Department of Law

European Union Law

CORPORATE MOBILITY AND REGULATORY COMPETITION IN THE EVOLUTION OF THE EU INTERNAL MARKET: A CRITICAL APPRAISAL

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LIST OF FREQUENTLY USED ABBREVIATIONS

AG	Advocate General
ALP	Arm's Length Principle
APA	Advance Price Agreement
ATAD	Anti-Tax Avoidance Directive
ATP	Aggressive Tax Planning
BEPS	Base Erosion and Profit Shifting
CCTB	Common Corporate Tax Base
CCCTB	Common Consolidated Corporate Tax Base
CFC	Controlled Foreign Company
CIT	Corporate Income Tax
CJEU	Court of Justice of the European Union
DAC	Directive on Administrative Cooperation
DG	Directorate General
DTC	Double Tax Convention
ECJ	European Court of Justice
EEC	European Economic Community
EU	European Union
EUR	Euro
GBP	Pound Sterling
GC	General Court
HTC	Harmful Tax Competition
MLI	Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting
OECD	Organization for Economic Co-operation and Development
PE	Permanent Establishment
SDP	Significant Digital Presence
SE	Societas Europaea
SHRD	Shareholder Rights Directive
SMEs	Small and Medium-sized Enterprises
SPE	Societas Privata Europaea
TEU	Treaty on the European Union
TFEU	Treaty on the Functioning of the European Union
TNMM	Transactional Net Margin Method
USD	United States Dollar

INTRODUCTION

In the context of the current pandemic crisis, the European Union has recently approved the largest stimulus package ever financed through the EU budget. This multiannual financial framework, which is mainly constituted by the adoption of the EU's long-term budget and the *NextGenerationEU* (a EUR 750 billion temporary recovery instrument), has an estimated value of more than EUR 1,800 billion. However, the path for the adoption of such massive measures has not been without controversy. Most prominently, a complex debate has arisen surrounding the appropriate means by which the *NextGenerationEU* should be financed.

At first, the main obstacle seemed to be the reluctance of the so called 'Frugal Four' (Austria, Denmark, the Netherlands, and Sweden), soon joined by Finland, countries which showed concerns about their role as 'EU net contributors' and preferred the instrument of loans rather than non-refundable grants. At the other end of the spectrum, instead, a block of several Southern and Eastern European countries led by Italy, France, and—after some initial hesitation—Germany tried to negotiate more flexible conditions in the name of cooperation and solidarity. Subsequently, further tensions have arisen when discussing the implementation of a digital tax, since countries like Ireland and Luxembourg joined the 'sceptic' front.

It was in this context that the political climate was overheated by reciprocal accusations.

On the one hand, the Frugal countries blamed Southern Member States of having historically struggled to effectively use EU funds because of inefficient bureaucracy and lack of vision, which had often led to wastes and expenses on white elephants. On the other hand, Mediterranean countries accused Member States like the Netherlands, Ireland, and Luxembourg of exploiting freedom of movement for companies and capital through unfair regulatory competition. In particular, those countries have been held responsible for implementing unsustainable regulatory systems which attracted foreign firms and thus reduced the tax income of Member States from which those firms depart.

With all this taken into consideration, the question arises as to what regulatory competition is and what its effects on the European Union framework

are.

The aim of this research is to explore this concept, by reference to the two fundamental freedoms which allow corporate mobility within the EU internal market, namely freedom of establishment and free movement of capital.

Indeed, the main aim of such freedoms is to allow the optimal allocation of factors of production across the Union. This poses a question: is competition between Member States' legal systems is compatible with such a goal? Crucial economic and social aspects must be taken into account when assessing the matter.

In particular, Chapter I concerns the notions *('regulatory competition'*, *'freedom of establishment'*, and *'free movement of capital'*) which are essential in order to study the phenomenon, with specific regard to the relevant provisions of the Treaties and the case law of the Court of Justice of the European Union.

Additionally, in Chapters II and III the development and the impact of regulatory competition is gauged with respect to corporate governance and business taxation, with a specific focus on digital economy and multinational enterprises, in order to assess *(i)* which elements are more likely to influence the mobility choices (*'regulatory arbitrage'*) of corporations, and *(ii)* whether and to what extent their influence has so far caused a *'race to the top'* or a *'race to the bottom'* in the regulatory framework at both EU and national level.

Lastly, Chapter IV deals with the strategy adopted so far by the European Commission to face the critical issues discussed in the rest of the dissertation. More specifically, the aim of the last chapter is indeed to assess whether the favourable conditions granted by Member States to certain undertakings—the focus is on the 'tax ruling saga' which has recently involved several multinational enterprises—in order to attract them can constitute State aid and thus justify the application of the related rules, in light of the most recent decisions of the Commission and rulings of the Court.

In conclusion, the main aim of this work is to provide some helpful elements in order to understand whether and to what extent regulatory competition and its effects on the internal market should be involved in the public debate concerning the recovery measures in the context of the current pandemic crisis.

CHAPTER I

CORPORATE MOBILITY AND REGULATORY COMPETITION

1.1 *Regulatory competition and the fundamental freedoms within the framework of the internal market*

The establishment of a common market has been at the heart of the European project from the outset. Recognised as a main feature of the Union by Article 3 TEU[1], the development of such a shared market was conceived to boost the integration process. The common market is a form of economic integration allowed by a unique combination of factors such as a free trade area, customs union, a common external policy, and free movement of the factors of production.

Until 1986, integration was limited by Article 100 of the EEC Treaty[2] (now Article 115 TFEU[3]) which required unanimity in order to reach harmonisation through legislative means and by the intense use of overly detailed directives that could not fully meet the needs of a common market, especially considering the massive ongoing technological development.

In 1985 the Commission's *White Paper*[4] promoted the elimination of physical, technical, and fiscal barriers by shifting from harmonisation towards mutual recognition and facing the problem of the unanimity requirement.

One year later, the *Single European Act* set the goal of achieving a single market by 1992 and brought two major legislative innovations to the EEC Treaty: Article 100a (now Article 114 TFEU), that introduced a general legislative harmonising power without the unanimity requirement; and Article 8a, where the definition of internal market (now in Article 26 TFEU) was laid down for the first time, providing that *'the internal market shall comprise an area without internal*

[1] Treaty on European Union [2008] OJ C 326/12 (TEU). Article 3 provides that *'the Union shall establish an internal market. It shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy […]. It shall promote economic, social and territorial cohesion, and solidarity among Member States'*.
[2] Treaty establishing the European Economic Community [1957] (EEC).
[3] Treaty on the Functioning of the European Union [2008] OJ C 326/12 (TFEU).
[4] COMMISSION OF THE EUROPEAN COMMUNITIES, *Completing the Internal Market: White Paper from the Commission to the European Council*, COM/85/0310 final, 1985.

frontiers in which the free movement of good, persons, services and capital is ensured in accordance with the provisions of the Treaties'.

In the framework of the internal market, free movement of goods and other factors of production has encouraged the development of the phenomenon known as regulatory competition.

The aim of this chapter is indeed to focus on that phenomenon, its historical development and its possible interpretations. In section 1.1, once regulatory competition will be described, it will be possible to compare the European attempt for a 'reflexive harmonisation' with the American 'competitive federalism', also briefly mentioning how the impact of regulatory competition and freedom of movement affects the European legal environment in fields other than corporate and tax law, with specific regard to labour and trade union law.

The second and the third part of the Chapter deal with freedom of establishment (section 1.2) and free movement of capital (section 1.3) respectively. For each of them, the applicable law, the scope of application and the development of the Court of Justice of the European Union (CJEU) case law will be analysed. The focus will always be on how those freedoms constitute the fundamental basis for corporate mobility and on their relationship with regulatory competition and regulatory arbitrage.

1.1.1 The concept of regulatory competition and its preconditions

Regulatory competition has been described as *'a process whereby legal rules are selected (and de-selected) through competition between decentralised, rule-making entities'*[5]. This economic theory of government organisation was developed for the first time by C. Tiebout in 1956[6] when discussing fiscal

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[5] See C. BARNARD, S. DEAKIN, *Market Access and Regulatory Competition*, Jean Monnet Working Paper n. 9, 2001, available at <https://jeanmonnetprogram.org/archive/papers/01/012701.html>, pp. 4-6; another definition is provided in K. GÖDKER, L. HORNUF, *Regulatory Competition*, in A. MARCIANO, G. B. RAMELLO (eds.), *Encyclopedia of Law and Economics*, Springer, 2019, p. 1787: *'regulatory competition describes the activity of private or public lawmakers who intend to produce novel or alter current legislation in response to competitive pressure from other private or public lawmakers'*.

[6] C. M. TIEBOUT, *A Pure Theory of Local Public Expenditures*, in *Journal of Political Economy*, 64, 1956, pp. 416-24.

federalism. He argued that a decentralised governmental system competing to attract residents by granting tax benefits produces efficient outcomes[7].

The access of foreign companies and capitals increases the economic activity of a State and might, for instance, reduce unemployment, raise tax revenue, and lower welfare costs. Thus, *'the State—or to be more exact: the political elite—will therefore try to frame the economic and legal environment in a business-friendly fashion'*[8].

This phenomenon allows lawmakers to use a greater flow of information and a wider range of solutions for their responses to various legal issues. Consequently, regulatory competition also provides law subjects—thus both natural and legal persons—with the choice between different rules that can bring different sorts of benefits.

There are at least three requirements that must be met by a legal environment to allow the existence of regulatory competition: *(i)* decentralisation, *(ii)* mutual recognition, and *(iii)* freedom of movement.

Clearly, *(i)* decentralisation is key: it is necessary for law subjects to have the opportunity to choose among different legal systems, in which different rules are implemented. This behaviour of law subjects is called 'regulatory arbitrage' or 'law shopping'. It refers to firms' choice of the legal regime that best suits their preferences[9], whereas 'regulatory competition' refers to regulators' attempt to attract or not to lose firms due to a more favourable legal environment. Within the European Union, decentralisation is granted by the discretion and the legislative autonomy of each Member State within the limits of its competence, according to

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[7] See V. MOVSESYAN, *Regulatory Competition Puzzle: The European Design*, LEM Papers Series n. 30, 2006, available at <https://ssrn.com/abstract=985319>, p. 21.

[8] W. SCHÖN, *Playing Different Games? Regulatory Competition in Tax and Company Law Compared*, in *Common Market Law Review*, 42, 2005, p. 332. Indeed, the author believes that regulatory competition: *(i) 'enhances the economic well-being of the electorate, thus raising the probability that the government will be re-elected'*; and *(ii) 'lead to higher tax revenue, thus improving the quality and quantity of public goods supplied by the government and giving politicians more leeway for redistributive measures'*.

[9] See also the definition provided by GÖDKER, HORNUF, *Regulatory Competition*, p. 1788: *'legal arbitrage can be understood as a legal planning technique that is carried out to avoid taxes and other legal rules to circumvent regulatory costs'*.

the principle of conferral[10]. Those are indeed crucial characteristics of the Union which allow a certain degree of intergovernmentalism, as opposed to the EU supranational dimension.

(ii) Mutual recognition[11] between the different legal systems is also a prerequisite for regulatory competition, as it requires States *'to accept as legitimate the regulatory decisions taken by other units within the federal space, at least in contexts where inter-state trade or mobility of resources is at stake'*[12]. The principle of mutual recognition is *'firmly embedded in the primary law of the European Union as a distinctive feature in the application of the fundamental freedoms'*[13].

The last fundamental precondition for regulatory competition is *(iii)* freedom of movement. In an economic model with perfect freedom of movement, natural and legal persons will decide to move to the legal system in which rules tend to increase their wealth and do not suffer from an inappropriately high or low level of regulation. So, as it happens in any competitive market, the supply of rules will try to meet the demand of law consumers. According to this neoliberal vision, *'regulatory competition is not an accident, and even less an abuse, but a constituent element of the internal market'*[14], capable of bringing numerous efficiencies: it is thus a 'race to the top'. It is not even necessary, in theory, that movement occurs:

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[10] Article 5(1) TEU, first sentence, provides that *'the limits of Union competences are governed by the principle of conferral'* ; an analysis of *'the competence problem in the Union'* is provided by D. GALLO in C. FASONE, D. GALLO, J. WOUTERS, *Re-connecting Authority and Democratic Legitimacy in the EU: Introductory Remarks*, in *European Papers*, 5, 1, 2020, section II, pp. 180 et seq: the author observes that *'what at first sight is a very straightforward principle, the principle of conferral, the bulwark for the articulation of the relationships between the Union and the States, faces several problems in its implementation'*.

[11] For an overview on the concept of mutual recognition, see W. ROTH, *Mutual Recognition*, in P. KOUTRAKOS, J. SNELL (eds.), *Research Handbook on The EU's Internal Market*, Edward Elgar Publishing, 2017, pp. 427-459, where recognition is described as *'a mode of cooperation between national legal system whereby acts of foreign authorities, judgements and decisions of foreign courts are taken into account in the domestic legal system in such a way as to give them some or even an equivalent legal status and effect as if they were acts, judgements or decisions delivered by domestic institutions'*.

[12] Z. ADAMS, S. DEAKIN, *Freedom of Establishment and Regulatory Competition*, in A. ARNULL, D. CHALMERS (eds.), *The Oxford Handbook of European Union Law*, Oxford: Oxford University Press, 2015, p. 541.

[13] ROTH, *Mutual Recognition*, cit, p. 427.

[14] F. COSTAMAGNA, *At the Roots of Regulatory Competition in the EU: Cross-border Movement of Companies as a Way to Exercise a Genuine Economic Activity or just Law Shopping?*, in *European Papers*, 4, n. 1, 2019, p. 186.

'just the threat of leaving can be sufficient to effect policy changes, as can the fear that new entrants to the market will choose to locate elsewhere'[15].

However, EU law and its four fundamental freedoms are far from pure economic theory and do not constitute a system with perfect freedom of movement. In fact, the integration process has suffered from a certain degree of asymmetries on multiple levels[16]. This is the reason why the European case is worth a deeper analysis.

Indeed, many concerns arise when this purely economic approach clashes with the safeguard of fundamental non-economic and social values[17]. Moreover, there is often a certain degree of tension between the efficiency of the internal market and the legislative autonomy of Member States, especially when matters of exclusive competence of the latter, such as direct taxation, are at stake.

In the internal market, harmonisation and regulatory competition can *prima facie* be seen as two opposite ends of the integration process spectrum. In the European Union, in fact, the aforementioned decentralisation is allowed by a multi-tiered and non-fully harmonised structure.

However, such a dichotomy is not necessarily so evident. According to S. Deakin[18], while central legislation can be seen as a *'monopoly regulator'*, as in the case of federal law in a competitive federalist system like the U.S., it can otherwise

[15] An overview on the basic theory of regulatory competition is provided by B. G. CARRUTHERS, N. R. LAMOREAUX, *Regulatory Races: The Effects of Jurisdictional Competition on Regulatory Standards*, in *Journal of Economic Literature*, 54, 1, 2016, pp. 53-57.
[16] See FASONE, GALLO, WOUTERS, *Re-connecting Authority and Democratic Legitimacy*, cit, p. 183, where, while discussing the *'democratic deficit'* in relation to the *'competence problem'* in the Union, GALLO observes that *'the problem of the disconnection between the place of authority and the nature of the democratic control that the exercise of EU (conferred) powers entails is further worsened by the asymmetries featuring the degree of integration reached by Member States in a certain policy area or on a single issue'*.
[17] A reflection on this conflict is provided by D. GALLO, *On the Content and Scope of National and European Solidarity Under Free Movement Rules: The Case of Golden Shares and Sovereign Investments*, in *European Papers*, 1, 3, 2016, p. 845, where the author concludes that *'it is essential for the EU institutions to take a resolute course of action in order to ensure greater legal certainty and strike a fair balance between internal market purposes and socio-economic regulation, i.e., between the Single Market and the European Social Model'*.
[18] S. DEAKIN, *Two Types of Regulatory Competition: Competitive Federalism versus Reflexive Harmonisation. A Law and Economics Perspective on* Centros, in *Cambridge Yearbook of European Legal Studies*, vol. 2, 1999, pp. 221-260.

be seen as a tool to grant *'reflexive harmonisation'*, meaning that it can be aimed at creating a *'dynamic efficiency'* while preserving the conditions for local diversity[19].

It is not easy to assess to what extent the system laid down by the Treaties stimulate a reflexive harmonisation, but the many issues arising as regards to regulatory competition and the development of related case law suggests that there is still a long way to go before the European process of integration—both positive and negative integration—reaches that point.

Regulatory competition is a matter that has been carefully analysed, and the four fundamental freedoms are the main object of an incredible amount of literature. However, the aim of this work is to study the relationship between the two of them, focusing specifically on the causes and the consequences of corporate mobility. This relationship, and its recent developments, are gradually shedding light on how the freedom of movement—specifically freedom of establishment and free movement of capital—can influence company law, tax law, and competition law, affecting many aspects of the life of undertakings.

1.1.2 The 'Delaware effect' and its European application. A race to the top or a race to the bottom?

When analysing regulatory competition, it is not easy to assess whether it constitutes a 'race to the top' or a 'race to the bottom'; in other words, it is not clear whether and in what sense regulatory competition leads to higher or lower standards of legislation.

The term *'race to the bottom'* was coined by W. Cary[20] when writing about Delaware, the most famous example of regulatory competition. The American State of Delaware has historically attracted company incorporations because of its

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[19] On the same line of reasoning, see SCHÖN, *Playing Different Games?*, cit, p. 365: *'if senior legislators (at the federal level in the U.S. or at the Community level in Europe) succeed in offering attractive legal alternatives to the domestic "products" of legislation, this would combine both the advantages of harmonisation (i.e. transparency, simplicity and cross-border applicability) and the advantages of regulatory competition (i.e. market pressure, product innovation, political responsibility). The current policy of the European Institutions points in this direction'*.

[20] See W. CARY, *Federalism and Corporate Law: Reflections Upon Delaware*, in *Yale Law Journal*, 83, 1974, pp. 663-669.

favourable corporate law regime[21], which Cary believed endangered the interests of shareholders in favour of the benefits to managers. However, other authors have later argued that *'Delaware attracts incorporations not because its laws are lax, but because they are efficient'*[22]. The Delaware example is therefore the first, and probably most evident, proof that there is not only one way to look at the effects of regulatory competition.

The concept of a *'market for corporate charters'*[23] was born during the second half of the twentieth century in the U.S., when Delaware quickly gained supremacy as the main State for incorporation and re-incorporation.

Such a supremacy has been explained in literature by referring to different factors of corporate law, tax law, and competition law.

First of all, Delaware's primacy in that 'market' is due to a scheme of reduction of transactional costs. Given that corporations[24] can be seen as a *'nexus of contracts'*[25] between various different parties (shareholders, directors, stakeholders…), those contracts imply different types of agency costs[26] (vertical, horizontal, shareholders-stakeholders) that derive from the interactions between the parties. The most relevant costs that a business will consider when choosing the place of incorporation are the costs of contracting (or credit's cost) and the costs of ownership. The most efficient jurisdiction for the incorporation of a company is, according to this point of view, that one that minimises those costs[27].

[21] Even though federal law creates minimum standards for trade in company shares and governance rights, corporate law falls mainly outside the scope of federal law. See below for further elements which have influenced Delaware primacy in the market for reincorporation.

[22] See D. CHARNY, *Competition among Jurisdiction in Formulating Corporate Law Rules: An American Perspective of the Race to the Bottom in the European Communities*, in *Harvard International Law Journal*, 32, n. 2, 1991, pp. 423-457.

[23] The case of *'Corporate Chartermongering'* in the US is described by CARRUTHERS, LAMOREAUX, *Regulatory Races*, cit, pp. 71-76.

[24] See J. ARMOUR, H. HANSMANN, R. KRAAKMAN, M. PARGENDLER, *Foundations of Corporate Law*, European Corporate Governance Institute Law Working Paper N° 336, 2017, available at <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2906054>.

[25] For an overview on this concept, see M. JENSEN AND W. MECKLING, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, in *Journal of Financial Economics* 3, 1976, p. 305, referring to A. ALCHIAN, H. DEMSETZ, *Production, Information Costs, and Economic Organization*, in *American Economic Review,* 62, 1972, p. 777.

[26] See J. ARMOUR, H. HANSMANN, R. KRAAKMAN, *Agency Problems, Legal Strategies and Enforcement,* European Corporate Governance Institute Law Working Paper n. 135, 2009, available at <http://ssrn.com/abstract=1436555>.

[27] See S. LOMBARDO, *Regulatory Competition in European Company Law. Where do we stand twenty years after* Centros*?*, European Corporate Governance Institute Law Working Paper n. 452, 2019, available at <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3392502>, pp. 8-12.

Delaware is capable of both reducing ownership's costs and not increasing credit's costs. For instance, the State is highly dependent on franchise taxes[28] and has no alternative available revenue to finance its expenditure. This condition makes Delaware inherently responsive and sensitive to companies' corporate legal problems. In addition, Delaware's constitution requires a particularly high threshold of votes in the legislative houses to change the corporation code, granting the stability of the legislation in force. Moreover, Delaware has invested in legal capital and judicial and administrative expertise so strongly connected to corporate law that such investments would probably not be useful for any purpose other than attracting companies and building up an incredibly efficient system of corporate law[29]. Those elements, together with the very high quality of the judicial system, have created a reputation that has consistently attracted more firms. Interestingly, and logically, the aforementioned advantages become more significant with a greater number of companies incorporated into Delaware's jurisdiction, thus providing with valid argument those who believe that the Delaware effect creates a race to the top.

Secondly, Delaware also offers a favourable regime for business taxation: its legislation indeed does not *'impose a state corporate income tax on income relating to intangible assets held by companies registered in the state and, like some other US states, allows anonymous shell companies'*[30].

Thirdly, a further reason pointed out by scholars[31] for Delaware supremacy lies on matters of competition law. Indeed, the lack of a sizable urban population[32]

[28] It is important to bear in mind that Delaware's incentive to compete on the market for incorporation relies heavily on the existence of a franchise tax, i.e. an annual tax levied by the government on all corporations registered in the State. However, there is no example of such a tax within the European Union. Indeed, Article 5(1)(c) of Directive (EC) 2008/7, which has replaced Directive (EEC) 69/335, provides that *'Member States shall not subject capital companies to any form of indirect tax whatsoever in respect of [...] registration or any other formality required before the commencement of business to which a capital company may be subject by reason of its legal form'*.

[29] See N. DE LUCA, *European Company Law: Text, Cases and Materials*, Cambridge, 2017, pp. 86-87, and SCHÖN, *Playing Different Games?*, cit, p. 336.

[30] OXFAM, *Tax Battles. The Dangerous Global Race to the Bottom on Corporate Tax*, Oxfam Policy Paper, 12 December 2016, available at <https://www.oxfam.org/en/research/tax-battles-dangerous-global-race-bottom-corporate-tax>, p.16.

[31] See ADAMS, DEAKIN, *Freedom of Establishment and Regulatory Competition*, cit, p. 541.

[32] According to US CENSUS BUREAU, *Annual Estimates of the Resident Population for Incorporated Places*, 2019, the most populated city in Delaware is Wilmington City that counts 70.851 inhabitants. The report is available at <https://www.census.gov/data/tables/time-series/demo/popest/2010s-total-cities-and-towns.html>.

has allowed for the avoidance of the development of a progressive policy with modern and invasive antitrust legislation, which would have been inconvenient for many corporations.

With all of this taken into consideration, it is easier to understand why Delaware is so appealing for companies, especially for big corporations with high revenue which have an elevated number of shareholders and thus a fragmented ownership.

As said before, there is no uniform opinion amongst scholars and commentators on how the Delaware effect has impacted on the standards of U.S. legislation[33]. While in the sixties and seventies the predominant opinion was that regulatory competition was bringing a race to the bottom, it did not take long before some part of the literature started to believe that the ultimate result of Delaware effect was the enhancement of corporate legislation and the maximisation of companies' welfare[34].

However, even though transactional costs are surely important, they are not the only costs—and maybe not even the most important—that a business takes into account when choosing the place of incorporation, especially on an international level where movement is often neither free nor cheap.

Hence, the results of this debate cannot be regarded as conclusive, especially since company law is not the only motivating factor for corporate mobility and thus is not the only subject affected by the effects of regulatory competition and regulatory arbitrage.

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[33] For an overview on the approach of the Supreme Court to the matter see F. TUNG, *Before Competition: Origins of the Internal Affairs Doctrine* in *Journal of Corporation Law*, 32, 2006, pp. 33–101; the matter has also been recently discussed by M. KAHAN, *The State of State Competition for Incorporations*, in J. N. GORDON, W. RINGE (eds.), *The Oxford Handbook of Corporate Law and Governance*, Oxford: Oxford University Press, 2018, pp. 105 et seq., where the author addresses three fundamental debates: the *'directional'*, the *'competition'*, and the *'federalism'* debate.

[34] See, amongst others: R. ROMANO, *The Genius of American Corporate Law,* AEI Studies in Regulation and Federalism, 1993; P. GENSCHEL, T. PLUMPER, *Regulatory Competition and International Co-operation*, in *Journal of European Public Policy*, 4, 4, 1997, pp. 626 et seq.; and EDITORIAL, *Global capital rules, okay?*, in *The Economist*, 1 March 2001, available at <https://www.economist.com/leaders/2001/03/01/global-capital-rules-okay>, where the authors submits that *'competition among regulators, at least across borders, is a good thing. Fears that competition of this sort starts a race to the bottom—that is, to lax regulation—are misplaced. Well-regulated markets are more efficient; that means they grow. So competition among regulators favours those who do a good job. A monopoly regulator can err on the side of heavy-handedness or neglect and expect to get away with it [...]'*.

In fact, scholars have taken into account many factors when assessing the effects of regulatory competition on various sectors. First to consider is whether the race has degraded regulatory standards or it has simply spurred countries to abandon inefficient restrictions. Another important factor is the extent to which the race to the bottom is 'self-limiting', meaning that—as previously noted in the Delaware case—the country that has attracted many corporations by lowering its standards will probably be also interested in retaining them by implementing an efficient legislative system. It is true, moreover, that some corporations will prefer legal systems that grant them hardcore restrictions about sensitive matters (e.g. defensive strategies against hostile takeovers in the field of company law). The political dimension also plays a fundamental role: elected politicians will be interested in following policies in line with their electors' ideology, which will have different outcomes when considering the effects that a liberal or protectionist approach has in fields like labour law or environmental law. Information is another key factor: a better system will be attractive for law consumers only if those law consumers are informed about its high quality, and only if they actually value that quality; otherwise, the investments and efforts made by that system to improve will result in a waste.

In conclusion, this major uncertainty in the assessment of the effects of regulatory competition is probably due to the material impossibility of a general assertion. In order to understand whether the Delaware effect can find an EU dimension as well[35], and consequently how its impact can be described, it is necessary to carefully analyse the specific fields of legislation concerned and evaluate whether and how they have changed in response to regulatory competition.

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[35] On the basis of their empirical findings and of the available data collected from previous researches, C. GERNER-BEUERLE, F. M. MUCCIARELLI, E. SCHUSTER, M. SIEMS, *Why Do Businesses Incorporate in Other EU Member States? An Empirical Analysis of the Role of Conflict of Laws Rules*, in *International Review of Law and Economics*, 56, 2018, pp. 26-27, concluded that the UK could be considered a *'European Delaware'*, as it was the *'most popular target destination'* for corporate mobility. The potential impact of Brexit (on which see *infra*) on the approximately 330,000 UK companies established and operated by entrepreneurs based in other Member States are analysed in J. ARMOUR, H. FLEISCHER, V. KNAPP, M. WINNER, *Brexit and Corporate Citizenship*, in *European Business Organization Review*, 18, 2017, pp. 225 et seq., in M. MANNAN, I. WUISMAN, *Freedom of Establishment for Companies in Europe (EU/EEA)*, Ars Aequi Libri, 2019, pp. 123-125, and in T. BIERMEYER, M. MEYER, *The Use of Corporate Mobility Instruments and Brexit: An Empirical Analysis*, in *European Company Law*, 17, 1, 2020, p. 15.

This will be the main task of Chapters II and III for corporate governance and business taxation respectively.

Most prominently, there are two considerations that will have to be always kept in mind while assessing those effects.

The first is that the introduction of a certain rule in two different countries might have different effects, depending on each State's economy and tradition. For example, considering corporate law, lowering minimum capital requirements can have a greater impact in a country in which the framework is mainly composed by small businesses. On the contrary, minimum capital requirements will hardly be a concern for countries prevalently populated by large multinational corporations. A further example is provided by tax law. According to the *'small is competitive hunch'*[36], small countries are generally less affected than bigger countries by the lowering of the income tax rate. The reason for such an asymmetry is that, assuming that small countries are less populated, they will lose less than what they will gain by attracting foreign tax subjects.

The second consideration is that, as previously mentioned, it is necessary to acknowledge the distinction between business efficiencies and social values. Indeed, a certain rule could allow for businesses to improve their competitiveness within the market while simultaneously causing devastating social effects for the individuals. This potential consequence thus suggests that it is worth preliminarily mentioning the main findings about potential social consequences of regulatory competition for individuals of both case law and literature before turning to the main topic of business and companies.

1.1.3 An overview on the impact of regulatory competition besides corporate matters

Even though this dissertation deals with a series of matters that are immediately related to companies' life, it is nonetheless necessary to briefly refer to other fields—directly connected to social issues and individuals—that are

[36] See V. H. DEHEJIA, P. GENSCHEL, *Tax competition in the European Union*, MPIfG Discussion Paper n. 3, 1998, available at <http://hdl.handle.net/10419/43162>, pp. 23-26.

significantly affected by regulatory competition: labour law, trade union law and, more generally speaking, social dumping, welfare, social protection, and human rights.

It was clear from the beginning of the European integration process that the Community would have had to face the problems related to regulatory competition, and both *Ohlin*[37] and *Spaak*[38] reports approached the matter viewing regulatory competition in the field of labour as a *'race to the top'* that could potentially *'level up'*[39] labour market standards. The impact on labour law of freedom of movement and the broad interpretation given to the latter by the European Court of Justice (ECJ) can be observed in the two landmark cases *Viking*[40] and *Laval*[41].

Viking[42] was a Finnish company that was willing to reflag its vessel in Estonia in order to strengthen its competitiveness, thanks to the more favourable conditions of the Estonian labour market. In response of Viking's initiative, the Finnish seamen's union called a strike. The subsequent preliminary ruling by the Court was an important occasion for some clarifications about some fundamental features of the internal market.

First of all, the Court admitted that workers' collective actions fell outside the scope of its competence. Nevertheless, the Court held not only that all the Member States are obligated to respect the principles of Community law even in the fields of their exclusive competence[43], but also that, consequently, the European Union, through its institutions and thus also through the Court, can intervene even outside the scope of its competence in order to achieve the fundamental purposes of the Treaties. The fact that the matter concerned pertains to fundamental right

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[37] INTERNATIONAL LABOUR OFFICE, *Social Aspects of European Economic Cooperation,* in *International Labour Review*, 74, 1956, pp. 99–278.

[38] COMITÉ INTERGOUVERNEMENTAL CRÉÉ PAR LA CONFÉRENCE DE MESSINE, *Rapport des Chefs de Délégation aux Ministres des Affaires Etrangères (Spaak)*, Brussels, 21.4.1956, reproduced in part in *Political and Economic Planning*, n. 405, 1956.

[39] ADAMS, DEAKIN, *Freedom of Establishment and Regulatory Competition*, cit, p.539.

[40] Case C-438/05 *International Transport Workers' Federation and Finnish Seamen's Union v Viking Line ABP and OÜ Viking Line Eesti* [2007] ECLI:EU:C:2007:772.

[41] Case C-341/05 *Laval un Partneri Ltd v Svenska Byggnadsarbetareförbundet, Svenska Byggnadsarbetareförbundets avd. 1, Byggettan, Svenska Elektrikerförbundet* [2007] ECLI:EU:C:2007:809.

[42] For an overview on the relationship between *Viking* and the four freedoms see C. BARNARD, *The Substantive Law of the EU. The Four Freedoms*, Oxford: Oxford University Publishing, 6th edn., 2019, pp. 73, 225-226, 229-230, 322, 411, 449, 576.

[43] *Viking*, para 40.

does not in principle limit the Court, as already stated in *Schmidberger*[44] and *Omega*[45]. Instead, the limitations derived from other fields of EU law, such as competition law, cannot be analogically transposed to restrict freedom of establishment[46]. In *Viking*, thus, the Court explicitly opens to 'negative integration' as the main path to be followed by the EU where 'positive integration' is not possible[47].

Secondly, not only did the Court reaffirm the vertical direct effect of Article 49, but it also extended direct effect to a horizontal dimension. Indeed, relying on the *'quasi-legislative'* power of trade unions, the Court recognised a sort of horizontal direct effect of Article 49[48].

Lastly, the Court took a step back from the so called 'Schmidberger formula'[49], that it had previously adopted to introduce a sort of presumption that fundamental rights could in principle be a legitimate justification for restrictions of freedoms. Indeed, in *Viking* the Court abandoned the 'practical concordance' theory, according to which when two fundamental rights conflict the interpreter should find the solution by which both of them receive the least relevant possible harm. Instead, the Court shifted towards a different approach that implies the usual

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[44] Case C-112/00 *Eugen Schmidberger, Internationale Transporte und Planzüge v Republik Österreich* [2003] ECLI:EU:C:2003:333.

[45] Case C-36/02 *Omega Spielhallen- und Automatenaufstellungs-GmbH v Oberbürgermeisterin der Bundesstadt Bonn* [2004] ECLI:EU:C:2004:614, para 36.

[46] *Viking*, para 53.

[47] For an overview on the many theories of integration, see C. BARNARD, S. PEERS, *European Union Law*, Oxford University Press, 2nd edn, 2017, pp. 32-35: the authors mention and explain neofunctionalism, liberal intergovernmentalism, multi-level governance, rational choice institutionalism, constructivism.

[48] *Viking*, para 61. However, the concise explanation provided by the Court has been strongly criticized. The Court's reasoning is probably too brief and it has been deemed to be not convincing by many commentators. For an overview on the point, see S. ENCHELMEIER, *Horizontality: the Application of the Four Freedoms to Restriction Imposed by Private Parties*, in KOUTRAKOS, SNELL (eds.), *Research Handbook on The EU's Internal Market*, cit, p. 58; see also K. LENAERTS, J. A. GUTIÉRREZ-FONS, *The Constitutional Allocation of Powers and General Principles of EU Law*, in *Common Market Law Review,* 47, 2010, p. 1666, where the authors suggest that *'the ECJ may have felt that granting a margin of appreciation to trade unions in such a broad way, as if they were Member State authorities, was inappropriate'*.

[49] *Schmidberger*, para 81: *'the interests involved must be weighed having regard to all the circumstances of the case in order to determine whether a fair balance was struck between those interests'*.

evaluation based on the same proportionality test that is applied for all the possible restrictions to the fundamental freedoms[50].

According to A. Saydé, *Viking* shows that *'the extra competitive pressures generated by mutual recognition are likely to translate into a pressure on domestic producers to relocate in low(er)-regulation States, in order to regain their capacity to compete'*[51]. In his opinion, thus, the risk is that 'freedom' of movement becomes an 'obligation' of movement for those companies that are struggling to survive the extra-competitive environment that the freedom of establishment has caused. Following the same line of reasoning, it might be argued that, in turn, Member States, struggling to enhance the competitiveness of their own legal systems, could be forced to lower their regulatory standards in order to regain their competitiveness.

In a different instance, the *Laval*[52] case of 2007 concerned a Latvian company that won a contract to refurbish a school in Sweden. In response to Laval's willingness to use its Latvian workers, Swedish trade unions called an industrial action to claim the application of Swedish collective labour agreements. When Laval consequently brought the case before the Court to claim the breach of its freedom to provide services, the Court pointed out that *'the right of trade unions of a Member State to take collective action by which undertakings established in other Member States may be forced to sign the collective agreement for the building sector [...] is liable to make it less attractive, or more difficult, for such undertakings to carry out construction work in Sweden, and therefore constitutes a restriction on the freedom to provide services within the meaning of Article 49 EC'*[53].

The reasoning of the Court is in line with its 'market access' approach—that will be discussed further in paragraph 2.2 in relation to freedom of establishment—

[50] For an overview on the relationship between fundamental rights and the four freedoms, see N. N. SHUIBHNE, *Fundamental Rights and the Framework of Internal Market Adjudication: Is the Charter Making a Difference?*, in KOUTRAKOS, SNELL (eds.), *Research Handbook on The EU's Internal Market*, cit, pp. 215-240.
[51] A. SAYDÉ, *Freedom as a Source of Constraint: Expanding Market Discipline through Free Movement*, in KOUTRAKOS, SNELL (eds.), *Research Handbook on The EU's Internal Market*, cit, p.53.
[52] For an overview on the relationship between *Laval* and the four freedoms, see BARNARD, *The Substantive Law of the EU*, cit, pp. 27, 28, 298, 448, 449.
[53] *Laval*, para 99.

and the problem with *Laval* is to understand how a collective action renders access to the market as *'more difficult'* or *'less attractive'*. By applying the intuitive approach suggested by E. Spaventa[54], C. Barnard[55] concludes that the action was a breach of Laval's freedom to provide services because it prevented Laval from entering the Swedish market with Estonian cheaper labour cost.

It is clear therefore that the concerned approach can have extreme consequences from a regulatory competition point of view, and that it can endanger worker rights and significantly lower the standards of labour legislation.

In addition, Deakin believes that *Laval 'gives the* Posting of Workers Directive[56] *a "pre-emptive" effect, reading it, contrary to its own clearly expressed intent, as if it were a ceiling, not a floor'* and that it is '*inconsistent with the recent move towards the encouragement of experimentalist approaches to governance in the European Union, through such techniques as "reflexive harmonisation"'*[57].

In conclusion, *Viking* and *Laval* show that, even though the Court is conscious of the significant problem deriving from the potential and concrete social dumping that regulatory competition and regulatory arbitrage cause, it still believes that this risk is not enough to justify protectionism. Indeed, protectionist measures would affect the internal market in such a way that they would frustrate the entire mechanism built up by means of the four freedoms[58]. However, a limitation of regulatory competition is probably desirable for those situations in which national law and practices might endanger fundamental rights of individuals. In the framework of EU law freedom of movement is a constitutional value, but this circumstance cannot entail its primacy on the other fundamental rights. It appears therefore that the EU urgently needs to develop a theory of regulatory competition,

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[54] See E. SPAVENTA, *From Gebhard to Carpenter: Towards a (non-)Economic European Constitution,* in *Common Market Law Review*, 41, 2004, pp. 757-758.
[55] BARNARD, *The Substantive Law of the* EU, cit, p.27.
[56] Directive 96/71/EC of the European Parliament and of the Council of 16 December 1996 *concerning the posting of workers in the framework of the provision of services* [1997] OJ L 18.
[57] S. DEAKIN, *Regulatory Competition After Laval*, in *Cambridge Yearbook of European Legal Studies*, 10, 2007, pp. 608-609.
[58] See LENAERTS, GUTIÉRREZ-FONS, *The Constitutional Allocation of Powers and General Principles of EU Law,* cit, p. 1666: *'while it is in principle legitimate for trade unions to seek to protect workers from social dumping, it is equally true that trade unions are not entitled to shield local labour markets from competition coming from Member States with low average wages'*.

capable of individuating a break-even point between companies' wealth and social instances[59].

1.2 *Freedom of establishment for companies*

1.2.1 Freedom of establishment for companies, a general overview

Freedom of establishment for natural and legal persons was introduced in the internal market by the Treaty with the idea that in order to grant an optimal utilisation of the factors of production—labour and capital—it was necessary to allow the highest degree of mobility. In particular, freedom of establishment is the *'culmination of the other freedoms, as it involves the movement of both capital and people'*[60].

Article 54 TFEU provides that *'companies or firms formed in accordance with the law of a Member State [...] shall [...] be treated in the same way as natural persons who are nationals of Member States'*. The main issues historically related to restrictions to the exercise of freedom of establishment for companies concern both inbound (restrictions imposed by the 'host country') and outbound (restriction imposed by the 'home country') movements. Indeed, those movements are capable of causing legal obstacles, such as the uncertainty about the law applicable to most of the events that involve the life of a company (*lex societatis*), and also raise concerns regarding the divergent socio-economic policies of the Member States.

On the one hand, freedom of establishment can contribute to the maximisation of productivity, the creation of economies of scale and the improvement of consumers' welfare. On the other hand, however, its social and political implications have caused a story of tension between the freedom to benefit from regulatory competition and the need to respect national rules.

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[59] On *'a delicate and sensitive issue like the one represented by the balance between the State and the Market'* and on *'the application of free movement to private actors'* see D. GALLO, *Social Security and Health Services in EU Law: Towards Convergence or Divergence in Competition, State Aids and Free Movement?*, EUI Working Papers RSCAS n. 19, 2011, where the author observes (p. 17) that free movement rules prescind institutionally from the aims of market liberalisation and economic efficiency and confer upon individuals fundamental economic rights.

[60] MANNAN, WUISMAN, *Freedom of Establishment for Companies in Europe (EU/EEA)*, cit, p. 9.

1.2.2 The meaning and the scope of Articles 49 and 54 TFEU

Articles 49 and 54 TFEU allow companies and firms *'formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Union'*[61] to exercise their freedom of establishment within the Union, ultimately meaning that those legal entities can establish branches, subsidiaries, and agencies ('secondary establishment')[62] or transfer their seat ('primary establishment') to another Member State[63], provided that *'restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited'*[64]. Freedom of establishment constitutes therefore the core of corporate mobility. When Article 54 refers to *'companies or firms'*, it means those constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law, save for those which are non-profit making[65].

The Court clarified in *Cadbury Schweppes*[66] and *Stauffer*[67] that the applicability to firms and companies of Article 49 requires, respectively, an actual establishment, meaning a permanent presence in the host country, and the pursuit of a genuine economic activity there. According to the reasoning of the Court in *Gebhard*[68], *'establishment'* is a broad concept and the related rules apply when a person is willing *'to participate, on a stable and continuous basis, in the economic*

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[61] Article 54(1) TFEU.
[62] For a definition of 'secondary establishment', See case 33/78 *Somafer SA v Saar-Ferngas AG* [1978] ECLI:EU:C:1978:205, para 12, where the Court observes that *'the concept of branch, agency or other establishment implies a place of business which has the appearance of permanency, such as the extension of a parent body, has a management and is materially equipped to negotiate business with third parties so that the latter, although knowing that there will if necessary be a legal link with the parent body, the head office of which is abroad, do not have to deal directly with such parent body but may transact business at the place of business constituting the extension'*.
[63] On the broad interpretation provided by the Court for the cross-border element of freedom of establishment see BARNARD, *The Substantive Law of the EU*, cit, pp. 206-208.
[64] Article 49(1) TFEU.
[65] On the subjective scope of freedom of establishment see S. LOMBARDO, *Some Reflections on Freedom of Establishment of Non-profit Entities in the European Union*, in *European Business Organization Law Review*, 14, 2013, p. 225.
[66] Case C-196/04 *Cadbury Schweppes v Commissioners of the Inland Revenue* [2006] ECLI:EU:C:2006:544, para 54
[67] Case C-386/04 *Centro di Musicologia Walter Stauffer* [2006] ECLI:EU:C:2006:568, paras 19-20.
[68] Case C-55/94, *Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano* [1995] ECLI:EU:C:1995:411, para 37.

life of a Member State other than his State of origin'[69]. The temporary nature of an activity, valued on the basis of its duration, regularity, periodicity, and continuity, can help in understanding whether freedom of establishment or the freedom to provide services is at stake[70]. This criterion for the distinction between the two freedoms is also partially codified by Article 4 of the *Services Directive*[71].

The scope of applicability of freedom of establishment provisions is limited by Article 51(1) TFEU, that excludes activities which are connected with the exercise of official authority, even though that provision can be described as an almost-impossible-to-invoke clause given the narrow interpretation provided by the Court in *Reyners*[72] and *Notaries*[73].

Freedom of establishment is supported by two fundamental principles[74]: the 'principle of equivalence', for which a Member State cannot prohibit, impede or render less attractive the movement to another Member State nor discriminate cross-border mobility by applying conditions less favourable than the ones that it would apply to domestic situations; and the 'principle of effectiveness,' according to which national authorities cannot render too difficult the creation of an establishment in their country.

Consistently with the shift towards a 'market access' approach progressively adopted by the Court for the other freedoms—it is possible to think about *Säger*[75] for services or, to a certain extent, about *Italian Trailers*[76] for goods[77]—in *Gebhard* the Court introduced a new test ('Gebhard Test'), holding that *'national measures liable to hinder or make less attractive the exercise of fundamental freedoms guaranteed by the Treaty must fulfil four conditions'*[78]:

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[69] Ibid., para 25.
[70] Ibid., para 27.
[71] Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 *on services in the internal market* (Services Directive) [2006] OJ L 376
[72] See case C-2/74, *Jean Reyners v Belgian State* [1974] ECLI:EU:C:1974:68, para 45.
[73] See case C-392/15, *European Commission v Hungary* [2017] ECLI:EU:C:2017:73, para 64.
[74] See, amongst others, Case C-262/09 *Meilicke and Others* [2011] ECLI:EU:C:2011:438, para 55.
[75] Case C-76/90, *Manfred Säger v Dennemeyer & Co. Ltd* [1991] ECLI:EU:C:1991:331, paras 12-14.
[76] Case C-110/05, *Commission v Italy* [2009] ECLI:EU:C:2009:66, para 34.
[77] For an overview on the innovation brought by *Italian Trailers*, see BARNARD, *The Substantive Law of the EU*, cit, pp. 100-104, 134-142.
[78] Case C-55/94, *Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano* [1995] ECLI:EU:C:1995:411, para 37.

firstly, those measures must be non-discriminatorily applied between foreign persons and domestic persons; secondly, they must be the response to an imperative requirement of general interest; thirdly, they must be suitable for securing the attainment of the objective which they pursue; lastly, they must be proportionate, meaning that they must not go beyond what is necessary[79].

Ultimately, Article 52(1) TFEU introduces limitations allowing restrictions based on an exhaustive[80] list of three grounds of justification: public policy, public security, and public health. Those derogations must be interpreted in respect of the principle of proportionality[81], and of the fundamental human rights[82], and they cannot be used to serve economic purposes or be based on exclusively economic grounds[83]. Thus, every restrictive measure must be proportionate, necessary and non-discriminatory.

