundamental provisions in the field of tax competition between EU Member States and Chapter 3 regulates the approximation of laws.

Article 110 (former Article 90 TEC) expressly provides that no Member State shall apply, directly or indirectly, to the products of other Member States any internal taxation of any kind higher than the taxes that apply directly or indirectly to similar domestic products. Also, no Member State applies domestic products to other Member States' products to indirectly protect other production sectors.

Furthermore, Article 111 (ex Article 91 TEC) lies down that products exported to the territory of one of the Member States may not benefit from any reimbursement of internal taxes higher than those effectively levied, directly or indirectly. With precise regards to other taxes than turnover tax, excise duties and other indirect taxes, exemptions or refunds may be granted for exports to other Member States and countervailing duties may be imposed on imports from Member States, only if the envisaged measures have been previously approved for a limited period by the Council, acting on a proposal from the Commission in accordance with Article 112 (ex Article 92 TEC).

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[13]Bishnodat Persaud – *The OECD Harmful Tax Competition Policy: A Major Issue for Small States,* in Biswas, R. (ed.) (2002), International Tax Competition: Globalisation and Fiscal Sovereignty, Commonwealth Secretariat, London, https://doi.org/10.14217/9781848597587-en, p. 27.

On the basis of Article 113 (ex Article 93 TEC), the Council, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, shall adopt provisions on the harmonization of legislation on turnover tax, and other indirect taxes, insofar as such harmonization is necessary to ensure the establishment and functioning of the internal market and to avoid distortions of competition.

The procedure to be followed for the approximation of laws is detailed in Chapter 3 of Title VII, stating that the European Parliament and the Council, acting in accordance with the ordinary legislative procedure and after consulting the Economic and Social Committee, shall adopt measures on the approximation of laws, regulations and administrative provisions of the Member States which have as their main objectve the establishment and functioning of the internal market.

It should be noted that the text of the treaty allows Member States which consider it necessary to maintain the national provisions justified by the important requirements in the field of the common foreign and security policy and the common security and defense policy or relating to the protection of the environment or the working environment. In these particular situations, the respective member state should notify the Commission of the reasons for the maintenance of these provisions. However, if a Member State considers it necessary to introduce national provisions based on new scientific evidence relating to the protection of the environment or the working environment due to a problem specific to that Member State arising after the adoption of the harmonization measure, it shall address to the Commission a notification of the measures envisaged and the reasons for their adoption. Within six months of the abovementioned notifications, the Commission shall approve or reject the relevant national provisions after verifying whether or not they constitute a case of arbitrary discrimination or a disguised restriction on trade between Member States. It is also important to establish whether or not they might affect in any way the the functioning of the internal market or they constitute an obstacle the fundamental freedom of movements with the EU.

Where a Member State invokes a particular public health problem in a field which has previously been the subject of harmonization measures, it shall inform the Commission, which shall immediately consider whether it is necessary to propose appropriate measures to the Council.

In order to respect the fiscal sovereignty enjoyed by EU Member States, Art. Article 115 (ex Article 94 TEC) provides that the Council must decide unanimously, in accordance with a special legislative procedure, and after consulting the laws, regulations and administrative provisions of the Member States which have a direct impact on the establishment or functioning of the internal market. In this procedura, the Coucil must consider opinion of The European Parliament and the Economic and Social Committee.

Article 116 (ex Article 96 TEC) explains the notion of distortion of competition in the common market as follows: when the Commission finds that a disparity between the laws and regulations of different Member States

distorts the conditions of competition in the internal market, and this is why a distortion has to be eliminated, the Commission consults with the Member States concerned. If this consultation does not eliminate the distortion in question, the European Parliament and the Council, acting in accordance with the ordinary legislative procedure, shall adopt the relevant Directives. Any other useful measures provided for in the Treaties may be adopted.

At the same time, a consultation procedure may be followed by states to prevent the adoption of laws that have the effect of distorting loyal tax competition. According to art. 117 (ex Article 97 TEC), the Commission, after consulting the Member States, shall recommend to the States concerned appropriate measures to avoid distortion. When a Member State is looking to adopt or to amend national provisions does not comply with the Commission's recommendation, the other Member States may not be required, under Article 116, to amend their national provisions with a view to eliminating this distortions. When the Member State which has disregarded the Commission's recommendation causes only distortion to its detriment, Article 116 shall not apply.

Sinn has studied the issue of tax competition at the European Union level by showing that intensifying the phenomenon between states for attracting mobile capital will limit the ability of Member States to maintain their current high level of social transfers. 14 He believes that it is necessary to establish a central European Union-level authority responsible for redistributive policies, so that Europe "does not have to give up the progress made in the social plan."15

From our point of view, it is also possible to consider the extensions of the prerogatives of a particular existing authority, acquiring in addition to the competences already exercised and competencies in the field of concrete monitoring of the tax competition.

Conclusions

The literature on tax competition is centered on analyzes focused exclusively on the provision of economic and financial information. In reality, however, much of the tax regulations of the states and, in particular, of the Member States of the European Union produce effects on tax competition within the European common market and also on the global market. Thus, the theoretical analysis identifies the need for European Union action to limit the fiscal competition and for the Member States to intervene in the process of fiscal harmonization, without canceling the positive effects of the competition between their fiscal policies. In this context, it is important to respond to the need to monitor and to balance the competitive actions in the tax field.

[14]Sinn, H.W., „How Much Europe? Subsidiarity, Centralization and Fiscal Competition”, Scottish Journal of Political Economy, nr. 41, 1994, pp. 85-107.

[15]Sinn, H.W., „Tax Harmonization and Tax Competition in Europe”, European Economic Review, nr. 34, 1990, pp. 489-504, p. 502.

We advocate fiscal harmonization based on fiscal coordination and not to achieve total harmonization, which would involve the elimination of the benefits of tax competition as follows:

- The impossibility of using fiscal policies to counter economic imbalances (economic and financial crises). During the recent global financial crisis, states' governments have opted for revenue maximization either by increasing quotas or by introducing special taxes, or these methods are specific to the tax competition environment.
- Fair and reasonable competition contributes to the increased competitiveness and to the development of the business environment.
- The current global economic and financial environment is characterized by competition for access to finance and attracting foreign investment to all less developed countries. The use of fiscal policy as a tool for fiscal competition can take place in a regional context, especially for newly integrated EU Member States.
- Fiscal harmonization between 28/27 states with such a diverse economic potential would, in our view, imply too high compromises for both high-spending and low-income countries. The first category of states should resize their public spending to the detriment of their direct beneficiaries and another category of states should painfully adjust their citizens' incomes to allocate a larger share to the public budget.

So, there are arguments in favor and arguments against the process of tax harmonization at EU level, and the first of them do not counterbalance the importance of others. In other words, neither tax competition, nor tax harmonization can be eliminated, which only provides for fiscal coordination with the implicit acceptance of elements of tax competition.

As we have seen, EU imperative rules of law (in particular the provisions of the Treaty on the Functioning of the European Union, but also the regulation in taxation directives) create the necessary framework for monitoring tax competition and require delegation of these powers to the European and Member States' specialized administrative authorities.

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