1.2.3 The clash of irreconcilable theories: the real seat versus the seat of incorporation

The *lex societatis* of a corporation determines its legal personality and capacity, the applicable rules that govern its formation, dissolution and management, the rules that apply to its directors' liability, and the existence of shareholders' liability. The criteria to determine the *lex societatis* of a corporation vary depending on whether a certain jurisdiction adheres to the 'real seat theory' or the 'incorporation theory'. The former theory has been adopted in most civil law European countries, like Italy, France, and Germany, while the latter has been adopted in some common law jurisdictions, like the United Kingdom and Ireland, and in a minority of civil law countries, like the Netherlands and Denmark[84]. These

[79] On the concept of 'proportionality' in the context of EU law, see V. KOSTA, *The Principle of Proportionality in EU Law: An Interest-based Taxonomy*, in J. MENDES (ed.), *EU Executive Discretion and the Limits of Law*, Oxford: Oxford Publishing, 2019.
[80] See case C-388/01 *Commission v Italy* [2003] ECLI:EU:C:2002:575, para 20.
[81] See, amongst others, case C-100/01 *Ministre de l'Intérieur v Olazabal* [2002] ECLI:EU:C:2002:712, para 43, and Case C-108/96 *MacQueen* [2001] ECLI:EU:C:2001:67, para 23.
[82] Case C-260/89 *ERT v DEP* [1991] ECLI:EU:C:1991:254, para 43.
[83] See case 352/85 *Bond v Netherlands* [1988] ECLI:EU:C:1988:196, para 34.
[84] For the extent of the applicability of the incorporation theory—limited to corporate capacity—in Danish law, see J. L. HANSEN, *A new look at Centros: From a Danish point of view*, in *European Business Law Review*, 18, 2002, pp. 85 et seq.

matters of conflict of laws belong thus to those subjects that should traditionally fall within the scope of private international law, increasingly harmonised during the last two decades under regulations such as *Recast Brussels I*[85] and *Rome II*[86].

According to the real seat (or *siège reel* or *sitztheorie*) theory, in order to determine the *lex societatis* one should view the reality of the situation rather than the legal form, referring cumulatively to indicators such as the registered office, the place of central administration and of the headquarters, the place where the company's policy is decided, the place of the stock exchange in which the companies' shares are listed, the place of the directors' meetings and residences, the place of the shareholders' meetings, the place where documents are kept and the place where banking transaction are executed[87]. In contrast, according to the seat of incorporation theory, the *lex societatis* depends exclusively on the jurisdiction where the company is registered or incorporated, in line with the American 'internal affairs rule'[88], for which the *lex societatis* is the law of the country where the corporation is organised.

While the movement from a home country to a host country that adopts the same theory does not raise concerns, some questions have arisen regarding the movement between countries that adopt different theories. For example, a company that moves its real seat from a country that adopts the incorporation theory to a country that adopts the real seat theory would potentially acquire a double nationality. On the same line of reasoning, a company that moves only its registered office from a country that adopts the incorporation theory to a country that adheres to the real seat theory would potentially lose the nationality of the home country without gaining any other nationality, risking serious recognition problems and even to be involuntarily wound up.

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[85] Regulation (EU) No 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters [2012] OJ L 351.

[86] Regulation (EC) No 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations (Rome II) [2007] OJ L 199.

[87] See case C-73/06 *Planzer Luxembourg Sàrl v Bundeszentralant für Steuern* [2007] ECLI:EU:C:2007:397, paras 60-61.

[88] A comparison between the European and the U.S. approach to the *lex societatis* matter is provided in M. G. DORE, *Deja Vu All Over Again? The Internal Affairs Rule and Entity Law Convergence Patterns in Europe and the United States*, in *Brooklyn Journal of Corporate, Financial & Commercial Law*, 8, 2, 2014, pp. 317 et seq.; on the 'internal affairs doctrine' and the Supreme Court approach to the matter, see also TUNG, *Before Competition*, cit.

1.2.4 Early case law development and the first rise of concerns about regulatory arbitrage

The decisions of the ECJ on the matter of freedom of establishment for companies have not been always consistent. An analysis of the path followed by the Court in its judgement is crucial to better understand how and why the interpretation of this freedom has been significantly broadened. It can be pointed out, however, not only that some questions remain unsolved, but also that the Court's judgements themselves have sometimes been the source of new doubts.

The logical, although not chronological, starting point to analyse the Court's approach to corporate mobility across the EU is in *Vale*, where the Court clearly stated that *'companies are creatures of national law and exist only by virtue of the national legislation which determines their incorporation and functioning'*[89]. That fundamental principle had found its first application in *Daily Mail*[90].

Daily Mail was a company incorporated in the UK that wanted to move its real seat to the Netherlands and at the same time retain its English nationality. For a company to do so, English law[91] required the authorisation of the UK treasury. Daily Mail claimed that this requirement was a breach of its freedom of establishment under Articles 49 and 54 of TFEU. The Court disagreed, confirming that, although national law cannot constitute an obstacle for companies to exercise their freedom of establishment, it is always a matter of national law to individuate under which circumstances (connecting factors) a legal entity can acquire, retain or lose the nationality of a Member State[92].

The conclusions in *Daily Mail* were confirmed also in *Cartesio*[93], where the Court held that only Member States are entitled to define connecting factors for a company to retain their nationality[94]. A certain degree of criticism amongst commentators arose when they noticed that this principle gave to national

[89] Case C-387/10 *VALE* [2012] ECLI:EU:C:2012:440, para 27.
[90] Case C-81/87 *Daily Mail* [1998] ECLI:EU:C:1988:456.
[91] Section 482(1)(a), Income and Corporation Taxes Act, 1970.
[92] *Daily Mail*, para 24.
[93] Case C-210/06 *Cartesio Oktató és Szolgáltato bt* [2008] ECLI:EU:C:2008:723.
[94] Ibid, para 109.

legislation the autonomy to limit corporate mobility[95], especially in those countries that had not adopted the incorporation theory, with the growing risk of creating disparities across Europe. It was noticed that *'the outcome of a free movement case under the right of establishment of companies as interpreted by the European Court of Justice depends in an arbitrary manner on the type of private international company law doctrine in force in the Member State of incorporation and the receiving Member State'*[96]. On the other hand, it was also argued that this interpretation provided by the Court was capable of rendering the real seat theory a *'protective mechanism against regulatory arbitrage'*[97], and that free movement was not necessarily desirable for stakeholders: indeed, it could also have a negative impact on transaction costs for third parties, especially caused by the increasing of *'costs of information and of legal advice for costumers and other market participants'* and the higher *'risk of an incorrect judgement'*[98] by an adjudicator not familiar with foreign legal regimes.

The limit of national law autonomy emerged in *Indus*[99], where the Court found a breach of the freedom of establishment in Dutch Law on Income Tax[100] and Dutch Law on Corporation Tax[101]. The Court held that those provisions were discriminatory and disproportionate[102], for they impeded an outbound migration without the payment of tax on unrealised capital gains and profits, especially exchange rate gain.

On the same line of reasoning, the Court found another breach of freedom of establishment based on the principle of non-discrimination in *Marks &*

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[95] On the reaction of Hungarian literature to *Cartesio,* see P. METZINGER, Z. NEMESSÁNYI, A. OSZTOVITS, *Freedom of Establishment for Companies in the European Union*, Complex, 2009.
[96] C. GERNER-BEUERLE, M. SCHILLING, *The Mysteries of Freedom of Establishment After* Cartesio, in *The International and Comparative Law Quarterly*, 59, 2, 2010, p. 322.
[97] M. GELTER, Centros*, the Freedom of Establishment for Companies and the Court's Accidental Vision for Corporate Law*, in F. NICOLA, B. DAVIES (eds), *EU Law Stories. Contextual and Critical Histories of European Jurisprudence*, Cambridge: Cambridge University Press, 2017, p. 321.
[98] See GERNER-BEUERLE, SCHILLING, *The Mysteries of Freedom of Establishment After* Cartesio, cit, pp. 322-323.
[99] Case C-371/10 *National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond / kantoor Rotterdam* [2011] ECLI:EU:C:2011:785.
[100] Article 16, *Wet op de inkomstenbelating* 1964.
[101] Article 8, *Wet op de vennootschapsbelasting* 1969.
[102] *Indus*, paras 81-85.

Spencer[103]. In that case, the Court held that treating the losses of a foreign subsidiary differently from those of domestic subsidiaries[104], done so by impeding group tax relief that would have allowed foreign subsidiaries' losses to be set off against the domestic parent company's profit, constituted a discriminatory measure[105]. Although tax law falls in the scope of the competences of Member States, this circumstance does not authorise Member States to rule that field completely ignoring EU law[106]. As the Court would have later stated in *Viking*, *'even if, in the areas which fall outside the scope of the Community's competence, the Member States are still free, in principle, to lay down the conditions governing the existence and exercise of the rights in question, the fact remains that, when exercising that competence, the Member States must nevertheless comply with Community law'*[107].

1.2.5 From the *Centros* trilogy to *Pulbud*: the evolution and the interpretation of the concept of *'genuine economic activity'*

The need for genuine economic activity in the host country in order to benefit from the freedom of establishment clarified in *Stauffer*[108] had been for the first time partially contradicted in *Segers*[109], where the Court stated that *'the fact that the company conducts its business through an agency, branch or subsidiary solely in another Member State is immaterial'*[110]. This judgement, a first *'vehicle for law shopping'*[111], was almost ignored until the topic gained again, more strongly than ever, the attention of European jurists and scholars, with the so called '*Centros*

[103] Case C-446/03 *Marks & Spencer plc v David Hasley* (Her Majesty's Inspector of Taxes) [2005] ECLI:EU:C:2005:763.
[104] Ibid, para 34.
[105] Ibid, paras 32-33.
[106] Ibid, para 57.
[107] *Viking*, para 40.
[108] *Stauffer*, paras 19-20.
[109] Case 79/85 *D. H. M. Segers v Bestuur van de Bedrijfsvereniging voor Bank- en Verzekeringswezen, Groothandel en Vrije Beroepen* [1986] ECLI:EU:C:1986:308.
[110] Ibid, para 16.
[111] For an overview on the concept of law shopping related to *Segers* judgement see COSTAMAGNA, *At the Roots of Regulatory Competition*, cit, p. 190; see also the Opinion of AG Darmon delivered on 10 June 1986, Case 79/85, *Segers*, para 6.

trilogy', constituted by three famous cases: *Centros*[112], *Überseering*[113], and *Inspire Art*[114].

Centros Ltd was a private company incorporated in the UK. After it applied to constitute a branch in Denmark, the Danish registrar of companies refused to register it. The registrar argued that Centros was actually seeking to establish its principal business rather than a branch in Denmark, as at that time it had not carried out any business activity in the UK. According to Danish authorities, the company was trying to evade Danish law on minimum capital requirement (at that time DKr 200,000) by exploiting UK company law—which was much more lenient as it had no rules on minimum capital requirement—and therefore abusing of its freedom of establishment. According to Danish authorities, this behaviour was liable of endangering public creditors (that could not secure debts by means of guarantees), as well as, more generally speaking, all the other creditors given that the initial capitalisation was not appropriate.

In *Centros* judgement, the Court used again—as it had done in *Segers*—the term *'immaterial'*[115] to refer to the circumstance that the company had been registered in another Member State without carrying there any genuine economic activity, but only for the purpose of benefiting from a more advantageous legislation. In particular, the measure adopted by Danish authorities was deemed to be unsuitable to protect creditors[116]. As a matter of fact, the Court held, a major degree of protection would not have been granted if Centros Ltd had carried out its business in the UK. Again, the only relevant conditions for freedom of establishment to apply seemed to be that the company was formed in accordance with the national law of a Member State and that it had an actual establishment in the host country, meaning a permanent presence as later clarified in *Cadbury*

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[112] Case C-212/97 *Centros Ltd v Erhvervs-og Selskabsstyreslen* [1999] ECLI:EU:C:1999:126.
[113] Case C-208/00 *Überseering BV v Nordic Construction Company Baumanagement GmbH (NCC)* [2002] ECLI:EU:C:2002:632.
[114] Case C-167/01 *Inspire Art Ltd* [2003] ECLI:EU:C:2003:512.
[115] *Centros*, para17.
[116] On the recognition of creditors' protection as an overriding reason of public interest, see DG INTERNAL MARKET AND SERVICES, UNIT B3, *Guide to Case Law Of the European Court of Justice on Articles 49 et seq. TFEU: Freedom of Establishment*, 2011, referring to: Case C-167/01 *Inspire Art Ltd* [2003] ECLI:EU:C:2003:512, paras 105, 142; Case C-171/02 *Commission v Portugal* [2004] ECLI:EU:C:2004:270, paras 42, 55; Case C-411/03 *SEVIC Systems* [2005] ECLI:EU:C:2005:762, para 28.

Schweppes. Logically, in countries that adhere to the incorporation theory, the latter requirement is satisfied when the company simply has its registered office there[117].

In *Überseering*, the case concerned the recognition, by German law, as a legal entity of a company formed in accordance with Dutch law that carried its entire business in Germany. In this case, the Court added that the *'genuine economic activity'* requirement was not met only when there was no activity within the entire Community[118], somehow anticipating *Polbud*[119] judgement. The triptych was completed by *Inspire Art*, in which the Court affirmed that introducing additional minimum capital requirements, denomination requirements, and joint and several liability of directors for foreign companies was a breach of their freedom of establishment[120]. Again, the place where the business is carried out was deemed to be generally *'irrelevant'*[121].

While in *Vale*[122] the Court confirmed the principle which denies to the Member States the ability to discriminately hinder cross-border conversions of companies that are willing to change their *lex societatis*, the question regarding whether this movement could be realised through the isolated transfer of the registered office, without moving the business of the company, was answered in *Polbud*.

In *Polbud* the Court disagreed with AG Kokott, who argued in her Opinion[123] that freedom of establishment should not apply to situations in which, given that the movements concerned only involved the choice of the most favourable *lex societatis*, there is not even an establishment. The Court determined that, for freedom of establishment to apply, it is sufficient that a company carries out an economic activity in the home country or also in another country, as long as it is carried out within the European Union. *Polbud* represents the culmination of a

[117] *Centros*, paras 20-21.
[118] *Überseering*, paras 75, 94-95.
[119] Case C-106/16 *Polbud — Wykonawstwo sp. z o.o.*, in liquidation [2017] ECLI:EU:C:2017:804, see *infra*.
[120] *Inspire Art*, para 103.
[121] Ibid, para 95; according to G. B. PORTALE, *Il Diritto Societario tra Diritto Comparato e Diritto Straniero*, in *Rivista di Diritto Societario*, 2013, p. 335, *Inspire Art* judgement was the main opening to the *Gründungstheorie*, essentially a German version of the theory of incorporation.
[122] *Vale*, paras 44-48.
[123] Opinion of AG Kokott delivered on 4 May 2017, case C-106/16 *Polbud*, para38.

path started with *Segers*, seemingly tempered by *Daily Mail*, and vigorously reaffirmed with the *Centros* trilogy.

1.2.6 *'Law shopping'* and the limit of abuse

Through the *Centros* trilogy, the Court implicitly declared[124] that corporate mobility can be used as a tool that allows regulatory arbitrage—thus law shopping—by companies, therefore incentivising regulatory competition among Member States. The only limit set by the Court lies in the concept of abuse[125].

In *Kafoed*[126], the Court explicitly recognised that the prohibition of abusive exploitation of EU law is a general principle of EU law[127], consistent with the explanation provided by the landmark case *Emsland-Stärke*[128]. Accordingly, in order for a certain conduct that relies on a determinate EU law rule to constitute an abuse, it is necessary that it meets two types of requirements[129]. Firstly, an 'objective test'[130] must be carried out in order to assess whether or not the purpose of the EU law rule concerned has been reached. Secondly, a 'subjective test'[131] must be carried out in order to assess whether or not there was an intention to take advantage of that rule by artificially creating the needed conditions. There is an abuse every time the conduct has not reached the purpose for which the concerned

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[124] See *Inspire Art*, para 98: *'[...] the question of the application of those articles is different from the question whether or not a Member State may adopt measures in order to prevent attempts by certain of its nationals improperly to evade domestic legislation by having recourse to the possibilities offered by the Treaty'.*

[125] On the still controversial concept of abuse of EU law see K. E. SØRENSEN, *Abuse of Rights in Community Law: A Principle of Substance or Merely Rhetoric?*, in *Common Market Law Review*, 2006, p. 428; see also A. SAYDÉ, *Abuse of EU Law and Regulation of the Internal Market*, Oxford and Portland: Hart Publishing, 2016, pp. 11 et seq.

[126] Case C-321/05 *Hans Markus Kofoed v Skatteministeriet* [2007] ECLI:EU:C:2007:408

[127] Ibid, para 38.

[128] Case C-110/99 *Emsland-Stärke GmbH v Hauptzollamt Hamburg-Jonas* [2000] ECLI:EU:C:2000:695.

[129] For an overview on the tests to establish an abuse see P. KOUTRAKOS, *The* Emsland-Stärke *Abuse of Law Test in the Law of Agriculture and Free Movement of Goods,* in R. DE LA FERIA, S. VOGENAUER (eds), *Prohibition of Abuse of Law*, Oxford and Portland: Hart Publishing, p.203 et seq.

[130] *Emsland-Stärke*, para 38.

[131] Ibid, para 53. See also Opinion of AG Poiares Maduro delivered on 7 April 2005, case C-225/02, *Halifax*, paras 70-71, where AG Poiares Maduro criticizes the *subjective test*, holding that the intention to obtain an advantage can be deducted by objective circumstances. *Halifax* was the first case in which the ECJ ruled on abuse of EU law in relation to the field of (indirect) taxation.

rule was introduced by lawmakers and the author had the intention to take advantage of that rule by artificially creating the needed conditions.

The abuse of the freedom of establishment must be assessed on a case-by-case basis[132], always keeping in mind that Gebhard Test's criteria must also be conservatively applied[133]. Thus, an abuse would require very clear evidence of an act of fraud to be demonstrated. A blurred line was set by the Court in *Centros*, talking about *'wholly artificial arrangements, which do not reflect "economic reality" and which are aimed at circumventing national legislation'*[134].

Even though some commentators have argued that the Court had already *'excluded that law shopping constitutes an abuse'*[135] in *Centros*, it is with *Polbud* that the Court explicitly confirmed that the incorporation of a company in another Member State *'for the purpose of enjoying the benefit of more favourable legislation does not in itself constitute an abuse'*[136].

Notably, in *Polbud* the Court refers to the broader concept of *'legislation'* and not only to company law, allowing the interpreters to extend the notion of abuse provided for in the judgement to fields other than those strictly related to the *lex societatis*. The judgement has thus a general importance and it is significant for all the sectors involved in the life of a business, including tax law.

Carefully analysing the Court's reasoning in *Centros* and *Polbud*, the 'Emsland-Stärke's Test' appears to be consistently applied. Indeed, the Court believes that: firstly, the objective criteria are not satisfied, given that the choice of incorporating in a Member State whose company law is more favourable is in line with the purpose of freedom of establishment; secondly, the absence of a genuine economic activity in the host country cannot be an indicator for the total artificiality of the registration/incorporation. Therefore, the ECJ seems to be coherent with its case law when it does not find any abuse in *Centros* and *Polbud*.

Once it is clear that law shopping is not in itself an abuse of freedom of establishment, the question arises of under which conditions law shopping

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[132] *Inspire Art*, para 105.
[133] MANNAN, I. WUISMAN, *Freedom of Establishment for Companies in Europe (EU/EEA)*, cit, p. 61.
[134] *Centros*, para 51.
[135] See.COSTAMAGNA, *At the Roots of Regulatory Competition,* cit, p. 197.
[136] *Polbud*, para 62.

combined with other factors can cause an abuse. An answer was apparently provided by the Court in *Cadbury Schweppes* (2006)*,* a case decided by the Court after *Centros* (1999) but before *Polbud* (2017). In that case, the UK Controlled Foreign Company (CFC) legislation was challenged because it taxed companies' profits deriving from their subsidiaries established in foreign countries[137] with a lower level of taxation. The Court insisted on the concepts of real establishment and genuine economic activity as the real purpose of the freedom at stake, and for the first time it also indicated how to recognise *'wholly artificial arrangements'*[138]. The criteria set by the Court specifically referred to physical existence, and more specifically to *'premises, staff and equipment'*[139], in order to identify whether a company has a genuine economic activity in a certain Member State or the incorporation there represents a wholly artificial arrangement.

Thus, as *Cadbury Schweppes* eventually cleared out the limit of the abuse, why did the Court decide in *Polbud* not only to go back to *Centros* approach, but to go even further? Literature provides two explanations[140].

Firstly, the threshold set by *Cadbury Schweppes* was too high[141], especially when compared to the thresholds set by the Court to prove an abuse of EU law in contexts other than freedom of establishment, such as VAT cases[142]. This observation is particularly true for the objective part of Emsland-Stärke's Test.

Secondly, *Centros* and *Cadbury Schweppes* are not necessarily incompatible. Indeed, *Centros* does not say that it is prohibited for national

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[137] In *Cadbury Schweppes* the foreign country was Ireland.

[138] *Cadbury Schweppes,* para 67.

[139] Ibid.

[140] See COSTAMAGNA, *At the Roots of Regulatory Competition*, cit, p. 198.

[141] See a further example in Case C-128/08 *Glaxo Wellcome GmbH & Co. KG v Finanzamt München II* [2009] ECLI:EU:C:2009:559, para 100, where the Court states that the proof of an abuse *'cannot be limited to wholly artificial arrangements, established on the basis of objective elements, but covers all cases in which a resident taxpayer has acquired shares in a resident company from a non-resident shareholder at a price which, for whatever reason, exceeds the nominal value of those shares'*.

[142] See for example Case C-425/06 *Ministero dell'Economia e delle Finanze v Part Service Srl* [2008] ECLI:EU:C:2008:108 *(Part Service)*, para 62, where the Court holds that the national court, in the assessment which it must carry out, *'may take account of the purely artificial nature of the transactions and the links of a legal, economic and/or personal nature between the operators involve [...] notwithstanding the possible existence, in addition, of economic objectives arising from, for example, marketing, organisation or guarantee considerations'*.

authorities to adopt restrictive measures when there is an abuse of freedom of establishment.

In conclusion, although *Cadbury Schweppes* limitations were appreciated and re-proposed by many Member States and Advocate Generals, the Court opted with *Polbud* for the broadest interpretation of freedom of establishment and, consequently, the strictest interpretation of abuse. However, given that this approach does not necessarily preclude the Court from upholding national measures that are aimed at preventing the abuse of freedom of establishment, there is a crucial need for the Court to set a new threshold. If the one set in *Cadbury Schweppes* has proved to be too high, the ECJ could in the future take inspiration from its case law in other fields in order to set a new threshold.

1.2.7 The need for a XIV European company law directive and the introduction of Directive 2019/2121

The program of harmonisation in which the Community had embarked since 1968 by means of its thirteen company law directives appeared to have failed to fill the need for a higher degree of certainty regarding cross-border conversions. That is why the 2003 *Commission Action Plan on Modernising Company Law* (*Action Plan 2003*)[143], after *Centros*, introduced a fourteenth directive amongst its priorities. In the absence of any innovation on that front, in 2012 the European Parliament invited the commission to propose a new directive on the cross-border transfer of company seats, expressly mentioning the relevant case law[144]. Six years later, in 2018, the Commission eventually presented the proposal for what is now Directive 2019/2121[145].

This Directive amends Directive 2017/1132 and tries to harmonise cross-border conversions (and cross-border divisions), as the phenomenon has

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[143] COMMISSION OF THE EUROPEAN COMMUNITIES, Communication from the Commission to the Council and the European Parliament of 21 May 2003. *Modernising Company Law and Enhancing Corporate Governance – A Plan to Move Forward*, COM, 2003, pp. 284 et seq.
[144] European Parliament resolution of 2 February 2012 with recommendations to the Commission on a 14th company law directive on the cross-border transfer of company seats (2011/2046(INI)).
[145] Directive (EU) 2019/2121 of the European Parliament and of the Council of 27 November 2019 amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions [2019] OJ L 321.

empirically proved to be exponentially growing[146] across Europe. The deadline for implementation is by the end of January 2023.

While provisions of company law will be discussed more in detail in chapter II, as it deals mostly with corporate governance-related issues, at the time of writing it is too early to gauge the impact of the Directive on the regulatory competition topic.

1.3 *Free Movement of Capital*

1.3.1 From Rome to Lisbon: development of free movement of capital

Besides freedom of establishment for companies, the other fundamental freedom that is crucial for the purpose of this research is free movement of capital. Unlike freedom of establishment, free movement of capital concerns investments and not the entrepreneurial activity *strictu sensu*. Historically, free movement of capital has been closely linked not only to the internal market but also to the further purpose of an Economic and Monetary Union (EMU)[147]. Indeed, fixed exchange rates and free movement of capital cannot be achieved when incompatible economic policies are applied.

In theory, movement of capital is free when undertakings' demand and investors' supply can meet in the country that they freely choose because it offers the most favourable conditions[148]. It is immediately intuitable that this situation can bring a certain degree of regulatory competition capable of leading to tensions between the Member States. This is especially true in the field of taxation. Those tensions might be caused, for example, by the fear of capital drain-offs, of a loss of

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[146] Data about cross-border corporate mobility across the EU are collected in T. BIERMEYER, M. MEYER, *Cross-border Corporate Mobility in the EU: Empirical Findings (Vol. 2),* ETUI, 2019, available at <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3477495>. At p. 1, the authors claim that *'overall, the Report shows that CbCM is a phenomenon of the 21st century: integration in the form of a freedom of establishment for companies through corporate mobility exists only since this millennium and has increased steadily since the early 2000s'*.

[147] For an overview on the history of the EMU, see J. PAYNE, E. HOWELL, *The Creation of a European Capital Market*, in KOUTRAKOS, SNELL (eds.), *Research Handbook on The EU's Internal Market*, cit, pp. 241-262.

[148] See W. MOLLE, *The Economics of European Integration: Theory, Practice, Policy*, Aldershot: Ashgate, 5th edn, 2006.

financial competitiveness, or of a loss of confidence of international investors in the country's capability to attract new capitals.

Free movement of capital was introduced by Article 67 of the 1957 Treaty of Rome, but *'only to the extent necessary to ensure the proper functioning of the common market'*. Article 67 thus provided a qualified obligation. The reason is most likely that in the post-war period States were looking for stability. A total and immediate liberalisation could generate the fear of losing that stability, and thus Member States opted for a gradual liberalisation of capital and payments. This first cautious approach, apparently tempered by the introduction of the first two capital directives in 1960 and 1963, was also confirmed in *Casati*[149], where the Court excluded that Article 67 could have direct effect.

After the first two capital directives adopted in 1960 and 1963, Directive 88/361[150] was an important sliding door. Article 1 of the Directive finally introduced a full liberalisation of movement of capital, and its direct effect was confirmed in *Bordessa*[151]. Furthermore, Annex I provided for a non-exhaustive nomenclature of capital movements that today is still used by the Court. Article 67 became Article 73(b)(1) after Maastricht and then Article 56(1) after Amsterdam. Between Maastricht and Amsterdam, moreover, the Court recognised the vertical direct effect of the provision in *Sanz de Lera*[152]. Then, only after the crucial step represented by the implementation of the monetary union and the creation of the Euro-zone, the concerned provision was included in Article 63 TFEU with the Treaty of Lisbon.

1.3.2 The scope of Article 63 TFEU

Article 63 deals with both capital and payments, although the latter were included in Article 106 EEC and not in the original Article 67 EEC that concerned capital. The distinction between capital and payments was acknowledged by the

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[149] Case 203/80 *Criminal proceedings against Guerrino Casati* [1981] ECLI:EU:C:1981:261.
[150] Council Directive (EEC) 88/361 of 24 June 1988 for the implementation of Article 67 of the Treaty [1988] OJ L 178/5.
[151] Joined cases C-358/93 and C-416/93 *Criminal proceedings against Aldo Bordessa, Vicente Marí Mellado and Concepción Barbero Maestre* [1995] ECLI:EU:C:1995:54, para 35.
[152] Joined Cases C-163/94, C-165/94 and C-250/94 *Criminal proceedings against Lucas Emilio Sanz de Lera, Raimundo Díaz Jiménez and Figen Kapanoglu* [1995] ECLI:EU:C:1995:451, para 41.

Court in *Luisi and Carbone*[153]: *'[...] current payments are transfers of foreign exchange which constitute the consideration within the context of an underlying transaction, whilst movements of capital are financial operations essentially concerned with the investment of the funds in question rather than remuneration for a service'*. Clearly, the aforementioned list of Annex I has helped in clarifying the distinction. It includes amongst movements of capital, for example, investments in real property, direct investments, portfolio investments, inheritances, transfer of banknotes and coins, mortgages, financial loans and credit, guarantees, receipt of dividends from a foreign company, etc.

Article 63 has a broader territorial scope of application when compared to the articles regarding other fundamental freedoms. Indeed, it has an extraterritorial scope that allows it to also include also movements of capital (and payments) between a Member State and a third country. The reason for this choice is not expressed in the Treaty[154]. However, it is possible to believe that the aim of the provision is to strengthen the credibility of the EMU and at the same time try to create and maintain competitive centres for financial services within the EU. An interesting point of view[155], strongly related with the main topic of this dissertation, is that by liberalizing movements also to and from third countries, the Treaty avoids regulatory competition between Member States aimed at granting the most favourable conditions of capital's entry and exit in order to attract more foreign (extra-EU) investments. It can be argued, however, that if a foreign investor is free to move his capital to and from each Member State equally, he will have more choices when looking for the Member State that offers the more favourable regime—e.g. tax regime—once the capital has entered the EU. Thus, free movement of capital would, in that sense, stimulate regulatory competition.

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[153] Case 282/82 *Graziana Luisi and Giuseppe Carbone v Ministero del Tesoro* [1984] ECLI:EU:C:1984:35, paras 20-21.

[154] For three possible explanations for the extraterritorial scope of Article 63 TFEU, see J. SNELL, *Free Movement of Capital: Evolution as a Non-Linear Process*, in P. CRAIG, G. DE BÚRCA (eds.), *The Evolution of EU Law*, Oxford: Oxford University Publishing, 2nd edn, 2011, where the author suggests that the broad reach of the provision is aimed at: *(i)* avoiding investors entering or exiting Europe through the most liberal jurisdiction within the EU; *(ii)* bolstering the credibility of the single currency; and *(iii)* implementing the principle of an open market economy under Article 119 TFEU.

[155] Ibid.

Nonetheless, it must be noticed that the extraterritorial scope of Article 63 is limited in various ways. First of all, the Court often tries to limit this broad application of the Treaty by holding that other freedoms apply to the case[156]. Secondly, Article 64(1) introduces a 'grandfather clause' that saves some restrictions adopted under national law or EU law before 31 December 1993[157]. Thirdly, Articles 64(2), 64(3), 65(4), and 66 (so called 'safeguard measures') confer a series of restrictive powers that the European Parliament, the Council and the Commission can exercise under specific circumstances[158]. Fourthly, Article 75 allows the European Parliament and the Council to adopt administrative measures concerning capital and payments in order to prevent and combat terroristic activities.

Once the territorial scope of Article 63 is thus defined, its material scope is partially determined by the non-exhaustive list included in the aforementioned Annex I. However, free movement of capital often overlaps with other fundamental freedoms, making it hard for the interpreter to distinguish which is the freedom at stake. Distinctions can be crucial because only Article 63 has an extraterritorial scope of application. Thus, it is only when free movement of capital is at stake that movements between Member States and third countries are considered and 'protected' by the Treaty. While case law now allows the identification of some areas in which only free movement of capital applies[159], the line is often still blurry when distinguishing between free movement of capital and freedom to provide services, and between free movement of capital and freedom of establishment.

With regards to the first distinction, *Fidium Finanz*[160] may be considered the landmark case. In the case, a Swiss company challenged the German legislation that introduced a prior authorisation regime for the provision of financial services based on the place where the provider had its central administration. To decide

[156] See for example case C-452/04 *Fidium Finanz AG v Bundesanstalt für Finanzdienstleistungsaufsicht* [2006] ECLI:EU:C:2006:631.
[157] Or before other deadlines for some countries that entered later the EU.
[158] See BARNARD, *The Substantive Law of the EU*, cit, p. 526.
[159] Ibid, p. 530, referring to: property purchase and investment, building, and land subdivision; currency and other financial transactions; loans; investment in companies, especially where the national rule affects those who do not have a dominant interest in the company; Golden Share cases; tax treatment of certain capital movements.
[160] Case C-452/04 *Fidium Finanz AG v Bundesanstalt für Finanzdienstleistungsaufsicht* [2006] ECLI:EU:C:2006:631.

whether free movement of capital or freedom to provide service was at stake, the Court referred to the 'theory of parallelism', according to which when in principle both freedoms could apply, if one of them is considered as marginal or entirely secondary to the other, the other should be applied[161].

As regards the second distinction, the most critical situations are those cases in which shareholding is involved. A first important clarification has come with *Commission v Portugal*[162]. There, the Court held that freedom of establishment applies to cases in which shareholders hold an amount of shares *'in the capital of a company established in another Member State'* that allows them '*to exert a definite influence on that company's decisions'*[163]. In other cases, when the shareholding does not give the holder a definite influence on the company, there is another distinction to be made: if the shareholding can be described as a mere financial portfolio investment, without any intention to influence the management and control of the company, only free movement of capital is at stake[164]. In this regard, in *Kronos International*[165] the Court added that a 10 per cent shareholding is not necessarily the evidence of a control or a definite influence in the company. If, however, the investment is a direct investment which is potentially capable of providing some degree of control, and when the provision concerned is in principle applicable also in the absence of a definite influence or the Court has doubts about the presence of a definite influence, then rules of both freedom of establishment and free movement of capital apply[166]. Ultimately, in *FII (No.2)*[167] the Court remarked that *'national rules relating to the tax treatment of dividends from a third country which do not apply exclusively to situations in which the parent company exercises*

[161] Ibid. para 49, where the Court refers to the criterion of the *'predominant consideration'*.
[162] Case C-543/08 *European Commission v Portuguese Republic* [2010] ECLI:EU:C:2010:669.
[163] Ibid, para 41.
[164] Case C-35/11 *Test Claimants in the FII Group Litigation* [2012] ECLI:EU:C:2012:707, para 92.
[165] Case C-47/12 *Kronos International Inc. v Finanzamt Leverkusen* [2014] ECLI:EU:C:2014:2200, para 55.
[166] See, amongst others, case C-157/05 *Winfried L. Holböck v Finanzamt Salzburg-Land* [2007] ECLI:EU:C:2007:297, para 23, and case C-531/06 *Commission v Italy (pharmacists)* [2009] ECLI:EU:C:2009:315, para 40. See also case C-118/96 *Jessica Safir v Skattemyndigheten i Dalarnas län, formerly Skattemyndigheten i Kopparbergs län* [1998] ECLI:EU:C:1998:170, where AG Tesauro in his Opinion (paras 9-19) criticizes the cumulative application of the rules governing the different freedoms.
[167] Case C-35/11 *Test Claimants in the FII Group Litigation v Commissioners of Inland Revenue, The Commissioners for Her Majesty's Revenue & Customs* [2012] EU:C:2012:707.

decisive influence over the company paying the dividends must be assessed in the light of Article 63 TFEU'[168].

1.3.3 Restrictions on the movement of capital and derogations under Article 65 TFEU

Article 63 TFEU prohibits discriminatory restrictions. This kind of restriction has been often found by the Court in the field of taxation measures. On the contrary, it is difficult to find cases aside from tax law in which the Court has found breaches of Article 63 funded on a discriminatory approach[169]. A rare example is indeed provided by *Commission v Portugal*[170], where a breach of Article 63 was found in the prohibition laid down by Portuguese law precluding investors from other Member States from acquiring more than a given number of shares in certain Portuguese undertakings[171].

The Court has gradually adopted a 'market access' approach also when considering capital movements. Thus, also national rules which restrict or create an obstacle to free movement of capital fall in the scope of the prohibition laid down by Article 63. According to case law, it is possible to individuate a non-exhaustive list of matters in which also non-discriminatory measures that hinder or render less attractive the access to the market can be challenged under free movement of capital provisions. Firstly, cases in which the law requests a prior authorisation for foreign direct investments, as in *Association Eglise de Scientologie de Paris*[172]. Secondly, cases regarding the so called 'golden shares', like *Commission v Germany (Volkswagen)*[173]. Thirdly, cases regarding privatisations, like *Essent*[174].

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[168] Ibid, para 99.
[169] See BARNARD, *The Substantive Law of the EU*, cit, p.533, where the author explains that the reason for the small number of discriminatory measures in the field of capital might be the single currency: *'[...] it is not logical to assimilate foreign currencies with foreign nationals'*.
[170] Case C-367/98 *Commission of the European Communities v Portuguese Republic* [2002] ECLI:EU:C:2002:326.
[171] Ibid, para 40.
[172] Case C-54/99, *Association Eglise de scientologie de Paris and Scientology International Reserves Trust v The Prime Minister* [2000] ECLI:EU:C:2000:124.
[173] Case C-112/05 *Commission of the European Communities v Federal Republic of Germany* [2007] ECLI:EU:C:2007:623.
[174] Joined cases C-105/12 to C-107/12 *Staat der Nederlanden v Essent NV* (C-105/12), *Essent Nederland BV* (C-105/12), *Eneco Holding NV* (C-106/12) *and Delta NV* (C-107/12) [2013] ECLI:EU:C:2013:677.

As for all the other fundamental freedoms, the Treaty includes some derogations for free movement of capital as well.

Article 65(1)(a) introduces a specific derogation. It allows Member States to apply tax provisions distinguishing between resident and non-resident taxpayers or according to the place where the capital is invested. For the purpose of this chapter, it is interesting to notice that this is the only case in which the Treaty expressly allows a derogation to a fundamental freedom based on an economic ground. The reason for this different approach lies in the fact that direct taxation is not harmonised within the EU. Member States are still strongly willing to retain their fiscal sovereignty[175], and this is also confirmed by the interpretation given to this provision. Accordingly, to apply this derogation the Court should, firstly, carry out the so called 'comparability test', as described in *Schumacker*[176]: the national measure is lawful whenever the situations are not comparable. Secondly, if and only if the situations are comparable, then the national measure is unlawful unless it can be justified by an overriding reason in the general interest[177].

Article 65(1)(b) allows Member States to take measures *'to prevent infringements of national law and regulations'*. It thus introduces a general derogation. The general character is confirmed by the fact that the provision literally says *'in particular'* when listing the fields in which the derogation may apply, thus meaning that the concerned list is non-exhaustive. It refers to taxation[178], prudential supervision of financial institutions, and procedures for statistical or administrative information[179].

Moreover, the last part of Article 65(1)(b) declares the lawfulness of national measures restricting capital movement when they are justified on the grounds of public policy or public security. There are two interesting differences

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[175] See P. VAN CLEYNENBREUGEL, *Regulating Tax Competition in the Internal Market: Is the European Commission Finally Changing Course?*, in *European Papers*, 4, n.1, 2019, pp.232-233, where the author observes that *'given that Member States consider personal income and corporate taxation to be closely linked to their sovereignty, harmonisation initiatives have been limited in presence and scope in those fields'*.

[176] Case C-279/93 *Finanzamt Köln-Altstadt v Roland Schumacker* [1995] ECLI:EU:C:1995:31.

[177] See case C-204/90 *Hanns-Martin Bachmann v Belgian State* [1992] ECLI:EU:C:1992:35.

[178] For example, national measures aimed at preventing tax evasion are in principle lawful under Article 65(1)(b), as the Court pointed out in Case C-439/97 *Sandoz GmbH v Finanzlandesdirektion für Wien, Niederösterreich und Burgenland* [1999] ECLI:EU:C:1999:258, para 24.

[179] Although there is no case law in this specific matter.

that can be noticed when comparing this provision to the similar ones governing the other freedoms. Firstly, public health is not mentioned. Secondly, as the Court cleared out in *Association Eglise de Scientologie de Paris*[180], in order to be justified on those grounds, a measure must pass two tests: the usual proportionality test (suitability and necessity), and a legal certainty test[181]. The latter requires the measure to set some objective elements and standards according to which the national court will have to assess the conduct of the person concerned.

1.3.4 The interaction between free movement of capital, corporate mobility, and regulatory competition

Previously in this chapter, when considering freedom of establishment, it was assessed that it is the foundation of corporate mobility and that it brings questions and problems in many different legal matters connected to regulatory competition. On the contrary, the interaction between free movement of capital and regulatory competition has mainly brought reflections connected with taxation. These different characterisations, however, do not undermine the strong interconnection between the two freedoms. In fact, it has been observed that, particularly in the field of direct investment and shareholding in companies' equity, the interaction between those two freedoms is so strong that it is not always easy to distinguish which one applies to the case. Thus, when considering corporate mobility-related phenomena, it seems wise to include both the freedoms in the analysis.

As a starting point, it is necessary to point out that the presence of mechanisms such as those provided by Article 65 apparently avoids that free movement of capital *'trigger a competitive dynamic between Member States seeking to lower taxes to prevent the exit of capital from their territories'*[182].

[180] *Association Eglise de Scientologie de Paris,* paras 21-22.
[181] But it is also arguable that the assessment of legal certainty is part of the proportionality test. See for example the reasoning of the Court in case C-190/17 *Lu Zheng v Ministerio de Economía y Competitividad* [2018] ECLI:EU:C:2018:357.
[182] VAN CLEYNENBREUGEL, *Regulating Tax Competition in the Internal Market*, cit, p. 229.

However, the fact that direct taxation[183] falls outside the scope of the Treaties allows in practice Member States to apply their tax laws in a way that could stimulate businesses to move their capital there. The clearest example are countries that lower their corporate income tax rate and attract new capitals. The takeaway from *Indus* was that Member States from which the capital is departing can tax it upon exit, but they cannot in principle impede the movement.

The phenomenon of tax competition, which will be analysed in Chapter III, essentially involves companies[184]. This is mainly due to the fact that the consequences of regulatory arbitrage in this field become relevant only when the capital concerned reaches certain thresholds, which are usually typical of corporate income and not of personal income. Moreover, it is also true that for practical reasons it is normally easier for companies rather than for natural persons to operate on a multi-jurisdictional level. Thus, while tax competition mainly concerns companies, it cannot be denied that it ends up having a strong, usually negative, impact on individuals, as a social side-effect that has been previously considered.

In conclusion, free movement of capital is a fundamental tool that allows companies, along with their freedom of establishment, to erode their tax base and shift their profits from Member State A to Member State B when Member State B adopts a tax policy that those companies find more favourable. Thus, according to the scheme analysed in section 1.1, the system constituted by the combination of freedom of establishment and free movement of capital, when wholly considered, is capable of triggering a mechanism of regulatory competition and regulatory arbitrage whose consequences will be explored in the subsequent chapters.

[183] For an overview on direct tax cases assessed by the Court, see F. WEISS, C. KAUPA, *European Union Internal Market Law*, Cambridge: Cambridge University Press, 2014, pp. 311-315, where the authors mention cases regarding taxation of dividends, preferential tax treatment of income from domestic sources other than dividends, taxation of income from immovable property, and tax breaks for inheritances and charitable donations.

[184] See A. PERRONE, *Tax Competition e Giustizia Sociale nell'Unione Europea*, Wolters Kluwer, 2019, p. 5.

CHAPTER II

CORPORATE GOVERNANCE AND REGULATORY COMPETITION

2.1 *Corporate governance between transnational convergence and national dependence*

The term *'corporate governance'* can be used to describe both the system of management and control of corporations and the rules that are implemented for the regulation of such a system. The first definition was provided by the 1992 *Cadbury Report*[1]: accordingly, corporate governance is *'the system by which companies are directed and controlled'*. That definition was later reproduced by the EU, in its two action plans for company law[2], and by the OECD[3].

Corporate governance systems are crucial in dealing with the crucial agency problems of companies and are heavily influenced by the theory that a country adopts to explain the corporate purpose. Therefore, different approaches to corporate governance codes are the outcome of different theories of corporate purpose[4]. For example, in a certain legal system the main purpose of companies might be regarded as the pursuit of the interest of the State, while elsewhere the supreme goal could be the maximisation of value of shareholders, the welfare of

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[1] COMMITTEE ON THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE, *Financial Aspects of Corporate Governance*, 1992, introduction, para 2.5.

[2] Communication from The Commission to the Council and the European Parliament. *Modernising Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward* [2003] OJ C 63, and Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions Action Plan. *European company law and corporate governance - a modern legal framework for more engaged shareholders and sustainable companies* COM/2012/0740 final, 2012, in the introduction of which it is affirmed that *'corporate governance defines relationships between a company's management, its board, its shareholders and its other stakeholders. It determines the way companies are managed and controlled'*.

[3] OECD, *G20/OECD Principles of Corporate Governance*, first issued in 1999.

[4] An overview on the matter is provided by R. J. GILSON, *From Corporate Law to Corporate Governance*, in GORDON, RINGE (eds), *The Oxford Handbook of Corporate Law and Governance*, cit, pp. 15 et seq.: the author lists a series of *'models in corporate law'*, such as *(i)* the stakeholder model, *(ii)* the team production model, *(iii)* the director primacy model, and *(iv)* the shareholder primacy model. However, GILSON is aware that the theoretical importance of these models has not been recognized by courts so far: in fact, *'some 40 years after economics began making important inroads into corporate law scholarship, a significant amount of academic, but not judicial, attention is still directed at devising the right "model" of corporate law and governance'*.

stakeholders, or even the welfare of customers. The two main theories are probably those that identify the corporate purpose as shareholder's primacy and, secondly, stakeholder's primacy[5], with the former proving to be the most followed of the two during the present century. The natural evolution of company law, however, has also called for new forms of compromise, which have been found with the theories of the so called 'enlightened shareholder value'[6] and 'entity-oriented purpose'[7].

Literature[8] has observed that corporate governance rules have a broader scope of corporate law *per se*, meaning that, when considering corporate governance, corporate statutory law is integrated by other complementary[9] sources: corporate governance codes[10], guidelines, best practices and a series of other soft law tools that fund standards whose respect is often granted through the so called 'comply or explain' rule.

Corporate governance codes have been gradually shaped by globalisation, and it is nowadays possible to analyse a common basic structure for corporate law, as forecasted by literature at the end of last century[11]. That prediction rested

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[5] In GILSON, *From Corporate Law to Corporate Governance*, cit, p. 16, the author describes the *'stakeholder model'* by saying that *'a stakeholder model of corporation law or governance recognizes that the corporation is a major social institution that is at the core of a capitalist system'*.

[6] The UK has implicitly adhered to this theory through its *Companies Act 2006*, especially with the provision laid down in Section 172. This approach strikes a balance between the competing interests of different stakeholders in order to benefit the shareholders in the long run. Thus, shareholders remain ultimate beneficiaries of the directors' activity but there is an orientation towards the long-term productivity and a broader set of factors that directors need to consider in complying with their duties. For an overview on the matter, see D. MILLON, *Enlightened Shareholder Value, Social Responsibility, and the Redefinition of Corporate Purpose Without Law*, in *Washington & Lee Public Legal Studies Research Paper Series*, Working Paper June 16, 2010, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1625750.

[7] This is the path followed by the Netherlands, which see the company as an autonomous entity, distinct by its participants and organs. Directors are thus trustees of companies' assets, and their aim is to maximize the value of those assets, with an implicit and indirect benefit for both stakeholders and shareholders.

[8] In particular, see D. CORAPI, *Corporate Governance*, in A. Nuzzo, A. PALAZZOLO (eds.), *Disciplina delle Società e Legislazione Bancaria. Studi in Onore di Gustavo Visentini*, LUISS University Press, 2020, pp. 90-92.

[9] On the concept of *'complementarity'* of company law, see SCHÖN, *Playing Different Games?,* cit, pp. 353-355.

[10] To name a few: *Codice di Autodisciplina* (Italy), *Deutscher Corporate Governance Codex* (Germany), *UK Corporate Governance code* (UK)**,** *AFEP-MEDEF Code* (France).

[11] The convergence of corporate laws was for the first time described and analysed by H. HANSMANN, R. KRAAKMAN, *The End of History for Corporate Law,* Yale International Centre for Finance, Working Paper n. 9, 2000, where the authors observed that *'despite the apparent divergence in institutions of governance, share ownership, capital markets, and business culture across developed economies, the basic law of the corporate form has already achieved a high degree of uniformity, and continued convergence is likely'*.

primarily on the progressive affirmation of the theory of shareholder primacy and at the same time on the *'failure of alternative models'*[12], such as the manager-oriented model, the labour-oriented model, the State-oriented model, and the stakeholder models.

In particular, convergence is due to a set of factors, amongst which competition is included[13]. In this case, the 'race to the standard' in corporate structure is aimed at lowering the cost of equity capital, developing new product markets, incentivising coherent business reorganisation, and allowing rapid abandon of inefficient investments. Even though there might be particular reasons and exceptional circumstances for which the adoption of the standard might also bring some disadvantages—especially in systems that have not adopted the very same theory of corporate purpose adopted by the system to which the standard originally belongs—it will likely render firms who adopt it more attractive and innovative, therefore facilitating their access to private equity markets and institutional investors[14].

While business law has always been influenced by the *lex mercatoria* and corporate governance codes are thus on the path to convergence, no transnational corporate governance system has been recognised so far. There is, in fact, also a *'path dependence'*[15] from national law, meaning that codes, guidelines, best practices—traditional soft law instruments of corporate governance which have a functional and practical rather than formal and theoretical character[16]—and

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[12] Ibid, p. 3; see also page 9, where the authors define the shareholder-oriented model as the *'standard model'*.
[13] Ibid, pp. 13-14, where *'the force of competition'* is listed together with *'the force of logic'* and *'the force of example'*.
[14] However, see *infra* paragraph 3.3.1 for a negative assessment on the relationship between the convergence towards the model of the private limited company and the facilitation of access to capital markets.
[15] On the theory of path dependence of corporate structures across the different economies of the world, see L. BEBCHUK, M. J. ROE, *A Theory of Path Dependence in Corporate Ownership and Governance*, in *Stanford Law Review*, 52, 1, 1999, pp. 127 et seq., where the authors identify two main sources of path dependence: the economic structure and the corporate legal rules; see also GILSON, *From Corporate Law to Corporate Governance*, cit, p. 9, where the author observes that *'corporate governance is path dependent—history matters significantly'* and that *'initial conditions, determined by fortuitous events or non-economic factors such as culture, politics, or geography, can start the system down a specific path'*.
[16] In I. FERRERO FERRERO, R. ACKRILL, *Europeanization and the Soft Law Process of EU Corporate Governance: How Has the 2003 Action Plan Impacted on National Corporate Governance Codes?*, in *Journal of Common Market Studies*, 54, 4, 2016, p. 892, the authors reach the general conclusion

corporate law in general, are still influenced by the society and the economy in which they are created and applied.

The purpose of this Chapter is to assess whether and to what extent these two opposite trends—transnational convergence and national dependence—have interacted with regulatory competition within the internal market, and how corporate governance has been accordingly shaped across the Member States. In order to do so, the first step will be to describe the main attempts of harmonisation at the EU level, mainly focusing on the role of the thirteen company law directives (section 2.2). The second step will instead be to analyse the room left to companies for regulatory arbitrage justified by reasons of corporate governance and to assess how that phenomenon has influenced the choices of both EU and national lawmakers (section 2.3). Lastly, the outcomes of this research might prove useful in reaching some conclusions (section 2.4).

2.2 *Reflexive harmonisation of corporate governance within the EU*

Following the decisions of the Court in the *Centros* trilogy, questions regarding the effects of regulatory competition on company law have arisen at the beginning of this century. However, harmonisation of company law has been deemed an essential need of the internal market since the launch of the integration project. A process of positive, although limited, integration has indeed taken place by means of the *Thirteen Company Law Directives*, which are worth mentioning. It must be kept in mind, preliminarily, that the *Third*[17], the *Sixth*[18], the *Tenth*[19], and

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that *'with soft law, context matters. In contrast to hard law, where the "issuer" is de facto the national legislator, our research has shown that, for soft law corporate governance policies, the issuer has a significant impact on the measures laid down'.*

[17] Third Council Directive (ECC) 78/855 of 9 October 1978 based on Article 54 (3) (g) of the Treaty concerning mergers of public limited liability companies [1978] OJ L 295, repealed and replaced by Directive (EU) 2011/35 of the European Parliament and of the Council of 5 April 2011 concerning mergers of public limited liability companies [2011] OJ L 110.

[18] Sixth Council Directive (ECC) 82/891 of 17 December 1982 based on Article 54(3)(g) of the Treaty, concerning the division of public limited liability companies [1982] OJ L 378; that directive was complementary to the first generation.

[19] Directive (EC) 2005/56 of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies [2005] OJ L 310.

the *Eleventh*[20] directives deal with corporate mobility rather than corporate structure and that the *Fifth* and the *Ninth* directives never entered into force.

The *First company law Directive*[21], issued in 1968, concerned some core minimum standards of compulsory disclosure for both public and private companies[22], the validity regime for obligations assumed by the companies towards third parties, the nullity of companies, and some related safeguard measures. The *Second Directive*[23] instead regarded some minimum requirements, such as capital requirements, for the formation of public companies. In response to the new issues arising from the evolution of corporate mobility, the first two directives have been repealed and replaced by recent directives, respectively in 2009[24] and 2012[25]. Those directives, in turn, together with those related to corporate mobility, have been codified in *Directive 2017/1132*[26].

[20] Eleventh Council Directive (EEC) 89/666 of 21 December 1989 concerning disclosure requirements in respect of branches opened in a Member State by certain types of company governed by the law of another State [1989] OJ L 395.
[21] First Council Directive (ECC) 68/151 of 9 March 1968 on co-ordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community [1968] OJ L 65.
[22] Mainly regarding constitution and statutes.
[23] Second Council Directive (ECC) 77/91 of 13 December 1976 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent [1977] OJ L 26.
[24] Directive (EC) 2009/101 of the European Parliament and of the Council of 16 September 2009 on coordination of safeguards which, for the protection of the interests of members and third parties, are required by Member States of companies within the meaning of the second paragraph of Article 48 of the Treaty, with a view to making such safeguards equivalent [2009] OJ L 258.
[25] Directive (EU) 2012/30 of the European Parliament and of the Council of 25 October 2012 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 54 of the Treaty on the Functioning of the European Union, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent [2012] OJ L 315.
[26] Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law [2017] OJ L 169. Codification is a tool by which, in the *'interests of clarity and rationality'* (see recital 1) previous legislation is brought together in a single new act. Normally, therefore, there are no deadlines for the implementation of codified Directives. Nevertheless, Article 162(4) of the Directive provides that *'by 30 June 2016, the Commission shall review the functioning of those provisions which concern the reporting and documentation requirements [...], and in particular their effects on the reduction of administrative burdens on companies, in the light of experience acquired in their application, and shall present a report to the European Parliament and the Council, accompanied if necessary by proposals to amend those provisions'.*

While the first generation of directives put the stress on harmonisation, it did not take long before Member States regained their room for manoeuvre thanks to a second generation which had a more flexible structure, amongst which were the so called 'accounting directives': *Fourth*[27], *Seventh*[28], and *Eighth*[29] directives. Those directives laid down basic accounting standards by means of a series of 'opt-in' solutions that basically corresponded to the main habits already used across the Member States.

The third generation of directives was the main turning point. Following the new approach suggested by the *Single European Act* in 1986, decentralisation was applied in the field of company law, limiting central intervention and thus limiting harmonisation. The 'reference to standards' principle introduced a presumption that the compliance with the minimum standards set by the directives necessarily implied the compatibility with EU law. The main evidence was the *Twelfth Directive*[30] that left to Member States the competence in providing some key rules regarding disclosure and creditor protection in the case of single-member private limited-liability companies.

Ultimately, the fourth generation of directives, amongst which is the *Thirteenth Directive*[31] (also known as *Takeover Bids Directive*), followed the path laid down by its predecessor, going even further by encouraging self-regulatory bodies and local-level action.

The sliding door for the harmonisation of corporate governance across the EU is the *Proposal for a Fifth company law directive*[32], drafted by the Commission in 1972, thus belonging to the period of first-generation directives. Hence the

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

[28] Seventh Council Directive (EEC) 83/349 of 13 June 1983 based on the Article 54 (3) (g) of the Treaty on consolidated accounts [1983] OJ L 193.

[29] Eighth Council Directive (EEC) 84/253 of 10 April 1984 based on Article 54 (3) (g) of the Treaty on the approval of persons responsible for carrying out the statutory audits of accounting documents [1984] OJ L 126.

[30] Twelfth Council Company Law Directive (EEC) 89/667 of 21 December 1989 on single-member private limited-liability companies [1989] OJ L 395.

[31] Directive (EC) 2004/25 of the European Parliament and of the Council of 21 April 2004 on takeover bids [2004] OJ L 142.

[32] COMMISSION OF THE EUROPEAN COMMUNITIES, *Proposal for a Fifth directive on the coordination of safeguards which for the protection of the interests of members and outsiders, are required by Member States of companies within the meaning of Article 59, second paragraph, with respect to company structure and to the power and responsibilities of company boards* [1972] OJ C 131.

Proposal had ambitious goals of harmonisation, namely the creation of a uniform legal environment for German, Belgian, French, Luxembourgish, Dutch, and Italian public limited companies[33]. The original *Proposal*, however, failed in finding the consensus of Member States. The influence of German corporate law appeared excessive for the other Member States, with special regard to the adoption of a mandatory two-tier board structure[34] and the provisions concerning the participation of employees in the governance of the company. In addition, the UK would have joined the Community in 1973, but the UK traditional corporate governance structure was highly incompatible with the principles laid down by the *Proposal*. As a matter of fact, while German and French corporations were collocated in the framework of 'insider systems', where *'share ownership tends to be concentrated in the hands of family groups or held in large blocks by other corporations'*[35], in the UK 'outsider system' the predominant mode of ownership was through the holdings of institutional investors. The UK model has traditionally been oriented towards shareholder value—and this is true even in its 'enlightened' version—while the two-tier board and the employee involvement are mainly a guarantee for stakeholders, also because in insider systems such as the German one the risk of hostile takeovers, and thus the risk for shareholders of losing control of the firm, is lower.

The influence of the new approach of the second and third generations of directives was crucial for the amendments to the *Proposal* which were introduced by the Commission in 1983[36], 1990[37], and 1991[38]. In fact, the *Amended Proposal* was less intrusive for the legislations of Member States and was aimed at setting

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[33] Called respectively *Aktiengesellschaft* in Germany, *société anonyme* in Belgium, France, and Luxembourg, *naamloze vennootschap* in the Netherlands, and *società per azioni* in Italy.

[34] *Proposal for a Fifth Directive*, pp. 6-7.

[35] S. DEAKIN, *Regulatory Competition Versus Harmonisation in European Company Law*, ESRC Centre for Business Research, University of Cambridge, Working Paper n. 163, 2000, p. 9; however, the same considerations also apply to Italy.

[36] COMMISSION OF THE EUROPEAN COMMUNITIES, *Amended proposal for a Fifth directive founded on Article 54 (3) (g) of the Treaty concerning the structure of public limited companies and the powers and obligations of their organs* [1983] OJ C 240.

[37] COMMISSION OF THE EUROPEAN COMMUNITIES, *Second amendment to the proposal for a Fifth Council Directive based on Article 54 of the EEC Treaty concerning the structure of public limited companies and the powers and obligations of their organs* [1991] OJ C 7.

[38] COMMISSION OF THE EUROPEAN COMMUNITIES, *Third amendment to the proposal for a fifth Council directive based on article 54 of the ESC treaty concerning the structure of public limited companies and the powers and obligations of their organs* [1991] OJ C 158.

some minimum standards and principles, which were a compromise between the need for convergence within the internal market and the will of preservation of Member States' national corporate governance traditions. The one-tier board was reintroduced, though as merely optional for founding partners, and a higher threshold[39] for the mandatory involvement of employees was set, even allowing Member States to opt for any available co-determination mechanism other than the participation of employees in the board. However, the *Amended Proposal* was not successful because of a certain degree of reluctance of Member States to accept those innovations, especially in the context of the consistently increasing supremacy of the theory of shareholders primacy and the subsequent development of flexible, UK-inspired, corporate governance structures.

Even though the *Fifth Directive* has never been adopted, it is possible to notice that the provisions regarding the double-tier board have later been autonomously implemented by some Member States, such as Italy in its 2003 reform of company law, and that some of its provisions regarding shareholders have later inspired the *Shareholder Rights Directives*[40].

Finally, the one or two-tier board options and the employees' participation are also key elements of the *SE Regulation*[41], which provides that a *Societas Europaea* shall comprise *'either a supervisory organ and a management organ*

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[39] Shifting from the number of 500 workers required by the *Proposal* to the number of 1000 workers required by the *Amended Proposal*.

[40] Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement [2017] OJ L 132 (*Shareholder Rights Directive II*), and Directive (EC) 2007/36 of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies [2007] OJ L 184 (*Shareholder Rights Directive I*).

[41] Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE) [2001] OJ L 294. It has been argued that the *Societas Europaea*, albeit its harmonising aim, has been exploited for the purpose of regulatory arbitrage by some companies. On that critic see H. EIDENMÜLLER, A. ENGERT, L. HORNUF, *Incorporating Under European Law: The Societas Europaea as a Vehicle for Legal Arbitrage*, in *European Business Organization Law Review*, 10, 1, 2009, p. 1: according to the authors, in particular, regulatory arbitrage would be encouraged by the fact that under the *SE Regulation* a *SE* can be constituted with a one-tier board structure *'in jurisdictions that impose a two-tier structure on their national public companies'*; moreover, the enhancement of corporate mobility through the *SE Regulation* would have the effect of incentivising legal arbitrage *'with a view to corporate tax savings'*. However, in the more recent MANNAN, WUISMAN, *Freedom of Establishment for Companies in Europe (EU/EEA)*, cit, p. 113, it is observed that *'given the high number of SEs that have remained in the Czech Republic and Germany after formation, it would appear that the formation of SEs has been inspired less by a desire for corporate mobility rather than for other reasons, such as "freezing" employee participation at a certain threshold in Germany'*.

(two-tier system) or an administrative organ (one-tier system) depending on the form adopted in the statutes'[42] and that *'employee involvement in an SE shall be governed by the provisions of Directive 2001/86/EC*[43] *'*[44], which in its preamble mentions in the first place the *Amended Proposal for a Fifth Directive*.

At the beginning of the new millennium, after a period during which integration was exclusively top-down and after the failure of Commission's attempts to force the adoption of the German model across the EU, the new challenges brought by the steadily increasing cross-border mobility and the major bankruptcy cases of Enron (2001), Worldcom (2002), and Parmalat (2003) reshaped the approach to the matter. The aforementioned Commission's *Action Plan 2003* opened to the setting of new minimum standards, through the individuation of 26 corporate governance priorities, which were characterised by the predominance of the UK model[45], which in turn had already heavily influenced other corporate law systems, such as the Dutch one. The available data[46] show that the index of convergence with the 26 Commission's priorities was 53.85% for the UK and for the Netherlands in 2003, i.e. the year in which the *Action Plan* was published. Interestingly, at the time of the *Cadbury Report*, in 1992, the index of convergence of the UK was already 34.62%, even though the *Action Plan* had not even been drafted yet, while the Dutch index only showed a 11.54% convergence in 1997. Additionally, and more interestingly, in 2000 the index was still only at 3.85% for Germany[47]. These empirical findings seem to confirm the shift from a 'German model' to a 'UK model'.

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[42] Ibid, Article 38(b).

[43] Council Directive (EC) 2001/86 of 8 October 2001 supplementing the Statute for a European company with regard to the involvement of employees [2001] OJ L 294 (*SE Directive*).

[44] *SE Regulation*, Article 1(4).

[45] The influence of the advent of the UK on EU corporate governance is described in M. GELTER, *EU Company Law Harmonisation between Convergence and Varieties of Capitalism*, European Corporate Governance Institute, Law Working Paper n. 355/2017, 2019, available at <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2977500>, p. 34, where the author describes continental jurisdictions as the *'main force of resistance'* against the *'formal and superficial, but not entirely irrelevant'* convergence towards the UK model.

[46] FERRERO FERRERO, ACKRILL, *Europeanization and the Soft Law Process of EU Corporate Governance*, cit, pp. 888.

[47] The German index was brought to 30.77% by the *Geman Code of Corporate Governance* published on 6 June 2000.

In this respect, it has been noticed by some scholars that insider systems are normally implemented in real seat jurisdictions, while outsider systems are usually typical of jurisdictions which adhere to the seat of incorporation theory[48]. Hence, the overlap between the latter countries and the preferred countries of destination for cross-border movements of corporations during the first fifteen years of the millennium—thus after *Centros*[49]—cannot be surprising[50].

However, Brexit has already impacted on those data, given the steadily increasing number of cross-border mergers where the acquiring company is German and the merger company is British, and the more general tendency of outbound movements from the UK[51]. It is still to be determined whether this shift will be capable of reversing the trend of EU corporate governance integration. At the time of writing, it is nonetheless possible to notice that Brexit deprives the EU of a key-actor in the development of corporate models. Indeed, the UK has so far played a crucial role in both spontaneous convergence, by providing rules and solutions which have stimulated regulatory competition, and central harmonisation, by leading the institutional and academic debate on the enhancement of European company law[52].

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[48] According to M. VIÉNOT, quoted by DEAKIN, *Regulatory Competition Versus Harmonisation in European Company Law*, cit, p.12, *'in Anglo-Saxon countries the emphasis is for the most part placed on the objective of maximising share values, whilst on the European continent and France in particular the emphasis is placed more on the human assets and resources of the company'*.

[49] S. DEAKIN argues *that 'diversity of practice at Member State level is [...] undermined by the increased possibilities for corporate migration following the Centros case'* in *Reflexive Governance and European Company Law*, in *European Law Journal*, 15, 2, p. 244.

[50] According to BIERMEYER, MEYER, *Cross-border Corporate Mobility in the EU: Empirical Findings*, cit: the UK, the Netherlands, and Luxembourg. See also GERNER-BEUERLE, MUCCIARELLI, SCHUSTER, SIEMS, *Why Do Businesses Incorporate in Other EU Member States?*, cit, p. 26, where the authors observe that *'conflict of laws rules plays a key role: countries that have a clear-cut version of the "incorporation theory" attract more incorporations than countries which have retained elements of the "real seat theory"'*.

[51] See BIERMEYER, MEYER, *The Use of Corporate Mobility Instruments and Brexit*, cit, p. 20, where the authors report that *'UK companies make use of cross-border mergers and cross-border seat transfers of Societates Europaeae (SEs) in order to move from the UK to other EU Member States. For 2018, seventy-six entry transactions could be identified compared to 116 exit transactions. As regards 2019, the picture is even more drastic thus far. Only twenty-eight entry transaction could be identified, as opposed to 222 exit transactions'*.

[52] The topic is analysed in H. EIDENMÜLLER, *Collateral Damage: Brexit's Negative Effects on Regulatory Competition and Legal Innovation in Private Law*, European Corporate Governance Institute, Working Paper n. 403, 2018. The author begins his reasoning from two premises: that *(i) 'regulatory competition between the EU Member States is, in principle, beneficial because it initiates a "discovery process" for new and, hopefully, more efficient legal products*; and that *(ii) 'Brexit will reduce the level of regulatory competition in the EU'* as *'choosing UK legal products*

In conclusion, corporate governance—especially in its soft law dimension—appears to be a field in which reflexive harmonisation is more likely to occur than it is in other sectors of law. This phenomenon has also been referred to as *'reflexive governance'* or *'open method of coordination'*[53]. According to this view, a limited intervention from Brussels integrated by the convergence of corporate purpose theories has allowed Member State to retain their traditional systems while simultaneously enhancing new efficiencies. Consequently, corporate governance might be described as an appropriate environment for the development of a race to the top.

This consideration, however, does not imply that there is no room for regulatory competition. It means, instead, that regulatory competition occurs but it is characterised differently than in other fields.

For example, if corporate law is compared to tax law (which will be described in Chapter III), some key differences might be noticed.

First of all, unlike some tax preferential regimes, corporate legal forms are never offered only to foreign investors, as they are also always available for domestic businesses. In this way, the room for harmful practices aimed exclusively at attracting foreign investors is reduced.

Secondly, administrative secrecy and tax preferential regimes bring an advantage that is objective and directly measurable in monetary terms[54]. Corporate governance rules, on the contrary, show a degree of subjectivity, meaning that the effects that they cause are strictly related to the economic and social context in

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will likely be more difficult in the future'. Eventually, the author then concludes that Brexit will reduce the incentive to innovate that comes from competitive pressure at a national level, and that on the European level *'the loss of expertise in the "real" law-making process within the European institutions'* will cause the impoverishment of debates and the suffering of the quality of outcomes, as the EU will *'no longer benefit from UK influence and contributions'*. See also R. GHETTI, *Unification, Harmonisation and Competition in European Company Forms*, in *European Business Law Review*, 29, 5, 2018, p. 842, where the author observes that *'the success of corporate governance unification or harmonisation in Europe would appear to depend heavily on the unification of political governance, but today, especially after Brexit, the road to Political Union is longer and steeper than ever'*.

[53] Those terms are used in, amongst others, DEAKIN, *Reflexive Governance and European Company Law*.

[54] In W. SCHÖN, *Tax Legislation and the Notion of Fiscal Aid: A Review of 5 Years of European Jurisprudence*, in I. RICHELLE, W. SCHÖN, E. TRAVERSA (eds.), *State Aid Law and Business Taxation*, 2016, p. 4, it is observed that *'the main difference between fiscal aid and (most) other means of subsidization stems from the fact, that any tax as such is just the opposite of a financial benefit'*.

which they are implemented (path dependence), a hunch that is witnessed by their frequent nature of soft law.

Thirdly, even though some governance rules can potentially undermine the interests of stakeholders[55]—workers, creditors, and tort victims—negative externalities are less likely to occur. In fact, shareholders, who are ultimately entitled to choose and control the corporate structure, are the immediate beneficiaries of the company's success, but it is also true that, aside from specific situations, stakeholders generally benefit from the same company's well-being from which shareholders benefit. Instead, in the field of taxation, companies find their counterpart in welfare and public expenditure, which is normally harmed and reduced by tax competition.

2.3 *Limited regulatory arbitrage and matters of regulatory competition in the field of corporate governance*

The consequence of the *'defensive harmonisation'*[56] described in the previous paragraph is that regulatory arbitrage in the field of corporate law has proved to be limited, at least when considering the great expectations that followed the Court decision in *Centros*. Indeed, as a recent study[57] shows, the *lex societatis* determines only a part of the many rules that govern the activities of a company. Hence, there are rules, such as those related to the protection of third parties, that might fall outside the scope of the *lex societatis* and thus rely on different connecting factors under private international law[58].

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[55] Many concerns arose after more scandals breaking at the beginning of the century, especially with the collapse of Enron (2001), Worldcom (2002), and Parmalat (2003). For an overview on the impact of Enron case on corporate governance, also on a transnational level, see S. L. GILLAN, J. D. MARTIN, *Corporate Governance post-Enron: Effective Reforms, or Closing the Stable Door?*, in *Journal of Corporate Finance*, 13, 2007, pp. 929 et seq.

[56] This expression is used by C. GERNER-BEUERLE F. MUCCIARELLI, E. SCHUSTER, M. SIEMS, *The Illusion of Motion: Corporate (Im)Mobility and the Failed Promise of* Centros, in *European Business Organization Law Review*, 20, 2019, p. 452, when describing the reaction of Member States to the threat of regulatory arbitrage in the field of board-level employee participation.

[57] Ibid, pp. 425 et seq.

[58] See ibid, p. 428, where the authors observe that *'in this pure form, the incorporation theory cannot be found in any jurisdiction'* and that, therefore, even the uniform adoption of the incorporation theory could not bring complete harmonisation of company law.

A clear example is provided by the *Insolvency Regulation*[59], as it introduces the concept of *'centre of main interests'*, that can be seen as an equivalent of the real seat theory. The landmark case in that field was *Kornhaas*[60], in which the ECJ allowed the application of German insolvency law to a UK incorporated company.

Another overlap may occur between national company law, where the connecting factor is the *lex societatis*, and *Rome II Regulation*, particularly in the field of non-contractual obligation. Indeed, *Rome II Regulation* provides different connecting factors that might sometimes be incompatible with the *lex societatis*, especially vis-à-vis the theory of incorporation. The two main examples are tort law, which refers to the *lex damni*[61], and the *culpa in contrahendo—'the law applicable to a non-contractual obligation arising out of dealings prior to the conclusion of a contract'*—which refers to the *'law that applies to the contract'*[62]. Similar uncertainties arise when considering the law applicable to directors' liability, and, to a certain extent, to the liability of shareholders for obligations of the company, when it is hard to determine whether company law or the law applicable to non-contractual obligations—and thus *Rome II Regulation*—should apply[63].

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[59] Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings [2015] OJ L 141; on the impact of regulatory competition on insolvency law; see H. EIDENMÜLLER, *Comparative Corporate Insolvency Law*, in GORDON, RINGE (eds.) *The Oxford Handbook of Corporate Law and Governance*, cit, p. 1036: the author believes that regulatory competition in the field of insolvency law can be regarded as both a race to the top, *as 'it creates an "international laboratory" for better solutions, spurring regulatory competition between states for the best "insolvency product"'*, and a race to the bottom, considering that *'last-minute forum shopping by firms—possibly initiated by dominant lenders—can create problems, especially for outside creditors whose interests might be compromised by the move'*. In particular, interestingly, EIDENMÜLLER argues that there is a sort of inequality in regulatory arbitrage, as *'not all firms have the knowledge and money to engage in sophisticated regulatory arbitrage and, as a consequence, might not have access to an efficient domestic insolvency or restructuring regime'*.

[60] Case C-594/14 *Simona Kornhaas v Thomas Dithmar as liquidator of the assets of Kornhaas Montage und Dienstleistung Ltd* [2015] ECLI:EU:C:2015:806.

[61] Ibid, Article 4(1): *'[...] the law applicable to a non-contractual obligation arising out of a tort/delict shall be the law of the country in which the damage occurs irrespective of the country in which the event giving rise to the damage occurred and irrespective of the country or countries in which the indirect consequences of that event occur'*.

[62] Ibid, Article 12(1).

[63] Three approaches pursued by Member State to distinguish which is the applicable law in cases of directors' liability are described in GERNER-BEUERLE, MUCCIARELLI, SCHUSTER, SIEMS, *The Illusion of Motion*, cit. The first *(i)* is based on substantive law: accordingly, company law should apply to breaches of directors' duties, the articles of association, or company law itself, while *Rome II Regulation* should apply to obligations arising from wrongful acts not grounded in company law. The second *(ii)* approach considers the type of harmful act: only if it involves the exercise of

In conclusion, when a company exercises its freedom of establishment for mere purposes of regulatory arbitrage for corporate governance rules, it faces the risks that many of the aspects of a business strictly related to corporate matters are not necessarily governed by corporate law. Chances of overlaps and uncertainty become more relevant when the company has its real seat in Member States that *'rely extensively on insolvency and tort law to regulate corporate behaviour, as is the case for most of the largest EU economies'*[64]. When those risks, together with the administrative costs of mobility, outweigh the benefits deriving from reincorporation, regulatory arbitrage in the field of corporate law becomes disadvantageous[65].

Having clarified that regulatory arbitrage for corporate law has features, trends, and effects that are deeply different from those that will be observed for tax law in Chapter III, the next step is nonetheless to focus—both from a comparative and from an EU law point of view—on some specific matters related to corporate governance that have been somehow shaped and influenced by regulatory competition: the legal form of the company (paragraph 2.3.1); minimum capital requirements (paragraph 2.3.2); and control-enhancing mechanisms (2.3.3).

2.3.1 Competing for the best legal form: the UK private limited company and its equivalent counterparts across the Member States

Small businesses have traditionally been at the heart of European economy. They normally present similar features which, should the business be carried out in the legal form of a company, are likely to benefit from specific characteristics of corporate governance. In particular, in addition to the need of retaining limited liability, an adequate legal form should grant a high degree of flexibility and a certain enhancement of shareholder rights.

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corporate powers, corporate law is applicable. Lastly, the third *(iii)* approach focuses on the injured party: the so called *'reflective loss to the shareholders'* is governed by company law, while the *lex loci commissi delicti* applies to damage caused to stakeholders.

[64] Ibid, p. 462.

[65] In GERNER-BEUERLE, MUCCIARELLI, SCHUSTER, SIEMS, *Why Do Businesses Incorporate in Other EU Member States?*, cit, p. 24, the authors argue that *'businesses may not choose a legal system by way of incorporation that is too unfamiliar to them'*.

The first successful legal form capable of meeting those requirements has been the UK *Private Limited Liability Company* (*Ltd*). This type of company was created in 1907 thanks to the *Companies Act*, later amended and replaced by the other *Companies Acts* of 1985, 1989, 2004, and 2006. The main features of the *Ltd* are flexibility in governance, low capital requirements, and autonomy of shareholders. Since its introduction, the importance of the *Ltd* grew exponentially until it became, in 2006, the default model for UK companies, swapping its former residual role with the public company. In particular, since 2006 the minimum capital requirement has been set at GBP 1[66], by omitting the related provisions, in order to allow the UK *Ltd* to even increase its attractivity for small and medium-sized enterprises (SMEs).

After the *Centros* trilogy—and in particular after *Inspire Art*—more than 50,000[67] *Ltd*s incorporated in the UK started operating their businesses in Germany. German reaction was to issue the *Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbrauchen 2008* (*MoMiG*), that introduced the Unternehmergesellschaft (*UG*), a particular type of *Gesellschaft mit beschrankter Haftung* (*GmbH*)[68] that simplifies the formalities for constitution but at the same time provides a series of rules for the protection of creditors. The minimum capital was set at EUR 1, clearly influenced by the UK *Ltd* experience.

The same process of lowering the minimum capital to EUR 1 has been observed in many other Member States: in France, the *loi 2003-721*[69] lowered the minimum capital requirement for the *societè à responsabilitè limitèe* (*SARL*) from EUR 7,500 to EUR 1; in Italy, the *Decreto-Legge 1/2012*[70] introduced the new *società a responsabilità limitata semplificata* (*SRLS*), with the same minimum capital[71]; in the Netherlands, the *Flex BV Act 2012* deleted any reference to the

[66] Or better, any value above zero.
[67] PORTALE, *Il Diritto Societario tra Diritto Comparato e Diritto Straniero*, cit, p. 335.
[68] *UG*s are often referred to informally as *'mini-GmbHs'*.
[69] *Loi n° 2003-721 du 1 août 2003 pour l'initiative économique*.
[70] *Decreto-Legge 24 gennaio 2012, n. 1 (Raccolta 2012), Disposizioni urgenti per la concorrenza, lo sviluppo delle infrastrutture e la competitività (12G0009) (GU Serie Generale n.19 del 24-01-2012 - Suppl. Ordinario n. 18).*
[71] The minimum capital requirement was lowered to EUR 1 also for the *società a responsabilità limitata* (*SRL a capitale ridotto*) one year later, by the *Decreto-Legge 28 giugno 2013, n. 76, Primi interventi urgenti per la promozione dell'occupazione, in particolare giovanile, della coesione*

minimum capital for the *Besloten vennootschap* (*BV*); in Portugal, with a similar provision, in 2009 the minimum capital *de facto* requirement for the *sociedade por quotas* (*Lda*) has been lowered to EUR 1[72]; lastly, also the Irish *Private Company Limited by Shares* and the Cypriot *Private Limited Company* have lowered their minimum capital requirements to EUR 1 and EUR 2 respectively.

The lowering of minimum capital requirements has been balanced by lawmakers through the introduction of measures such as the mandatory indication of the legal form adopted in the name and in the acts and correspondence of the company—three examples are the *UG*[73], the Italian *SRLS*[74] and the Spanish *sociedad limitada de formaciòn sucesiva* (*SLFS*)[75]—and the provisions regarding specific legal reserves. As regards the latter, the *UG* shall constitute a revenue reserve amounting to 25% of the profits referable to the reporting period[76], while the Spanish *SLFS* shall constitute a revenue reserve amounting to 20% of the profits[77]. Moreover, the *SLFS* can pay dividends only if the statement of financial position shows a net assets/capital share ratio amounting at least to 60%[78].

That is not all: the abovementioned forms of companies share many other similarities. As regards to the rights of shareholders, under the UK *Companies Act 2006* the annual general meeting of a *Ltd* is not anymore mandatory, and the same

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sociale, nonché in materia di Imposta sul valore aggiunto (IVA) e altre misure finanziarie urgenti. (13G00123) (GU Serie Generale n.150 del 28-06-2013), Article 9, paragraph 15-ter, amending *Codice Civile*, Article 2463.

[72] *Código das Sociedades Comerciais*, Decree law no. 262/86, dated September 2, as amended by Decree law no. 64/2009.

[73] Pursuant to paragraph 5a(1) of the *Gesetz betreffend die Gesellschaften mit beschränkter Haftung* (*GmbHG*) the name of the company shall include '*Unternehmergesellschaft*'.

[74] Codice civile, Article 2463-bis(4).

[75] This legal form was introduced in Spain by the *Ley 14/2013, de 27 de septiembre, de apoyo a los emprendedores y su internacionalización*, which amended Articles 4, 5, and 23 and introduced Article 4.bis of the the *Ley de sociedades de Capital*, approved through the *Real Decreto Legislativo 1/2010 de 2 de julio 2010*. Pursuant to new Article 4 the *SLFS* does not have to comply with the minimum capital requirement of EUR 3,000 normally requested for the *Sociedad de responsabilidad limitada*, in fact *'[...] podrán constituirse sociedades de responsabilidad limitada con una cifra de capital social inferior al mínimo legal [...]'*.

[76] *GmbHG*, paragraph 5a(3).

[77] *Ley 14/2013*, Article 4.bis(1)(a); the same reserve shall be constituted by the Italian *SRL a capitale ridotto* under Article 2463(5) of the *Codice civile*, adding 1/5 of the profits for the year until the reserve, together with the legal capital, reaches the sum of EUR 10,000 (which is the ordinary minimum capital requirement for the *SRL*). On the same line of reasoning, when the legal capital of a UG reaches the threshold of EUR 25,000, that company automatically becomes a GmbH.

[78] Ibid, Article 4.bis(1)(b); a general overview on reserves and financial ratios is provided by P. ATRILL, E. MCLANEY, *Accounting and Finance for Non-Specialists*, Pearson, 10th edn., 2017, pp. 130-132, 195-246.

applies for the German *UG*, apart from when it is called by 10% of the shareholders, which is the same threshold set for the French *SARL*. In addition, in the UK *Ltd*, the German *UG*, the Italian *SRLS*, and the French *SARL*, it is possible that the function of the general meeting is replaced by written resolutions of the shareholders, with *quorum* requirements identical to those of the general meeting[79].

Furthermore, strong similarities can also be found in the provisions allowing one natural person to be the only shareholder of this type of company and at the same time to benefit from the limitation of liability. In this case, however, general minimum standards had already been provided by the *Twelfth Company law Directive* and were later codified in Directive 2009/102[80]. Examples of single member companies are the Italian *SRL unipersonale* and the Spanish *Sociedad Unipersonal*.

Lastly, all the aforementioned forms of companies benefit from a series of accounting and fiscal benefits—not closely related to corporate governance matters—that are aimed at incentivising the competitiveness of small businesses. Indeed, those legal forms are often[81] the default model for the creation of start-ups and innovative enterprises, which, for the very reason of being constituted in such forms and meeting certain other requirements, gain access to preferential regimes.

At the EU level, the need for a 'European Private Company' (EPC) was for the first time acknowledged by the Commission's *Action Plan 2003*, as the *High Level Group of Company Law Experts* (so called 'Winter Group') had noted in its report[82] that the *Societas Europaea* could not respond to the need of SMEs, which have traditionally constituted the majority of businesses across the EU[83]. In

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[79] This rule is contained in provisions which are almost identical to each other: *Companies Act 2006*, Part 13 Chapter 2; *GmbHG*, paragraph 48(2); *Codice civile*, Article 2479(3); *Code de Commerce*, Article L223-27(1).

[80] Directive (EC) 2009/102 of the European Parliament and of the Council of 16 September 2009 in the area of company law on single-member private limited liability companies [2009] OJ L 258. Annex I of the directive lists the type of companies to which the Directive applies: they are UK ltd and its counterparts named in the paragraph.

[81] For example, in Germany and in Italy.

[82] The Winter Group was a committee of experts nominated by the Commission. On 4 November 2002 the Group issued its *Report of the High Level Group of Company Law Experts a Modern Regulatory Framework for Company Law in Europe.*

[83] According to the European Commission's website, available at <https://ec.europa.eu/growth/smes_en>, *'small and medium-sized enterprises are the backbone of Europe's economy. They represent 99% of all businesses in the EU. They employ around 100 million*

particular, in the *Action Plan* the Commission observed that *this 'new legal form at EU level […] would primarily serve the needs of SMEs which are active in more than one Member State'*[84]. However, as *'the Group nevertheless observed that the first priority should be to adopt the Tenth Directive on cross-border mergers'*, the Commission postponed the adoption of any measure and limited itself to launching a feasibility study including *'an in-depth analysis of the legal, tax and social policy regimes relevant to SMEs'*.

Consequently, it was only in 2008 that the Commission presented its *Proposal for a Council Regulation on the statute for a European private company*[85], or *Societas Privata Europaea* (SPE), in the context of a wider package named 'Small Business Act for Europe'. The objective of the proposal was the enhancement of the competitiveness of SMEs, through the facilitation of their establishment and the reduction of compliance costs, aside from aspects of labour law, tax law[86], accounting, or insolvency.

The most discussed elements of the proposal were four: *(i)* the cross-border element; *(ii)* the minimum capital requirement; *(iii)* the possibility of splitting the registered office and the headquarters in different jurisdictions; and *(iv)* the rules governing employee participation at board level.

First, *(i)* the proposal did not require any mandatory cross-border element[87]. Second, *(ii)* the minimum capital threshold was set at EUR 1[88], consistently with the recent development of the private limited companies across the Member States. Third, *(iii)* the SPE would not have been *'under any obligation to have its central*

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people, account for more than half of Europe's GDP and play a key role in adding value in every sector of the economy'.

[84] *Action Plan 2003*, paragraph 3.5.

[85] COM/2008/0396 final, 2008.

[86] It was highlighted, however, that *'the choice of SPE as a legal form to conduct business activities in the EU should [have] be[en] neutral from a tax perspective'*.

[87] According to paragraph 4 of the Explanatory Memorandum, '*the proposal aims to make the Single Market more accessible to SMEs by providing them with an instrument that facilitates the expansion of their activities in other Member States. However, the proposal does not make the creation of an SPE subject to a cross-border requirement (e.g. shareholders from different Member States or evidence of cross-border activity). In practice, entrepreneurs usually set up businesses in their own Member State before expanding to other countries. An initial cross-border requirement would, therefore, significantly reduce the potential of the instrument. In addition, a cross-border requirement could easily be circumvented and monitoring and enforcing it would put an unreasonable burden on Member States'*.

[88] *Proposal for a EPC*, Article 19(4).

administration or principal place of business in the Member State in which it has its registered office'[89]. Fourth, *(iv)* the participation of employees would have been governed by national rules of Member States of the place of incorporation, combined with specific rules in the case of cross-border mergers and seat transfers. Those specific rules were inspired by the *SE Directive*, in turn inspired by German company law, and would have applied *'where the employees of the SPE in the home Member State account[ed] for at least one third of the total number of employees of the SPE including subsidiaries or branches of the SPE in any Member State'*[90].

The first Member State showing concerns about the content of the proposal was France, a country traditionally adhering to the *siège reel* (real seat) doctrine. In particular, the French presidency of the Council proposed[91] a new Article 7 which would have not allowed the split between the registered office and the real seat *(iii)*. Instead, the amended proposal opted for a seat *'governed by national law in accordance with Community law'*.

Moreover, in March 2009 the European Parliament adopted a resolution[92] by which it called on the Commission *'to initiate a consultation with the social partners, with a view to evaluating and where necessary streamlining, creating or reinforcing the provisions for employees' participation in the internal market'*. The subsequent resolution[93] of the Parliament on the *Proposal* contained a series of changes as regards the four abovementioned crucial elements. First off, *(i)* it required a cross-border element, demonstrated by either a cross-border business intention or corporate object, an objective to be significantly active in more than one Member State, establishments in different Member States, or a parent company registered in another Member State[94]. Additionally, *(ii)* the amended proposal

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[89] Ibid, Article 7(2).
[90] *Proposal for a EPC*, Article 38(2).
[91] COUNCIL OF THE EUROPEAN UNION, *Interinstitutional File*, 2008/0130 (CNS), 11 December 2008.
[92] EUROPEAN PARLIAMENT, Resolution of 12 March 2009 on employees' participation in companies with a European statute and other accompanying measures, 2009.
[93] EUROPEAN PARLIAMENT, *Legislative resolution of 10 March 2009 on the proposal for a Council regulation on the Statute for a European private company*, 2009.
[94] Ibid, amended Article 10(2); indeed, the amended recital 2(a) observed that *'existing Community forms of company have a cross-border component. That cross-border component should not be an obstacle for the founding of a European private company (SPE). The Commission and Member States should, however, without prejudice to the requirements of registration and within two years of registration, conduct ex-post monitoring in order to examine whether the SPE has the required cross-border component'*.

allowed the minimum capital threshold to be lowered to EUR 1 only where *'the articles of association require that the executive management body sign a solvency certificate'*, otherwise providing that the threshold should have been set at EUR 8,000[95]. Furthermore, *(iii)* the Parliament disagreed with the Council's French presidency's proposal and thus endorsed the possibility of splitting the real seat and the registered office under Article 7(2). Lastly, *(iv)* the Parliament changed the condition under which the *SE Directive* should have been applicable to govern the employee participation, introducing new quantitative thresholds[96].

Between April 2009 and May 2011 seven compromise proposals were issued by Czech, Swedish, and Hungarian presidencies, but no agreement was reached on the four main matters. Therefore, the Commission decided to focus on a fourteenth company law directive and eventually withdrew the proposal in 2014[97].

Therefore, private limited companies and their equivalent counterparts across the Member States remain formally non-harmonised on a path of national dependence, although the needs they try to satisfy are almost identical and thus their main features are very similar (providing for limited liability but at the same time governance structures and shareholder rights close to those of partnerships) thanks to a simultaneous process of transnational convergence.

In particular, Member States' lawmakers have traditionally set a precise limit: those companies shall not have access to public capital markets. This limit was first overcome by the Italian legislator, who allowed the *SRL* to issue *titoli di*

[95] Ibid, amended Article 19(4).
[96] Ibid, amended Article 34(1a).
[97] EUROPEAN COMMISSION, *Withdrawal of obsolete Commission proposals* [2014] OJ C 153. See also GHETTI, *Unification, Harmonisation and Competition in European Company Forms*, cit, pp. 828-829, there the author points out that *'the failure of the SPE project was not due to lack of demand for a unified legal form for small companies'* and thus *'the Commission put forward a new proposal for a Societas Unius Personae'* through two public consultations and an impact assessment. However, the Commission announced that the proposal would be withdrawn, which it formally did on 3 July 2018.

debito[98] in 2003, and then in 2012[99] and 2014[100] provided some *SRL*s, especially innovative SMEs and start-ups, with new means to access capital markets: minibonds, financial bills, convertible bonds, work for equity, stock options, equity-based crowdfunding, participative financial instruments[101].

The need to combat the historical problem of insufficient liquidity and undercapitalisation[102] of SMEs and to emancipate those businesses from dependence on bank lending has been recently addressed by the EU. In particular, in 2015 the Juncker Commission launched the Capital Markets Union (CMU) policy[103]. Significantly, amongst the priorities there was the enhancement of financing for innovation, start-ups and non-listed companies. The Commission and the Parliament pointed out that SME Growth Markets, a new category of trading venue introduced by *MiFiD II*[104], were still relatively unexplored, especially when considering that *'data suggest that newly listed SMEs in such venues tend to outperform other private companies as regards both overall growth and job generation'*[105]. Thus, in order to facilitate the access of SMEs to capital markets,

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[98] *Titoli di debito* are debt securities. They can be issued pursuant to Article 2483 of the Codice civile. However, they have been largely unsuccessful, because they could only be traded by institutional inverstors, who are liable for the insolvency of the SRL should they decide to trade those securities with non-institutional investors. Moreover, these securities shall have a minimum nominal value of EUR 50,000. See G. F. CAMPOBASSO, *Diritto Commerciale. Diritto delle Società (vol. 2)*, UTET, 2nd edn, 2015, pp. 562-564.

[99] *Decreto-Legge 22 giugno 2012, n. 83.*

[100] *Decreto-Legge 24 giugno 2014, n. 91***,** *Disposizioni urgenti per il settore agricolo, la tutela ambientale e l'efficientamento energetico dell'edilizia scolastica e universitaria, il rilancio e lo sviluppo delle imprese, il contenimento dei costi gravanti sulle tariffe elettriche, nonché per la definizione immediata di adempimenti derivanti dalla normativa europea* (so called *Decreto Competitività*).

[101] In particular, Article 26(5) of the *Decreto-Legge 179/2012* as amended by Article 57 of the *Decreto-Legge 50/2017* allows all SMEs (defined as those companies constituted as *SRL*s which remain below the threshold set by Article 2(1)(f) of Regulation (EU) 2017/1129) to offer their shares to the public on online platforms, openly derogating to Article 2468(1) of the Codice civile, which instead states that '*le partecipazioni dei soci non possono essere rappresentate da azioni né costituire oggetto di offerta al pubblico di prodotti finanziari*'.

[102] On this topic, see also the *'Allowance for Growth and Investment'* proposed by the Commission and analysed below in paragraph 3.2.3.

[103] See EUROPEAN COMMISSION, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions. *Action Plan on Building a Capital Markets Union*, COM/2015/468 final, 2015.

[104] Directive (EU) 2014/65 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast) [2014] OJ L 173; Article 33(3)(a) of the directive describe Growth Markets as *'Multilateral Trading Facilities'* where *'at least 50 % of the issuers whose financial instruments are admitted to trading [...] are SMEs'.*

[105] EUROPEAN PARLIAMENTARY RESEARCH SERVICE, *Enabling SMEs' access to capital markets*, 2019.

the administrative requirements and the quantitative thresholds provided for the access to SME Growth Markets have been lowered by Regulation 2019/2115[106]. However, the access to those markets necessarily entails going public, i.e. issuing shares through an IPO, something that is not compatible with the form of private limited companies allowed across the Member States.

In conclusion, regulatory competition in the context of legal forms seems to shed the light on the concrete intertwinement between market features and corporate governance rules. Regulatory arbitrage in this field has triggered a mechanism which, in turn, has provided companies with governance structures that are more suitable for their purposes. As observed by literature, competition amongst Member States *'appears to be producing more successful company forms in spontaneous fashion'*[107].

2.3.2 Minimum capital requirement and protection of creditors after *Centros*: a new perspective on the phenomenon of undercapitalisation

The essential facts of *Centros* have been described above in Chapter I, where it has been said that Danish authorities held that Centros Ltd was trying to evade Danish law on minimum capital. The question referred to the Court was related to the compatibility with freedom of establishment of the registration of a branch of a *'company which has its registered office in another Member State and has been lawfully funded with company capital of GBP 100 (approximately DKK 1,000) [...] where, instead of incorporating a company in the latter Member State, that procedure must be regarded as having been employed in order to avoid paying up company capital of not less than DKK 200,000 (at present DKR 125 000)'*[108].

First of all, the Court took advantage of the opportunity to clarify the functions of minimum capital requirement: the protection of public creditors, as they *'they cannot secure those debts by means of guarantees'*, and the protection of creditors in general (thus public and private ones), especially *'by anticipating the*

[106] Regulation (EU) 2019/2115 of the European Parliament and of the Council of 27 November 2019 amending Directive 2014/65/EU and Regulations (EU) No 596/2014 and (EU) 2017/1129 as regards the promotion of the use of SME growth markets [2019] OJ L 320.
[107] GHETTI, *Unification, Harmonisation and Competition in European Company Forms*, cit, p. 841.
[108] *Centros*, para 13.

risk of fraudulent bankruptcy due to the insolvency of companies whose initial capitalisation was inadequate'[109].

The problem of the inadequate capitalisation of private companies, especially family-owned businesses, is a direct consequence of the gradual process of lowering the minimum capital requirement observed in the previous paragraph. An example worth mentioning is provided by Italy, where the legislator—in the context of the 2003 reform of company law[110]—amended Article 2467 of the *Codice civile* to combat undercapitalisation of companies registered as *SRL*. The new mechanism provided by Italian law is called *postergazione*[111] and it entails that the refund of loans received by shareholders shall happen only after the other creditors are satisfied[112]. The rules apply when the gearing ratio[113] shows a high level of debt and more in general when a capital injection in the form of equity appears more *'reasonable'*[114] than one in the form of debt.

Going back to *Centros* ruling, however, the measure adopted by Danish authorities in that case was deemed to be unsuitable to protect creditors. The Court believed that the Danish refusal to registrar the branch was *'not such as to attain the objective of protecting creditors [...] since if the company concerned had conducted business in the United Kingdom, its branch would have been registered in Denmark, even though Danish creditors might have been equally exposed to risk'*[115]. Moreover, the Court believed that less restrictive means, *'which interfere less with fundamental freedoms, by, for example, making it possible in law for*

[109] Ibid, para 32.
[110] *Decreto Legislativo 17 gennaio 2003, n.6, Riforma organica della disciplina delle società di capitali e società cooperative, in attuazione della legge 3 ottobre 2001, n. 366 (G.U. n. 17 del 22-1-2003- Suppl. Ordinario n.8).*
[111] The provision is analysed by CAMPOBASSO, *Diritto Commerciale*, cit, pp. 560-561, where the author observes that this rule cannot be regarded as a coercive conversion of those sums from equity to debt, but it is instead a degradation of the position of those creditors who are also shareholders of the company which benefits from the loan.
[112] However, in order to face the emergency situation caused by the coronavirus pandemic, this rule has been temporarily frozen by the *Decreto-Legge 8 aprile 2020, n. 23*, *Misure urgenti in materia di accesso al credito e di adempimenti fiscali per le imprese, di poteri speciali nei settori strategici, nonché interventi in materia di salute e lavoro, di proroga di termini amministrativi e processuali (20G00043) (GU Serie Generale n.94 del 08-04-2020),* Article 8.
[113] This financial ratio, also known as 'debt-to-equity (D/E)', 'risk', or 'leverage' ratio, is explained in ATRILL, MCLANEY, *Accounting and Finance for Non-Specialists*, cit, p. 224. It considers the relationship between debt and equity.
[114] *Codice civile*, Article 2467(2), which uses the word *'ragionevole'.*
[115] *Centros*, para 35.

public creditors to obtain the necessary guarantees'[116], could be used to pursue the same aim.

After *Centros*, Member States' rules regarding minimum capital have been highly criticised by commentators[117], who not only argued that the legal capital doctrine does not protect creditors[118], but also that it imposes costs on companies[119] and even on some creditors[120]. According to those critiques the fact that legal capital is substantially a fixed asset hinders the optimal allocation of goods[121]. In 2002, the aforementioned report issued by the Winter Group highlighted the need for flexibility and simplification of the rules regarding, amongst others, capital requirements, inspired by the American *Model Business Corporation Act*.

Whereas for private limited companies minimum capital requirements have followed the abovementioned path of consistent lowering without any form of positive harmonisation at an EU level[122], the minimum capital requirement for public limited companies was set at *'25,000 European units of account'*[123] by

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[116] Ibid, para 37.

[117] See L. ENRIQUES, J. R. MACEY, *Creditors Versus Capital Formation: The Case against the European Legal Capital Rules*, in *Cornell Law Review*, 86, 6, 2001, pp. 1165 et seq; see also J. ARMOUR, *Legal Capital: An Outdated Concept?*, in *European Business Organization Law Review*, 7, 1, 2006, p. 5, and W. SCHÖN, *The Future of Legal Capital*, in *European Business Organization Law Review*, 5, 3, 2004, p. 429.

[118] See ENRIQUES, MACEY, *Creditors Versus Capital Formation*, cit, p. 1186: *'the legal capital doctrine assumes, falsely, that the fixed amount of a firm's legal capital informs current and potential creditors of the resources that a firm possesses and may not freely distribute to its shareholders. In the real world, however, creditors (and potential creditors) care neither about these resources nor about the legal capital rules that are supposed to signal these resources'.*

[119] See ibid, p. 1195: *'the European rules are costly in that they delay company formation and increases of capital through the issuance of new shares [...]'.*

[120] See ibid, p. 1198: *'some creditors [...] would prefer to bear a higher risk of default in exchange for a higher return on their investment. Thus, the legal capital rules benefit risk-averse lenders (like banks) that prefer low-risk and lower-return investments, not risk-preferring capital providers (like finance companies, private equity investors, or venture capitalists) that prefer higher-risk investments because of the higher returns associated with such investments'.*

[121] It was noticed *supra* in paragraph 1.2.1 that the optimal allocation of the factors of production is one of the main purposes pursued across the EU through the implementation of the four freedoms.

[122] See also M. ANDENAS, F. WOOLDRIDGE, *European Comparative Company Law*, Cambridge: Cambridge University Press, 2009, p. 1, where the authors observe that *'the prospect of regulatory competition increasing the number of domestic businesses incorporating abroad, has increased the pressure to reduce capital requirements'.*

[123] It is important to bear in mind that the Directive only set a minimum standard. Therefore, Member States are free to opt for higher thresholds. The *'European units of account'* were calculated pursuant to Decision (ECSC) 3289/75 of the Commission of 18 December 1975 on the definition and conversion of the unit of account to be used in decisions, recommendations, opinions and communications for the purposes of the Treaty establishing the European Coal and Steel Community [1975] OJ L 327.

Article 6(1) of the *Second company law Directive*[124]. The provision was later reproduced in Article 6(1) of Directive 2012/30 (now Article 45(1) of Directive 2017/1132), which accordingly sets the minimum capital requirement at EUR 25,000. In addition, pursuant to Article 6(2) of Directive 2012/30 (now Article 45(2) of Directive 2017/1132), *'every five years the European Parliament and the Council [...] shall examine and, if need be, revise the amount expressed in paragraph 1 in euro in the light of economic and monetary trends in the Union and of the tendency to allow only large and medium-sized undertakings to opt for the types of company listed in Annex I'*[125].

The rationale behind the difference between public and private companies' capital rules is expressed in recitals 2 and 3 of Directive 2017/1132. Accordingly, *'in order to ensure minimum equivalent protection for both shareholders and creditors of public limited liability companies, the coordination of national provisions relating to their formation and to the maintenance, increase or reduction of their capital is particularly important'* and it is *'especially important in relation to public limited liability companies, because their activities predominate in the economy of the Member States and frequently extend beyond their national boundaries'.*

In summary, aside from the aforesaid criticisms about legal capital rules, it can be noticed that the European legislator has been more concerned about the convergence of legal capital rules for public companies rather than about minimum requirements for private companies—for the latter the process of convergence has been left to the spontaneous action of regulatory competition—albeit three significant factors. Firstly, the problem of undercapitalisation usually involves small-sized companies, more likely to be formed as private companies, while public companies are normally provided with significant capital injections for the very reasons explained by the aforementioned recitals 2 and 3 of directive 2017/1132. Secondly, it might be argued that those reasons are in partial contradiction with the primacy of SMEs across the EU, which, as said before, has often been recalled by

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[124] It is important to bear in mind that the Directive only set a minimum standard. Therefore, Member States are free to opt for higher thresholds.
[125] Annex I concerns the various forms of public limited companies and their similar counterparts allowed by each Member State.

the Commission itself. Lastly, the threshold of EUR 25,000 does not seem high enough to provide any significant guarantee for creditors. Interestingly, in fact, the EU itself has set the minimum capital requirement for the *Societas Europaea* at the higher threshold EUR 120,000[126].

In conclusion, in respect of minimum capital requirements, the effects of regulatory competition, which are necessarily influenced by the concrete economic context in which undertakings carry out their business, seem to have proved more successful than the harmonising action of EU legislation in providing companies with efficient corporate rules.

2.3.3 How control-enhancing mechanisms are implemented across the EU: non-voting preference shares, multiple voting shares, and loyalty shares

Non-voting preference shares, multiple voting shares (MVS) and loyalty shares are control-enhancing mechanisms which have been criticised for increasing the risk of distorted decisions and of the tunnelling of companies' assets[127]. Depriving some shares of their voting rights and allowing some others to confer multiple voting rights are derogations from the 'one share, one vote' principle, which grants to external investors an influence on the business proportional to their stake. Control-enhancing mechanisms, instead, are aimed at granting the stability of ownership, which might be crucial to ensure long-term profits and to bring thus benefits to both shareholders and various types of stakeholders.

Common law systems, that typically belong to countries which adopt liberal policies, have traditionally allowed control-enhancing mechanisms such as dual class structures[128], in the spirit of contractual freedom. The *UK Companies Act*

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[126] *SE Regulation*, Article 4(2). It must be noticed, however, that the high costs for the formation of a *Societas Europeaea* have been deemed to be one of the main reasons for its limited success. See, amongst others, EIDENMÜLLER, ENGERT, HORNUF, *Incorporating Under European Law*, cit, p. 32, and MANNAN, WUISMAN, *Freedom of Establishment for Companies in Europe (EU/EEA)*, cit, p. 111, GHETTI, *Unification, Harmonisation and Competition in European Company Forms*, cit, p. 825.

[127] Those critiques are reported by C. GERNER-BEUERLE, M. SCHILLING, *Comparative Company Law*, Oxford: Oxford University Press, 2019, pp. 384 et seq.

[128] Dual class structures allow a company to issue both voting and non-voting shares. The latter are normally 'preference' shares that compensate the reduced administrative rights with the enhancement of economic rights, such as preference in case of distribution of dividends.

2006, inspired by the *Delaware General Corporation Law*[129], allows companies to adopt both voting and non-voting preference shares, and it also allows—even though the matter has been controversial[130]—multiple voting shares. However, MVS are not common in the UK. The reason is probably that, as noticed above, the UK is an outsider system, which favours a fragmented ownership and the predominance of institutional investors, who are normally not attracted by companies issuing that type of shares. In particular, the *Listing Rules* issued by the Financial Conduct Authority introduce constraints and additional safeguards[131] for outside investors on the listing of companies with control-enhancing mechanisms, especially when those companies are willing to access the premium segment of the stock market.

The approach to the matter in continental Europe is significantly different. In Germany, MVS—which had already been subject to many constraints and restrictions such as a mandatory ministerial authorisation—were prohibited in 1998 by the *Stock Corporation Act* (*AktG*)[132]. Instead, German law allows the articles of association to provide for voting caps[133], but only if the company is not listed on a regulated market. Section 134(1) of the *AktG*, moreover, prohibits voting caps imposed on individuals, in order to prevent the avoidance of the rules regarding

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[129] Title 8, Chapter 1 of the *Delaware Code*. It is the statute governing corporate law in Delaware**.**

[130] For an overview on this topic, see GERNER-BEUERLE, SCHILLING, *Comparative Company Law*, cit, p. 386.

[131] An example is the mandatory appointment of independent directors by minority shareholders under *Listing Rules* 6.1.4B(2) and 9.2.2E.

[132] See *Stock Corporation Act*, section 12(2), amended by *Gesetz zur Kontrolle und Transparenz im Unternehmensbereich* (*KonTraG*), 1998, Article 1(3). However, companies are allowed to adopt a dual structure of voting and non-voting preference shares.

[133] In the *Volkswagen* case (2007), cit *supra*, a landmark case in the field of golden shares, the ECJ held that even though *'the capping of voting rights is a common instrument of company law, also used in other Member States'* (para 31), the legal framework (in that case a specific German law called 'VW Law' which at the same time capped voting rights to 20%, required a majority of over 80% of the company's capital for the adoption of certain decisions by the general assembly, and allowed the State to appoint two members of the supervisory board) cannot enable State authorities *'to exercise considerable influence on the basis of such a reduced investment'* (para 51). Otherwise, such a legal framework would be, in fact, incompatible with Article 63 TFEU, thus breaching free movement of capital. As the Court noticed, indeed, *'by limiting the possibility for other shareholders to participate in the company with a view to establishing or maintaining lasting and direct economic links with it which would make possible effective participation in the management of that company or in its control, this situation is liable to deter direct investors from other Member States'* (para 52). An overview on golden shares is provided by GALLO, *On the Content and Scope of National and European Solidarity*, cit, pp. 827-838, and M. CLARICH, *Manuale di diritto amministrativo*, Il Mulino, 3rd edn, 2017, pp. 360-361.

control-enhancing mechanisms. As a matter of fact, applying voting caps to some individuals but not to others would have in practice the same effect of allowing MVS. However, distinguishing between classes of shares, by applying voting caps only to some of them, is not prohibited.

The principle of equality amongst shareholders is also a traditional part of French company law[134]. Non-voting preference stocks (*actions de préférence sans droit de vote*) were introduced in 1978 but only for up to 25 per cent of the legal capital and as long as they carried increased dividend rights. However, the dual-class regime was only effectively implemented and rendered attractive in 2004[135]. Thanks to its reform, today French company law only requires that non-voting preference shares do not represent more than the half of the share capital. It is also possible to provide for voting caps in the articles of association. However, those shall apply to all shares, preventing discrimination amongst shareholders on the same line of reasoning of German law. In fact, French law goes even further as it does not allow the distinction between classes of shares for the purpose of setting voting caps[136].

Recently, the strict adherence to the 'one share, one vote' principle has been further mitigated in continental Europe. As capital markets have been consistently more affected by short-termism[137] and speculative strategies, legislators have looked for adequate tools for incentivising long-period investments. Accordingly, the main idea was to increase administrative rights (voting rights) in proportion to the duration of the ownership of the share (normally referring to the uninterrupted period during which common shares were registered in the so called 'loyalty register'). The ultimate result of this search has been the adoption of the so called 'loyalty shares'. Unlike MVS, loyalty shares do not necessarily belong to a special

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[134] See *Code de Commerce*, Article L225-122(1): *'[...] le droit de vote attaché aux actions de capital ou de jouissance est proportionnel à la quotité de capital qu'elles représentent et chaque action donne droit à une voix au moins*'.

[135] *Ordonnance n° 2004-604 du 24 juin 2004 portant réforme du régime des valeurs mobilières émises par les sociétés commerciales et extension à l'outre-mer de dispositions ayant modifié la législation commerciale*.

[136] Pursuant to the *Code de Commerce*, Article L225-125, '*les statuts peuvent limiter le nombre de voix dont chaque actionnaire dispose dans les assemblées, sous la condition que cette limitation soit imposée à toutes les actions sans distinction de catégorie, autres que les actions à dividende prioritaire sans droit de vote*'.

[137] At the Brussels ECGI roundtable of 18 June 2018 *'Loyalty shares'*, Z. SAUTNER defined *'short-termism'* as *'taking measures that increase short-term performance at the cost of long-term value'*.

class of shares[138]: they can also be common shares owned by an individual shareholder to whom some voting privileges are assigned. Hence, those shares are not capable of transferring those privileges when they are transferred to a different owner[139]. Loyalty shares *'attribute to their long-term holders increased voting rights'*[140] and have two main aims: first, they facilitate the listing of shares and the increase of the float stock, so that shareholders are provided with a new defensive instrument against hostile takeovers, especially in the context of IPOs; second, loyalty shares incentivise stable ownership of shareholders, in order to allow the management to set long-term goals for the development of the company.

In the Netherlands, the implementation of a loyalty—*in casu* loyalty dividends—scheme was for the first time announced by the company Koninklijke DSM N.V. (DSM) in 2006. The plan of DSM was challenged by many investors on the ground of the shareholders' equality principle contained in Section 2:92, paragraph 1 of the Dutch Civil Code (*Burgerlijk Wetboek*). Even though loyalty shares were eventually never implemented by DSM, in 2007 the Dutch Supreme Court (*Hoge Raad der Nederlanden*)[141] ruled that *'this provision does not contain a* per se *prohibition on financial differentiation between shareholders in the articles of association (even without creating a separate class of shares) provided that the arrangement does not contravene the general principle of equal treatment of shareholders'*[142]. Therefore, according to the *Hoge Raad*, the equality principle only applies to shareholders who are in the same position and thus need to be treated equally in equal circumstances. Hence, loyalty shares schemes should be in principle allowed, provided that all shareholders could, in theory, meet the requirements to access those schemes. Since that fundamental judgement, loyalty

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[138] On this important difference, see CAMPOBASSO, *Diritto Commerciale*, cit, p. 208, and GERNER-BEUERLE, SCHILLING, *Comparative Company Law*, cit, p. 390.
[139] Save for the case of death of the shareholder, when the privilege can be inherited together with the inherited shares in countries like Italy.
[140] M. VENTORUZZO, *The Disappearing Taboo of Multiple Voting Shares: Regulatory Responses to the Migration of Chrysler-Fiat*, European Corporate Governance Institute, Working Paper n. 288, 2015, p. 1.
[141] Rek.nr. 07/11510, 14 December 2007 [2007] ECLI: NL: HR: 2007: BB3523 on the appeal proposed by the public prosecutor in the interest of the law against the judgement of the *Amsterdam Gerechtshof* (Amsterdam Court of Appeal) in *Claimants v. Koninklijke DSM N.V. and Vereniging van Effectenbezitters*, 28 March 2007 [2007] ECLI:NL:GHAMS:2007:BA1717.
[142] J. DELVOIE, C. CLOTTENS, *Accountability and short-termism: some notes on loyalty shares*, in *Law and Financial Markets Review*, 9, 1, 2015, p. 21.

shares schemes have been often implemented in the Netherlands (where MVS were already allowed) even in the absence of a specific legal basis in Dutch company law. In short, Dutch law does not restrict companies from putting in their articles, at their discretion, loyalty shares schemes.

Following the Dutch path, an important step for continental Europe was taken by France in 2014 through its *Loi Florange*[143]. Thanks to the intervention of the French legislator, now the *Code de Commerce* allows—and in the case of listed companies it becomes even a default rule, unless disapplied by a resolution adopted by a qualified majority of two thirds of the shareholders' meeting—the doubling of voting rights for shareholders that have held their shares for at least two years[144].

In contrast, Italy, which has historically adhered to the stricter German interpretation of the 'one share, one vote' principle, allowed non-voting preference shares for non-listed companies[145] only in 2003 through its reform of company law. That reform, however, maintained the prohibition of MVS and loyalty shares.

On 1 August 2014, a few months after the French reform, the Italian company Chrysler-Fiat reincorporated in the Netherlands, also to take advantage of the control-enhancing system provided by Dutch law. Indeed, the company immediately issued 'special voting shares' to shareholders who had kept their shares for at least three years. Ten days later, in reaction to the *'shock of losing one of its better-known national champions'*[146], the Italian legislator converted into law[147] the so called *Decreto Competitività*. The new decree introduced MVS (up to a maximum of three votes per share) for non-listed companies[148], even allowing

[143] *Loi n° 2014-384 du 29 mars 2014 visant à reconquérir l'économie réelle*; however, shares carrying loyalty dividends had been allowed since 1994 in Article L232-14 of the *Code de Commerce*.

[144] *Code de Commerce*, Article L225-123(1) provides that '*un droit de vote double de celui conféré aux autres actions, eu égard à la quotité de capital social qu'elles représentent, peut être attribué, par les statuts à toutes les actions entièrement libérées pour lesquelles il sera justifié d'une inscription nominative, depuis deux ans au moins, au nom du même actionnaire*'.

[145] On the other hand, however, non-voting preference shares (*azioni di risparmio*) had been allowed for listed companies since 1974.

[146] VENTORUZZO, *The Disappearing Taboo of Multiple Voting Shares*, cit, p. 3.

[147] Law 11 august 2014, n. 116.

[148] In 2020, the so called *Decreto Rilancio* (*Decreto-Legge 19 maggio 2020, n. 34, Misure urgenti in materia di salute, sostegno al lavoro e all'economia, nonché di politiche sociali connesse all'emergenza epidemiologica da COVID-19*) has extended the faculty of issuing MVS also to listed companies. This rule has been provided in the context of a series of measures aimed at preventing the risk of hostile takeovers against Italian companies whose financial situation has been endangered by the pandemic crisis.

them to keep that voting structure once listed. Moreover, the decree introduced loyalty shares, allowing the articles of association to double voting rights of the shares held for at least 24 months by a shareholder[149]. Interestingly, while in France a qualified majority is required to derogate from the default loyalty shares scheme provided by the law ('opt-out' regime), in Italy a supermajority is instead required for the introduction of loyalty shares ('opt-in' regime).

Whereas a majority of scholars believes that the implementation of Italian loyalty shares was clearly stimulated by reasons of regulatory competition[150], there is also an alternative, minority view[151]: accordingly, the main reason for the reform was to protect Italian listed companies, whose capitalisation had been halved by the 2008 financial crisis, from hostile takeovers, and the aim of rendering the Italian system more attractive could only have had, if any, a secondary role. In particular, it is argued that there is no proven link between loyalty shares and corporate mobility. In fact, on the one hand, even after the introduction of loyalty shares other Italian companies such as Ferrari[152], Exor[153] and Campari[154] have migrated to the Netherlands and adopted 'special voting shares'. On the other hand, it is also

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[149] Article 127-*quinquies* of the *Decreto Legislativo 24 febbraio 1998, n. 58 (TUF)*, *Testo unico delle disposizioni in materia di intermediazione finanziaria*, provides that *'gli statuti possono disporre che sia attribuito voto maggiorato, fino a un massimo di due voti, per ciascuna azione appartenuta al medesimo soggetto per un periodo continuativo non inferiore a ventiquattro mesi [...]'*.

[150] This view is also supported by the name by which the reform has been called: '*competitività*' means 'competitiveness'. See also R. GALULLO, A. MINCUZZI, *Da Mediaset a Fiat-Chrysler: perché l'Olanda è il paradiso delle holding*, in *Il Sole 24 Ore*, 8 June 2019, available at <https://www.ilsole24ore.com/art/mediaset-fiat-chrysler-e-rolling-stones-ecco-perche-l-olanda-attrae-grande-business-ACLjeHP>.

[151] This theory is proposed by G. D. MOSCO, *Voto maggiorato: prime verifiche d'effettività e prospettive di riforma*, in NUZZO, PALAZZOLO (eds.), *Disciplina delle Società e Legislazione Bancaria*, cit, pp. 198, 200-203.

[152] In 2013 the Italian Ferrari S.p.A. was merged by absorption in the Dutch New Business Netherlands N.V., renamed Ferrari N.V. in 2015.

[153] In 2016 the Italian Exor S.p.A. was merged by absorption in the Exor Holding N.V., renamed Exor N.V.

[154] However, in 2020, when the Italian Davide Campari - Milano S.p.A. reincorporated in the Netherlands as Davide Campari - Milano N.V., in the press release *Campari Group Announces the Transfer of Registered Office of Davide Campari-Milano S.P.A to the Netherlands*, 2020, available at <https://www.camparigroup.com/en/campari-group-announces-transfer-registered-office-davide-campari-milano-spa-netherlands>, the group held that *'from a strategic standpoint, through the transfer of the registered office in the Netherlands and the simultaneous introduction of an enhanced voting rights mechanism compared to the current double voting rights mechanism already adopted by the Company, Campari intends to pursue the following objectives:* (i) *adopting a flexible share capital structure [...];* (ii) *rewarding long-term shareholders more effectively and extensively [...];* (iii) *benefitting from a highly recognized and appreciated corporate law framework by international investors and market operators [...]'*.

arguable that many other companies which might have benefited from other jurisdictions' flexible voting systems were not attracted enough to migrate.

The two theories are not necessarily incompatible. It is probably true that, even though control enhancing mechanisms are not *per se* a sufficient reason to justify corporate mobility, they can be one of those reasons. As such, they contribute to regulatory competition to the extent by which they are taken into account together with other factors discussed (i.e. taxation, other corporate governance matters) or mentioned (e.g. labour, capital market structure, antitrust policy, efficiency of the judicial system) in this work. Indeed, it cannot be denied that there is a strong relationship between control-enhancing systems and takeover law, and that the former can play an important role in the context of defensive strategies against hostile takeovers, rendering MVS and, especially, loyalty shares particularly attractive for controlling shareholders.

A new chapter of this saga has been recently opened by the judgement rendered by the Amsterdam Court of Appeal (*Gerechtshof*) on 1 September 2020 in *Mediaset* case[155]. Mediaset S.p.A. is an Italian mass media company controlled by the Italian holding Fininvest S.p.A., which holds 44% of Mediaset's shares. In 2016 Fininvest accused Vivendi S.A., a French company holding a 29% stake in Mediaset, of having adopted a fraudulent strategy in order to lower the stock price with the aim of facilitating the takeover of Mediaset[156]. This complex litigation has gradually reached an intricate multi-jurisdictional dimension. In particular, Vivendi has requested the *Amsterdam Gerechtshof* to block a cross-border merger by incorporation between Mediaset Italia and Mediaset España. The result of this merger, a newly incorporated Dutch holding entity[157], would be aimed at the creation of a European Media Hub. The new Dutch entity would adopt a loyalty shares scheme that, according to Vivendi, would unreasonably disadvantage the

[155] *Vivendi S.A. v. Mediaset Investment N.V.* [2020] ECLI:NL:GHAMS:2020:2379.
[156] F. GEROSA, *Mediaset, Vivendi e Simon chiedono l'iscrizione al registro del voto maggiorato in Olanda*, in *Milano Finanza*, 22 August 2019, available at <https://www.milanofinanza.it/news/mediaset-vivendi-e-simon-chiedono-l-iscrizione-al-registro-del-voto-maggiorato-in-olanda-201908221141104018>.
[157] B. CORNELISSE, M. S. DAMSTÉ, M. VAN AGT, B KEMP, P. HEZER, *Recent developments in Dutch loyalty share schemes*, 2020, available at <https://www.lexology.com/library/detail.aspx?g=f7198b73-a946-4a2e-95c5-8370d2733f2c>.

position of the French company. Surprisingly, the *Amsterdam Gerechtshof* agreed with Vivendi and blocked the merger.

Even though it is not clear yet whether or not this judgement will be capable of overruling the *DSM* judgement, it is possible to imagine that the adoption of loyalty shares schemes in the future will need careful justification in order to avoid the challenges coming from minority shareholders. In particular, the Dutch Court observes in the ruling that the aforementioned Section 2:92 of the Dutch Civil Code was aimed at the implementation of Article 42 of the *Second Company Law Directive* (now Article 85 of *Directive 2017/1132*), which states that *'the laws of the Member States shall ensure equal treatment to all shareholders who are in the same position'*. Therefore, the Dutch provision shall be interpreted by taking into account the CJEU case law, even when it is applied to subjects which do not immediately fall into the scope of the Directive. Consequently, given that loyalty shares schemes breach the principle of equality amongst shareholders, they need an objective justification. The justification, in addition, must meet the requirements of a four-prong test similar to the test provided by the ECJ[158] for the assessment of restrictive measures in the context of the four fundamental measures: *(i)* it must be introduced for a legitimate aim; *(ii)* it must be suitable for reaching that aim ('suitability' or 'appropriateness')[159]; *(iii)* it must be necessary, meaning that there must not be equally effective available means that would have a less negative impact on the position of shareholders ('necessity'); and *(iv)* it must be proportionate *strictu sensu*, meaning that the disadvantages it brings cannot outweigh the advantages, taking into account all the various interests involved that should be balanced ('balancing stage').

The decision of the Dutch court, however, is not satisfying with regards to a number of aspects. It is not clarified, for example, whether it is the scheme structure or the applicability of the scheme itself that should be scrutinised through this test. It can be thus whether the EU is aware of the growing need for uniform

[158] For an overview on the case law of the Court of Justice on the proportionality test see, amongst others, G. SCACCIA, *Proportionality and the Balancing of Rights in the Case-law of European Courts*, in *Federalismi.it*, 4, 2019, pp. 8 et seq.
[159] See KOSTA, *The Principle of Proportionality in EU Law*, cit, pp. 2-3, where the author observes that the distinction between the *(i)* and *(ii)* step is traditional of German law, whereas the ECJ normally considers them together.

rules on the matter. The answer to that question probably lies in the process that brought to the *Shareholder Rights Directive II* (*SHRD II*).

In particular, even though the report[160] drafted by the Reflection Group on the future of EU company law[161] recommended the adoption of a regulation seeking to incentivise long-term, stable shares ownership through instruments such as loyalty shares[162], neither the Commission's *Action Plan 2012* nor the subsequent *SHRD II*, which is aimed at encouraging shareholder engagement in the long-term, mention loyalty shares offering enhanced voting or dividend rights. This is true notwithstanding that, in its opinion on first reading, the European Parliament had proposed the amendment of recital 9(a) of the *SHRD II* providing that *'in order to encourage positive and long-term shareholder engagement, mechanisms incentivising long-term shareholding should be put in place'*[163]. Moreover, the Parliament had also gone further by proposing a new Article 3(e)(a) which explicitly mentioned loyalty shares, providing that a *'[...] Members State shall define the qualifying period in order to be considered a long-term shareholder, but this period shall not be less than two years. The mechanism [...] shall include one or more of the following advantages for long term shareholders: additional voting rights; tax incentives; loyalty dividends; loyalty shares'*[164]. It is not clear why the Parliament abandoned that position in its opinion on first reading in 2017.

Significantly, however, in the draft bill[165] recently issued by the Spanish Ministry of Economy loyalty shares are introduced in the *Ley de Sociedades de*

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[160] REFLECTION GROUP ON THE FUTURE OF EU COMPANY LAW, *Report of the Reflection Group on the future of EU company law*, Brussels, 5 April 2011, available at <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1851654>.

[161] The Group was established in 2010 by the Commission to provide a report for a conference to be held in Brussels during May 2011.

[162] See *Report of the Reflection Group on the future of EU company law*, paragraph 3.1.3 (*'Long term ownership'*): *'[...] The Group therefore feels that EU regulation should seek to secure that companies all across the EU have the option (clearly EU regulation would have an enabling character) to include clauses allowing for differential voting rights or additional profit distribution rights in their Articles of association'*.

[163] COMMITTEE ON LEGAL AFFAIRS OF THE EUROPEAN PARLIAMENT, *Report on the proposal for a directive of the European Parliament and of the Council amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EU as regards certain elements of the corporate governance statement*, 2015, amendment n. 6.

[164] Ibid, amendment n. 42.

[165] *Anteproyecto de Ley por la que se modifica el texto refundido de la Ley de Sociedades de Capital, aprobado por el Real Decreto Legislativo 1/2010, de 2 de julio, y otras normas financieras, para adaptarlas a la Directiva (UE) 2017/828 del Parlamento Europeo y del Consejo, de 17 de mayo de*

Capital within the context of the (albeit late) implementation of *SHRD II*. The draft bill, highly criticised by Spanish literature[166], follows the path given by Italy and proposes an 'opt-in' system. The Spanish case might suggest that, although the *SHRD II* does not explicitly concern them, loyalty shares are now considered by Member States a priority for the purposes and in the fields covered by the Directive.

Lastly, it has been noticed above[167] that takeover law is unavoidably involved in control-enhancing mechanisms and 'tenured voting' matters. Such involvement is confirmed, for example, by the fact that the aforementioned Italian *Decreto Competività*, introducing MVS and loyalty shares, was integrated with the revision of the Italian system of thresholds concerning mandatory public offers. The question that arises, indeed, is whether and how tenured voting should be considered when calculating those thresholds.

The *Takeover Bids Directive* does not include shareholders' agreement, which are another example of alteration of the relationship between ownership and control, amongst the events capable of triggering the public offer obligation[168]. However, in Italy and France the votes acquired thanks to control-enhancing mechanisms are taken into account in order to assess when the mandatory offer obligation arises. Consequently, it has been argued that *'tenured voting also represents a response to regulatory competition within Member States. In this respect, however, Europe is a special environment, where regulation—specifically, takeover regulation—strongly influences companies and shareholders to efficiently*

2017, por la que se modifica la Directiva 2007/36/CE en lo que respecta al fomento de la implicación a largo plazo de los accionistas.

[166] See, amongst the others, A. G. Martínez, *The Case Against the Implementation of Loyalty Shares in Spain*, in *Oxford Business Law Blog*, 2019, available at <https://www.law.ox.ac.uk/business-law-blog/blog/2019/07/case-against-implementation-loyalty-shares-spain>, J. C. González Vázquez, *The So-Called Loyalty Shares: An Unnecessary Mistake (Albeit An Avoidable One)*, in *The Corner*, 24 November 2020, available at <https://thecorner.eu/spain-economy/the-so-called-loyalty-shares-an-unnecessary-mistake-albeit-an-avoidable-one/90925/>.

[167] See also C. Mosca, *Should Shareholders Be Rewarded for Loyalty? European Experiments on the Wedge Between Tenured Voting and Takeover Law*, in *Michigan Business & Entrepreneurial Law Review*, 8, 2, 2019, pp. 272 et seq.

[168] Nevertheless, Article 5(1) of the Directive provides that *'where a natural or legal person, as a result of […] the acquisition by persons acting in concert with him/her, holds securities of a company […] which, added to any existing holdings […] of those securities of persons acting in concert with him/her, directly or indirectly give him/her a specified percentage of voting rights in that company, giving him/her control of that company, Member States shall ensure that such a person is required to make a bid as a means of protecting the minority shareholders of that company'*.

bargain in shaping the most appropriate structure of their voting power' and that *'deviations from the one share, one vote principle at the level of single Member States may require a tailor-made adaptation of the law, touching sensible areas for the integrity of the European market and bearing the risk of excessive fragmentation across Europe'*[169].

In conclusion, regulatory competition seems to have stimulated spontaneous transnational convergence in the field of control-enhancing mechanisms that has provided national company laws with efficient tools in order to enhance shareholding stability and tackle speculative short-termism. However, this phenomenon does not seem effective enough to satisfy the need for legal certainty and avoid potential harmful effects deriving from some crucial differences between Member States' corporate laws. Hence, with all of this taken into consideration, an intervention of harmonisation at the EU level, albeit not foreseen in the short-term, appears desirable.

2.4 *Concluding remarks. Corporate governance as an insufficient albeit complementary incentive for cross-border reincorporation*

It has been noted that *'there is no uniform assessment of company law harmonization in the European Union'*[170]. Indeed, literature is divided between those authors who believe that it has been a successful process and those who think instead that the European effort to regulate the subject has proved to be a failure[171].

It can be argued that the transnational convergence of corporate governance within the European context has often been limited by the significant room for manoeuvre conceded to national lawmakers. Consistent with the concept of 'reflexive governance', neither 'top-down' nor 'bottom-up' harmonisation have fully taken place.

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[169] Ibid, p. 280.

[170] GELTER, *EU Company Law Harmonisation*, cit, p. 3.

[171] Ibid; on the same topic see also J. N. GORDON, *Convergence and Persistence in Corporate Law and Governance*, in GORDON, RINGE (eds.), *The Oxford Handbook of Corporate Law and Governance*, cit, pp. 28 et seq.

On the one hand, pure 'top-down' harmonisation, such as the one provided by first-generation directives or by the *SE Regulation*[172], seems unsuitable to take into account the path dependence of corporate governance. Indeed, the shift from a German to a UK-inspired model, particularly evident after *Centros*, has not avoided the polarisation into two, sometimes competing, positions: outsider and insider systems. Whereas the premises are purely theoretical and concern the way in which company law looks at the corporate purpose, the outcomes of those different approaches can be seen in practice in the most part of legislative choices made by Member States. Therefore, even though *'the divergent EU countries were member states in a transnational federation with legislative and executive authority, which on many dimensions sought to "harmonize" local regimes'* and *'company law and corporate governance practices seemed a natural target'*[173] for that process of integration, practical cases have shown that the balance between transnational convergence and path dependence has not been found in a series of matters. Those matters, in turn, have provided companies with various available regimes they could opt for.

However, on the other hand, 'bottom-up' harmonisation, meaning in this case that companies could in theory all opt for the 'best' corporate governance structure offered across the EU, is hindered by the different features, strategies, and objectives that each company has. This path dependence, in fact, precludes the possibility of finding an absolute 'best' or 'most convenient' corporate governance. Furthermore, factors such as legal uncertainty and re-incorporation costs, which often outweigh the benefits deriving by the adoption of a specific *lex societatis*, render regulatory arbitrage less attractive for companies when its very purpose lends itself only to corporate governance advantages.

With all this taken into consideration, some limited forms of legal arbitrage have taken place. Especially, corporate governance issues seem to have played a complementary role: despite seeming insufficient when considered independently, they have often contributed to a justification for corporate mobility when

[172] Nevertheless, it has been argued that a weakness of the *SE Regulation* is in fact to leave too many important matters to the discretion of national laws. See for example MANNAN, WUISMAN, *Freedom of Establishment for Companies in Europe (EU/EEA)*, cit.

[173] GORDON, *Convergence and Persistence in Corporate Law and Governance*, cit, p. 51.

considered together with other reasons (primarily fiscal advantages). In general, companies have been looking for flexible regimes with regards to matters such as shareholder rights and obligation. Consequently, countries like the UK or the Netherlands, which provided liberal shareholder-oriented solutions, were particularly successful in the market for (re)incorporations.

In turn, mechanisms of regulatory competition and consequent convergence took place. The efforts of the EU legislator to keep the pace with those dynamics were not always successful. Instead, national courts (e.g. the Dutch court on the loyalty share schemes cases) and governments (e.g. the Italian government intervention after Chrysler-Fiat reincorporation in the Netherlands) have often intervened and reshaped the subjects before the proposed directives and regulations could enter into force and harmonise a certain sector.

The last question concerns the assessment of the effects that this competition can cause within the regulatory framework of corporate governance. In general, it was noticed that regulatory competition in this field is more likely a race to the top. This is especially true when it is compared to tax competition. Indeed, it can be observed that corporate governance models are always non-discriminatory, thus there is no room for ‘targeted competition’, meaning that neither better conditions nor preferential regimes are offered exclusively to foreign investors. Moreover, the advantages provided by certain governance structures are relative and subjective, whereas the advantage provided by tax competition is always monetarily quantifiable and necessarily entails a diminution of tax income and the consequent reduction of public expenditure and welfare. Ultimately, while those stakeholders which are more exposed to the risk of negative externalities (mainly creditors) benefit from the success of the company under normal conditions, on the contrary the social system usually suffers from the harm caused by the diminution of tax income.

In particular, within the EU, regulatory competition related to corporate governance matters has generally been a tool for the enhancement of the correspondence between small and medium-sized enterprises (efficient legal forms and accessible capital requirements), core to the European economy, and adequate legal structures that could boost their potentiality instead of hindering their

development. It seems, therefore, that competition between corporate law systems pursue the optimal allocation of resources. Hence, it appears highly compatible with the main goal of the internal market.

Nevertheless, the spontaneous transnational convergence stimulated by regulatory competition seems to have also left some grey areas of legal uncertainty, such as in the case of control-enhancing mechanisms, within which positive integration might be desirable in order to avoid harmful asymmetries.

In conclusion, all things considered, Brexit will probably be particularly harmful for this sector. Indeed, the UK has traditionally acted as a leading and powerful innovator at EU level and stimulating competitor at national level. It is, however, too soon to gauge the damage caused by the loss of a key-actor in the encouragement and promotion of this race to the top.

CHAPTER III

BUSINESS TAXATION AND REGULATORY COMPETITION

3.1 *Corporate taxation and the concept of 'harmful tax competition'*

3.1.1 Tax competition as a global issue

The international tax regime has always been resistant to cooperation and coordination of tax policies. The main evidence lies in the fact that its framework is composed by more than 3000[1] bilateral tax treaties—also known as 'Double Tax Conventions' (DTCs)[2]—rather than on a few open multilateral ones. Even though nowadays the technical language used in those treaties is almost fully harmonised thanks to the model[3] provided by the Organisation for Economic Co-operation and Development (OECD), the same cannot be said for substantive tax legislation.

As a matter of fact, countries mostly act as competitors for investment and revenue and show an inability in cooperating and coordinating their policies. While originally tax competition saw its relevance limited to the role of 'tax havens', i.e. small (usually tropical) countries with extremely favourable tax regimes, today it is a global phenomenon analysed in numerous reports of international organisations and national institutions and at the centre of the attention of worldwide literature.

The undesirable effects of regulatory competition in the field of taxation are normally referred to as 'Harmful Tax Competition' (HTC). From that point of view, tax competition is clearly a race to the bottom: a phenomenon that causes the reduction of tax revenue for a country and the consequent decrease of the budget designated for public expenditure. Thus, the social consequences of HTC must be

[1] See Y. BRAUNER, *What the BEPS*, in *Florida Tax Review*, 16, 2, 2014, p. 61.
[2] For an overview on the historical development of the institutional approach to the problem of double taxation in international tax law, see T. RIXEN, *From Double Tax Avoidance to Tax Competition: Explaining the Institutional Trajectory of International Tax Governance*, in *Review of International Political Economy*, 18, 2, 2011, pp. 197 et seq.
[3] OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017*, available at <https://www.oecd.org/ctp/treaties/model-tax-convention-on-income-and-on-capital-condensed-version-20745419.htm>.

always kept in mind when discussing the matter[4]. Obviously, it might be argued that disparities between different countries' welfare were born before tax competition became an actual issue; however, HTC has surely contributed to increases in such differences.

Aside from social aspects, the main topic of this chapter is to analyse the influence of regulatory competition on tax law within the EU. In particular, having observed that tax competition is generally relevant only when speaking of companies, and especially multinationals, the focus will be on corporate taxation.

In order to do so, however, a necessary step will be to preliminarily focus on the general concept of 'harmful competition' and to understand how the problem has been faced at a global level, especially taking into account the initiatives of the OECD. Without a proper competence on the matter, indeed, the EU has approached those issues being largely inspired by such initiatives. Only once the most common practices and the regulatory framework, on both the international and the EU level, will be described (sections 3.1 and 3.2), it will be possible to understand the reasons for the limited contribution of the Court (section 3.3) and try to reach some conclusions (section 3.4).

In that regard, a valid starting point can be the recognition that a fiscal distortion is, first of all, a market distortion. Thus, the complete lack of competence of the EU in the field of direct taxation, caused by the historical willingness of Member States to retain their fiscal sovereignty, might be seen as a paradox when considering that the Treaties are aimed at establishing an internal market that should be as free as possible from any kind of distortion.

In theory, tax competition should not necessarily be a race to the bottom. Potentially, indeed, it would be capable of lowering tax rates to a level by which the EU could gain attractivity to compete against the other main financial centres of the world[5]. This reasoning makes sense as long as the effects of tax competition

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[4] For an overview on the relationship between company tax competition and personal income taxation and more in general on the indirect social effects of corporate tax competition see S. GANGHOF, P. GENSCHEL, *Taxation and democracy in the EU*, in *Journal of European Public Policy*, 15, 1, 2008, pp. 58 et seq.

[5] On the same line of reasoning, see above in section 1.3 the reasons behind the choice for the introduction of an extraterritorial scope to Article 63 TFEU. Other possible arguments in favour of tax competitions are reported in A. FANTOZZI, *La Competizione Fiscale*, in P. BORIA (ed.), *La*

are symmetric, both economically and socially speaking. Unfortunately, the high degree of fiscal and social asymmetries across the Member States inhibits the potential positive effects of regulatory competition, precluding it to be considered the input for a race to the top in the field of taxation.

In 2015, a report[6] by the European Commission about the potential adoption of a common corporate income taxation listed some of the reasons why the reduction of tax revenue generated by tax competition could be incompatible with the welfare policies adopted across EU: the decrease of public goods provided through public expenditure; the increase of taxation on immovable factors, like labour[7]; and the lack in redistribution of wealth and a greater concentration of income amongst a few individuals.

Therefore, it seems that tax competition cannot ensure the optimal allocation of resources within the Union's economy. While international and EU institutions have apparently acknowledged the damage that HTC could cause, not all Member States seem totally aware of the problem and, most of all, capable of finding immediate and shared solutions.

3.1.2 'General tax competition' and the race to the bottom in the corporate income tax rate

There are two ways of looking at HTC. The first and broader interpretation includes in the concept of HTC also the lowering of corporate income tax rates *per*

Concorrenza Fiscale tra Stati, CEDAM, 2019, pp. 65-66. In particular, the author mentions the most recent findings of Israeli American literature, according to which: *(i)* tax competition allows a better allocation of financial sources and the maximisation of global wealth; *(ii)* taxing multinationals in the State where they receive certain services would often constitute double taxation as those multinational would have already paid for the factors of productions they use in that State; *(iii)* foreign investors have no obligation to contribute to the welfare of the source State beyond what they have already paid for the goods and services they purchased; *(iv)* prohibiting tax competition would seriously harm the poorest countries which aim at a fair redistribution of wealth through the implementation of competitive tax regimes. P. RUSSO, G. FRANSONI, L. CASTALDI offer a different point of view in *Istituzioni di Diritto Tributario*, Giuffè, 2nd edn, 2016, p. 314, where they submit that all taxpayers are obligated to contribute to the welfare, albeit to different degrees depending on the level of participation to social collectivity.

[6] COMMISSION STAFF WORKING DOCUMENT, *Report on the EURO AREA*, COM/2015/85 final, 2015.

[7] See SCHÖN, *Playing Different Games?*, cit, p. 350, where the author argues that tax competition has a harmful effect on labour conditions because *'different actors in this game have different bargaining power. Capital is mobile while labour is not, therefore the relative tax burden of capital and labour might shift to the detriment of workers'*.

se ('general tax competition')[8], whereas the second and narrower interpretation identifies HTC only with those measures concerning selected elements of the Corporate Income Tax (CIT), that are closely linked to particular practices of base erosion and profit shifting (BEPS) ('targeted tax competition')[9]. While the latter interpretation is thus compatible with the view that tax competition is not necessarily a race to the bottom, as it only finds the harmfulness in a limited (though relevant) number of practices, the former is probably more adherent to what reports and empirical findings have shown.

The empirical evidence demonstrating that in the EU internal market tax competition is 'general' and not only 'targeted' can be found when considering countries' size. Indeed, *'small States tend to gain more from tax rate cuts than large States'*[10], because by lowering their domestic income small States will lose less than what they will gain by attracting foreign income. The fact that in the EU countries have very different sizes allows small States[11] to compete even on the general CIT rate, and not only on specific preferential tax regimes and incentive schemes. Logically, countries with higher tax rates and public expenditure are normally more affected by tax competition.

It must be immediately clarified that it is not progressivity as a feature of the tax system that is at stake here. Rather, the issue is instead the generally excessive lowering of the tax rate. Ultimately then, the phenomenon brings not only

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[8] This phenomenon is also referred to as *'tax cut fever'*. See for example A. QUATTROCCHI, *Gli Aiuti di Stato nel Diritto Tributario*, CEDAM, 2020, p. 98. However, in 2018 Commissioner P. MOSCOVICI declared: *'Let's make no mistake: the headline rate is not what triggers tax evasion and aggressive tax planning. That comes from schemes that facilitate profit shifting'*. See also R. TOPLENSKY, *Multinationals pay lower taxes than a decade ago*, in *Financial Times*, 11 March 2018, available at <https://www.ft.com/content/2b356956-17fc-11e8-9376-4a6390addb44>, where the author observes nonetheless that *'since 2008, countries have cut headline corporate taxes by 5 per cent [...]'*.

[9] See P. GENSCHEL, A. KEMMERLING, E. SEILS, *Accelerating Downhill: How the EU Shapes Corporate Tax Competition in the Single Market*, in *Journal of Common Market Studies*, 49, 3, 2011, p. 587. See also L. SALVINI, *I regimi fiscali e la concorrenza tra imprese*, in *Giurisprudenza Commerciale*, 2, 2016, pp. 130 et seq.

[10] GENSCHEL, KEMMERLING, SEILS, *Accelerating Downhill*, cit, p. 587.

[11] According to the OECD official website, for instance, in 2019 the composite effective average tax (CEAT) rate of Ireland was 12%, and the one of Cyprus 10.4%; whereas Germany had a CEAT rate of 27.5%, France 30.3%, and Italy 27.2% (data available at <https://stats.oecd.org/Index.aspx?DataSetCode=CTS_ETR>); on the same topic see RIXEN, *From Double Tax Avoidance to Tax Competition*, cit, pp. 31-32, where the author submits that virtual and real tax competition hurts big country governments.

distortions of the internal market, but also more general harmful consequences on the integration process.

In the aforementioned *Commission Staff Working report*[12], some arguments are carried out to maintain this broad interpretation of HTC. Firstly, low income on direct taxation has often been balanced by Member States by an increase of indirect taxation such as VAT, producing a regressive effect, i.e. affecting low-income brackets more than high-income ones, and thus increasing economic and social disparity. Secondly, profit shifting itself, the main manifestation of 'targeted' competition, is influenced by CIT rate. Indeed, the latter stimulates and incentivises the former.

According to the report, between 1995 and 2014 the average CIT statutory rate[13] across the EU passed from 35% to 23%. In the same period, the highest rate passed from Germany's 56,8% to France's 38%, and the lowest rate from Hungary's 19,6% to Bulgaria's 10%[14]. The report also notices that rate reduction has been much more common that base broadening, even though some Member States have tried to balance the former with the latter. Indeed, not only is tax rate reduction the most suitable system to attract foreign investments, but it is also a key protection against profit shifting and the competition brought by other Member States. Regulatory competition is therefore capable of transforming legislative policy choices in obligations, arising from the States' need for self-defence mechanisms.

Last but not least, the general reduction of CIT rates has the further consequence of lowering corporate taxation below the level of taxation on other types of income, as in the case of labour taxation. Clearly, this asymmetry could potentially bring more disparities and a certain degree of social tension.

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[12] COMMISSION STAFF WORKING DOCUMENT, *Report on the EURO AREA*, COM/2015/85 final, 2015.

[13] The statutory rate is not always the effective rate eventually applied.

[14] See also FANTOZZI, *La Competizione Fiscale*, cit, p. 63, where the author reports further data to confirm that competition has involved everyone, not only developing countries: the OECD States average CIT rate passed from 48,2% (1985) to 25,4% (2012).

3.1.3 The harmful practices of base erosion and profit shifting. Source base and residence base as traditional criteria for international taxation

The starting point for the analysis of the most common harmful tax practices within the EU is to analyse the original instruments implemented to combat tax avoidance.

Normally, according to the principle of territoriality, countries tax residents on a residence base, through an 'unlimited' taxation of their worldwide profits[15], and foreigners on a source base, through a 'limited' taxation on profits arising from sources located in the taxing State.

Those widely adopted criteria have been complemented through an incredibly high number of DTCs, aimed at mitigating the problem of double taxation in those cases in which private international laws of two countries potentially cause that the same income is taxed twice. Double taxation, for example, might happen in cases in which profits are moved from the country where they were realised—and thus taxed on a source base—to the country where the beneficiary is resident—and thus taxed on a resident base. Normally, in the international context, DTCs assign priority to taxation on a source base, meaning that it is up to the home State—or better, the State where the payee is resident—to alleviate the double taxation.

It is important to preliminarily remark that tax residence is not necessarily defined by rules identical to those that define the *lex societatis*[16]. Nevertheless, factors largely equivalent to the 'real seat' notion are usually decisive for the determination of a company's tax residence[17]. Indeed, the traditional criterion

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[15] On the *'worldwide taxation principle'*, see RUSSO, FRANSONI, CASTALDI, *Istituzioni di Diritto Tributario*, cit, pp. 313-314, where the authors explain that the justification for the residency-source taxation rests on the territorially limited coercive power of the State. Such a principle is criticised because, according to the authors: *(i)* the legislative power of the State has no territorial limitation; *(ii)* it seems impossible to find universal criteria in order to define 'residency' of a taxpayer and 'source' of an income.

[16] A clear explanation is provided by GERNER-BEUERLE, MUCCIARELLI, SCHUSTER, SIEMS, *Why Do Businesses Incorporate in Other EU Member States? An Empirical Analysis of the Role of Conflict of Laws Rules*, p. 24, where the authors highlight that *'the concept of tax residence diverges from the mere formal registered seat and is normally a fact-intense criterion, which, for instance, considers the place of a company's business or its headquarter'*.

[17] See SCHÖN, *Playing Different Games?*, cit, p. 346, where the author observes that *'tax law—this seems to be the unchallenged international consensus outside the United States—follows the "real seat" doctrine'*.

adopted by countries to directly charge non-resident undertakings is based on their physical presence within the country's territory, referred to as 'permanent establishment' (PE)[18]. That notion was elaborated in 1927, thanks to the *Model Treaty on Double Taxation and Tax Evasion*[19] drafted by the League of Nations.

Thus, one might think that, vis-à-vis mobility choices, tax advantages should be *'unlikely to be significant for companies that only have a "letterbox" in the incorporation country while doing business in another Member State'*[20] (like in the *Centros* and *Polbud* cases). This should be true especially considering that, as noticed in Chapter I, no franchise tax is allowed in the EU.

However, literature's empirical findings suggest that more favourable legal rules influence businesses' strategic decision to reincorporate in another country *'as far as this choice allows businesses to reduce their tax bill, whether directly, or by benefitting from lower levels of transparency'*[21]. On the one hand, companies can directly (by transferring their real seat together with their registered office) benefit from the lower CIT rates offered by certain countries, champions of 'general tax competition'. On the other hand, companies can indirectly (by registering letterbox holdings which do not carry any genuine business activity in the country of incorporation) exploit fiscal asymmetries and lack of transparency.

Indeed, DTCs have proved to be only a partial solution for the problems deriving from the differences between various jurisdictions. The system that has just been synthetically described, in fact, has proved to be suffering from the presence of *'secrecy jurisdictions'* (at the time of writing, Luxembourg and the

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[18] See on the concept of PE see RUSSO, FRANSONI, CASTALDI, *Istituzioni di Diritto Tributario*, cit, pp. 329-330.
[19] *Draft Model Treaty on Double Taxation and Tax Evasion* 1927, Article 5(1).
[20] Ibid. The authors also add that '*However, it is likely to be relevant for companies that have some physical connection to the country of incorporation – with the consequence that the tax authorities apply domestic tax law, despite the fact that the company's managers are based abroad'*.
[21] See GERNER-BEUERLE, MUCCIARELLI, SCHUSTER, SIEMS, *Why Do Businesses Incorporate in Other EU Member States?*, cit, p. 14. See also GALULLO, MINCUZZI, *Da Mediaset a Fiat-Chrysler: perché l'Olanda è il paradiso delle holding*, cit.

Netherlands are 6th and 8th respectively in the Financial Secrecy Index Ranking)[22] and fiscal asymmetries[23].

Moreover, the efficiency of traditional international taxation criteria, based on the physical presence, has also been undermined by the advent of the new digital economy. In particular, by the end of the nineties, new high-tech multinationals brought a process that involved them as both innovators and main beneficiaries of their own innovation. As a matter of fact, they developed a digital world that eventually allowed them to implement a series of strategies to avoid taxation, partially or totally.

Once the basic tools for understanding international taxation have been briefly described, it is possible to go into more detail in the analysis of the most important concepts, aside from the aforesaid general lowering of the CIT rate, that are immediately related to harmful practices of tax competition.

3.1.4 Treaty shopping and Aggressive Tax Planning

The first concept worth mentioning is treaty shopping. Treaty shopping is essentially regulatory arbitrage in the field of taxation, with specific regard to bilateral tax treaties. Through treaty shopping, companies can pick those provisions that are more favourable to them and organise their business in order to maximise the benefits deriving from the combinations of those rules. In particular,

Treaty shopping is key in the implementation of 'Aggressive Tax Planning' (ATP). It is possible to define ATP as an articulated conduct of a certain entity,

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[22] The notion of *'secrecy jurisdiction'* for tax havens was introduced by the Tax Justice Network (TJN) in 2009 together with its *Financial Secrecy Index*. The definition provided by the TJN explains that '*a secrecy jurisdiction provides facilities that enable people or entities escape or undermine the laws, rules and regulations of other jurisdictions elsewhere, using secrecy as a prime tool'*. At the time of writing, the UK *'has a central role in the system and is arguably the most important player of all: it has responsibility for many of the biggest satellite secrecy jurisdictions, including the Cayman Islands, Jersey, the British Virgin Islands, and Bermuda'* but the *'continental European pole is also highly significant, and includes Luxembourg, Germany, Belgium, Austria, Cyprus, and Gibraltar inside the European Union'*. See <https://fsi.taxjustice.net/>.

[23] In SCHÖN, *Playing Different Games?,* cit, pp. 359-360, the author argues that *'borders matter in the context of international taxation'* and *'Member States of the European Union are currently locked in between the dynamic evolution of a European framework for international taxation and the old territorial rules on the avoidance of double taxation'* especially considering that *'most double taxation treaties were agreed upon long before the European Court embarked on its course in direct taxation'*.

normally a multinational, aimed at minimizing the effective taxation on its income. It usually follows a three-steps scheme[24].

The first step is to erode as much as possible the gross profit realised in those countries with high taxation in which the main tangible assets and labour are based, shifting that money to other countries with low taxation by means of the various techniques that will be analysed in this Chapter. These tools usually have both a technological and a legal component. The combination of the two factors, as said before, allows companies to overtake the traditional categories and criteria on which international taxation has been based in the twentieth century.

The second step is to use treaty shopping in order to identify those countries that have adopted rules that can be combined in triangular schemes in order to minimise both exit and entry taxation.

The third and last step is to minimise the impact of tax provisions of the country in which the 'ultimate company' is resident, by means of the negotiation with local tax authorities of targeted agreements in the form of tax rulings[25] or through other legal tools that allow to avoid that the application of a transparency regime[26].

In order to understand how tax bases are eroded and corporate profits are shifted, it is helpful to analyse the key features of: *(a)* hybrid mismatches arrangements, *(b)* permanent establishments, and *(c)* transfer pricing. Lastly, once those notions are clearer, it is possible to provide a *(d)* practical example to which they apply.

Lastly, it is worth preliminarily remarking that all the steps that contribute to ATP are in principle legitimate and lawful. With regard to digital payments and transfers and dematerialisation in general, it is obvious that they have brought incredible transversal benefits. In relation to the legal tools used to distribute assets and liabilities between different entities that belong to the same economic group, those are surely vital means for the sustainability of businesses.

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[24] For an overview on the concept of ATP, see T. GASPARRI, *Stati sovrani ed imprese multinazionali alla sfida del Fisco, tra sostanza e trasparenza*, Note e Studi Assonime, n.15/2017, 2017, pp. 14 et seq.
[25] On the relationship between those rulings and State aid rules in the EU, see Chapter IV.
[26] For an overview on tax transparency in the context of international taxation, see RUSSO, FRANSONI, CASTALDI, *Istituzioni di Diritto Tributario*, cit, pp. 417-420.

However, tax avoidance is a concept that is very close the one of abuse of law already discussed in Chapter I[27]. Conducts of tax avoidance do not openly infringe the rule, but they go against its spirit. The breach is not formal, but substantive.

a) Hybrids and double non-taxation

A specific phenomenon that has a significant relevance for the purpose of this chapter is caused by the so called 'hybrid mismatches arrangements'. In general, those are situations that allow companies to exploit the circumstance in which the same entity or the same financial instrument is classified in two different ways by two countries. *ATAD 2*[28], which will be analysed below, lists three kinds of mismatches: hybrid mismatches[29], reverse hybrid mismatches[30], and fiscal residency mismatches[31].

Amongst the harmful consequences that hybrid mismatches arrangements are capable of causing, there is *'double deduction'*: it is defined as *'a deduction of the same payment, expenses or losses in the jurisdiction in which the payment has its source, the expenses are incurred or the losses are suffered (payer jurisdiction) and in another jurisdiction (investor jurisdiction)'*[32]. Another relevant potential effect of hybrid mismatches arrangements is a *'deduction without inclusion'*, which

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[27] For a distinction between abuse of law and tax avoidance see ibid, pp. 61-62, where the authors refer to the fact that in the case of abuse the formally respected law normally gives rights, whereas in the case of tax avoidance the formally respected law creates duties. Moreover, the abuse has generally an individual dimension, while tax avoidance implies a harm to public goods.
[28] *Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries* [2017] OJ L 144 (*ATAD 2*).
[29] Ibid, Article 1 amending Article 9 of *ATAD 1*.
[30] Ibid, Article 1 amending Article 9a(1) of *ATAD 1*: *'Where one or more associated non-resident entities holding in aggregate a direct or indirect interest in 50 per cent or more of the voting rights, capital interests or rights to a share of profit in a hybrid entity that is incorporated or established in a Member State are located in a jurisdiction or jurisdictions that regard the hybrid entity as a taxable person, the hybrid entity shall be regarded as a resident of that Member State and taxed on its income to the extent that that income is not otherwise taxed under the laws of the Member State or any other jurisdiction'*.
[31] Ibid, Article 1 amending Article 9b(1) of *ATAD 1*: *'To the extent that a deduction for payment, expenses or losses of a taxpayer who is resident for tax purposes in two or more jurisdictions is deductible from the tax base in both jurisdictions, the Member State of the taxpayer shall deny the deduction to the extent that the other jurisdiction allows the duplicate deduction to be set off against income that is not dual-inclusion income […]'*.
[32] Ibid, Article 1 amending Article 2 of *ATAD 1*.

happens when there is a deduction in the payer jurisdiction and at the same time the concerned income is not taxed in the *'payee jurisdiction'*[33].

With specific regard to financial instruments, harmful tax behaviours might be favoured by those hybrids that are considered as debt in one jurisdiction and as equity in another jurisdiction. When those hybrid financial instruments are transferred from the former to the latter, the payment of interests in the country of departure is deductible, while the same payment is not taxed in the country of destination because it is considered as a payment of dividends.

In relation to companies, it is also possible to talk about 'hybrid entities'. Indeed, some companies are considered 'transparent' in some jurisdictions—i.e. they are not considered subject to tax while their shareholders are—whereas they are deemed 'opaque'—i.e. they are taxpayers and thus directly charged by tax authorities—in some other jurisdictions. Thanks to triangular schemes, it is possible to shift profits to the country in which a company of the group is considered transparent, so that in principle its shareholders will be liable for taxes. However, if the shareholders, in turn, are companies considered opaque in the jurisdiction where they reside, that transaction will be taxed according to the controlled foreign income (CFC) rules of that jurisdiction. If that jurisdiction is a secrecy jurisdiction where corporate income is barely taxed or not taxed at all, this triangulation will cause a 'double-non taxation'. Similar results can also be obtained through the so called 'stateless corporations' (not recognised as resident taxpayers by any jurisdiction) or the so called 'dual resident corporations' (recognised as resident taxpayers in two jurisdictions).

b) Permanent establishment as a tool for harmful tax practices

The concept of PE has already been mentioned. Its interpretation has given rise to uncertainties that have been exploited by undertakings to gain tax advantages. In particular, Article 5 of the aforementioned *OECD Model* describes the PE as the *'fixed place of business through which the business is wholly or partly carried on'*. This 'material' definition appears to be close to the one given by the ECJ in *Cadbury Schweppes*, analysed in Chapter I. That case, indeed, dealt with the

[33] See ibid, where the *'payee jurisdiction'* is described as *'any jurisdiction where that payment or deemed payment is received, or is treated as being received under the laws of any other jurisdiction'*

CFC measure adopted by the UK in order to render less favourable the tax regime for companies' profit deriving from subsidiaries resident in countries with a lower CIT rate (*in casu*, Ireland). However, unlike that judgement, in the OECD definition specific elements like premises, staff, and equipment are not mentioned.

In the same Article 5 there is also a (residual) 'personal' definition of PE: where an *'agent [...] is acting in a Contracting State on behalf of an enterprise and [...] habitually concludes contracts, [...] and these contracts are in the name of the enterprise [...], that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise'*. But the scope of this provisions is limited by the derogations laid down in the 'negative list' provided by Article 5(4). In particular, when the activities of the agent are merely *'auxiliary'* or *'preparatory'*, there is no PE.

This derogation allows companies to fragmentate their business activities that are present within a certain country. Indeed, many small units that appear to be committed in auxiliary or preparatory activities would instead constitute a PE if considered together. Furthermore, many multinationals relied on the similar scheme of *'commissionaire arrangements'*, allowed by the previous version of the *Model*, to avoid taxation in the country where the profits were effectively realised[34].

Again, it must be cleared that means like companies' divisions are essential for business organisation and are indeed completely lawful. However, the problem arises when those faculties are used to realise strategies for tax avoidance.

c) Transfer pricing

Lastly, transfer pricing is the most common and relevant HTC practice. Technically, 'transfer pricing' is a process by which tax law determines the appropriate price for transactions between companies of the same group, having goods or services as objects—normally intangibles—that could potentially be provided for excessively low or high prices in order to shift profits from one

[34] See for example the *Apple* case, further explained in Chapter IV.

jurisdiction to another. In fact, the main aim of these harmful practices is usually to move intangibles away from high-tax jurisdictions to low-tax jurisdictions[35].

The main criterion adopted to assess these intra-group transactions is the 'arm's length principle' (ALP). According to this principle, the transfer price should be determined by pretending that the transaction was realised in a free competitive market, rather than between companies of the same group (integrated companies).

There are, however, some criticisms of this principle. It might be argued that the application of the arm's length principle is not consistent with a legal system that allows complex group structures for the purpose of distributing costs and liabilities. Another more general critique is that the principle is too ambitious to elaborate criteria that are successfully applicable to different type of transactions, made by different forms of companies, regarding different kinds of goods, between different jurisdictions[36].

Returning to the principle itself though, once it is assumed through the ALP that the entities involved in the transactions must be treated like two 'stand-alone' companies (non-integrated companies), it is necessary to carry out a 'comparability analysis' in order to identify a comparable market where a comparable transaction has occurred between two really independent undertakings.

The *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*[37] issued by the OECD in 2010 describe five factors that can be used to carry out the analysis: *(i)* the characteristics of property or services; *(ii)* the *'functional analysis'*, which takes into account the role that the undertaking has in the group; *(iii)* the conditions applied in the contract; *(iv)* the economic conditions that constitute the features of the concerned relevant market; *(v)* the business strategies adopted by the undertakings involved. This list of comparability factors

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[35] For a detailed explanation of the economic effects of transfer pricing, see BRAUNER, *What the BEPS,* cit, p. 96-98. Instead, for a legal analysis of transfer pricing see PERRONE, *Tax Competition,* cit, pp. 41-51.

[36] See RUSSO, FRANSONI, CASTALDI, *Istituzioni di Diritto Tributario*, cit, pp. 416-417, where the authors criticize the approach of Italian tax law to the matter, while praising the efforts of the Internal Revenue Service (IRS) in the U.S.

[37] The *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (*Transfer Pricing Guidelines*) were issued for the first time in 1995. The last updated version before the advent of the *BEPS Action Plan* (see below) to which it is possible to refer for this purpose, was in 2010. The innovations brought by BEPS project were introduced in the 2017 version, which will be analysed below.

is not exhaustive, meaning that it is possible to use factors that are not included in the guidelines.

Through the comparability analysis, it is thus possible to individuate an independent transaction that is comparable to the intra-group one. It is then necessary to understand how to find the appropriate transfer price for the intra-group transaction. The most suitable methods provided by the guidelines are the *'traditional methods'*, meaning those that allow to directly apply the price of the independent transaction to the comparable infra-group transaction. Those are the *'comparable uncontrolled price'* method, the *'resale price'* method, and the *'cost plus'* method.

However, in some situations traditional methods are not deemed applicable. This is true especially in cases in which the contribution of each undertaking to the group's value chain is uncertain. For those situations, the guidelines introduce the residual *'transactional profit methods'*. These methods are based on the profits that the undertakings realise through the transaction. The first one is the *'transactional profit split'* method, that ignores the special conditions applied to the transaction in order to determine the profit that a comparable independent transaction would have realised. The second one is the *'transactional net margin method'* (TNMM), that has been largely used in Europe, facilitating the implementation of ATP.

The TNMM considers only the net margin profit deriving from the transaction for each company involved. The comparability analysis must be carried out with regard to *'internal comparables'* (pretending that the company realised the concerned transaction with other independent entities), or, when that is impossible, with regard to *'external comparables'* (pretending the margin net profit that an independent company would have realised in a different but comparable transaction). The problem arises when considering which party of the transaction should be analysed. The general criterion is that it should be the party for which the functional analysis is easier, thus, the one that had the least complex role in the transaction and for which it is possible to presume that the net profit margin was the lowest.

Multinationals have often allocated fundamental intangibles, such as unique IP rights, in companies that are resident in countries with a low CIT. This

circumstance has allowed multinationals to claim that the main contribution for certain intra-group business activities has come from those companies. Thus, the application of the TNMM to those situations substantially allows profits to be shifted into low-tax jurisdictions. Essentially, the net margin profit will be moved from one company of the group to the other strategically placed in a more favourable jurisdiction, contributing to an increase of the tax base of the latter while eroding the tax base of the former.

d) A concrete example of ATP: the case of Google

Once the essential notions have been provided, it is possible to provide a practical example of ATP, namely the so called 'Double Irish with Dutch sandwich' (a variation of the more common 'Double Irish') implemented by Google[38].

The scheme was based on several triangulations, exploiting some national laws which gave up upon some withholding tax on royalties, which, in turn, were addressed to tax havens which do not tax them, such as Bermuda.

In particular, Google USA transferred the rights of use of its technologies to Google Ireland Holding (GIH), a controlled company incorporated under Irish law. GIH had its central control and management seat in Bermuda (and thus it was not considered as resident under Irish tax law), where it revalued the IP rights and booked the capital gain. That gain was not taxed, as there is basically no business taxation in Bermuda.

The IP rights were sublicensed to another company of the group (GNL), incorporated in the Netherlands but with neither employees nor any business activities there. In turn, GNL sublicensed the IP rights to a further sublicensee: another subsidiary (GIS) of the group which was incorporated under Irish law and resident in Ireland.

GIS was the only company involved in the scheme which carried out a genuine economic activity—at least if one refers to the definition provided in *Cadbury Schweppes* and analysed in Chapter I—thus it collected Google's

[38] The scheme, together with other crucial elements of taxation on digital enterprises, is explained by F. GALLO, in his intervention *Regime fiscale dell'economia digitale* before the Italian *Commissione Finanze della Camera dei Deputati* of 24 February 2015, available at <https://www.salviniesoci.it/pubblicazioni/regime-fiscale-delleconomia-digitale/>, and by PERRONE, *Tax Competition*, cit, pp. 54-55.

worldwide profits (except for U.S. profits), which should have been taxed under Irish 12,5% CIT rate.

However, thanks to the TNMM, GIS shifted those profits to GNL, which in turn shifted them to GIH, in the form of payments for royalties which were not subject to any withholding tax neither in Ireland nor in the Netherlands. In this way, the tax bases of GIS and GNL, which would have been taxed in Europe, were largely eroded. The profits were mainly allocated to GHI, which was not subject to any business taxation as it was resident in Bermuda. Moreover, profits were not even taxed in the U.S., as Google shielded them by deferring taxation.

3.1.5 The BEPS Project: the Action Plan and the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting

In 2012, the G20 requested the OECD to study the main harmful tax practices, in order to assess which measures could potentially be the most suitable to face the critical consequences brought by tax competition. The OECD thus set up the Base Erosion and Profit Shifting (BEPS) Project[39], an international framework to better understand and combat tax avoidance[40] by multinational enterprises. The OECD immediately found out that *'BEPS practices cost countries 100-240 billion USD in lost revenue annually, which is the equivalent to 4-10% of the global corporate income tax revenue'*[41]. At the time of writing, 137 countries have adhered to BEPS Project and four annual reports have been released[42].

The most relevant outcomes of the BEPS Project are so far the 15-points *Action Plan on Base Erosion and Profit Shifting* (*BEPS Action Plan*) and *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (*MLI*)

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[39] For an overview on BEPS in general, see BRAUNER, *What the BEPS*, cit.

[40] It is important to keep in mind that harmful tax competition is a phenomenon that is always realized through tax avoidance, thus through lawful means, in respect of legal provisions, even though against their spirit. It is thus appropriate to refer to 'tax avoidance' and not to 'tax evasion'.

[41] See the official website of BEPS Project at <https://www.oecd.org/tax/beps/>.

[42] The last report is *OECD/G20 Inclusive Framework on BEPS: Progress Report July 2019-July 2020*, available at <https://www.oecd.org/tax/beps/oecd-g20-inclusive-framework-on-beps-progress-report-july-2019-july-2020.htm>.

The *BEPS Action Plan* was published by the OECD on 19 July 2013. Its 15 actions are mainly aimed at increasing the consistency of international taxation, basing taxation on the economic reality rather than on formal agreements, and granting transparency and legal certainty. In addition to these three main purposes, *Action 1* is aimed at addressing *'the tax challenges of the digital economy'*, whereas *Action 15* deals with the need for a *'Multilateral Instrument'* capable of replacing the large number of bilateral tax treaties.

It has been said before that the several versions of the *Model Tax Convention on Income and on Capital* have contributed to the harmonisation of the language used in many bilateral treaties. However, the *MLI*, drafted in 2017, is more ambitious. It is indeed aimed at responding to *'the need for an effective mechanism to implement agreed changes in a synchronised and efficient manner across the network of existing agreements for the avoidance of double taxation on income without the need to bilaterally renegotiate each such agreement'*[43]. Its provisions introduce a minimum standard for many bilateral treaties' clauses, especially covering the scope of *Action 2* (*'Neutralise the effects of hybrid mismatch arrangements'*), *Action 6* (*'Prevent treaty abuse'*), *Action 7* (*'Prevent the artificial avoidance of PE status'*), and *Action 14* (*'Make dispute resolution mechanisms more effective'*). At the time of writing, 94 countries have signed the MLI, and 54 jurisdictions have ratified, accepted or approved it. The Convention will become effective on 1 January 2021 for over 600 treaties concluded among the 54 jurisdictions, with an additional 1100 treaties to become effectively modified once the *MLI* will have been ratified by all the 94 signatories.

As the *MLI* implements the principles and rules elaborated in the *BEPS Action Plan*, their contents can, for the purpose of this thesis, be simultaneously analysed.

As said before, the *Action Plan* has three main purposes. Accordingly, the actions can be divided in three categories[44]: *(i)* those related to the importance of

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[43] *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (MLI), 2017, preamble.
[44] See PERRONE, *Tax Competition,* cit, pp. 237-257.

the economic substance of transactions[45], *(ii)* those related to the consistency of international tax law, and *(iii)* those related to the transparency of tax regimes.

(i) Action 8 (*'Intangibles'*), *Action 9* (*'Risks and capital'*), *Action 10* (*'Other high-risk transactions'*), *Action 6*, and *Action 7* belong to the first category. The first three actions named deal with transfer pricing. They are the core of the *Aligning Transfer Pricing Outcomes with Value Creation* report, issued in 2015, that has essentially brought the innovations that led to the 2017 version of the *Transfer Pricing Guidelines*.

The main idea underlying the report—and thus the new guidelines—is that methods like the TNMM allows companies to hide the substantial economic reality behind formal agreements that are aimed at allocating intangibles[46] in law-tax jurisdictions, in order to shift their profits there. Thanks to the report, the identification of intangibles[47] shifts from a formal approach to a substantial one, based on the creation of value that is effectively reached through the key-activities of *'development, enhancement, maintenance, protection and exploitation'* of the intangibles and *'on the manner in which they interact with other intangibles, with tangible assets and with business operations'*[48].

Once the intangible is identified, its owner must be identified as well. It is here that the most important innovation brought by the report can be seen, as it states that legal ownership is irrelevant *'if the legal owner neither controls nor performs'* the functions related to the aforenamed five key-activities, and that in

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[45] On the concept of *'substantial economic activity'*, see A. C. DOS SANTOS, *What Is* Substantial Economic Activity *for Tax Purposes in the Context of the European Union and the OECD Initiatives against Harmful Tax Competition?*, in *EC Tax Review*, 24, 3, 2015, pp. 166 et seq.

[46] *Action 8* is aimed at combating misallocation and misevaluation of intangibles, by *'adopting a broad and clearly delineated definition of intangibles; ensuring that profits associated with the transfer and use of intangibles are appropriately allocated in accordance with (rather than divorced from) value creation; developing transfer pricing rules or special measures for transfers of hard-to-value intangibles; and updating the guidance on cost contribution arrangements'*.

[47] See OECD, *Aligning Transfer Pricing Outcomes with Value Creation*, 2015, para 6.12, where the report gives a definition of *'intangibles'*: *'something which is not a physical asset or a financial asset, which is capable of being owned or controlled for use in commercial activities, and whose use or transfer would be compensated had it occurred in a transaction between independent parties in comparable circumstances'*. Thus, the following are not necessarily features of an intangible: *(i)* having a monetary connotation; *(ii)* having a specific legal protection; or *(iii)* being autonomously transferrable.

[48] Ibid, para 6.6.

that case *'the legal owner would not be entitled to any ongoing benefit attributable to the outsourced functions'*[49].

A question thus arises about who is entitled to the benefits deriving from intangibles. In order to respond, it is necessary to calculate the Intangible Related Return (IRR), meaning the transfer price that should be paid to each company considering the assets used, the costs incurred, the functions performed and the risks assumed. To determine the IRR, the 'DEMPE[50] test' and the 'FAR[51] analysis' must be carried out: if any company of the group involved in the transaction performed one of the five key-activities, then it should have a return parameterised to the functions performed, the assets used, and the risks assumed.

It has already been said that *Action 6* is also amongst those actions aimed at reconnecting taxation to the economic reality of businesses, and that its scope has been recently covered by the *MLI*. In particular, *Action 6* deals with treaty abuse, and its content has been concretised in the *MLI* through the provisions about—amongst the other issues—treaty shopping, hybrid mismatches arrangements, and dual residency. Indeed, a general rule that *'treaties are not intended to be used to generate double non-taxation'*[52] is laid down. Moreover, the so called 'Principal Purpose Test' [53] is introduced. This test must be used to assess when a certain benefit has been obtained by the abuse of a 'Covered Tax Agreement' (CTA)[54], considering the object and the purpose of the concerned CTA. Furthermore, in order to discourage treaty shopping practices, Article 8(1) *MLI* also provides that *'provisions of a CTA that exempt dividends paid by a company which is a resident of a Contracting Jurisdiction from tax or that limit the rate at which such dividends may be taxed [...] shall apply only if the ownership conditions described in those provisions are met throughout a 365 days period [...]'*. Lastly, Article 10 *MLI* provides an anti-abuse clause for PE for situations in which profits deriving from a transaction between two *'Contracting Jurisdictions'* are attributable to a PE in a

[49] Ibid, para 6.54.
[50] 'DEMPE' is the acronym of the five fundamental activities: Development, Enhancement, Maintenance, Protection, and Exploitation.
[51] 'FAR' is the acronym of Functions (performed), Assets (used), and Risks (assumed).
[52] See *Action 6*; see also *MLI*, Article 6.
[53] *MLI*, Article 7(1).
[54] *'Covered Tax Agreements'* are those agreements that fall in the scope of application of the *MLI*.

third jurisdiction and are not taxed in the jurisdiction where the company receiving that income is resident[55].

Action 7 is the last action of the first category. It deals with the harmful practices related to PE, and its content is implemented in Part IV (Articles 12-15) of the *MLI*. To combat the abuse realised through fragmentation, these provisions allow the interpreter to consider that a PE exists every time many preparatory or auxiliary activities are carried out by companies of the same group within the territory of a certain jurisdiction, excluding the applicability of the 'negative list' provided by Article 5(4) of the *OECD Model Tax Convention*. Moreover, Article 12 *MLI* has provided the definition of personal PE mentioned before, not linked anymore to the *'authority to conclude contracts'*, but instead focused on the fact that *'a person is acting in a Contracting Jurisdiction to a Covered Tax Agreement on behalf of an enterprise and, in doing so, habitually concludes contracts'*.

(ii) The second category of actions—measures for the improvement of the consistency of international tax law—includes *Action 2*, *Action 3* (*'Strengthen CFC rules'*), *Action 4* (*'Limit base erosion via interest deductions and other financial payments'*), and *Action 5* (*'Counter harmful tax practices more effectively, taking into account transparency and substance'*). These actions are less incisive than those belonging to the first category. However, they generally deal with the asymmetries and lack of consistency of tax laws amongst jurisdictions, and are essentially aimed at finding new solutions to avoid double non-taxation.

(iii) The last category includes those actions whose purpose is to enhance transparency in international taxation, namely *Action 5*, *Action 12* (*'Require taxpayers to disclose their aggressive tax planning arrangements'*), and *Action 13* (*'Re-examine transfer pricing documentation'*). *Action 5* provides for a *'compulsory spontaneous exchange on rulings related to preferential regimes'*; *Action 12* is aimed at disclosing those international tax schemes and transactions that could be considered *'aggressive or abusive'*. Lastly, *Action 13* is aimed at introducing a disclosure requirement for multinationals: they should inform tax

[55] In those cases, *'the benefits of the CTA shall not apply to any item of income on which the tax in the third jurisdiction is less than 60 per cent of the tax that would be imposed'* in the Contracting Jurisdiction where the company receiving that income is resident *'on that item of income if that permanent establishment were situated'* in the said Contracting Jurisdiction.

authorities about their *'global allocation of the income, economic activity and taxes paid among countries according to a common template'* (so called 'Country by Country Reporting').

3.2 *European taxation within the internal market: negative integration within the field of direct taxation and the impact of the BEPS Project*

The EU has no taxing jurisdiction, apart from the payroll tax imposed on its civil servants[56]. While indirect taxation, such as value added tax (VAT), has been uniformed and harmonised to a certain extent through positive integration, direct taxation falls entirely within the scope of national sovereignty[57]. The reluctance of Member States in losing their fiscal sovereignty has always prevailed over the push for harmonisation, eventually culminating in Article 114(2) TFEU[58] that limits the scope of the legislative power of the EU. As a consequence, today, every Member State has a veto right in tax matters, which can only be addressed by means of the unanimity required by Article 115.

Nevertheless, direct taxation has been the object of an interesting process of negative integration[59], thanks to the ECJ case law, especially regarding the interaction between fiscal matters and freedom of movement, and the serious approach of important tax institutions on both a global (OECD/G20) and a European level.

There is a tension between the progressive implementation of free movement rights, especially freedom of establishment and free movement of

[56] TFEU, Protocol (No 7) on the privileges and immunities of the European Union [2012] OJ C 326, Article 12(1) provides that *'officials and other servants of the Union shall be liable to a tax for the benefit of the Union on salaries, wages and emoluments paid to them by the Union [...]. They shall be exempt from national taxes on salaries, wages and emoluments paid by the Union'*.

[57] But European institutions are aware that the EMU would benefit from a *'Fiscal Union'* in order to face its expenditure: see A. IARA, *Revenue for EMU: A Contribution to the Debate on Fiscal Union*, in *European Commission Taxation Papers*, Working Paper n. 54, 2015.

[58] Which provides that the ordinary legislative procedure provided for in paragraph 1 *'shall not apply to fiscal provisions'*.

[59] In P. J. WATTEL, *Taxation in the Internal Market*, in KOUTRAKOS, SNELL (eds.), *Research Handbook on The EU's Internal Market*, cit, pp. 319-320, the author lists five main factors in the process of negative harmonisation of direct taxation within the internal market: the Court case law; the *OECD Model*; the need to face regulatory competition within the EU; the austerity measures brought by unacceptable public debts; and the need for serious actions against tax avoidance, tax fraud and abuse.

capital, and national direct tax policy. The former has indeed incentivised phenomena such as HTC, ATP, and, more in general, the so called 'beggar-thy-neighbour'[60] policies.

It is apparently a paradox that the best way to respond to this race to the bottom that endangers the economic stability of Member States would probably be the harmonisation of direct taxation, but still Member States themselves firmly oppose it. There are, indeed, some explanations.

Firstly, the most basic right of national parliaments, their very first reason of existence, is the right to vote on taxes, according to the fundamental democratic principle 'no taxation without representation'. Thus, the general sensitiveness about the democratic deficit[61] in the EU becomes even more worrying for Member States when the right to vote on taxes is at stake[62].

Secondly, there is an inverse proportionality between the harmonisation of indirect taxation and the willingness of Member States to lose their fiscal sovereignty in direct taxation matters. Indeed, the more indirect taxation is harmonised at an EU level, the more direct taxation remains the only instrument for Member States to implement their economic and social policies.

3.2.1 The first approach of the EU to harmful tax practices: the *Code of Conduct*

One of the first attempts of the EU to respond to the issue of HTC was the adoption of a *Code of Conduct* for business taxation. The Code was set out in the conclusions of the Council of Economics and Finance Ministers (ECOFIN) of 1 December 1997[63]. In the conclusions the Council recognises *'the need for*

[60] For a *'quasi-contractual'* analysis of externalities, spill-over, and beggar-thy-neighbour policies see SCHÖN, *Playing Different Games?,* cit, pp. 349-350.
[61] For a general overview on the concept of 'democratic deficit' in the EU, see BARNARD, PEERS, *European Union Law*, cit, pp. 139-140.
[62] See FASONE, GALLO, WOUTERS, *Re-connecting Authority and Democratic Legitimacy*, cit, p. 184, where GALLO argues that *'[...] the responsibility for rule of law backsliding and democratic decay affecting several Member States lies primarily at national level [...]'* as *'national governments have been unwilling to confer further powers to the EU so as to complete the Economic and Monetary Union (EMU)'.*
[63] COUNCIL, *Conclusion of the ECOFIN Council Meeting on 1 December 1997 concerning taxation policy* (*Code of Conduct*) [1997] OJ C 2/1.

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'.

The *Code* is a source of soft law, and as such it is an instrument of mere peer pressure and not legally binding. The *Code* is aimed at the *'segregation'*[64] of beneficiaries of the favourable fiscal regime introduced in the economic life of a determined Member State. Thus, the main innovations brought by the *Code* are the 'rollback clause'[65] and the 'standstill clause'[66]. According to the former, Member States undertake a roll back of existing tax measures that constitute harmful tax competition, whereas according to the latter, Member States refrain from introducing any such measures in the future.

The *Code* also lists[67] some criteria that may help in assessing the harmfulness of tax measures. It is worth mentioning those that are reported on the website of the European Commission[68] at the time of writing: *'an effective level of taxation which is significantly lower than the general level of taxation in the country concerned; tax benefits reserved for non-residents; tax incentives for activities which are isolated from the domestic economy and therefore have no impact on the national tax base; granting of tax advantages even in the absence of any real economic activity; the basis of profit determination for companies in a multinational group departs from internationally accepted rules, in particular those approved by the OECD; lack of transparency'*.

Lastly, it is also interesting to notice that the Council is aware of the potential overlap between the *Code of Conduct* and the rules on State aid[69]. That is

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[64] PERRONE, *Tax Competition*, cit, p. 20.
[65] *Code of Conduct*, para D.
[66] Ibid, para C.
[67] Ibid, para B.
[68] Available at <https://ec.europa.eu/taxation_customs/business/company-tax/harmful-tax-competition_en#:~:text=The%20Code%20of%20Conduct%20requires,Code%20(%22rollback%22)>.
[69] See also P. J. WATTEL, *Comparing Criteria: State Aid, Free Movement, Harmful Tax Competition and Market Distorting Disparities*, in *State Aid Law and Business Taxation*, 2016, p. 69, where the author reports that *'the Commission studied that blacklist and in 2001 launched a largescale State aid initiative against 15 national tax measures of which 13 were also on the Code of Conduct group's blacklist. This means that 20 % of the tax measures under scrutiny were caught by both sets of rules'*.

why paragraph J of the *Code* states that the Commission shall publish guidelines on the application of State aid rules to measures related to direct business taxation. Indeed, in 1998 the Commission adopted the guidelines[70]. The relationship between regulatory competition and State aid rules—with specific regard to rulings granted by Member States' tax authorities to undertakings in the context of ATP—will be described in Chapter IV.

However, there are strong doubts about the efficiency of the *Code of Conduct*, especially when considering its soft law nature[71]. Indeed, many problems remained unsolved after its publication.

Anyway, the *Code of Conduct*'s experience shows that a correct approach to the matter should involve a full and convinced commitment of each Member State, instead of a sterile intervention of central EU Institutions through instruments of soft law deprived of a solid basis of consensus.

3.2.2 An attempt to harmonise: integration in the field of direct taxation within the internal market

Aside from the *Code of Conduct*, a number of hard law tools—mainly directives which find their legal basis in Article 115 TFEU—has been implemented by the EU in order to fix some minimum harmonised standards in the field of direct taxation, especially regarding the field of business taxation.

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[70] See *Commission Notice on the application of the State aid rules to measures relating to direct business taxation* OJ C 384, 10.12.1998, pp. 3–9.

[71] For an overview on the critiques moved to the efficiency of the *Code of Conduct*, see PERRONE, *Tax Competition,* cit, pp. 20-21. However, a reform of the Code is now included in the Commission's new agenda on tax good governance supporting the recovery strategy. See press release *Press remarks by Commissioner Paolo Gentiloni on fair and simple taxation: a new package of measures to contribute to Europe's recovery and growth* of 15 July 2020, where the Commissioner explains the content of EUROPEAN COMMISSION, Communication from the Commission to the European Parliament and the Council. *An Action Plan for Fair and Simple Taxation Supporting the Recovery Strategy*, COM/2020/312 final, 2020.

Many of the measures adopted by the EU followed not only the publication of the BEPS Project results[72], but also the publication of the Commission's *Action Plan*[73] for making corporate taxation fairer and more efficient.

For the purpose of this work, the following are worth mentioning: *(a) Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States* (*Parent-Subsidiary Directive*)[74], which has replaced *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*[75], and has been amended by the *SAAR*[76] (Specific Anti-Avoidance Rules) and *GAAR*[77] (General Anti-Avoidance Rule) Directives; *(b)* the *ATAD Directives*—*ATAD 2*[78] has amended *ATAD 1*[79]—and a series of six directives aimed at enhancing administrative cooperation between tax authorities of the Member States: *DAC 1*[80],

[72] In particular, the publication by the OECD of the *BEPS 2015 Final Reports*; for a general overview of the first impact of BEPS Project on EU legislation, see M. F. DE WILDE, *Taxing Multinationals Post-BEPS - What's Next*, in *Erasmus Law Review*, 10, 1, 2017, pp.1-2: indeed, not only the EU has actively participated to the negotiation and the drafting of the 15 points *Action Plan*, but it has also implemented measures that are directly inspired by the *Plan* itself.

[73] Communication from the Commission to the European Parliament and the Council. *A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action*, COM/2015/0302 final, 2015.

[74] [2011] OJ L 345.

[75] [1990] OJ L 225.

[76] Council Directive 2014/86/EU of 8 July 2014 amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [2014] OJ L 219 (*SAAR Directive*).

[77] Council Directive (EU) 2015/121 of 27 January 2015 amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [2015] OJ L 21 (*GAAR Directive*).

[78] Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries [2017] OJ L 144 (*ATAD 2*). ATAD is the acronym of Anti-Tax Avoidance Directive.

[79] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market [2016] OJ L 193 (*ATAD 1*).

[80] Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC [2011] OJ L 64 (*DAC 1)*.

DAC 2[81], *DAC 3*[82], *DAC 4*[83], *DAC 5*[84], and *DAC 6*[85]; *(c)* the *I+R Directive*[86], aimed at ensuring that *'interest and royalty payments are subject to tax once in a Member State'*[87] and the *Arbitration Convention*[88].

a) The Parent-Subsidiary Directive

The *Parent-Subsidiary Directive* deals with intragroup cross-border dividends and its main aim is to *'exempt dividends and other profit distributions paid by subsidiary companies to their parent companies from withholding taxes and to eliminate double taxation of such income at the level of the parent company'*[89], in cases in which the parent company and the subsidiary are allocated in two different Member States. The Directive is in response to the need of ensuring free movement of capital in the internal market and not hindering the grouping together of companies of different Member States, which *'may be necessary [...] to ensure the effective functioning of such an internal market'*[90].

The main preconditions for the Directive to apply are that the parent and the subsidiary are resident in two Member States, that both are subject to CIT and correctly registered as companies[91], and that parent company has at least a 10% holding in the capital (or of voting rights) in the subsidiary. An important derogation

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[81] Council Directive 2014/107/EU of 9 December 2014 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation [2014] OJ L 359 (*DAC 2*).
[82] Council Directive (EU) 2015/2376 of 8 December 2015 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation [2015] OJ L 332 (*DAC 3*).
[83] Council Directive (EU) 2016/881 of 25 May 2016 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation [2016] OJ L 146 (*DAC 4*).
[84] Council Directive (EU) 2016/2258 of 6 December 2016 amending Directive 2011/16/EU as regards access to anti-money-laundering information by tax authorities [2016] OJ L 342 (*DAC 5*).
[85] Council Directive (EU) 2018/822 of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements [2018] OJ L 139 (*DAC 6*).
[86] 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 [2003] OJ L 157 (*I+R*).
[87] Ibid, recital 3.
[88] Convention 90/436/EEC on the elimination of double taxation in connection with the adjustment of profits of associated enterprises [1990] OJ L 225/10, based on the Commission's proposal for a directive to eliminate double taxation in the case of transfers of profits between associated enterprises in different Member States [1976] OJ C 301.
[89] *Parent-Subsidiary Directive*, recital 3.
[90] Ibid, recital 4.
[91] Namely: private companies, public limited companies, European companies, and European Co-operative Societies.

is that Member States can decide to exclude the parent companies that have not maintained the concerned holdings[92] for an uninterrupted period of at least 2 years from the scope of the provisions laid down by the Directive.

According to Article 4, in case of distribution of profits from the subsidiary to the parent company, the Member State's jurisdiction where the parent company is resident should *'refrain from taxing such profits'* or *'tax such profits while authorising the parent company [...] to deduct from the amount of tax due that fraction of the corporation tax related to those profits and paid by the subsidiary'* in the Member State where the subsidiary is resident. Indeed, as said before, international taxation practice normally assign priority to taxation on a source base, meaning that it is up to the country of residence to alleviate the double taxation.

With regard to the source jurisdiction, in addition, Article 5 provides that the Member States in which the subsidiary resides shall exempt those profits from the withholding tax.

Lastly, in order to reach the main aim of avoiding double taxation, Article 7(2) provides a safeguard measure that ensures that the *'Directive shall not affect the application of domestic or agreement-based provisions designed to eliminate or lessen economic double taxation of dividends'*.

The application of those anti-double taxation rules might create favourable conditions for tax avoidance, paradoxically allowing phenomena of double non-taxation.

Therefore, the *Parent-Subsidiary Directive* has been amended by *(i) SAAR* (2014) and *(ii) GAAR* (2015) directives, aimed at introducing new anti-avoidance rules.

The *(i)* modifications brought by the *SAAR Directive* are aimed *at 'avoiding situations of double non-taxation deriving from mismatches in the tax treatment of profit distributions between Member States'*[93]. In particular, it is clarified that the tax exemption contained in Article 4 is limited *'to the extent that such profits are not deductible by the subsidiary'*[94], meaning that instead those profits will be taxed if they are deductible in the Member State where the subsidiary is resident. Clearly,

[92] Ibid, Article 3(2)(b). This derogation is really similar to the content of Article 8(1) *MLI*.
[93] *SAAR Directive*, recital 3.
[94] Ibid, Article 1.

the aim of this modification is to combat hybrid mismatch arrangements, in line with the purpose and the content of *Action 2* of the *BEPS Action Plan*[95].

The *(ii) GAAR Directive* as well is aimed at preventing the potential abuse of the *Parent-Subsidiary Directive*, but on a more general level. Hence, it excludes from the scope of beneficiaries of the *Parent-Subsidiary Directive* those *'arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of this Directive, are not genuine having regard to all relevant facts and circumstances'*[96].

Once again, the influence of the *BEPS Action Plan*—and namely of the first category of Actions analysed above—is clear, in particular considering that new Article 1(3) of the *Parent-Subsidiary Directive* provides that *'arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality'*[97].

b) The Anti-Tax Avoidance Directives (ATAD) and the Directives on Administrative Cooperation (DAC)

The *Anti-Tax Avoidance Directive* (*ATAD 1*) was adopted in 2016 in order to face the issues arising from hybrid mismatches arrangements and has been amended by *ATAD 2* in 2017. In particular, *ATAD 2* amended Articles 1, 2, and 9 of *ATAD 1* and introduced Articles 9a and 9b.

The amendments were deemed necessary for several reasons, amongst which it is possible to mention the need for broadening the horizon of *ATAD 1*. Indeed, the provisions of *ATAD 1* were limited to hybrids in the EU context, without taking into account triangulations in which third countries were involved. *ATAD 2* has expanded the territorial scope of application to hybrid situations involving third countries[98].

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[95] An analysis of the amendment can be found in I. DE GROOT, *Exemption Method in the EU Parent-Subsidiary Directive Amended in Respect of Hybrid Instruments: What about the Credit Method?*, in *EC Tax Review*, 24, 3, 2015, pp. 158 et seq.
[96] *GAAR Directive*, Article 1.
[97] Ibid.
[98] See *ATAD 1* as amended by *ATAD 2*, Article 1. Moreover, the mechanism introduced in Article 9(3) for situations in which extra EU jurisdictions are involved is aimed at granting a minimum standard across the Member States that should in principle prevent one Member State to exploit

The anti-avoidance rules provided by the directives *apply 'to all taxpayers that are subject to corporate tax in one or more Member States, including permanent establishments in one or more Member States of entities resident for tax purposes in a third country'*[99], and they can be derogated by the provisions of a DCT only when such provisions are *'aimed at safeguarding a higher level of protection for domestic corporate tax bases'*[100].

In its current form, *ATAD 1* provides a general anti-avoidance rule (Article 6)[101] and four special anti-avoidance rules: *(i)* the interest limitation rule (or 'EBITDA-rule') (Article 4); *(ii)* the exit taxation rule (Article 5); *(iii)* the CFC rule (Articles 7 and 8); and *(iv)* the hybrid mismatch rules (Articles 9, 9a and 9b).

First of all, the Directive implements *Action 4* of the BEPS Project. Indeed, *(i)* Article 4 introduces a limit for the deductibility of interests, corresponding to the 30% of the earnings before interest, taxes, depreciation, and amortisation (so called 'EBITDA-rule').

Article 5 of *ATAD 1* introduces an *(ii)* exit taxation rule which is based on the judgement provided by the ECJ in *Indus*. Indeed, it provides for a tax on unrealised capital gains with conditional payment facilities. In fact, commentators have noticed that such a mechanism *'is to a large extent a codification of the case law of the Court in this area'* as it goes even further than the ECJ in shifting *'from case law regarding the question whether and under which conditions Member States may impose exit taxes on unrealized capital gains, to a directive prescribing that the Member States have to subject such unrealized capital gains to an exit tax'*[102].

Articles 7 and 8 of the Directive have the same object of *Action 3* of the *BEPS Action Plan*: thus, they deal with *(iii)* CFC rules. In particular, if an entity or a PE located in a Member State does not pay taxes on profits or those profits are

double deduction in order to be more attractive than other Member States for third countries' investors. Especially, in those cases in which a hybrid between two third countries is 'imported' in a Member State through a non-hybrid instrument, the income is not deductible if the deduction would cause a double deduction or a deduction without inclusion.

[99] *ATAD 1*, Article 1(1).

[100] Ibid, Article 3.

[101] Article 6 reproduces the general anti-avoidance rule introduced by the *GAAR Directive*.

[102] S. PEETERS, *Exit Taxation: From an Internal Market Barrier to a Tax Avoidance Prevention Tool*, in *EC Tax Review*, 26, 3, 2017, p. 132.

exempted under the law of that Member State, that entity or PE should be treated as a CFC, under the conditions laid down by Article 7(a) and (b)[103]. In that case, the Member State shall tax: the non-distributed income of the entity or the income of the permanent establishment if the income is derived from one of the categories listed in Article 7(2)(a)[104]; and the non-distributed income of the entity or permanent establishment arising from non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage.

Significantly, Article 7(2)(b) does not reproduce a definition of *'non-genuine arrangements'* identical to the one provided by the *GAAR Directive* (that is instead recalled by Article 6). Indeed, it refers to functions, assets, and risks, under the clear influence of the FAR analysis of the *Aligning Transfer Pricing Outcomes with Value Creation* report published by the OECD in 2015.

However, the main purpose of *ATAD 1* and *ATAD 2* is to provide *(iv)* rules concerning the tax treatment of hybrid mismatches.

Firstly, Article 9 of *ATAD 1* provided that in situations where there is a risk of double deduction, the deduction *'shall be given only in the Member State where such payment has its source'*[105], while in cases of deduction without inclusion it was the Member State of the payer that *'shall deny the deduction of such payment'*[106].

ATAD 2 amended Article 9 and introduced two new rules aimed at combating double deduction: a 'primary rule'[107], that denies the deduction in the Member State of the investor; and a 'defensive rule'[108], that—in the hypothesis in

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[103] The conditions are that: '(i) *in the case of an entity, the taxpayer by itself, or together with its associated enterprises holds a direct or indirect participation of more than 50 percent of the voting rights, or owns directly or indirectly more than 50 percent of capital or is entitled to receive more than 50 percent of the profits of that entity; and* (ii) *the actual corporate tax paid on its profits by the entity or permanent establishment is lower than the difference between the corporate tax that would have been charged on the entity or permanent establishment under the applicable corporate tax system in the Member State of the taxpayer and the actual corporate tax paid on its profits by the entity or permanent establishment'*.

[104] The categories are: *(i)* interest or any other income generated by financial assets; *(ii)* royalties or any other income generated from intellectual property; *(iii)* dividends and income from the disposal of shares; *(iv)* income from financial leasing; *(v)* income from insurance, banking and other financial activities; and *(vi)* income from invoicing companies that earn sales and services income from goods and services purchased from and sold to associated enterprises, and add no or little economic value.

[105] *ATAD 1*, Article 9(1).

[106] Ibid, Article 9(2).

[107] *ATAD 1* as amended by *ATAD 2*, Article 9(1)(a).

[108] Ibid, Article 9(1)(b).

which the investor (extra-EU) jurisdiction allows the double deduction—denies the deduction in the payer (EU) jurisdiction.

Secondly, also in cases of deduction without inclusion, *ATAD 2* has brought a 'primary'[109] and a 'defensive'[110] rule. The former denies deduction in payer jurisdiction, while the latter—in the hypothesis in which the 'primary rule' is circumvented—obliges the Member State of the payee to include in income 'the amount of the payment that would otherwise give rise to a mismatch outcome'.

Thirdly, *ATAD 2* deals with cases of *'disregarded PE'*, in line with *Action 7* of the *BEPS Action Plan*: save for those provisions contained in bilateral treaties concluded between a Member State and a third country, the Member State shall always require taxpayers to include the income deriving from a hybrid mismatch that would otherwise be attributed to the disregarded PE (i.e. the PE that is not subject to taxation in that Member State)[111].

Fourthly, as said before, *ATAD 2* introduces rules for both reverse hybrid mismatches and tax residency mismatches in the new Articles 9a and 9b respectively. The former essentially provides that where a non-resident company that holds at least a 50% control in a hybrid entity incorporated or established in a Member State is located in a jurisdiction that regards the hybrid entity as a taxable person, the hybrid entity shall be regarded as a resident of that Member State and taxed on its income to the extent that that income is not otherwise taxed under the laws of the Member State. Then, with regard to Article 9b, in order to avoid double deduction in cases of dual resident corporations, *'if both jurisdictions are Member States, the Member State where the taxpayer is not deemed to be a resident according to the double taxation treaty between the two Member States concerned shall deny the deduction'*.

Ultimately, stimulated by those *Actions* (*5*, *12*, and *13*) of the *BEPS Action Plan* that deal with the transparency of tax regimes, the EU has acknowledged[112]

[109] Ibid, Article 9(2)(a).
[110] Ibid, Article 9(2)(b).
[111] Ibid, Article 9(5).
[112] See recitals 1-2 of *DAC 1*: *'the Member States' need for mutual assistance in the field of taxation is growing rapidly in a globalised era. There is a tremendous development of the mobility of taxpayers, of the number of cross-border transactions and of the internationalisation of financial instruments, which makes it difficult for Member States to assess taxes due properly. This increasing*

the need for a serious strengthening of the administrative cooperation[113] between national tax authorities. In this context, the Council has adopted the *Directives on Administrative Cooperation* (*DAC*).

In particular, the general regime implemented by *DAC 1* has been amended by: *DAC 2*, introducing a system of mandatory automatic exchange of information in the field of taxation; *DAC 3*, expanding the scope of that system to mandatory automatic exchange of information on advance cross-border rulings and advance pricing arrangements (as recommended by *Action 5 BEPS*); *DAC 4*, implementing the system of Country by Country Reporting proposed by *Action 13* of the *BEPS Action Plan*; *DAC 5*, providing rules for the access to anti-money-laundering information by national tax authorities; and *DAC 6*, introducing new mandatory disclosure for cross-border arrangements that could be potentially used for ATP, with the target of enhancing the equality of taxation within the internal market (in line with *Action 12 BEPS*).

c) The Interest and Royalties Directive (I+R) and the Arbitration Convention

Together with the *Parent-Subsidiary Directive*, the *I+R Directive* is the main instrument through which direct taxation has found its very limited form of integration across the EU. Its aim[114] is thus to harmonise the internal market conditions for some specific forms of transactions, and not to specifically avoid HTC practices. In particular, the treatment of those transaction must be carried out across the EU in a way that ensures that double taxation is eliminated,

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difficulty affects the functioning of taxation systems and entails double taxation, which itself incites tax fraud and tax evasion, while the powers of controls remain at national level. It thus jeopardises the functioning of the internal market. Therefore, a single Member State cannot manage its internal taxation system, especially as regards direct taxation, without receiving information from other Member States. In order to overcome the negative effects of this phenomenon, it is indispensable to develop new administrative cooperation between the Member States' tax administrations. There is a need for instruments likely to create confidence between Member States, by setting up the same rules, obligations and rights for all Member States'.

[113] For an overview on administrative cooperation between tax authorities and its enhancement through the *DAC* see WATTEL, *Taxation in the Internal Market,* cit, pp. 331-333; on the same matter see also RIXEN, *From Double Tax Avoidance to Tax Competition*, cit, p. 30, where the author argues that *'national tax sovereignty renders effective international cooperation impossible'*.

[114] See recital 1 of *I+R Directive*: *'in a Single Market having the characteristics of a domestic market, transactions between companies of different Member States should not be subject to less favourable tax conditions than those applicable to the same transactions carried out between companies of the same Member State'*.

administrative formalities are facilitated, and cash-flow problems are avoided[115]. Thus, the *I+R Directive* only indirectly concerns the main topic of this research.

Specifically, the *I+R Directive* deals with intragroup cross-border payments and it calls for exemption from withholding tax by the source State on interest and royalty payments within groups of companies. The companies belonging to the same group are called *'associated companies'*, and the minimum holding requirement is set at 25%[116]. It was noticed, for example, that the implementation of the Double Irish with Dutch Sandwich was indeed possible because of the withholding exemption.

In conclusion, it must be noticed that even before the *I+R* and the *Parent-Subsidiary* directives the Community had already provided an instrument for the elimination of double taxation for associated enterprises, namely the *Arbitration Convention* of 1990. The *Convention* deals with cases in which Member States have incompatible positions regarding the transfer price of intragroup supplies of goods or services and such incompatible positions cause double taxation. It provides for a mutual agreement procedure and, in case it does not work, for mandatory arbitration. The Commission chairs a *Joint Transfer Pricing Forum* (JTPF) that has a consultative function performed by recommending the best practices in transfer pricing matters.

It has been observed that the practical application of the *Arbitration Convention* has been marginal and rare. The reason might be that it had a troubled story of entry into force, re-entries into force, and prolongations, and also that similar instruments developed by the OECD on a global level have soon proved to be more effective. However, some scholars argue that the *Convention* may have a significant preventative effect[117].

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[115] Ibid.

[116] Ibid, Article 3(b): *'a company is an "associated company" of a second company if, at least:* (i) *the first company has a direct minimum holding of 25 % in the capital of the second company; or* (ii) *the second company has a direct minimum holding of 25 % in the capital of the first company; or* (iii) *a third company has a direct minimum holding of 25 % both in the capital of the first company and in the capital of the second company'*.

[117] On the practical application and the limited success of the *Arbitration Convention*, see WATTEL, *Taxation in the Internal Market,* cit, p.330.

3.2.3 New scenarios: Commission's proposals for a CCCTB

'General tax competition' is normally realised through a race to the bottom in the tax rate, but the same effect can be reached through the lowering of the Corporate Tax Base (CTB). While it is true that this is a field in which the BEPS Project has proved to be less sensitive than it has been to matters of preferential tax regimes and other HTC practices, it is also true that the BEPS reports are amongst those factors that have stimulated the Commission to reiterate its proposal regarding the adoption of a Common Corporate Tax Base (CCTB)[118] and a Common Consolidated Corporate Tax Base (CCCTB) [119].

Indeed, the first attempt to introduce a CCCTB[120] failed in 2011, because of the objections of Ireland, Malta, Slovakia, Lithuania, Latvia, Cyprus, and Estonia, small States amongst which there are champions of general tax competition for the aforementioned reasons. However, in 2016 the Commission issued its two new proposals in the context of the implementation of many different new measures for preventing and combating HTC practices[121].

In the view of the Commission[122] not only would a CCCTB hinder harmful practices, but it would also contribute to the enhancement of administrative cooperation—and thus to the facilitation of cross-border transactions—by the creation of a one-stop-shop system. Through three equally weighted factors, namely assets, labour, and sales, the CCCTB would allow tax authorities to attribute income to where the value is created.

If compared to the 2011 proposals, the new attempt of the Commission has two new main features: firstly, the adoption of the CCCTB would be mandatory and not optional for Member States; secondly, the process would be articulated in a first phase concerning the adoption of a CCTB, and only after that a second phase concerning the adoption of a CCCTB.

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[118] *Proposal for a Council Directive on a Common Corporate Tax Base (CCTP)*, COM/2016/0685 final, 2016.
[119] *Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB),* COM/2016/0683 final, 2016.
[120] *Proposal for a Council Directive on a Common Consolidate Corporate Tax Base (CCCTB)*, COM/2011/0121 final, 2011.
[121] See press release *Commission proposes major corporate tax reform for the EU* of 26 October 2016.
[122] See the Explanatory Memorandums of both the proposals.

The first phase is described by the provisions of the Commission's *Proposal for a CCTB*. In particular, the adoption of the CCTB would be mandatory for all those groups beyond a certain size-related threshold that *'will refer to the total consolidated revenue of a group which files consolidated financial statements'*[123]. The proposal also contains a new definition of PE that implements *Action 7* of the *BEPS Action Plan*, and it introduces the broadest definition of *'tax base'*, i.e. it includes in the tax base all the income that is not explicitly exempted.

Besides the deduction of incurred costs (already provided by the 2011 proposal), the new proposal also includes a 'super-deduction'[124] for research and development (R&D) activities-related costs. At the same time, the proposed directive would provide a limitation for the deduction of interests, such as the one suggested by *Action 4 BEPS* and Article 4 of the *ATAD 1*.

Another initiative proposed by the Commission is the *'Allowance for Growth and Investment'*. This regime would be aimed at tackling the asymmetries between interests and profits. The fact that interests are deductible (while profits are not) often incentivises investors to finance undertakings through debts rather than through equity, giving rise to problems of undercapitalisation such as those analysed in Chapter II. Thus, the aim of the proposed regime would be to stimulate direct investments and sustainable growth. Moreover, taxpayers would be allowed to *'carry losses forward indefinitely without restrictions on the deductible amount per year'*.

The last relevant content of the proposal is about hybrid mismatches. However, given that mismatches would be eliminated by the adoption of a CCTB, then those provisions of the proposed directive would limit their applicability to transactions to and from third countries.

The second phase is described by the provisions of the *Commission's Proposal for a CCCTB*. Like for the CCTB the adoption of the CCCTB would also be mandatory. Aside from the definition of group (Article 7) and the provisions about withholding taxes (Article 10), anti-avoidance rules for disposals of shares

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[123] *Proposal for a Council Directive on a Common Corporate Tax Base,* Explanatory Memorandum.
[124] Ibid.

(Chapter IV), and the relationship between business reorganisations[125] and taxation of losses and unrealised capital gains (Chapter V), the most important content of the proposal is the *'formulary apportionment'*.

In order to individuate the so called *'value-jurisdiction'*[126] link, the new formula implies an analysis based on the three aforementioned equally weighted factors: *(i)* assets, *(ii)* labour, and *(iii)* sales: *(i)* only fixed tangible assets will be included in the assets factor; *(ii)* to calculate the labour factor, the total payroll will be divided by the number of employees *'in order to account for differences in the levels of wages across the Union and thereby allow for a fairer distribution'*; and *(iii)* the structure of the sales factor is based on sales destination.

The proposed directive would also include a safeguard clause with an alternative method of income allocation for those situations in which the application of the formulary apportionment does not fairly reproduce the economic reality of the business. Furthermore, there will be *'rules on adjusted formulae'* for those sensitive sectors in which there is a need for different criteria to be taken into account.

The new *'formulary apportionment'* is an innovative tool that might represent a step further *vis-à-vis* the FAR analysis and the DEMPE test provided for in the OECD *Transfer Pricing Guidelines*. It seems, indeed, that assets, labour and sales closely recall the criteria laid by the Court in *Cadbury Schweppes*: premises, staff and equipment.

Lastly, the proposal includes a one-stop-shop system that will likely benefit from the enhancement of administrative cooperation promoted by *DAC Directives*.

3.2.4 Addressing new challenges in the Digital Single Market: towards a European Web Tax?

[125] *'Business reorganisations'* refers to entries and exits from groups, and it is thus a concept closely related to corporate mobility.

[126] See PERRONE, *Tax Competition,* cit, p. 269: the *'value-jurisdiction'* principle allows to attribute income to the company which is located in the Member State where the income was realized. Indeed, the Commission's proposal holds that '*this combination reflects a balanced approach to distributing taxable profits amongst eligible Member States'*.

The 'Digital Single Market' was one of the 10 political priorities of the Juncker Commission (2014-2019). Indeed, the taxation of revenues deriving from the provision of digital services gives rise to many questions. There is, indeed, *'a huge mismatch between where revenues are booked and where users are located'*[127]. Digital multinationals normally operate without a material presence in the State in which they obtain their own revenues. This specific characteristic has allowed them to implement ATP, especially through the TNMM method, in order to shift their profits in low-tax jurisdictions, such as Ireland (e.g. the cases of Google, Facebook, and Apple) or Luxembourg (e.g. the case of Amazon).

A report[128] issued in 2017 estimated that, as of 2016, the EU was losing every year EUR 1.3 billion tax revenues from Apple, EUR 0.9-1.3 billion from Google, and EUR 0.6-0.8 billion from Facebook. Significantly, while the effective CIT rates paid by Google and Facebook outside the EU were around 9% and 28-34% respectively, in the EU such rates lowered to 0.82% and 0.03%. Furthermore, the authors of the report also estimated that the loss is on average much more significant in the ten largest Member States, further evidence of the abovementioned theory of small countries. The Member States more harmed by the phenomenon, have recently acknowledged the problem and decided to address it. The ultimate confirmation came in September 2017 from the *Joint initiative on the taxation of companies operating in the digital economy*, a political statement jointly drafted by the ministers of economy and finance of France, Germany, Italy, and Spain.

While *Action 1* of the *BEPS Action Plan* did not take a position on specific remedies for the problems brought by deprivation of tax revenues from the digital market, in 2018 the Task Force Digital Economy of the OECD published the *Tax Challenges Arising from Digitalisation-Interim Report*[129], that, together with the Communication of the Commission *A Fair and Efficient Tax System in the*

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[127] P. TANG, H. BUSSINK, *EU Tax Revenue Loss from Google and Facebook*, published by PvdA and S&D, 2017, available at <https://static.financieel-management.nl/documents/16690/EU-Tax-Revenue-Loss-from-Google-and-Facebook.pdf>, p. 3.
[128] Ibid.
[129] Available at <https://www.oecd.org/tax/tax-challenges-arising-from-digitalisation-interim-report-9789264293083-en.htm>.

European Union for the Digital Single Market[130], inspired the Commission's proposal of a package aimed at addressing the problem of taxation of digital services. The package is composed of two proposals[131] for two directives, introducing a temporary and a definitive regime respectively, and a recommendation[132]. The recommendation demands Member States to adopt the same provisions included in the proposed directives also in the DTCs concluded with third countries. Thus, the Commission faces the problem from the points of view of both the single Member States and the Union as a whole.

Preliminarily, the Commission has observed that there are three main features of the digital market which hinder the applicability to digital multinationals of the traditional criteria for business taxation: the lack of material presence, that renders ineffective the traditional interpretation of the concept of PE; the provision of services 'for free', which is compensated by the acquisition of personal data of the users[133]; and the obstacles for the protection of the rights of parties involved in e-commerce transactions. Those factors, in turn, bring three main questions about the Digital Single Market: *(i)* what, *(ii)* where, and *(iii)* how can Member States tax?

The *(i)* first question, regarding the object of taxation, is immediately clarified by the proposed directives, which refer to *'digital services'*: those are defined as *'services which are delivered over the internet or an electronic network and the nature of which renders their supply essentially automated and involving minimal human intervention, and impossible to ensure in the absence of information technology'*[134]. Digital services are provided through *'digital*

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[130] EUROPEAN COMMISSION, Communication from the Commission to the European Parliament and the Council. *A Fair and Efficient Tax System in the European Union for the Digital Single Market*, COM/2017/547 final, 2017.

[131] EUROPEAN COMMISSION, *Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services,* COM/2018/148 final, 2018 (*DST Proposal*); EUROPEAN COMMISSION, *Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence*, COM/2018/147 final, 2018 (*SDP Proposal*).

[132] EUROPEAN COMMISSION, *Commission Recommendation of 21.3.2018 relating to the corporate taxation of a significant digital presence*, C/2018/1650 final, 2018.

[133] For example, according to TANG, BUSSINK, *EU Tax Revenue Loss from Google and Facebook,* cit, over the period 2013-2015, Amazon almost did not make any profits, with an estimated profitability in the EU between 0.3% and 5%, with even a net loss in 2014.

[134] *Proposed Directive on laying down rules relating to the corporate taxation of a significant digital presence,* Article 3(5).

interfaces', described as *'any software, including a website or a part thereof and applications, including mobile applications, accessible by users'*[135].

The answer to the *(ii)* second question is provided through the reiteration of a concept already proposed in the framework of the OECD: the *'significant digital presence'* (SDP). The function of this new notion is to integrate, and not replace, the traditional definition of PE, which has proved inadequate for the digital market. This aim is pursued by setting a series of quantitative thresholds[136], already endorsed by *Action 1 BEPS*.

The *(iii)* last question refers to the appropriate method for the allocation of profits amongst undertakings. The Commission has opted for the Profit Split Method, introduced through a 'comply or explain' rule[137]. Accordingly, and in line with *BEPS Action Plan* (*Actions 8*, *9*, ad *10*) and the *Aligning Transfer Pricing Outcomes with Value Creation* a traditional FAR analysis is not sufficient to ensure a profit attribution to the SDP that reflects the creation of value. Hence, the DEMPE Test is transposed on a digital level where the *SDP Proposal* provides that *'due account shall be taken of the economically significant activities performed by the significant digital presence which are relevant to the development, enhancement, maintenance, protection and exploitation of the enterprise's intangible assets'*[138].

It is significant, however, that the Commission has not reiterated the proposal for a formulary apportionment, such as that one included in the *Proposal for a CCCTB*, heading back to the PE criterion instead, even though adapting that criterion to the specific features of the digital market. In the Explanatory Memorandum the Commission has observed that, even though *'the proposal for a CCCTB would be the optimal solution to ensure fairer and more efficient corporate*

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[135] Ibid, Article 3(2).

[136] Article 4(3) of the *Proposed Directive on laying down rules relating to the corporate taxation of a significant digital presence* provides that *'a "significant digital presence" shall be considered to exist in a Member State in a tax period if the business carried on through it consists wholly or partly of the supply of digital services through a digital interface and one or more of the following conditions is met with respect to the supply of those services [...]:* (a) *the proportion of total revenues obtained in that tax period and resulting from the supply of those digital services to users located in that Member State in that tax period exceeds EUR 7,000,000;* (b) *the number of users of one or more of those digital services who are located in that Member State in that tax period exceeds 100,000;* (c) *the number of business contracts for the supply of any such digital service that are concluded in that tax period by users located in that Member State exceeds 3,000'.*

[137] Ibid, Article 5(6).

[138] Ibid, Article 5(4).

taxation within the EU', the CCCTB's scope is currently limited to large multinational companies and the definition of PE in the *Proposal for a CCCTB* follows the one currently applied internationally. In particular, the formulary apportionment in the CCCTB *'may not sufficiently capture the digital activities of a company'*. However, the Commission has also shown a strong will to adapt the formula apportionment approach in order to effectively capture digital activities. Thus, amendments and further work to incorporate the Digital Single Market provisions into the CCCTB are welcomed by the Commission.

The regime so far described will, in the intention of the Commission, be introduced only after the settlement of a temporary regime. During that period, the *DST Proposal* would introduce an interim tax, the Digital Services Tax (DST). This indirect tax would apply to revenues created from certain digital activities, and specifically from*: 'the placing on a digital interface of advertising targeted at users of that interface; the making available to users of a multi-sided digital interface which allows users to find other users and to interact with them, and which may also facilitate the provision of underlying supplies of goods or services directly between users; the transmission of data collected about users and generated from users' activities on digital interfaces'*[139]. A crucial characteristic is that the DST would be applied only where the user plays a major role in value creation[140], and thus only in the Member State where the user is located within the tax period.

The DST would apply only to companies with total annual worldwide revenues of EUR 750 million and EU revenues of EUR 50 million, with a fixed tax rate of 3%[141] in order to avoid fiscal asymmetries between Member States.

Lastly, consistently with the *DAC Directives*, the Directive introducing the DST would provide for the creation of a one-stop-shop system, for the enhancement of administrative cooperation through tax authorities of the Member States.

[139] *Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services,* Article 3(1).

[140] The DST thus addresses the second of the three critical features of the digital market listed above: the provision of services 'for free', which is compensated by the acquisition of personal data of the users.

[141] Ibid, Articles 4 and 8; according to the website of the European Commission, the application of the DST would generate a tax income of around EUR 5 billion per year.

3.3 *The difficult relationship between corporate mobility and taxation in the Court's case law*

Having described the concept of tax competition and its implications at the EU level have been observed, it is finally time to analyse how the Court has assessed this phenomenon in practice.

When tax law interferes with free movement, Member States should in theory justify their own tax measure and show that it is proportionate. For example, in *Cadbury Schweppes*, France had to justify its higher CIT rate, given that it could be interpreted as a restriction that hindered or rendered the French market less attractive for an Irish company that enjoyed the lower CIT rate of Ireland. The reasons for taxation are, however, essentially economic, and the Court does not allow justifications based on purely economic grounds[142].

Fiscal autonomy of the Member States clashes with the principles of the internal market. In fact, the fundamental freedoms cannot be limited by discriminatory measures, and it has been pointed out in Chapter I that the Court has normally deemed those provisions that introduce advantages and disadvantages on the basis of persons' residence to be discriminatory, save for the derogation provided by Article 65(1)(a) TFEU. However, it has been noticed that residence[143] is also the main—and legitimate—criterion adopted by international tax law to deal with taxation of cross-border transactions. Thus, the application of a strict 'discriminatory approach' would lead the interpreter to consider almost all national direct tax measures unlawful, given that the great majority of them is based on the residence-source principle.

The case law of the Court appears uncoordinated and inconsistent. It seemed hesitant at the beginning, while it has later shown a higher degree of reverence for tax interests of the Member States. However, a balance between fiscal autonomy and freedom of movement has not been reached yet. Fiscal autonomy, indeed,

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[142] Save for what has been said above about Article 65(1)(a) TFEU, i.e. the only provision of the Treaty that allows for a derogation based on a purely economic ground.

[143] Here 'residency' refers to the principle of territoriality, i.e. the residency-source taxation. The Court accepted both criteria, respectively in case C-96/08 *CIBA Speciality Chemicals Central and Eastern Europe Szolgáltató, Tanácsadó és Keresdedelmi k* [2010] ECLI:EU:C:2010:185 (for taxation on residence base) and case C-311/08 *Société de Gestion Industrielle (SGI) v Belgian State* [2010] ECLI:EU:C:2010:26 (for taxation on a source base).

entails that cross-border situations are not comparable to wholly internal situations, while freedom of movement relies on that comparability.

The main cases have dealt with incoming dividends, outgoing dividends, double taxation, and tax avoidance (thus including double non-taxation). In those fields, the process of negative integration has, so far, failed in levelling the interests of the internal market with those of each Member State. The Court has seemed to misunderstand the breadth of its competence: in principle, the ECJ cannot prohibit disparities between taxing jurisdictions or allocate tax power[144]. The Court can only intervene in one-country problems, i.e. when national tax law of a Member State interferes with free movement rights.

P. J. Wattel has defined the Court's behaviour as an *'always somewhere approach'*[145], meaning that the ECJ has proved to have difficulty in acknowledging that *'overlaps'* (double taxation) or *'underlaps'* (double non-taxation) may occur within an uncoordinated system made up of 27 different taxing jurisdictions. However, it will be observed when analysing the *FII*[146] case that the Court has more recently accepted that each Member State is, in principle, free to decide whether or not to exercise its taxing jurisdiction on a certain company, as long as no discriminatory measure breaches free movement rights. Thus, a particular Member State cannot be blamed for declining its tax jurisdiction, even when the non-assumption causes a double non-taxation situation.

In conclusion, it seems that the harmful consequences of certain HTC practices are taken into account and, to a certain extent, deemed acceptable.

3.3.1 Taxation and freedom of establishment: the approach of the Court between restrictions and discrimination

The relationship between direct taxation matters and freedom of establishment in the case law of the CJEU can be analysed from two points of view:

[144] However, in her *The Substantive Law of the EU*, cit, BERNARD argues that the ECJ can rule on how Member States decide to exercise their tax competence.
[145] See WATTEL, *Taxation in the Internal Market,* cit, pp. 333-336
[146] Case C-446/04 *Test Claimants in the FII Group Litigation v Commissioners of Inland Revenue* [2006] ECLI:EU:C:2006:774¸ for a further example see also case C-414/06 *Lidl Belgium GmbH & Co. KG v Finanzamt Heilbronn* [2008] ECLI:EU:C:2008:278, para 52

(i) the point of view of Member States, assessing whether or not a tax provision adopted by a certain Member State can be deemed liable of breaching Article 49 TFEU; or *(ii)* the point of view of undertakings, assessing where is the limit beyond which certain schemes adopted by companies cannot be upheld in the name of freedom of establishment.

In respect of the first matter, *(i)* it has been submitted that the ECJ has inconsistently approached the matter of the interaction between Article 49 TFEU and national tax measures[147]. On the one hand, in *Futura Participations*[148] the Court held that *'a system, which is in conformity with the fiscal principle of territoriality, cannot be regarded as entailing any discrimination, overt or covert, prohibited by the Treaty'*[149]. On the other hand, in some other cases such as *FII* or *Commission v France*[150], the Court has followed the Opinion of AG Geelhoed in *ACT Group Litigation*[151]. Accordingly, there is a distinction between *'quasi-restrictions'*[152] and *'true restrictions'*[153]: the former are restrictions resulting inevitably from the coexistence of national tax systems, which fall outside the scope of the Treaty, while the latter are all those restrictions based on the residence of the taxpayer, which—if discriminatory—breach the fundamental freedoms.

Starting from the same line of reasoning adopted *Futura Participation,* the Court adopted a 'restrictions approach' in *Marks & Spencer*. The case concerned a British company willing to set off its losses incurred by its Belgian, German, and French subsidiaries by way of group relief against its total profits. However, UK law only allowed group relief for UK-based subsidiaries, prohibiting it for all subsidiaries established in another Member State which did not conduct any trading activities in the UK. The Court held that those provisions were a breach of Article 49, because they hindered *'the exercise by that parent company of its freedom of*

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[147] For an overview on the development of the Court's approach to the matter, see BARNARD, *The Substantive Law of the EU*, cit, pp. 422-432.
[148] See case C-250/95 *Futura Participations SA and Singer v Administration des contributions* [1997] ECLI:EU:C:1997:239
[149] Ibid, para 22.
[150] Case C-416/17 *European Commission v French Republic* [2018] ECLI:EU:C:2018:811.
[151] Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation v Commissioners of Inland Revenue* [2006] ECLI:EU:C:2006:773
[152] Opinion of AG Geelhoed delivered on 23 February 2006, case C-374/04, *ACT Group Litigation,* para 38.
[153] Ibid, para 79.

establishment by deterring it from setting up subsidiaries in other Member States'[154]. Such a restriction is only permissible if it pursues a legitimate objective compatible with the Treaty and is justified by imperative reasons in the public interest, as long as it passes the proportionality test.

In response, the UK proposed three justifications[155]. The first was that profits and losses should always be equally treated in the same tax system for the sake of the balancing of allocation of the power to impose taxes between the different Member States. The second justification was based on the risk of double deduction of losses in two Member States. Lastly, the third justification regarded the prevention of 'loss shifting': in fact, it is convenient for a group to shift its losses to a Member State where the CIT rate is higher, and therefore the tax value of the losses is higher.

The justifications offered by the UK were accepted by the Court. However, the ECJ observed that, in principle, those justifications would have not been proportionate if *'the non-resident subsidiary [had] exhausted the possibilities available in its State of residence of having the losses taken into account [...]'*, or if there was *'no possibility for the foreign subsidiary's losses to be taken into account in its State of residence [...]'*[156]. Therefore, essentially, the proportionality test was failed when the foreign subsidiary had no other available means to have its own losses taken into account in the Member State where it is resident. However, that was not the case and the UK's group relief scheme was deemed to be compatible with Article 49 TFEU. In *Oy AA*[157] the Court applied the same reasoning to profits instead of losses, leading eventually to the same result.

Thus, *Marks & Spencer* and *Oy AA* show a shift by the Court towards a restrictions approach that could in principle be more likely to uphold the validity of national direct tax laws. It must be noticed that the Court has explicitly observed in *Schempp*[158] that freedom of establishment does not guarantee in principle that a

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[154] *Marks & Spencer*, para 33.
[155] Ibid, para 43.
[156] Ibid, para 55.
[157] Case C-231/05 *Oy AA* [2007] ECLI:EU:C:2007:439.
[158] See case C-403/03 *Egon Schempp v Finanzamt München V* [2005] ECLI:EU:C:2005:446, para 45. See also SCHÖN, *Playing Different Games?*, cit, p. 356, where the author—while discussing the matter of coherence in the internal market tax laws—observes that *'it should be accepted that the*

company will not find disadvantageous tax conditions in the other Member State in which it is planning to transfer or set up a branch or a subsidiary.

In contrast, *ACT Group Litigation* and *FII* are the evidence of the other approach taken by the Court, the so called 'discriminatory approach', even though the cases concerned had different outcomes[159]. *ACT Group Litigation* regarded outgoing dividends, paid by a UK subsidiary to a non-UK parent. *FII* instead concerned incoming dividends, paid by non-UK subsidiary to a UK parent[160]. While in the first case the Court held that there was no discrimination because the situations of a UK parent (subject to UK tax law) and a non-UK parent (not subject of UK tax law) were not comparable[161], in the second case the Court found a discrimination in the fact that, given that the UK decided[162] to exercise its jurisdiction on the resident parent company, it cannot distinguish between resident and non-resident subsidiaries for the treatment of dividends.

The discriminatory approach, together with the principle of fiscal autonomy, was later confirmed also in *FII (No. 2)*, where the Court clarified that *'each Member State remains free to organise its system for taxing distributed profits, provided, however, that the system in question does not entail discrimination prohibited by the FEU Treaty'*[163].

In order to understand *(ii)* where the limit beyond which certain schemes adopted by companies cannot be endorsed in the name of freedom of establishment is, it is important to bear in mind the analysis carried out in Chapter I about the concept of abuse. In *Cadbury Schweppes*, indeed, the Court took the opportunity

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non-discrimination rule enshrined in the four freedoms is no cheap ticket for "free-riders" who want to live in the best of two tax worlds'.

[159] While in *FII* the Court found a breach of Article 49 because the challenged rules were discriminatory, in *ACT Group Litigation* the measures concerned were deemed to be compatible with freedom of establishment.

[160] Article 4 of the *Parent-Subsidiary Directive* allows the Member State where the parent company is resident to opt for a credit method in order to avoid double taxation. In *FII*, UK law provided the parent company with tax credits arising from the taxation of incoming dividends. The problem, however, was how this credit system was implemented. In fact, it allowed resident parents to deduct the amount of ACT (Advanced Corporation Tax) paid by their subsidiaries only if those subsidiaries were UK residents.

[161] See *Schumacker*, para 31, where the Court had accepted that *'in relation to direct taxes, the situations of residents and of non-residents are not, as a rule, comparable'.*

[162] For a similar argument, see case C-686/13 *X AB v Skatteverket* [2015] ECLI:EU:C:2015:375, para 39.

[163] *FII (No. 2)*, para 40.

offered by a case concerning intragroup taxation to apparently limit the broadness of freedom of establishment delineated in *Centros*. However, it was also the occasion to confirm that in principle there cannot be any presumption of abuse, as the ECJ has already clarified in *ELISA*[164]. Thus, *'a general presumption of tax avoidance or tax evasion cannot justify a fiscal measure which compromises the objectives of the Treaty'*[165].

Most recently, some further concerns have arisen about the compatibility of the Emsland-Stärke Test and the new anti-avoidance rules provided by *ATAD 1*.

In particular, it has been argued that the general anti-avoidance rule introduced in Article 6 of *ATAD 1* (and identical to the GAAR rule introduced in the *Parent-Subsidiary Directive*) is *'rooted in the abuse-concept developed by ECJ in matters of abuse of primary and secondary EU law'*, even though *'it serves a totally different purpose'*[166].

Moreover, it might be observed that while the provision at stake refers to arrangements put in place *'for the main purpose or one of the main purposes of obtaining a tax advantage'*[167], also in line with the Principal Purpose Test of Article 7(1) OECD *MLI*, the Court often seems to apply more taxpayer-friendly criteria, as it requires that such a purpose should be the *'essential'*[168], *'sole'*[169], *'principal'*[170], or *'predominant'*[171] reason for the transaction, using these adjectives interchangeably when applying the subjective part of *Emsland-Stärke* Test.

Lastly, a certain degree of uncertainty remains amongst interpreters as to whether the Court will apply the traditional test of its previous case law or broader criteria under the less restrictive wordings of *ATAD 1* (and *MLI*). In turn, further concerns might indeed surround the effective application of Article 49 TFEU when assessing the anti-avoidance rules as implemented by each Member State.

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[164] Case C-451/05 *Européenne et Luxembourgeoise d'investissements SA v Directeur général des impôts and Ministère public* [2007] ECLI:EU:C:2007:594.
[165] Ibid, para 91.
[166] L. DE BROE, D. BECKERS, *The General Anti-Abuse Rule of the Anti-Tax Avoidance Directive: An Analysis Against the Wider Perspective of the European Court of Justice's Case Law on Abuse of EU Law*, in *EC Tax Review*, 26, 3, 2017, p. 144.
[167] *ATAD 1*, Article 6(1)
[168] *Halifax*, para 75.
[169] *Emsland-Stärke*, para 50.
[170] *Part Service*, para 45.
[171] Case C-126/10 *Foggia - Sociedade Gestora de Participações Sociais SA v Secretário de Estado dos Assuntos Fiscais* [2011] ECLI:EU:C:2011:718 *(Foggia)*, para 35.

At the time of writing, the ECJ has provided a first response in *Lexel*[172]. The Court found indeed a breach of freedom of establishment in the general anti-avoidance rule implemented by Swedish law. Pursuant to that law, Swedish authorities had prohibited to a resident company the deduction for interest paid[173] to an associated company which was resident in a different Member State on the ground that the *'principal'*[174] reason for the transaction was to receive a substantial tax benefit, when such a tax benefit would not have been deemed to exist if both companies had been Swedish, since they would then have been covered by the provisions on intragroup transfers.

Firstly, the Court clarified that the situation of a company paying interests to a resident associated enterprise is comparable to the situation of a company paying interests to a non-resident associated company[175].

Secondly, the Court held that the need to combat tax avoidance, and more specifically tax base erosion, can be an overriding reason of public interest that justifies such a measure only when *'the specific objective of such a restriction must be to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory'*[176].

The reference to a *'specific'* purpose might suggest that the Court is not willing to lower the high threshold for finding an abuse of freedom of establishment in tax schemes just because of the introduction of the new EU (and OECD) anti-avoidance rules.

Lastly, an efficient approach to find a balance between free movement and fiscal sovereignty seems to be the one found by the Court in the field of exit taxation. Even though freedom of establishment incentivises companies to move to those countries where tax conditions are more favourable, for the Member State from which a company is departing it is not prohibited to tax the unrealised gains

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[172] Case C-484/19 *Lexel AB v Skatteverket* [2021] ECLI:EU:C:2021:34.
[173] Nonetheless, the interest limitation rule provided by Article 4 of *ATAD 1* did not apply to the case, as it only sets a cap (30%) for deduction. Instead, the general anti-avoidance rule provided by Swedish law was at stake.
[174] *Lexel*, para 30.
[175] Ibid, paras 43-45.
[176] Ibid, para 49.

that the company recorded within its jurisdiction[177]. That faculty, which is now an obligation under Article 5 of *ATAD 1*, can be a partial limitation of the potential damage caused by HTC practices. However, as clarified in *Indus*[178] and later codified in the 'step-up' rule provided by Article 5(2) of *ATAD 1*[179], it must be possible for the taxpayer to choose between paying immediately or paying when those gains are effectively realised. Commentators have welcomed the rule, since it *'is as such not aimed at preventing BEPS, but ensures that the efforts to reach such aim do not lead to double taxation on companies that relocate their activities across State borders'*[180].

In conclusion, even though positive harmonised rules have not been provided so far, literature[181] has so far summarised the framework resulting from the case law of the ECJ as follows: *(a)* subsidiaries of non-resident parent companies must be taxed in the same manner of resident companies, with regards to tax credits, CIT rate, interests for late payment on tax refunds, group relief, and tax benefits; *(b)* resident parent companies controlling non-resident subsidiaries should be treated for tax purposes in the same way in which parent companies controlling resident subsidiaries are treated[182]; *(c)* outgoing dividends, royalties, and interests must not be subject to any higher withholding tax than the tax that a resident would pay on the same incoming transactions; and *(d)* the exit might be a taxable event *per se* when the company which is transferring to another Member State has recorded unrealised capital gains in the Member State from which it is departing.

[177] For an overview on the matter of exit taxation, see PEETERS, *Exit Taxation: From an Internal Market Barrier to a Tax Avoidance Prevention Tool*, cit, pp. 122 et seq., and C. H. PANAYI, *Exit Taxation as an Obstacle to Corporate Emigration from the Spectre of EU Tax Law*, in *Cambridge Yearbook of European Legal Studies*, 13, 2011, pp. 245-282.
[178] See also SCHÖN, *Playing Different Games?*, cit, p. 360, where the author describes exit taxation as an instrument *'envisaged to "recapture" the deferred taxes when the assets leave the fiscal ambit of a jurisdiction'*, arguing that exit taxation is a rare case of coherence in international taxation.
[179] Accordingly, if the taxpayer exercises its right to defer the payment, such payment shall occur in instalments over five year.
[180] PEETERS, *Exit Taxation: From an Internal Market Barrier to a Tax Avoidance Prevention Tool*, cit, p. 132.
[181] WATTEL, *Taxation in the Internal Market*, cit, provides a complete list of cases regarding each matter at p.339.
[182] See ibid, where this finding is heavily criticized because it *'manifestly incorrectly equates subject-to-tax to not-subject-to-tax, even though no greater incomparability is conceivable in the light of object and purpose of equitable and coherent taxation'*.

3.3.2 Taxation and free movement of capital: transactions of shares, dividends, and deductions

The Court's approach to cases in which national tax measures interfere with free movement of capital has had a development similar to that one described in the previous paragraphs for freedom of establishment. Indeed, thanks to the two landmark cases *FII* and *ACT Group Litigation*, the ECJ passed from a restrictions approach to a discriminatory approach. In *Sandoz*, the Court went even further by stating that the mere imposition of a stamp duty—*in casu* provided by Austrian law but not by Belgian law—on loans could restrict the free movement of capital and therefore breach Article 63 TFEU.

The main fields in which national measures have been challenged are inheritances, property ownership, charitable gifts, and transactions of shares, dividends, and deductions[183]. Only the last area is immediately related to corporate mobility, which is the main topic of this dissertation.

STEKO[184] case concerned a situation comparable to the one in *Marks & Spencer*. German law on corporation tax[185] provided that a resident company could not deduct the depreciation of shares[186] held in a non-resident company, while the same resident company could have done so if those shares were held in a resident company. The Court held that the provision concerned introduced a distinction based on the place where the capital was invested, and therefore it constituted a breach of Article 63 TFEU. The Court ruled on two other cases about outgoing and incoming dividends by applying the same approach. In *Amurta*[187] the ECJ censured a Dutch measure that provided for a withholding tax on outgoing dividends paid

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[183] For an overview on the development of the Court's approach to the matter, see BARNARD, *The Substantive Law of the EU*, cit, pp. 537-542.

[184] Case C-377/07 *Finanzamt Speyer-Germersheim v STEKO Industriemontage GmbH* [2009] ECLI:EU:C:2009:29.

[185] *Körperschaftsteuergesetz* 1999, para 8b(2), first sentence.

[186] In *STEKO* (2009) the court referred to *'a holding of less than 10%'*. However, as noticed in Chapter I, in *Kronos International* (2012) the Court extended the scope of Article 63 in shareholding situations by denying the absolute need for a holding under the 10% threshold for its applicability.

[187] Case C-379/05 *Amurta SGPS v Inspecteur van de Belastingdienst/Amsterdam* [2007] ECLI:EU:C:2007:655.

from a resident company to a non-resident company[188]. On the same line of reasoning, in *Manninen*[189] the Court found a breach of free movement of capital in Swedish law, where it provided a tax credit only for taxed profits distributed by resident companies.

3.4 *Concluding remarks. A call for solidarity*

Unlike matters of corporate governance, regulatory competition in the field of business taxation seems to be necessarily a race to the bottom. In fact, asymmetries between fiscal systems might cause serious harm to countries' welfare: harmful tax competition can reduce public expenditure, affect labour taxation, amplify social disparities, and produce regressive effects.

In the EU, harmful tax competition is not only 'targeted', i.e. implemented through the application of preferential regimes for certain undertakings, but also 'general'. Indeed, the small size of some countries allows them to compete even on the general corporate income tax rate.

Those characteristics allow companies to orient their mobility choices in order to directly or indirectly benefit from lower taxation. In particular, digital multinationals play a significant role in this phenomenon through the implementation of aggressive tax planning.

The impact of harmful tax competition has pushed the EU to seek for regulatory solutions, but the unanimity requirement under the combination of Articles 114(2) and 115 TFEU has so far limited the success of this research. Moreover, the Court seems still reluctant to reduce the breadth of free movement in the name of the fight against tax avoidance and aggressive tax planning.

The experience of the *Code of Conduct* has shown that a non-binding instrument, not really shared and individually agreed by each Member State, cannot solve the many problems brought by regulatory competition in the field of taxation.

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[188] In para 84 the ECJ underlines that the effect of the restriction of free movement of capital could be *'neutralised'* by a DTC between the two concerned Member States, and that in those cases it is for the national court to determine whether or not this *'neutralisation'* has occurred. In particular, the Court has recognized that double taxation might be avoided by adhering to the *OECD Model* and implementing systems of capital import neutrality (CIN) and capital export neutrality (CEN), that are compatible with both the *Parent-Subsidiary Directive* and the *Arbitration Convention*.

[189] Case C-319/02 *Petri Manninen* [2004] ECLI:EU:C:2004:484.

In fact, such a phenomenon cannot be considered without taking into account its global dimension.

In that regard, the *MLI*, drafted by the OECD in the framework of the BEPS Project, has brought an enormous innovation. This is true not only because of the high number of European countries that have signed it, but also because the treaty is self-executing[190].

However, the *MLI* is only applicable to *'Covered Tax Agreements'*, which are only those agreements that have been notified to the depositary, i.e. the OECD, by each party[191], provided that each party is a signatory of the *MLI* and has ratified it.

It must be kept in mind, moreover, that the *MLI* introduces a minimum binding standard only for a certain part of its provisions, like the preamble and the *'Mutual Agreement Procedure'*[192] of Article 16, whereas in some other key matters the parties of the *MLI* retain their right to make reservations: to name a few, the anti-abuse rule for permanent establishments situated in third jurisdictions[193], the rules about hybrid mismatches arrangements[194], and those about transfers of dividends[195]. On the one hand, allowing each party of the treaty to reserve some fundamental taxation rights is a functional tool in order to render the *MLI* more attractive. It is also true, on the other hand, that this flexibility and graduality of the *MLI* risks to undermine its efficiency and its effectiveness.

Another significant weakness of the OECD BEPS Project—and thus of the *MLI*—is that the U.S. has not taken part in it. It was argued in this chapter that harmful competition is unavoidably a global issue, and also that the multinationals of the new digital economy are nowadays the main actors of the practices of base erosion and profit shifting in the EU. Given that those multinationals are mainly U.S. nationals, a full collaboration of the U.S. in the implementation of the new

[190] For an overview on the debate brought by the declarations of Mark Williams, president of the OECD Group that drafted the *MLI*, about the nature of the treaty, see A. CRAZZOLARA, *Il Trattato Multilaterale BEPS è Self-Executing?*, in *Rivista di Diritto Tributario*, online supplement of 24 May 2017, 2017, available at <http://www.rivistadirittotributario.it/2017/05/24/trattato-multilaterale-beps-self-executing/>.

[191] *MLI*, Article 2.

[192] The aim of this provision is very close to the one of the *Arbitration Convention*.

[193] Reservations allowed by Article 10(5) *MLI*.

[194] Reservations allowed by Article 7(15) *MLI*.

[195] Reservations allowed by Article 8(3) *MLI*.

measures would have been desirable. Unfortunately, in 2017 the Trump Administration introduced the *Tax Cuts and Jobs Act*[196] in Congress, aimed at re-attracting multinationals profits[197] by lowering the CIT rate to 21% (15.5% for repatriations), changing the way that the foreign income of U.S. corporations is taxed, and reducing incentives for corporations to shift profits outside the U.S.

The lack of cooperation by the U.S., which has decided to focus on a more liberal and nationalist tax policy, and the presence of secrecy jurisdictions undermine the effectiveness of the OECD work and seems to render the approach to the problem of taxation of digital multinationals in the EU[198] even more difficult. Indeed, countries like Italy[199], France, Spain, Austria and the UK[200] have adopted their own tax policies as regards the so called 'web tax', and the EU itself seems so far to endorse an autonomous approach to the matter, as no consensus can be found amongst the 27 Member States. In fact, Denmark, Sweden, and Ireland still maintain their opposition[201].

Furthermore, a recent confirmation of the (temporary) abandonment of the digital tax project lies in the fact that the *Digital Services Act*[202] and the *Digital*

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[196] *Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018.*
[197] The Congressional Budget Office (CBO) estimated that the act will bring about USD 320 billion in benefits for corporations, in the report available at <https://www.cbo.gov/publication/53787>.
[198] The impact of the *Tax Cuts and Jobs Act* on bilateral cross-border direct investments between the U.S. and the EU is fully analysed in A. GUACCERO, Compliance *e Tutela degli Investimenti Esteri Diretti. Spunti di Comparazione tra Stati Uniti ed Europa*, in NUZZO, PALAZZOLO (eds.), *Disciplina delle Società e Legislazione Bancaria*, cit, pp. 213-223. See also F. GALLO, *La concorrenza fiscale tra Stati*, in BORIA (ed.), *La Concorrenza Fiscale tra Stati*, cit, pp. 55-57.
[199] After the failure of the tax on business to business (B2B) digital transactions introduced by the *Legge di bilancio 2018*, the *Legge di bilancio 2019* (later amended by *Legge di bilancio 2020*) introduced a new tax on digital services, applicable to companies with worldwide revenues amounting to EUR 750 million or more and Italian revenues amounting to at least EUR 5.5 million. The concerned tax has a fixed rate of 3%, clearly inspired by the interim DST proposed by the Commission.
[200] The adoption of the *Digital Services Tax* was announced by the UK in 2018, when it was still a Member State. It entered into force on 1 April 2020 and introduced a new 2% tax on the revenues of search engines, social media services and online marketplaces which derive value from UK users. The criterion appears thus to be similar to the one proposed by the Commission for the interim DST, but the tax rate is lower.
[201] In particular, the Swedish Minister of Finance M. Andersson argued in 2019 that *'digital taxation is a global issue and the work within the EU should not precede the discussions being held within the OECD'* (<https://www.euractiv.com/section/economy-jobs/news/the-eus-digital-tax-is-dead-long-live-the-oecds-plans/>).
[202] EUROPEAN COMMISSION, *Proposal for a Regulation of the European Parliament and of the Council on a Single Market for Digital Services (Digital Services Act) and amending Directive 2000/31/EC*, COM/2020/825 final, 2020.

Market Acts[203] issued in December 2020 include no provisions in the field of taxation[204], notwithstanding that on 12 September 2020 Executive Vice-President V. Dombrovski had announced that the Commission would have presented *'an Action Plan on business taxation for the 21st century'* in the last quarter of 2020 and that the *EU 'will follow up on the work to the reform of the international corporate tax framework, which is currently ongoing in the OECD'* as the Union *'hopes for progress at the global level – and if not, [it] will move ahead with a digital tax proposal in the first half of [2021]'*[205].

As several reports had shown the significancy of the economic loss deriving from harmful practices, in 2019 Commissioner M. Vestager held that *'all companies, big and small, should pay their fair share of tax'*[206].

This call for solidarity and cooperation became vital during the 2020 pandemic crisis. Indeed, in the context of the implementation of the Recovery Plan, the Union needs new tools for financing the massive recovery instrument *NextGenerationEU*. Amongst these new tools, the Commission has individuated a reform of the *Code of Conduct*, a digital levy, a Financial Transaction Tax, a financial contribution linked to the corporate sector, and the implementation of the CCTB and the CCCTB.

Indeed, according to the Commission, *'corporate tax avoidance in the EU amounts to more than EUR 35 billion per year'* and *'these remarkable amounts of revenue lost are even more problematic given that the economic ramifications of COVID-19 will inevitably lead to substantially lower levels of tax revenue'*[207]. As

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[203] EUROPEAN COMMISSION, *Proposal for a Regulation of the European Parliament and of the Council on contestable and fair markets in the digital sector (Digital Markets Act),* COM/2020/842 final, 2020.

[204] See also EDITORIAL, *The EU unveils its plan to rein in big tech*, in *The Economist*, 15 December 2020, available at <https://www.economist.com/business/2020/12/15/the-eu-unveils-its-plan-to-rein-in-big-tech>, where the author observes that *'the only big, controversial area of technology policy left alone, indeed, is where tech giants pay their taxes'*.

[205] See press release *Remarks by Executive Vice-President Dombrovskis at the informal ECOFIN press conference* of 12 September 2020. Those declarations followed the pessimism arising from the U.S. suspension of talks at the Paris-based OECD. See S. FLEMING, J. BRUNSDEN, C. GILES, V. MALLET, *Europeans vow to pursue digital tax plans after US 'provocation'*, in *Financial Times*, 18 June 2020, available at < https://www.ft.com/content/df44d07c-f9cc-4025-9606-e46d2476375f>.

[206] See press release *Statement by Commissioner Margrethe Vestager following today's Court judgments on two tax State aid cases (Fiat in Luxembourg and Starbucks in the Netherlands)* of 24 September 2019.

[207] Communication from the Commission to the European Parliament and the Council*. An Action Plan for Fair and Simple Taxation Supporting the Recovery Strategy*, para 2.1.

observed by Commissioner P. Gentiloni, *‘the coronavirus pandemic and the necessary containment measures have dealt a brutal blow to Europe's economies. […] The priorities today are to strengthen our healthcare, support our workers, save our businesses. […] That also means everyone must pay their share: there can be no place for aggressive tax planning in a Europe of solidarity and fairness’*[208].

[208] Press release *European Semester Spring Package: Recommendations for a coordinated response to the coronavirus pandemic* of 20 May 2020.

CHAPTER IV

STATE AID AND REGULATORY COMPETITION

4.1 *Tackling harmful competition through the 'backdoor'*

It appears from the analysis carried out in Chapters II and III that, even though matters of corporate governance can play a complementary role, corporate mobility across the EU is largely incentivised by the pursuit of fiscal advantages. Regulatory competition triggered by free movement, in turn, seems to generally bring positive effects on the corporate governance regulatory framework, whereas its consequences on tax systems are more likely a race to the bottom with harmful economic and social effects.

It has been also observed that tax competition within the EU can be deemed as 'general', meaning that it also includes the mere competitive lowering of the CIT rate. Nevertheless, in the last decade the Commission has mainly focused on the intertwinement between State aid law and 'targeted' competition, especially in the context of multinationals' aggressive tax planning by means of tax rulings.

Indeed, as observed in Chapter III, a fiscal distortion is, first of all, a market distortion. By attempting *'harmonisation through the backdoor'*[1], the Commission is thus trying to tackle distortive phenomena of direct taxation, a field in which the EU has no competence, through those competition rules on which the Commission itself has exclusive competence[2].

In this chapter, the history of the interaction between EU State aid law and tax rulings will be briefly described in order to discuss the most recent cases ('tax ruling saga') in which the Commission has tried to rely on State aid rules for the purpose of fighting unduly alterations of the correct level playing field not only amongst undertakings across the Member States, but also amongst Member States themselves.

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[1] S. GARBEN, *Confronting the Competence Conundrum: Democratising the European Union through an Expansion of its Legislative Powers*, in *Oxford Journal of Legal Studies*, 55, p. 63.
[2] See Art. 3(1)(b) TEU.

In conclusion, in light of the most recent findings of the General Court, this research will try to gauge the potential regulatory impact of the tax ruling saga and the potential alternative solutions to the issues of harmful competition.

4.2 *Can tax rulings be an issue under State aid law?*

The assessment of the relationship between tax rulings and State aid law depends in the first place on the interpretation of Article 107(1) TFEU, which provides that *'any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market'*.

According to Article 107(1) TFEU, the concept of State aid is constituted by five fundamental elements, which are all necessary in order for a State measure to constitute State aid and thus be in principle incompatible with the internal market: *(i)* the beneficiary of the measure must be an undertaking[3]; *(ii)* the aid must be granted by a Member State and through State resources, meaning that the aid might come from all entities of the State, including private bodies appointed by the State to administer resources and public undertakings, as long as it is financed directly or indirectly by the State; *(iii)* the beneficiary must have obtained an advantage by the implementation of that measure[4]; *(iv)* the measure must be selective, meaning that *'Article 107 TFEU does not apply if all undertakings within a Member State benefit from assistance without any distinction being made between them'*[5]; and *(v)* the measure shall affect trade and competition, which are usually treated jointly[6].

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[3] In case C-41/90 *Klaus Höfner and Fritz Elser v Macrotron GmbH* [1991] ECLI:EU:C:1991:161 the Court clarified that *'the concept of an undertaking encompasses every entity engaged in an economic activity, regardless of the legal status of the entity and the way in which it is financed'*.

[4] The element of the advantage has been particularly discussed in relation to services of general economic interest (SGEIs). In particular, the landmark case on the matter was case C-280/2000 *Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH, and Oberbundesanwalt beim Bundesverwaltungsgericht* [2003] ECLI:EU:C:2003:415. In that judgement, the Court provided the necessary criteria to be met in order to exclude the advantage when the measure could be regarded as a compensation for costs incurred to provide a SGEI.

[5] P. J. SLOT, M. FARLEY, *An Introduction to Competition Law*, Oxford: Hart Publishing, 2nd edn, 2017, p. 263.

[6] In particular, the distortion of competition is normally assumed as soon as a State grants a selective advantage, whereas the effect on trade is only excluded for measures which have a purely local

The crucial element for the purpose of this chapter is the fourth one. In particular, two fundamental questions are of concern: what constitutes a selective measure; and whether and to what extent tax rulings can be included in such a category.

In order to respond to the first question it is necessary to describe the concept of 'selectivity'. A selective measure is a measure that is addressed to a limited group of undertakings, benefiting from the measure in question, while other undertakings, which are *'in a comparable legal and factual situation in the light of the objective pursued by the measure concerned'*[7], are excluded. The opposite of a selective measure is thus a general measure of economic policy. Selectivity can be material (*de jure* or *de facto*[8]) or regional, depending on the kind of criteria which are adopted to define the scope of the measure. In less clear situations where Member States adopt measures applicable to all undertakings fulfilling certain criteria, such as tax schemes, the selectivity of a measure should be assessed by means of a three-step analysis[9]: first, one should identify the reference system, which constitutes *'the benchmark against which the selectivity of a measure is assessed'*[10]; second, one should determine whether the given measure constitutes a derogation from that system (*prima facie* selectivity); and third, one should assess whether or not the derogation is justified by the nature of the reference system.

The answer to the second question, i.e. whether and to what extent tax rulings can be deemed selective, has been the object of an important debate. A

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character. With this regard, it should also be recalled that Article 3(2) of Regulation (EU) 1407/2013 sets a *de minimis* threshold amounting to *'EUR 200,000 over any period of three fiscal years'* (which becomes EUR 100,000 for *'undertaking performing road freight transport'*).

[7] See case T-210/02 RENV., *British Aggregates Association v European Commission* [2012] ECLI:EU:T:2012:110, para 1. The notion was later reproduced in the *Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (State aid Notice)*, para 137. In the *Working Paper on State Aid and Tax Rulings*, DIRECTORATE GENERAL COMPETITION (2015) refers to *'fiscal measures that discriminate between taxpayers in a similar factual and legal situation'* (para 2).

[8] See, *State aid Notice* paras 121-122: 'de jure *selectivity results directly from the legal criteria for granting a measure that is formally reserved for certain undertakings only'*, whereas 'de facto *selectivity may be the result of conditions or barriers imposed by Member States preventing certain undertakings from benefiting from the measure'*.

[9] See ibid, paras 126-141.

[10] Ibid, para 132.

report[11] issued in 2019 by the OECD defines tax rulings as *'rulings that have been granted to a foreign related party of their resident taxpayer or a permanent establishment'* and that *'can be an effective way to provide certainty to taxpayers and reduce the risk of disputes'*. In particular, the report lists five categories of rulings: *(a)* rulings related to certain preferential regimes; *(b)* advance pricing arrangements (APAs) or other cross-border rulings in respect of transfer pricing (advance cross-border rulings); *(c)* rulings providing for a downward adjustment of taxable profits; *(d)* permanent establishment rulings; and *(e)* related party conduit rulings.

APAs and advance cross-border rulings *(b)* constitute the most relevant category of rulings for the purpose of this Chapter and were included for the first time in an EU hard law instrument, namely *DAC 3*, in 2015. Accordingly, an APA, which is normally the outcome of the negotiation between tax authorities and the taxpayer, is *'any agreement, communication or any other instrument'* which: *(i)* is issued by the tax authorities of a Member States; *(ii)* is issued to a particular person or a group of persons and upon which that person or a group of persons is entitled to rely; *(iii)* determines in advance of cross-border transactions between associated enterprises, an appropriate set of criteria for the determination of the transfer pricing for those transactions or determines the attribution of profits to a permanent establishment[12]. Advance cross-border rulings, instead, share with APAs features *(i)* and *(ii)*, but also show some additional characteristics, as they: *(iii)* concern the interpretation or application of a tax measure; *(iv)* relate to a cross-border transaction or to the assessment of permanent establishments[13]; *(v)* are made in advance of the transactions or of the activities in another jurisdiction potentially creating a permanent establishment[14].

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[11] See OECD, *Harmful Tax Practices – 2019 Peer Review Reports on the Exchange of Information on Tax Rulings. Inclusive Framework on BEPS: Action 5*, 2019, available at <https://www.oecd.org/tax/beps/harmful-tax-practices-2019-peer-review-reports-on-the-exchange-of-information-on-tax-rulings-afd1bf8c-en.htm>.

[12] Article 1(b) of *DAC 3* amending Article 3 of *DAC 1* by introducing a new point 15.

[13] A higher degree of harmonisation between the OECD and the EU framework appears desirable, as the distinction between the categories of rulings seem blur. For instance, the OECD permanent establishment rulings appear partially overlapping with EU advance cross-border rulings.

[14] Article 1(b) of *DAC 3* amending Article 3 of *DAC 1* by introducing a new point 14.

Even though tax rulings are in principle tools aimed at granting legal certainty to taxpayers and transparency to tax authorities[15], they can play a fundamental role in the implementation of aggressive tax planning. While *'State aid control of fiscal measures is nothing new'*[16], the debate about tax rulings and State aid has arisen in recent years by a series of investigations carried out by the Commission. Therefore, it is worth describing in this section the main events that have brought the Commission and the Court to their most recent decisions and judgements in the tax ruling saga.

4.2.1 The early 2000s: soft law and the *Belgium* and *Gibraltar* cases

As said in Chapter III, in 1998 the Commission adopted the *Notice on the application of the State aid rules to measures relating to direct business taxation* in the context of the implementation of the *Code of Conduct*. The two instruments were complementary tools, as they were *'distinct both in their formal nature (different legal base, different institutions in charge of applying the rules) and in their scope, as regards the measures they can be applied to'*[17]. As well as the *Code*, the *Notice* was aimed at tackling harmful tax competition. In particular, the *Notice* took into account *'the major repercussions which some aid granted through tax systems may have on the revenue of other Member States'*[18].

In 2003, however, Competition Commissioner M. Monti expressed his disappointment when observing that *'considerable uncertainty still surround[ed]*

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[15] According to the *Joint Transfer Pricing Forum,* APAs are efficient tools for dispute avoidance, relieve tax administration from the burden of audits, and benefit taxpayers by granting legal certainty. See COMMISSION OF THE EUROPEAN COMMUNITIES, Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee. *Towards an Internal Market without tax obstacles. A strategy for providing companies with a consolidated corporate tax base for their EU-wide activities*, COM/2001/582 final, 2001.

[16] See E. TRAVERSA, A. FLAMINI, *Fighting Harmful Tax Competition through EU State Aid Law: Will the Hardening of Soft Law Suffice?*, in *European State Aid Law Quarterly*, 14, 3, 2015, p. 323, where the authors refer to case 17/57 *De Gezamenlijke Steenkolenmijnen in Limburg v High Authority of the European Coal and Steel Community* [1959] ECLI:EU:C:1959:3.

[17] TRAVERSA, FLAMINI, *Fighting Harmful Tax Competition*, cit, p. 326.

[18] *Commission Notice on the application of the State aid rules to measures relating to direct business taxation*, paragraph 3.

the implementation of that package in spite of the determination shown by most Members States and by the Commission'[19].

That uncertainty was probably due to the large criticism on the *'idea of a State aid control focused on the harmful nature of a measure for tax competition among Member States'*[20]. In particular, it was pointed out that such an idea went beyond the aim of the Treaties, or at least that it could not fall within the objective of State aid rules. In fact, State aid law is based on a case-by-case approach, can only apply within the territory of one Member State, and is not related to phenomena involving the relationship between Member States[21].

While the limited impact of the *Code* was observed in Chapter III, the same considerations cannot apply to the content of the *Notice*.

A first turning point was in 2003 when the Commission found a breach of State aid rules in a Belgian tax ruling system which allowed coordination centres to receive an exemption from certain taxes.

In its Decision[22] the Commission highlighted that the assessment of the measure was based on the guidelines provided by the *Notice* rather than on the *Code*. The approach followed by the Commission was endorsed by the Court in its ruling (*Forum 187*)[23], where the Court decided nonetheless to annul the Decision.

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[19] Press release *Statement by Commissioner Monti concerning the control of fiscal state aids* of 23 February 2003. Also the *I+R Directive* was part of the so called 'Monti Package'.

[20] TRAVERSA, FLAMINI, *Fighting Harmful Tax,* cit, p. 326.

[21] However, it must be borne in mind that *'the Court of Justice recognizes to the Commission a wide discretional power when applying competition rules'*, as pointed out by E. MOAVERO MILANESI, *The Importance of State Aid Rules of the European Union in the Context of the Global Financial and Economic Crisis*, in *Antitrust & Public Policies*, 1, 3, 2014, p.2. In particular, it is there noted that the justification provided by Article 107(3)(b) TFEU that allows measure implemented '*to remedy a serious disturbance in the economy of a Member State'* should in principle only concern events which occur in one country. However, in the context of the 2008 financial crisis, the scope of that justification has been broadened by the Commission far beyond its wording: *'during the first years of the global crisis, the European Commission authorized EU national governments to set up state aids measures, in order to avoid breakdowns of banks and other financial institutions and to give some relief to the real economy in the countries. Nearly all of them made large use of the open attitude of the EU competition authority'*. On the contrary, the applicability of State aid rules to problems with a cross-border dimension is criticised by J. DRENNE, *State aid and tax rulings: is there really a competition issue?*, panel 3 at the 8th International Concurrences Review Conference, 2017.

[22] Commission Decision of 17 February 2003 on the aid scheme implemented by Belgium for coordination centres established in Belgium [2003] OJ L 282/25 *(Belgium Decision)*.

[23] See joined cases C-182/03 and C-217/03 *Kingdom of Belgium (C-182/03) and Forum 187 ASBL (C-217/03) v Commission of the European Communities* [2006] ECLI:EU:C:2006:416, para 151, where the Court held that *'it is clear from the documents before the Court that the conclusions of*

The second key-moment was in 2011, when the appeals to set aside the 2004 *Gibraltar Decision*[24] finding a State aid in Gibraltar Corporation Tax Reform had a different outcome. Indeed, the Court upheld the decision, albeit the contrary opinion of the Advocate General.

Gibraltar wanted to implement a tax reform which would have resulted in a tax-free regime for offshore companies, as it included a scheme based on the number of employees employed in Gibraltar. The UK and Gibraltar argued that the measure would have been indistinctly applicable, and thus it could not be deemed selective. The AG agreed and added that *'harmful institutional or tax competition between Member States clearly does not fall within the mechanism for controlling State aid established by the Treaty'* and that *'the legitimate objective of combating harmful tax competition cannot justify distortion of the European Union's legal framework established in the area of competition law applicable to State aid, or even the adoption of ad hoc solutions conflicting with the rule of law as enshrined in Article 2 TEU'*[25].

The Court, although it did not even mention harmful tax competition in its judgement, disagreed and found a breach of Article 107 TFEU. In particular, it deemed the concerned measure to be selective. In fact, the Court believed that the fact that a measure is in principle applicable to all corporations cannot itself exclude selectivity. In particular, *'the criteria forming the basis of assessment which are adopted by a tax system must also, in order to be capable of being recognised as conferring selective advantages, be such as to characterise the recipient undertakings, by virtue of the properties which are specific to them, as a privileged category, thus permitting such a regime to be described as favouring "certain" undertakings'*[26]. Hence, provided that the UK had not offered any valid justification

the Council express an aspiration of a political nature and cannot, by reason of their contents, produce legal effects on which parties could rely before the Court'.

[24] Commission Decision of 30 March 2004 on the aid scheme which the United Kingdom is planning to implement as regards the Government of Gibraltar Corporation Tax Reform [2005] OJ L 85/1.

[25] Opinion of AG Jääskinen delivered on 7 April 2011, joined cases C-106/09 P and C-107/09 P, para 134; Article 2, first sentence of the TEU provides that *'the Union is founded on the values of respect for [...] the rule of law [...]'.*

[26] Joined cases C-106/09 P and C-107/09 P *European Commission and Kingdom of Spain v Government of Gibraltar and United Kingdom of Great Britain and Northern Ireland* [2011] ECLI:EU:C:2011:732, para 134. See also *State aid Notice*, para 130: *'the Court found that the fact*

for the selective advantage, Gibraltar reform fell within the scope of Article 107(1) TFEU.

4.2.2 Small countries, big multinationals: Commission investigating tax rulings

In June 2013 the Commission, *via* its dedicated Task Force Tax Planning Practices, started investigating several tax ruling practices implemented by Member States. So far, the Commission has been investigating the practices of seven Member States (Cyprus, Ireland, Luxembourg, Malta, the Netherlands, the UK, and Belgium).

Between June and October 2014, in particular, the Commission announced four major investigations[27] concerning APAs granted by tax authorities to Apple in Ireland, to Starbucks in the Netherlands, to Fiat Finance & Trade and Amazon in Luxembourg[28].

In order to understand the investigated schemes and the Commission's following decisions, it is necessary to bear in mind some of the key concepts described in Chapter III when describing the most common harmful practices in the context of ATP.

The first case concerned Fiat Finance and Trade (FFT), a company that is based in Luxembourg and is part of the Fiat group, for which it provides treasury service and financing. In September 2012, the company obtained a tax ruling which endorsed *'a method for arriving at a profit allocation to FFT within the Fiat group, […] and enable[d] FFT to determine its corporate income tax liability to*

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that offshore companies were not taxed was not a random consequence of the regime, but the inevitable consequence of the fact that the bases of assessment were specifically designed so that offshore companies had no tax base'.

[27] These investigations found their legal background in the procedural rules set by Regulation (EC) 1999/659, now repealed by Regulation (EU) 2015/1589.

[28] See the press releases *State aid: Commission investigates transfer pricing arrangements on corporate taxation of Apple (Ireland) Starbucks (Netherlands) and Fiat Finance and Trade (Luxembourg)* of 11 June 2014 and *State aid: Commission investigates transfer pricing arrangements on corporate taxation of Amazon in Luxembourg* of 7 October 2014. Complete analyses of those cases are provided by, amongst others, PERRONE, *Tax Competition*, cit, L. LOVDAHL GORMSEN, *European State Aid and Tax Rulings*, Edward Elgar Publishing, 2019.

Luxembourg on a yearly basis'[29]. According to the Commission, the concerned ruling had unduly reduced FFT's tax burden between 2012 and 2015 by EUR 20-30 million, as it allowed a method of profit allocation which constituted a selective tax advantage. In particular, in order to assess the selectivity of the measure, the Commission adopted the said three-steps test and believed that the reference system to be considered as a benchmark was Luxemburg general CIT system. Once the reference system was established, the evidence of the derogation from that standard was in the fact that the ruling allowed FFT to pay lower taxes than those it would have paid under the general CIT system[30]. Indeed, the Commission quoted the *MOL Magyar* judgement[31], in which the Court had held that *'the identification of the economic advantage is, in principle, sufficient to support the presumption that it is selective'* ('*MOL Magyar* presumption'). The Commission believed that the selective advantage derived from a deviation from the arm's length principle (ALP), which is a *'general principle of equal treatment in taxation falling within the application of Article 107(1) of the TFEU'*[32]. In fact, the Commission highlighted that it was not referring to the content of the OECD Model Tax Convention, which is instead a non-binding tool, and thus it was not replacing national tax authorities' interpretation of Luxembourgish law.

The second relevant case concerned the investigation against Starbucks. Starbucks Manufacturing EMEA BV (SMBV) is a Dutch company resident in the Netherlands. Between 2008 and 2015 the company benefited from a tax ruling granted by Dutch authorities which *'unduly reduced Starbucks Manufacturing's tax burden since 2008 by EUR 20-30 million'*[33]. SMBV paid a *'very substantial*

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[29] Commission Decision (EU) 2016/2326 of 21 October 2015 on State aid SA.38375 (2014/C ex 2014/NN) which Luxembourg granted to Fiat [2016] OJ L 351 (*Fiat Decision*), para 52.

[30] Ibid, para 217, where the Commission observes that *'indeed, where a tax measure results in an unjustified reduction of the tax liability of a beneficiary who would otherwise be subject to a higher level of tax under the reference system, that reduction constitutes both the advantage granted by the tax measure and the derogation from the system of reference'*.

[31] Case C-15/14 P *European Commission* v *MOL Magyar Olaj- és Gázipari Nyrt.* [2015] ECLI:EU:C:2015:362, para 60.

[32] *Fiat Decision*, para 228. On the compatibility between the principle of equal treatment and preferential tax regimes see G. MELIS, *Lezioni di Diritto Tributario*, Giappichelli, 2nd edn, 2014, p. 63.

[33] See the press release *Commission decides selective tax advantages for Fiat in Luxembourg and Starbucks in the Netherlands are illegal under EU state aid rules* of 21 October 2015. The exact amount of the sanction should have been calculated by Dutch tax authorities on the basis of the methodology established in the Commission decision.

royalty'[34] to Alki LP, a UK based company of Starbuck's group, in exchange for the right of use of the UK company's know-how. Those payments, according to Dutch law, were exempted from any withholding tax as they were addressed to a company which was resident in another Member State. Additionally, SMBV's tax base was further eroded by the inflated price paid to Starbucks Coffee Trading SARL (SCT), a Swiss company of the group, for green coffee beans. Thanks to the ruling, it was considered that the main risks and functions were assumed by Alki LP, which was the owner of the know-how. Alki LP, in turn, was a limited partnership whose shareholders were private limited companies based in the U.S. As both Alki LP and its shareholders had no employees, Alki LP was a hybrid entity, since it was considered 'transparent' in the UK but 'opaque' in the U.S., causing a phenomenon of double non-taxation. By applying the three-steps test, the Commission found the reference system in Dutch corporate tax system and then followed the same line of reasoning that it adopted in the *Fiat Decision*[35].

The third case, and probably the one with the greatest echo so far, concerned the two rulings granted by Irish tax authorities in 1991 and 2007, through which Apple implemented, according to the Commission, particularly aggressive tax planning. Apple group owned two subsidiaries in Ireland, namely Apple Sales International (ASI) and Apple Operations Europe (AOE). These companies were both indirectly controlled by an offshore holding, Apple Operations International (AOI). Even though the *lex societatis* applicable to both subsidiaries was Irish law, they were stateless corporations. Indeed, while U.S. law defines tax residence by reference to the place of incorporation, Irish tax law refers to the place of central management and control[36]. Given that these companies were incorporated in Ireland but did not have any employee or material presence in the country, they were not considered as resident neither by the U.S. nor by Ireland. ASI and AOE, which received the income deriving from Apple's business activity in Europe, made annual payments to Apple Inc., a holding of the group which was resident in the

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[34] Ibid, where the Commission explains that the royalty paid by SMBV did not adequately reflected market value.

[35] See Commission Decision (EU) 2017/502 of 21 October 2015 on State aid SA.38374 (2014/C ex 2014/NN) implemented by the Netherlands to Starbucks [2017] OJ L 83 (*Starbucks Decision*), paras 252 et seq.

[36] See section 23A of the *Tax Consolidation Act,* 1997 (Ireland).

U.S., in exchange for the right of use of the intangible assets owned by the American holding. The tax rulings granted by Irish authorities provided for those payments to be deductible, allowing ASI and AOE to erode their tax base[37]. Moreover, the rulings allowed the application of the TNMM method for the allocation of the profits amongst AOI, ASI, and AOE. According to the rulings, in particular, the two Irish subsidiaries operated as PEs, as they did not meet the criteria to be considered resident in Ireland. The functions performed by those PEs were considered only marginal and thus the majority of profits was attributed to their central seats. In practice, given that those companies were stateless, those profits were not taxed at all. While Irish CIT rate was 12.5%[38], the fact that only a small part of Apple's profits was taxed rendered the effective rate *'declined from 1% in 2003 to 0.005% in 2014'*[39]. As always, the Commission followed the three-steps analysis and found the reference system in the ordinary rules of taxation of corporate profit in Ireland. Indeed, the concerned application of the TNMM method allowed ASI and AOE to benefit from a lower taxation when compared to the one they would have been subject to if they were non-integrated companies. Such a deviation from the reference system could not be justified, in the Commission's opinion, by the distinction between the legal and factual situations of resident and non-resident companies[40]. Similar to the *Fiat case*, Apple argued that the Commission was interpreting Irish national law in light of the non-binding OECD principles, seeking to harmonise national business taxation laws. Again, the Commission rejected the argument by reaffirming that *'the arm's length principle [...] flows from Article 107(1) of the Treaty, as interpreted by the Court of Justice, which binds the Member States and from the scope of which national tax rules are not excluded'*[41].

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[37] This part of the scheme is thus comparable with the payments made by SMBV in favour of SCT in *Starbucks case*.

[38] Such a rate was already relatively law when compared to the statutory CIT rate of other Member States, as noticed *supra* in Chapter III.

[39] See the press release *State aid: Ireland gave illegal tax benefits to Apple worth up to €13 billion* of 30 August 2016. In fact, not only was a small part of the profits taxed, but the tax base had also already been eroded by the payments made to Apple Inc.

[40] Which was one of Ireland and Apple's arguments, rejected by Commission Decision (EU) 2017/1283 of 30 August 2016 on State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) implemented by Ireland to Apple [2017] OJ L 187 (*Apple Decision*), paras 236 et seq.

[41] Ibid, para 257.

Lastly, the fourth investigation launched by the Commission in 2014 concerned Amazon and the tax ruling issued by Luxembourgish tax authorities in 2001 and prolonged in 2011. In particular, the Commission investigated how the Amazon group had operated in the EU until 2014. Amazon EU SARL (AEU) is a company incorporated in Luxembourg under Luxembourgish law, which paid significant royalties to another company of the group, Amazon Europe Holding Technologies SCS (AEHT), in exchange for the right of use of the e-commerce platform used by Amazon group in Europe under a 'cost-sharing' agreement. AEHT was a 'transparent' company[42], thus its shareholders, who were U.S. residents, bore tax liability for its income. Hence, this hybrid entity caused a phenomenon of double non-taxation, given that the shareholders deferred their tax liability in the U.S. According to the Commission, the tax ruling endorsed a TNMM which allowed Amazon to shift the great majority of profits to AEHT in order to avoid taxation, as the transfer pricing arrangement produced *'a result that departs from a reliable approximation of an arm's length outcome'* as it was based on *'inappropriate methodological choices which result[ed] in a lowering of* [AEHT]*'s taxable income as compared to companies whose taxable profit reflects prices negotiated at arm's length on the market'*[43].

Following those four major investigations, the Commission has broadened the scope of its attention to further cases.

First, the Commission found a breach of Article 107 TFEU in a tax scheme also known as 'Belgium excess profit exemption'. The scheme was based on a tax ruling that compared the profits that a non-integrated company would have made to the profits effectively booked by 35 multinationals resident in Belgium. According to the ruling, the difference between the two amounts of profits constituted 'excess profits' which were exempted from taxation pursuant to Article 185(2)(b) of the Belgian *Code des impôts sur les revenus*[44]. The Commission

[42] According to Luxembourgish tax law, a limited partnership is not subject to the CIT.

[43] Commission Decision (EU) 2018/859 of 4 October 2017 on State aid SA.38944 (2014/C) (ex 2014/NN) implemented by Luxembourg to Amazon [2018] OJ L 153 (*Amazon Decision*), paras 562-564.

[44] Indeed, the rule provides that '*[...] pour deux sociétés faisant partie d'un groupe multinational de sociétés liées et en ce qui concerne leurs relations transfrontalières réciproques [...] lorsque, dans les bénéfices d'une société sont repris des bénéfices qui sont également repris dans les bénéfices*

believed that the excess profit exemption scheme deviated from the general Belgian CIT and could not be deemed as being an inherent part of that reference system, as *'the objective of the Belgian corporate income tax system is to tax all corporate taxpayers on their actual profits'*[45] regardless of their integrated or non-integrated condition. In particular, the scheme constituted a selective advantage for the eligible companies which was a non-justified departure from the ALP[46].

Second, the Commission found another violation of Article 107 in a series of tax rulings issued by Luxembourgish authorities since February 2010, which have endorsed a complex financial transaction between four companies of the Engie group[47]. Those companies were all incorporated in Luxembourg under Luxembourgish law. In particular, the transaction gave rise to a financial hybrid that caused double non-taxation, as the same income was simultaneously treated as debt—a loan whose interests were deductible—and as equity—an investment exempted from taxation under Luxembourgish tax law. According to the Commission, the scheme allowed Engie to avoid taxation on 99% of the profits which had been shifted[48].

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d'une autre société, et que les bénéfices ainsi inclus sont des bénéfices qui auraient été réalisés par cette autre société si les conditions convenues entre les deux sociétés avaient été celles qui auraient été convenues entre des sociétés indépendantes, les bénéfices de la première société sont ajustés d'une manière appropriée'.

[45] Commission Decision (EU) 2016/1699 of 11 January 2016 on the excess profit exemption State aid scheme SA.37667 (2015/C) (ex 2015/NN) implemented by Belgium [2016] OJ L 260 (*Belgium excess profit Decision*), para 126. Instead, Belgian authorities had argued that the objective of such provision, which was an inherent part of Belgian CIT system, was to reward group synergies and incentivise economies of scale.

[46] In the press release *State aid: Commission concludes Belgian 'Excess Profit' tax scheme illegal; around €700 million to be recovered from 35 multinational companies* of 11 January 2016 the Commission claimed *that 'the scheme reduced the corporate tax base of the companies by between 50% and 90% to discount for so-called "excess profits" that allegedly result from being part of a multinational group'*.

[47] Engie is a multinational which operates in the field of low-carbon energy and services.

[48] See press release *State aid: Commission finds Luxembourg gave illegal tax benefits to Engie; has to recover around €120 million* of 20 June 2018. More specifically, the Commission analysed the effects of the tax treatment conferred to Engie on three different levels: the level of the holding entities which directly benefited of the tax exemption on the shifted profits; the group level; and the Luxembourg level, meaning that the Commission found selectivity in the fact that Luxembourg gave up upon the application of its anti-abuse tax rules. See Commission Decision (EU) 2019/421 of 20 June 2018 on State aid SA.44888 (2016/C) (ex 2016/NN) implemented by Luxembourg in favour of ENGIE [2019] OJ L 78 *(Engie Decision)*, paras 289 et seq. The Commission refers to Article 6 of the Luxembourg Tax Adaptation Law or *Steueranpassungsgesetz* (*StAnpG*), which prohibits that taxes are evaded or mitigated by abuse of forms or constructions which are legal under civil law.

Lastly, the Commission found a breach of Article 107 in the 'group financing exemption' which allowed multinationals to derogate from the general UK CFC rules. That rule, in force between 2013 and 2018, did not need any specific rulings to be applied. In general, UK CFC rules refer to two tests *'to determine how much of the financing profits from loans granted by an offshore subsidiary are to be reallocated to the UK parent company and, hence, taxed in the UK'*[49]: the 'UK activities test', which refers to the extent to which lending activities are located in the UK; and the 'UK connected capital test', which refers to the extent to which loans are financed by capital deriving from the UK. The group financing exemption derogated from the obligation of applying both those tests, allowing financing *via* offshore subsidiaries with a partial (75%) or total exemption. In the Commission's opinion, while the deviation from the 'UK connected capital test' was acceptable as it avoided *'complex and disproportionately burdensome intra-group tracing exercises'*[50], the same justification could not apply for the deviation from the 'UK activities test'. Thus, the UK CFC scheme was partially incompatible with the internal market.

Furthermore, the Commission has four ongoing in-depth investigations at the time of writing. Three investigations concern other tax rulings granted by the Netherlands in favour of Nike[51] and in favour of Inter IKEA[52] and by Luxembourg in favour of Huhtamäki[53]. The fourth ongoing investigation concerns the reopening[54] of the *Belgium Excess Profit* case after the annulment of Commission's

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[49] See press release *State aid: Commission concludes part of UK tax scheme gave illegal tax advantages to certain multinational companies; remaining part does not constitute aid* of 2 April 2019.

[50] See ibid, whereas in Commission Decision (EU) 2019/1352 of 2 April 2019 on the State aid SA.44896 implemented by the United Kingdom concerning CFC Group Financing Exemption [2019] OJ L 216 (*UK CFC Decision*), para 160 the Commission held that it is in general acceptable *'that an* a priori *selective measure that is applied for specific cases to ensure that the rules to counter the tax avoidance in those cases are both sufficiently robust and at the same time manageable and administrable, can indeed be said to follow from an inherent mechanism necessary for the functioning and effectiveness of the CFC rules, provided it complies with the principle of proportionality'*.

[51] See press release *State aid: Commission opens in-depth investigation into tax treatment of Nike in the Netherlands* of 10 January 2019.

[52] See press release *State aid: Commission opens in-depth investigation into the Netherlands' tax treatment of Inter IKEA* of 18 December 2018.

[53] See press release *State aid: Commission opens in-depth investigation into tax treatment of Huhtamäki in Luxembourg* of 7 March 2019.

[54] See press release *State aid: Commission opens in-depth investigations into individual 'excess profit' tax rulings granted by Belgium to 39 multinational companies* of 16 September 2019.

Decision by the General Court (GC)[55]. Instead, the investigation concerning the alleged State aid granted by Luxembourg in favour of McDonald's Europe through certain tax rulings ended in 2019 when the Commission found that the concerned rulings were compatible with the internal market pursuant to Article 107[56].

4.2.3 The Commission's arm's length principle: flowing from Article 107 or *'harmonisation in disguise'*?

The investigations of the Commission were subject to a wide variety of critiques by both the applicants (Member States and multinationals) who challenged the subsequent decisions and literature[57]. It might be helpful to summarise those criticisms before proceeding with a deeper analysis.

It has been indeed argued that; *(i)* the Commission has failed in identifying the appropriate reference system when applying the three-steps test; *(ii)* in order to assess the deviation from such a reference system, the Commission, who lacks any competence on direct taxation, has developed its own ALP and has erroneously considered it part of national legislation; *(iii)* even if the Commission's use of its own ALP is in principle legitimate, the Commission has failed in applying it as it has introduced an illegitimate presumption of advantage.

In respect of the first issue, *(i)* in *Belgium excess profit* the Commission argued that the reference system applicable to the concerned multinationals was the

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[55] See joined cases T-131/16 and T-263/16 *Kingdom of Belgium and Magnetrol International v European Commission (Belgium Excess Profit)* [2019] ECLI:EU:T:2019:91.

[56] See Commission Decision (EU) 2019/1252 of 19 September 2018 on tax rulings SA.38945 (2015/C) (ex 2015/NN) (ex 2014/CP) granted by Luxembourg in favour of McDonald's Europe [2019] OJ L 195 (*McDonald's Decision*) and press release *State aid: Commission investigation did not find that Luxembourg gave selective tax treatment to McDonald's* of 19 September 2018.

[57] See, amongst the others, K. RICHARD, *Are All Tax Rulings State Aid: Examining the European Commission's Recent State Aid Decisions*, in *Houston Business and Tax Law Journal*, 18, 1, 2018, A. GIRAUD, S. PETIT, *Tax Rulings and State Aid Qualification: Should Reality Matter?*, in *European State Aid Law Quarterly*, 16, 2, 2017, DRENNE, *State aid and tax rulings: is there really a competition issue?*, cit, LOVDAHL GORMSEN, *European State Aid and Tax Rulings*, cit; P. NICOLAIDES, *State Aid and Tax Rulings*, in *European State Aid Law Quarterly*, 3, 2016, p. 416; R. FADIGA, *Of Apples, Cars, and Coffee – Against the Commission's Remedy to Unlawful Tax Rulings*, in *European Journal of Legal Studies*, 10, 2, 2018, p. 209; QUATTROCCHI, *Gli Aiuti di Stato nel Diritto Tributario*, cit, pp. 139-142.

Belgian general CIT system and not the transfer pricing rules applicable to an integrated company which was in a comparable factual and legal situation[58].

This reasoning has been accused of showing at least three weaknesses: first, it can be argued that, ignoring the differences between integrated and non-integrated companies, the Commission itself is instead paradoxically deviating from the general CIT system. In fact, not only Belgian national tax law (as well as Irish and Luxembourgish laws), but also the *I+R*, *Parent-Subsidiary*, and *ATAD* directives, which necessarily constitute part of the general CIT system of every Member State, provide specific rules for integrated companies[59], and thus do not consider multinationals in the same legal and factual situation as nationally organised groups or stand-alone entities; second, the very reason for the existence of transfer pricing lies in the presence of multinationals groups and integrated companies, whereas *'non-integrated companies cannot benefit from [transfer prices] since, by definition, they do not belong to a larger group where subsidiaries can charge each other transfer prices'*[60]; third, even if it is admitted that the profits of integrated and non-integrated companies could be in principle compared, it must be borne in mind that transfer prices for intra-group transactions are shielded from market forces, while non-integrated companies' operations are not[61].

With regard to the second issue, *(ii)* it was observed above that the Commission had followed its own approach to the matter of selectivity since

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[58] In case C-20/15 P *European Commission v World Duty Free Group SA and Others* [2016] ECLI:EU:C:2016:981 *(Duty Free)*, para 67, the ECJ held that the Commission should *be 'able to demonstrate that that measure is a derogation from the ordinary or "normal" tax system applicable in the Member State concerned, thereby introducing, through its actual effects, differences in the treatment of operators, although the operators who qualify for the tax advantage and those who do not are, in the light of the objective pursued by that Member State's tax system, in a comparable factual and legal situation'*.

[59] See LOVDAHL GORMSEN, *European State Aid and Tax Rulings*, cit, pp. 57-58. Those directives are analysed *supra* in Chapter II. In addition, it can be noticed that also the Court has highlighted the necessity of comparing companies which are in the same legal and factual situation. See, amongst others, case C-70/16 P *Comunidad Autónoma de Galicia and Redes de Telecomunicación Galegas Retegal SA v European Commission* [2017] ECLI:EU:C:2017:1002, para 61.

[60] GIRAUD, PETIT, *Tax Rulings and State Aid Qualification*, cit, p. 237.

[61] See NICOLAIDES, *State Aid and Tax Rulings*, cit, p. 425, where the author argues that *'revenue and costs can be artificially manipulated by multinational companies'* but *'this in itself does not make tax rulings selective'*. In fact, *'as long as a group company accounts for all the costs it incurs, just like an independent company, even if those costs are artificially high, it does not benefit from a selective advantage'*.

Belgium and *Gibraltar* cases, emancipating itself from the influence of the *Code of Conduct* and, to a certain extent, of the OECD framework.

One of the main features of the tax ruling saga was indeed the autonomous ALP adopted by the Commission, different from the one defined by Article 9 of the OECD *Model Tax Convention*[62]. It is thus necessary to assess on which legal basis and to what extent the Commission introduced its own ALP and deviated from the OECD standards which are normally transposed in national legislations.

Notwithstanding that the ALP is not mentioned by Articles 107-108 TFEU, the fact that the ALP, as interpreted by the Commission, was an inherent part of Article 107 was a crucial part of the Commission's arguments in *Fiat*, *Starbucks*, *Apple*, and *Belgium Excess Profit*. Consistent with this approach, since 2016 (thus after the opening decisions on most of those cases) the *Notice on State aid* provides that *'this arm's length principle necessarily forms part of the Commission's assessment of tax measures granted to group companies under Article 107(1) of the Treaty, independently of whether a Member State has incorporated this principle into its national legal system and in what form'*[63]. Therefore, arguments such as that one provided by Ireland in *Apple*[64], in that the ALP provided by the new OECD *Transfer Pricing Guidelines* has not been transposed in the Member State's legal order, cannot be raised. According to the Commission, therefore, the ALP has been part of Member States' law since they joined the EU (e.g. the ALP has been part of Irish law from 1973, thus it is applicable to all the rulings granted after that moment).

However, literature argued that the Commission was *'inventing a version of the ALP which is specific to EU law'* and which *'interfere[d] with the fiscal*

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[62] Article 9 provides that where *'conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly'*.

[63] *Notice on State aid*, para 172. Further features of the Commission's ALP were also provided by DIRECTORATE-GENERAL FOR INTERNAL POLICIES, *EU State Aid Law and National Tax Rulings*, 2015.

[64] *Apple Decision*, paras 153 and 177. Ireland argued that, in the first place, the ALP had never been transposed in Irish tax law. Moreover, Ireland submitted that, even if such a principle was considered as binding, the OECD had only adopted it in 2010, whereas the rulings were granted in 1991 and 2007. Accordingly, the ALP could not be retroactively applied in the assessment of those rulings.

autonomy of the Member States and circumvent[ed] Article 115'[65]. Indeed, it was noticed above that the same argument was also brought by Apple, which accused the Commission of *'harmonisation in disguise'*[66], i.e. of seeking to harmonise national tax law in breach of the Treaties.

The Commission has so far justified the application of its own ALP by reference to *Forum 187*, where the Court held that in order to assess whether a certain method of assessment of taxable income confers an advantage to its beneficiary *'it is necessary [...] to compare that regime with the ordinary tax system, based on the difference between profits and outgoings of an undertaking carrying on its activities in conditions of free competition'*[67].

Literature argues that *'this is a weak authority for the proposition that an autonomous EU ALP exists in Article 107 TFEU'*[68]. Although *Forum 187* refers to *'transfer prices [which] do not resemble those which would be charged in conditions of free competition'*[69] and describes what essentially is the 'cost plus' method, it does not mention the ALP. Moreover, it has been pointed out that in *Forum 187* the facts of the case referred to the OECD guidelines. Hence, if an ALP was involved at all, it was that one of the OECD framework.

The Commission found in paragraph 81[70] of *Forum 187* the legal basis for the application of the ALP as a principle of EU law. However, that paragraph only refers to the applicability of State aid rules to fiscal measures, which, as said before, is nothing new. Moreover, while the Commission explicitly refers to the application of its own ALP as a general principle flowing from Article 107 relying on *Forum 187* in the *Notice on State aid*, according to the *Notice* itself *'if a transfer pricing arrangement complies with the [...] OECD Transfer Pricing Guidelines, [...] a tax ruling endorsing that arrangement is unlikely to give rise to State aid'*[71].

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[65] LOVDAHL GORMSEN, *European State Aid and Tax Rulings*, cit, pp. 44-45. See also TRAVERSA, FLAMINI, *Fighting Harmful Tax Competition,* cit, p. 331, where the authors argue that even though State aid is a *'useful tool in the fight against harmful tax competition'*, it cannot be *'intended as a full substitute for the positive approximation of the corporate tax system of the Member States'*.
[66] The term is used by the General Court in Case T-755/15 *Grand Duchy of Luxembourg and Fiat Chrysler Finance Europe v European Commission* [2019] ECLI:EU:T:2019:670 *(Fiat)*, para 90.
[67] *Forum 187*, para 95.
[68] LOVDAHL GORMSEN, *European State Aid and Tax Rulings*, cit, pp. 45-46.
[69] *Forum 187*, para 96.
[70] *Forum 187*, para 81: *'It should be pointed out, first, that rules relating to tax are not excluded from the scope of Article 87 EC'*.
[71] *Notice on State aid*, para 173.

Lastly, further critical comments have arisen with respect to the compatibility of such an approach with the Court's case law on freedom of establishment and free movement of capital. In particular, it is observed that the Court has so far relied on the OECD ALP in order to assess transfer pricing cases and allow Member States to tackle wholly artificial arrangements. Any derogation from that method should in principle be commercially justified. However, not only does the Commission require an unconditional (even beyond the cases of wholly artificial arrangements) application of its own ALP, but it also considers such principle as an inherent part of Article 107 TFEU, ignoring the internal market case law which allows commercial justifications[72].

Lastly, *(iii)* as regards the application of the ALP in relation to the three-steps test, the Commission has been criticised for deducting the presence of an advantage (which is one of the constituent element of State aid) whenever the tax scheme derogates from the reference system (which is instead one of the three steps of the selectivity analysis), thus blurring the distinction between the assessment of the advantage and the assessment of selectivity.

On the one hand, it was noticed that in *Fiat* and *Starbucks* decisions the Commission interpreted *MOL Magyar* as if the Court introduced a general presumption of selectivity for each case in which a measure is capable of granting an economic advantage. This interpretation has caused a merger between the concepts of advantage and selectivity, often analysed together by the Commission, which often ends up referring to the more general and blur notion of *'selective advantage'*[73].

On the other hand, it might be argued that the concerned presumption is not applicable to the recent tax ruling saga for three main reasons[74]. First off, in *MOL Magyar* the Court distinguishes between individual aid and general schemes, observing that the presumption is only applicable to the former. However, both in

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[72] See, amongst others, *SGI*, which was mentioned *supra* in Chapter III.
[73] See for instance *Amazon Decision*, para 283. Interestingly, the very existence of such a presumption was excluded by the General Court in Case T-219/10 *Autogrill* [2014] ECLI:EU:T:2009:939, para 52. However, on appeal, the Court of Justice disagreed and went back to the more relaxed criteria originally provided by *Gibraltar* case.
[74] LOVDAHL GORMSEN, *European State Aid and Tax Rulings*, cit, p. 53.

MOL Magyar and in the sole subsequent judgement[75] in which that statement has been so far reiterated, the facts concerned general schemes. Hence, that presumption has not been applied by the Court on an individual aid case yet. Second off, there is no express ground in the judgement for exempting the Commission from the duty of applying the three-steps test. Third off, *Mol Magyar* case was not related to fiscal measures[76].

In conclusion, it might be observed that, on the one hand, the Commission has at the same time held that its own ALP is an inherent part of Article 107 TFEU, which is directly applicable in Member States. On the other hand, the Commission itself has applied the second step of the selectivity test by finding a selective advantage whenever the measure derogated from the reference system, so that national tax authorities lost their margin of appreciation when negotiating tax rulings. The combination of these factors constitutes the mechanism which has been accused of breaching Article 114(2) TFEU[77], as it, according to the applicants that have challenged the concerned decisions, deprives national authorities of their traditional criteria[78] in order to assess selectivity and it replaces those criteria with the Commission's own ALP. In addition, the fact that the new approach to the ALP was only explicitly formulated in 2016, thus after the opening decisions in *Fiat*, *Starbucks*, *Apple*, and *Amazon*, raises concerns about legal certainty[79].

4.2.4 The apparent paradox of recovery decisions and Member States' attractiveness

[75] Case C-270/15 P *Belgium v European Commission* [2016] ECLI:EU:C:2016:489, paras 2-8, 49-50.

[76] The case concerned instead a mining fee.

[77] See LOVDAHL GORMSEN, *European State Aid and Tax Rulings,* cit, p. 56, where the author suggests that *'knowing that it cannot attack the national law directly as it is outside of its competences, [the Commission] replaces the general national tax law with its own invented framework'*. In addition, R. FADIGA in his *Of Apples, Cars, and Coffee*, cit, p. 229, observes *that 'instead of requiring Member States to devise a method that the Commission accepts and that taxpayers can apply autonomously, the Commission requires Member States to obtain, through whichever method they choose, results that the Commission accepts'*.

[78] According to DIRECTORATE-GENERAL FOR INTERNAL POLICIES, *EU State aid law and national tax rulings*, p. 12, those criteria should be *'public, objective and verifiable'*.

[79] It must be noticed, in addition, that the Commission ALP was not even mentioned in the *Commission's draft Notice on the notion of State aid* of 2014. Further issues related to the alleged breach of the principle of legal certainty are discussed below.

A further critique has been made to the Commission in respect of its recovery orders. Indeed, in all the cases of the tax ruling saga the Commission ordered each concerned State to recover the incompatible aid from the beneficiaries. However, Member States and multinationals have argued that, even if the Commission's new interpretation of Article 107 is deemed acceptable, the recovery orders issued by the Commission have breached the principles of legal certainty and legitimate expectations as they relied on an unpredictable development of State aid rules.

It is thus necessary: first, to describe what recovery is; and second, to understand why Member States have been so reluctant in executing orders that allow them to receive multi-million Euro payments.

Recovery is a *'mechanism that attempts to restore the situation before the granting of aid'*[80]. The Commission orders recovery when a certain measure, in its opinion, constitutes State aid incompatible with the internal market[81]. While the power of the Commission to issue a 'recovery decision' is not expressly provided by Articles 107-108 TFEU, which only refer to the obligation to *'abolish'*[82] the aid, it finds its legal basis in Articles 16-17 of the *Procedural Regulation*[83]. Recovery is implemented in accordance with the procedures provided by Member States' national law, and it is subject to a ten-year limitation period (which is interrupted when the Commission starts new investigations) in order to grant legal certainty. Member States which granted the subsidy or the alleged beneficiaries of the aid can bring an action before the Court for the annulment of the recovery decision, but such initiative does not automatically suspend recovery[84]. For instance, whereas Amazon and Luxembourg have brought actions against the Commission[85], the recovery procedure is still ongoing at the time of writing.

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[80] LOVDAHL GORMSEN, *European State Aid and Tax Rulings*, cit, p. 63.
[81] The 'illegal' aid, meaning the aid that the Member State has failed to notify, does not *per se* trigger the recovery mechanism until the aid itself is found in breach of Article 107.
[82] Art. 108(2) TFEU.
[83] Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union [2015] OJ L 248.
[84] The decision can be suspended only in exceptional circumstances where the applicant shows: *(i)* a *prima facie* case for the action on the merits; *(ii)* urgency; and *(iii)* the risk of a serious and irreparable harm. For instance, in *Belgium Excess Profit* Belgium applied for interim measures, seeking the suspension of the Commission's Decision. However, the GC rejected the request as it believed there was no urgency in the case.
[85] Cases T-318/18 and T-816/17.

In particular, the Commission has so far ordered Luxembourg to recover EUR 23.1 million from Fiat, EUR 282.7 million from Amazon and around EUR 120 million from Engie, the Netherlands to recover EUR 25.7 million from Starbucks, and Ireland to recover the record sum of EUR 14.3 billion from Apple.

The question of why the Member States involved in those cases were so interested in challenging decisions that allowed them to recover significant amounts of money[86] finds its (apparently) paradoxical answer in the phenomenon of regulatory competition.

As noticed when describing the case of Delaware, for certain countries being attractive for foreign companies' capitals and incorporations is indeed crucial. As of 2019, in Ireland, Luxembourg, and the Netherlands, taxation on corporate profits contributes to 3.1%, 5.9%, and 3.7% of the respective GDPs[87], as opposed to bigger countries like France, Germany, and Italy were such percentages lower to 2.2%, 2%, and 1.9% respectively. Therefore, the former countries value the capability of offering legal certainty and favourable conditions to undertakings in the long-term more than a, albeit high, lump sum.

In theory, such a reasoning should not be applicable where the recovered money corresponds to the money that the State has lost for granting the aid. In fact, were that money to constitute a cost for the State, there would be little convenience, if at all, in granting the ruling. The question that arises is thus whether that money can be deemed State resources.

It has been said that State origin[88] is one of the essential elements for a measure in order to constitute State aid. Hence, scholars have argued that *'tax ruling cases use theoretical benchmarks to identify State resources'*[89], meaning that the Commission assumes that the selective advantage conferred to multinationals corresponds to a loss of tax revenue for the State. This presumption fails to be accurate to the extent to which the Commission seems to ignore the phenomenon of regulatory competition. Whereas the parallel between the tax discount and the

[86] For instance, according to the OECD, Irish GDP in 2019 was around USD 454 billion. Therefore, the EUR 14.3 billion recovery from Apple would grant Ireland an income correspondent to almost 4% of its GDP.
[87] The source is the OECD.
[88] State origin is the second feature of a State aid described *supra* in paragraph 4.2.
[89] GIRAUD, PETIT, *Tax Rulings and State Aid Qualification,* cit, p. 235.

revenue loss is in theory correct when the tax paid by the integrated company is compared to the tax that the company would have presumably paid in the absence of the ruling, in practice that assumption hides a misconception. Indeed, it is unlikely that without the ruling the State would have attracted the multinational to which the ruling itself has been granted[90]. Therefore, from this practical point of view, there is no loss but only a gain for the State which grants the ruling, and thus it might be successfully argued that the measure lack of a fundamental requirement—in that the measure itself is not granted through State resources—in order to be considered State aid pursuant to Article 107 TFEU.

Aside from the criticism on the qualification of the measure as State aid in the first place, it is interesting to analyse the arguments through which applicants have so far challenged the recovery decision. Indeed, such arguments deal with elements which are substantially linked with the Commission's findings about tax rulings' incompatibility with the internal market, and more specifically with the novel approach of the Commission to the ALP.

There are three situations in which the obligation to recover illegal aid would be prevailed over: the expiry of the limitation period; the absolute impossibility; the breach of a general principle of EU law.

Thus, general principles[91] of EU law can be used as defences by the applicants seeking the annulment of recovery decisions. Indeed, pursuant to Article 16(1) of the *Procedural Regulation 'the Commission shall not require recovery of the aid if this would be contrary to a general principle of Union law'*. The Court has so far recognised three general principles of EU law which constitute the main

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[90] See ibid, where the authors submit that *'Ireland's tax authorities negotiated Apple's taxable basis precisely because Apple had the possibility of shifting the corresponding revenues elsewhere if a satisfying compromise was not found'*. NICOLAIDES, *State Aid and Tax Rulings*, cit, p.426, seems to agree: *'[…] if the comparison is between the amount of tax that is paid without the tax ruling and the amount of tax that is paid with the tax ruling, then group companies do not receive a selective advantage, but a selective disadvantage. They pay more than what they would have paid without the tax rulings'*. See also M. ORLANDI, *Interpelli (tax ruling), accordi preventivi sui prezzi di trasferimento, principio di libera concorrenza ed aiuti di Stato: la nuova frontiera della disciplina della concorrenza*, in BORIA (ed.), *La Concorrenza Fiscale tra Stati*, cit, p. 146, where the author observes that in this sense the *ratio* of tax rulings is similar to the one of settlement agreements negotiated between private citizens and tax authorities.

[91] On the general principles in the Union legal order, see R. SCHÜTZE, *European Union Law*, Cambridge: Cambridge University Press, 2nd edn, 2018, p. 360; more specifically, on those which the CJEU has deemed suitable for countering recovery decisions, see LOVDAHL GORMSEN, *European State Aid and Tax Rulings*, pp. 64 et seq.

grounds on which an order of recovery might be countered: the protection of legitimate expectations, the principle of legal certainty, and the transfer of economic activity. The first *(i)* and the second *(ii)* grounds are relevant to the contested cases.

The *(i)* principle of legitimate expectations has played a key-role in the recent State aid cases. In *Commission v Germany*[92] the Court clarified that, in order for the applicant to invoke this principle, *'a diligent businessman'*[93] should have been able to determine if the procedure for granting an aid had been followed. The satisfaction of this condition is assessed through a two-steps test: first, the aid must be notified under Article 108(3) TFEU and it must not be granted before the end of the procedure; second, there must be *'exceptional circumstances on the basis of which [the applicant] had legitimately assumed the aid to be lawful'*[94].

In both *Fiat* and *Starbucks*, the parties argued that the Commission's deviation from the established OECD version of the ALP infringed on the legitimate expectations principle. The Commission, however, held that there were no *'precise assurances'*[95] as the *Code of Conduct* was just a soft law tool and neither is the OECD an EU institution nor the EU a member of the OECD.

Moreover, *(ii)* in *Fiat* Luxembourg argued that such a new interpretation of Article 107 TFEU infringed the legal certainty principle[96], which requires *'that rules of law be clear, precise and predictable as regards their effects, in particular where they may have unfavourable consequences for individuals and undertakings'*[97]. The breach, according to Luxembourgish authorities, was caused by the retroactive application of Article 107 TFEU in light of the Commission's own version of the ALP. However, the Commission replied that: firstly, there was *'no previous decision-making practice that might have created uncertainty about the fact that tax rulings could lead to the granting of State aid'*, as *'the Notice on*

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[92] Case C-5/89 *Commission of the European Communities v Federal Republic of Germany* [1990] ECLI:EU:C:1990:320.

[93] Ibid, para 14.

[94] Ibid, para 16. The exceptional circumstances must be assessed on a case-by-case basis. An analysis of the applicability of the principle of legitimate expectations to State aid cases is provided by J. S. PASTORIZA, *The Recovery Obligation and the Protection of Legitimate Expectations: The Spanish Experience*, in RICHELLE, SCHÖN, TRAVERSA (eds.), *State Aid Law and Business Taxation*, cit, p. 247.

[95] *Fiat Decision*, paras 357-358.

[96] Ibid, para 360.

[97] Joined Cases C-72/10 and C-77/10 *Criminal proceedings against Marcello Costa and Ugo Cifone* [2012] ECLI:EU:C:2012:80, para 74.

Direct Business Taxation makes express reference to tax rulings and the circumstances according to which they could be considered to lead to the granting of State aid'[98] whereas nothing is said about which is the ALP interpretation to be applied; secondly, given that the Commission had already applied the ALP to previous cases, even when Luxembourg was directly involved, there was *'nothing novel in the Commission's approach to the contested tax ruling'*[99].

In conclusion, the Commission has rejected the arguments of the parties in respect of both the principle of legitimate expectations and the principle of legal certainty.

4.2.5 The intervention of the General Court: is the backdoor still open?

All the decisions of the Commission were challenged before the Court, and the subsequent outcomes were not always identical. At the time of writing, while the *Fiat Decision*[100] was upheld by the Court, *Belgium Excess Profit, Starbucks*[101], and *Apple*[102] were annulled *ex tunc*.

The first intervention of the GC was its judgement in *Belgium Excess Profit*[103]. In this case, the appeal against the Commission's decision was brought by both Magnetrol International, one of the 35 multinationals involved, and Belgium, supported by Ireland. Unfortunately, since the GC found that *'the Commission erroneously considered that the Belgian excess profit system [...] constituted an aid*

[98] *Fiat Decision*, para 361.
[99] Ibid, para 362.
[100] Case T-755/15 *Grand Duchy of Luxembourg and Fiat Chrysler Finance Europe v European Commission (Fiat)* [2019] ECLI:EU:T:2019:670.
[101] Joined cases T-650/15 and T636/16 *Kingdom of the Netherlands and Others v European Commission (Starbucks)* [2019] ECLI:EU:T:2019:669.
[102] Joined cases T-778/16 and T-892/16 *Ireland and Others v European Commission (Apple)* [2020] ECLI:EU:T:2020:338.
[103] The judgement is currently under appeal before the ECJ.

scheme'[104] under Article 1(d)[105] of the *Procedural Regulation*, it was deemed unnecessary[106] to discuss the further arguments concerning the interpretation of the concepts of selectivity, advantage, legal certainty and legitimate expectations, which were the object of the other pleas submitted by the applicants.

Nevertheless, the GC took at least the chance to reiterate that since *'while direct taxation [..] falls within the competence of the Member States, they must nonetheless exercise that competence consistently with EU law'* and *'it is undisputed that the Commission is competent to ensure compliance with Article 107 TFEU'*[107], it follows that the Commission cannot be accused of exceeding its powers when it assesses a measures that grant certain undertakings advantageous tax treatment—*'although it does not involve the transfer of State resources'*[108]—under Article 107.

The Court has thus confirmed that the Commission has not encroached on the exclusive jurisdiction of Belgium on direct taxation, leaving room for the assessment of the remaining arguments in case the judgement is annulled by the ECJ. If the ECJ follows the recently delivered Opinion of AG Kokott and set aside the judgement while referring it back to the GC for a decision on the remaining pleas in law[109], the victory of Belgian authorities risks an overturning by the forthcoming judgement.

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[104] *Belgium Excess Profit*, para 135. In particular, the GC held that: *(i)* not all the essential elements of the scheme were apparent in the law (paras 90-98); *(ii)* while APAs normally grant *a priori* certain favourable conditions, Belgian authorities retained a certain margin on discretion to assess the condition under which the profit exemption was granted (paras 99-113); *(iii)* the beneficiaries of the alleged scheme could not be identified *ex ante* (paras 114-120); *(iv)* there was no systematic approach in the rulings (paras 121-134). These factors are discussed in detail by F. DE LICHTERVELDE, *The Excess Profit Exemption System is not an Aid Scheme: not the Ruling Expected, but not the End of the Story*, in *European State Aid Law Quarterly*, 3, 2019, pp. 386-387. Moreover, at p. 388 the author also observes that *'procedure, rather than substance, was fatal to the decision'*.

[105] Which provides that '*"aid scheme" means any act on the basis of which, without further implementing measures being required, individual aid awards may be made to undertakings defined within the act in a general and abstract manner and any act on the basis of which aid which is not linked to a specific project may be awarded to one or several undertakings for an indefinite period of time and/or for an indefinite amount'*.

[106] *Belgium Excess Profit*, para 136.

[107] Ibid, para 62. In particular, the GC refers to case C-269/09 *European Commission v Kingdom of Spain* [2012] ECLI:EU:C:2012:439, para 47.

[108] Ibid, para 66. This sentence might be considered a response to the aforementioned observation that '*tax ruling cases use theoretical benchmarks to identify State resources*' (GIRAUD, PETIT, *Tax Rulings and State Aid Qualification,* cit).

[109] Opinion of AG Kokott delivered on 3 December 2020, case C-337/19 P, *Belgium Excess Profit*, para 126.

About seven months after *Belgium Excess Profit*, on 24 September 2019 the GC delivered its *Fiat* and *Starbucks* judgements, which had opposite outcomes. While in *Fiat* the GC endorsed the Commission's Decision, *Starbucks Decision* was instead annulled. In both the judgement, moreover, the applicants (Fiat and Luxembourg, Starbucks and the Netherlands) were supported by the intervention of Ireland.

The most relevant pleas of the applicants against the Decisions can be summarised as follows[110]: *(i)* infringement of Articles 4 and 5 TEU, in so far as the Commission's analysis would lead to tax harmonisation in disguise; *(ii)* infringement of Articles 107 TFEU and breach of the principles of legal certainty and protection of legitimate expectations, in assessing the existence of an advantage on the basis of the Commission's own interpretation of the ALP; *(iii)* infringement of Article 107 TFEU, in respect of the assessment of selectivity with specific regard to the individuation of the appropriate reference system; and *(iv)* breach of the principle of legal certainty in respect of the recovery orders.

First of all, reiterating the findings of *Belgium Excess Profit*, the GC held that *(i)* although the reference system is provided by national law, the assessment of a deviation[111] from such a system falls within the scope of the competences of the Commission.

As regards the second and third matters, it is interesting to notice that in both judgements the Court preliminarily observed that although *'the Commission's approach of examining the criteria of advantage and selectivity concurrently [was] not in itself incorrect'*, the Court itself considered it *'appropriate to consider, first of all, whether the Commission was entitled to conclude that there was an advantage, before going on, if necessary, to examine whether that advantage had to be considered to be selective'*[112]. The Court thus insisted on the distinction between the two criteria, which were instead concurrently considered not only by

[110] *Fiat*, paras 90-99; *Starbucks*, paras 118-130.
[111] *'[...] by verifying, in a specific case, whether that tax ruling conferred on its beneficiary an advantage as compared to "normal" taxation, as defined by national tax law'* (*Fiat*, para 113).
[112] *Fiat*, para 121. Moreover, at para 332 the Court reiterated that *'the requirement as to selectivity under Article 107(1) TFEU must be clearly distinguished from the concomitant detection of an economic advantage'*. See also *Starbucks*, para 129.

the Commission, but also by the applicants[113].

However, *(ii)* the GC endorsed the Commission's application of the ALP for assessing the advantage on the basis of *Forum 187*[114]. Moreover, in *Fiat* the Court observed that the Commission had correctly referred to the OECD ALP only as *'reference document'* or as *'appropriate guidance'*, which therefore could not be binding for the Commission itself under the principles of legal certainty and legitimate expectations[115]. Nevertheless, commentators submitted that *'the Court did not endorse the far-reaching Commission theory that the ALP originates directly from EU law and would apply regardless of its recognition at the Member State level'*[116]. Indeed, the Court acknowledged the existence of different methodologies for the application of the ALP, thus recognizing that the Commission shall leave to Member States a certain margin of appreciation and possible inaccuracies[117]. Unfortunately, the judgements lack in clarifying the extent of this margin[118].

In particular, it might seem that in *Fiat* the Court approved the *MOL Magyar* presumption, as it held that *'the question whether the tax ruling at issue constitutes a derogation from the reference framework coincides with the identification of the advantage'*[119]. However, in *Starbucks* the GC clarifies that the Commission has the

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[113] By, for instance, Fiat in its first plea in law (whereas Luxembourg referred to selectivity in its first plea and to the advantage in its second plea).
[114] *Fiat*, para 142; *Starbucks*, para 143.
[115] *Fiat*, para 167.
[116] A. LAMADRID, *The Fiat and Starbucks Judgements*, in *Chillin'Competition*, 25 September 2019, available at <https://chillingcompetition.com/2019/09/25/the-fiat-and-starbucks-judgments/>.
[117] At para 196 of *Starbucks*, the Court held that *'the Commission must take into account the fact that the arm's length principle allows it to verify whether the transfer pricing accepted by a Member State corresponds to a reliable approximation of a market-based outcome and whether any variation that may be identified in the course of that examination does not go beyond the inaccuracies inherent in the methodology used to obtain that approximation'*. In fact, the Court upheld the complaint of the applicants according to which the Commission wrongly found that the mere choice of the TNMM (and not the uncontrolled price method) in the case at hand conferred an advantage, without it being necessary to examine the arguments of the defendant. See also LAMADRID, *The Fiat and Starbucks Judgements*, cit, where the author comments that *'[...] in other words, the Commission cannot simply assume that because the Member State acted in a seemingly arbitrary manner the outcome was wrong'*.
[118] But see *Starbucks*, para 196: *'[...] while it is common ground that the Member State has a margin of appreciation in the approval of transfer pricing, that margin of appreciation cannot lead to the Commission being deprived of its power to check that the transfer pricing in question does not lead to the grant of a selective advantage within the meaning of Article 107(1) TFEU'*.
[119] *Fiat*, para 361. Interestingly, it might be argued that it was in partial contradiction with the other part of the judgement in which it highlighted the dichotomy between the two elements (advantage and selectivity).

burden of proving the presence of an advantage and shall thus *'conduct a diligent and impartial examination of the measures at issue, so that it has at its disposal, when adopting a final decision establishing the existence and, as the case may be, the incompatibility or unlawfulness of the aid, the most complete and reliable information possible'*[120].

Moreover, the Court did not take position on the *(iii)* appropriateness of considering the general CIT system as the reference framework. In fact, in *Fiat* the GC found that, in any event, the tax ruling at issue derogated from both the Luxembourgish general CIT system and the more limited reference system, invoked by the Grand Duchy of Luxembourg and by Fiat, consisting of Article 164(3) of the *Luxembourg Income Tax Code*[121] and an administrative circular[122].

Instead, in *Starbucks* the GC did not assess the selectivity as it had found no advantage.

Lastly, the Court addressed the pleas about recovery *(iv)* by upholding the validity of the Commission's reasoning above described. Interestingly, as Luxembourg had complained about the potential *'serious economic repercussions'* of such a recovery by reference to recent critiques addressed to the Commission by a whitepaper issued by the U.S. government[123], the Court firmly rejected the

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[120] *Starbucks*, para 194. This paragraph might respond to the critiques made to the Court by, amongst the others, P. T. JAEGER, who has referred to the paradoxical principle *'in dubio contra reum'* when observing that *'the burden of proof automatically shifts in tax cases'* and that *'under consistent jurisprudence, any differentiation in the tax burden automatically triggers a suspicion that the measure is selective'* in *Tax Incentives Under State Aid Law: A Competition Law Perspective*, in RICHELLE, SCHÖN, TRAVERSA (eds.), *State Aid Law and Business Taxation*, cit, p. 48.

[121] *Loi du 4 décembre 1967 concernant l'impôt sur le revenu*.

[122] *Circulaire du directeur des contributions L.I.R. n° 164/2 du 28 janvier 2011*, issued by the director of Luxembourg taxes.

[123] See U.S. DEPARTMENT OF THE TREASURY, *The European Commission's Recent State Aid Investigations of Transfer Pricing Rulings*, available at <https://www.treasury.gov/resource-center/tax-policy/treaties/documents/white-paper-state-aid.pdf>, 2016. This whitepaper was issued in response to *Apple Decision*. On the American criticism see also RICHARD, *Are All Tax Rulings State Aid*, cit, pp. 1 et seq., where the author substantially agrees with the content of the U.S. Treasury's whitepaper and submits that: *(i)* tax uncertainty will likely produce harmful economic effects on cross-border investments, which will primarily affect U.S. multinationals and U.S. economy; *(ii)* the Commission departure from pre-existing case law and decision practice might undermine the work of the OECD and the U.S. for the creation of a common transfer pricing framework; *(iii)* the recoveries ordered by the Commission might be considered foreign income taxes that are deductible against U.S. taxes. In conclusion, the author goes even further by observing that *'the appropriate method for the Commission to more closely align Member State tax law and policy with the arm's length principle (either as formulated by the Commission or as provided in the OECD guidelines) is through multilateral, principle-based legislation, rather than ad hoc assessments'*.

argument not only because that reason did not constitute any general principle under *Article 16(1) of the Procedural Regulation*, but also because *'it is clear that the recovery of the aid at issue cannot, as such, have negative economic effects for the Grand Duchy of Luxembourg, since the sums recovered are allocated to its public finances'*[124].

Interestingly, it has been noticed that *'politically, the credibility of the Court and of the EU system may be reinforced by the fact that—fortuitously—it was only the US company (and the Netherlands) getting out of the hook, not the European one (and Luxembourg)'*[125].

In conclusion, while the Commission did not appeal against *Starbucks*[126], the judgement in *FTT* has been appealed by Fiat on 4 December 2019[127], and it is still to be seen whether the ECJ will agree with the findings of the GC. At the time of writing, it can be nevertheless observed that in *Fiat* and *Starbucks* the GC seemed to endorse the behaviour of the Commission in respect of the enforcement of State aid rules as a backdoor through which the EU can delegitimise, if not tackle, practices of harmful competition.

That backdoor was apparently closed by the Court itself in *Apple*, as the U.S. multinational obtained a victory that, according to some commentators, *'shocked tax policymakers'* and reassured taxpayers *'because it reaffirmed old conventions of international tax'*[128].

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[124] *Fiat*, para 415.

[125] LAMADRID, *The Fiat and Starbucks Judgements*, cit. This is the development wished by P.J. WATTEL, *The Cat and the Pigeons: Some General Comments on (TP) Tax Rulings and State Aid After the Starbucks and Fiat Decisions*, in RICHELLE, SCHÖN, TRAVERSA (eds.), *State Aid Law and Business Taxation*, cit, p. 193: *'the Commission should show [...] that it does not disproportionally target US groups [...]'*. These observations have been even strengthened by the outcome of *Apple*, on which see below.

[126] The decision of the Commission has been analysed by D. KYRIAZIS in *Why the EU Commission won't appeal the Starbucks judgment*, in *Multinational Group Tax & Transfer Pricing News*, 2019 (https://mnetax.com/why-the-eu-commission-wont-appeal-the-starbucks-judgment-37043) and in *Playing Chess like Commissioner Vestager*, in *European Law Blog*, 2019 (https://europeanlawblog.eu/2019/11/12/playing-chess-like-commissioner-vestager/#comments). The author submits that Executive Vice President M. Vestager's choice of giving up upon the appeal witnesses the substantial victory of the Commission. See also press release *Statement by Commissioner Margrethe Vestager following today's Court judgments on two tax State aid cases (Fiat in Luxembourg and Starbucks in the Netherlands)* of 24 September 2019.

[127] Case C-885/19 P. The judgement has been appealed also by Luxembourg and Ireland.

[128] See A. HAINES, J. WHITE, *Taking a bite out of Apple leaves a sour taste*, in *International Tax Review*, 14 August 2020, available at <https://www.internationaltaxreview.com/article/b1mw9z84s4zmdk/taking-a-bite-out-of-apple-leaves-a-sour-taste>.

However, a careful analysis of the judgement suggests that, even though *'the identity of the company affected and the amounts at stake made this the most visible of the recent cases in which the Commission has challenged tax rulings under State aid rules'*, *'from a strictly legal standpoint, the Apple case is not necessarily more relevant than the* Fiat *and* Starbucks *judgements'*[129].

In *Apple* the GC followed indeed the path of *Starbucks* and avoided digging into crucial questions—especially those related to selectivity—which remain therefore unanswered.

On the one hand, the Court confirmed once again the power of the Commission to rely on the ALP in order to determine whether or not there is a selective advantage. The Court, moreover, seemed to uphold the departure from Article 9 of the OECD Model Tax Convention, since it is a *'useful guidance'* which nonetheless remains a *'non-binding'* tool[130].

On the other hand, the Court maintained: first, that the Commission could not find an advantage in the inaccuracies inherent in the methodology used to obtain a certain approximation[131]; second, that the burden of proof concerning the existence of an advantage rested with the Commission, as a *'methodological error'* in the assessment of the transfer prices is not sufficient to presume an advantage[132].

However, the questions as to whether or not the ALP directly flows from Article 107, and thus whether it applies even when the Member States have not expressly incorporated it in their national legal systems[133], was not directly answered. In fact, the Court provided only a blur response when observing that *'the arm's length principle, as described by the Commission in the contested decision, is thus a tool enabling the Commission to make that determination in the exercise of its powers under Article 107(1) TFEU'*[134]. Hence, it appears that the Court is submitting that the Commission's ALP is *a* tool, yet it is not *the* tool.

In conclusion, in *Apple* the GC seems to have left room for manoeuvre to

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[129] A. LAMADRID, *The Apple Judgment in Context*, in *Chillin'Competition*, 15 July 2020, available at <https://chillingcompetition.com/2020/07/15/the-apple-judgment-in-context-cases-t-778-16-and-t-892-16/>.
[130] *Apple*, para 196. See also paras 214 and 224.
[131] Ibid, para 216.
[132] Ibid, paras 319 and 453.
[133] Ibid, para 197.
[134] Ibid, para 214.

both the Commission, by recognizing its power under Article 107, and Member States, by reiterating the existence of a certain margin of appreciation deriving from the various methodologies for assessing transfer prices.

Interestingly, however, the Court has for the first time taken advantage of the opportunity to express at least some regrets about *'the incomplete and occasionally inconsistent nature of the contested tax rulings'*[135]. The judgement has been appealed by the Commission[136], and it is thus to be seen whether the ECJ will concretise these regrets by enlarging the loophole that the Commission has found in Article 107.

4.3 *Concluding remarks. Waiting for the European Court of Justice while looking for available alternatives*

The tax ruling saga shows again the legal relevance of the phenomenon of regulatory competition. In this dissertation, the impact of regulatory competition has been assessed on matters within which the EU has no competence (direct taxation) or a certain degree of competence (company law). This chapter suggests that such an impact is relevant also in a field where the EU enjoys an exclusive competence. Indeed, even though State aid rules have been used to intervene on regulatory competition, it is also true that it is State aid law itself that ended up being shaped by such a phenomenon.

The need to address issues related to tax rulings pushed the Commission to force, to a certain extent, the concept of State aid. In turn, this new interpretation gave rise to questions which concern fundamental elements of Article 107 itself.

Even the Court played a role in the creation of uncertainties. According to

[135] Ibid, para 479; see also the press release of the Court *The General Court of the European Union annuls the decision taken by the Commission regarding the Irish tax rulings in favour of Apple* of 15 July 2020: *'although the General Court regrets the incomplete and occasionally inconsistent nature of the contested tax rulings, the defects identified by the Commission are not, in themselves, sufficient to prove the existence of an advantage for the purposes of Article 107(1) TFEU'*. In particular, the Court seems to criticise the *'regrettable methodological defect'* constituted by the *'lack of evidence submitted to the Irish tax authorities concerning the functions actually performed by the Irish branches and the assessment of those functions for the purpose of determining the profit to be allocated to those branches'* (paras 347-348).

[136] See press release *Statement by Executive Vice-President Margrethe Vestager on the Commission's decision to appeal the General Court's judgment on the Apple tax State aid case in Ireland* of 25 September 2020.

DG Competition, *'in general, rulings that cover intra-group transactions between two different Member States, where both companies carry out genuine economic activities on which they are taxed, have been found to be unproblematic'*[137]. However, it was observed in Chapter I that the notion of *'genuine economic activity'* has progressively lost relevance in the case law of the ECJ in the name of freedom of movement. Furthermore, it was assessed in Chapter II that, even though it can be a complementary factor, it is unlikely that companies exploit their movement rights for the sole purpose of benefiting from more favourable corporate law regimes in order to facilitate their (genuine) business activity.

Therefore, consistent with its own approach to free movement, and specifically with the case law analysed in Chapter III, *'the ECJ should use a discrimination test to determine if State aid was granted'*[138]. Vice versa, it should set aside the 'benchmark test' constituted by the application of the Commission's ALP, as *'group companies and stand-alone companies are not in a similar legal and factual situation exactly because the first are part of a group of related companies'*[139]. In short, *'the focus should not be on the often futile search for a real or hypothetical norm level but on the justification of the differential as such'*[140].

However, it has also been noticed that, even if the ECJ decides to apply the apparently more appropriate discrimination test, *'all cases of discrimination would have to be solved by increasing the tax burden (with retroactive effect and without any protection of legitimate expectations) on those taxpayers who were subject to the more lenient treatment'* and *'that would result in an overkill effect under Art. 107, 108 TFEU'*[141].

It can be argued, indeed, that the purpose of State aid rules is to enhance free competition, and thus also to facilitate cross-border activities. The Commission,

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[137] *Working Paper on State Aid and Tax Rulings*, cit, para 13.
[138] RICHARD, *Are All Tax Rulings State Aid,* cit, p. 40. On the same line of reasoning, see also JAEGER, *Tax Incentives Under State Aid Law: A Competition Law Perspective*, cit, p. 52.
[139] R. LUJA, *State Aid Benchmarking and Tax Rulings: Can We Keep It Simple?*, in I. RICHELLE, W. SCHÖN, E. TRAVERSA (eds.), *State Aid Law and Business Taxation*, cit, p. 114.
[140] SCHÖN, *Tax Legislation and the Notion of Fiscal Aid*, cit, p. 9.
[141] Ibid, p. 14. In GALLO, *La concorrenza fiscale tra Stati,* cit, pp. 54-55, the author submits that the application of the principle of non-discrimination is not enough. Indeed, according to the CJEU case law, it should only apply to situations in which a Member State is discriminating on the basis of the nationality of the taxpayer. Thus, the non-discrimination principle should be only complementary to the implementation of a broader policy of harmonisation.

instead, has tried to rely on Article 107 for their limitation. Hence, State aid law does not seem the appropriate tool to tackle harmful competition.

Moreover, even though one might argue that the threat of State aid investigations has provided the Commission with leverage on some Member States, especially in the context of the new proposals for harmonisation in the field of direct taxation, it cannot be denied that, in the already difficult scenario brought by Brexit, it might incentivise further phenomena of disaggregation[142]. It would be a paradox if the application of internal market law ended up pursuing anti-integration effects.

Even apparent successes have proved ineffective. Following the Commission's investigations, the 'Double Irish' was abolished. Such a structure was used by U.S. multinationals such as Apple, Google (through the variation 'Double Irish with Dutch Sandwich'), Microsoft, and Facebook[143] in order to shift their profits to offshore companies (mainly in Bermuda) and erode the Irish tax base constituted by their European profits. This step appeared to be crucial in order to bring an allocation of profits which was closer to the economic reality and thus a fairer taxation. Nonetheless, the political dimension of this 'victory' was, at least partially, undermined by the *Tax Cuts and Jobs Act*, which reattracted to the U.S. the business structures and profits of companies like Google and Apple[144]. Again, the lack of cooperation on a global level somehow hindered the work of the EU. In that regard, the welfare-oriented political agenda of the new U.S. administration might prove key to invert the trend.

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[142] On this point see also F. PEPE, *Sulla tenuta giuridica e sulla praticabilità geo-politica della "dottrina Vestager" in materia di tax rulings e aiuti di Stato alle imprese multinazionali*, in *Rivista trimestrale di diritto tributario*, 3, 2017, pp. 703 et seq. The author suggests that an alternative approach to tax rulings might be to assess them under Article 258 TFEU in the context of infringement procedures, only taking into account those harmful practices that appear to be reiterated by a certain Member State.

[143] The abolition of the scheme was announced by the Irish Finance Minister M. Noonan on 14 October 2014. The reform provided that all companies registered in Ireland must be tax resident in Ireland. Companies which were benefiting from the former difference with U.S. residency rules were given until the end of 2020 to restructure their business. See R. CUNNINGHAM, *Time is up for the double-Irish*, in *International Tax Law*, 30 October 2015, available at <https://www.internationaltaxreview.com/article/b1f9jw39whbktj/time-is-up-for-the-double-irish>, and A. BARKER, V. BOLAND, V. HOULDER, *Brussels in crackdown on 'double Irish' tax loophole*, in *Financial Times*, 9 October 2014, available at <https://www.ft.com/content/ba95cff0-4fcd-11e4-a0a4-00144feab7de>.

[144] See J. WHITE, *Apple expands US operations after Tax Cuts and Jobs Act*, in *International Tax Review*, 22 January 2018, available at <https://www.internationaltaxreview.com/article/b1f7n339f57y02/apple-expands-us-operations-after-tax-cuts-and-jobs-act>.

The ball is now in the ECJ's court. Should the Court go further in developing its aforementioned *'regrets'* concerning tax rulings, it might decide to definitively endorse the Commission's approach. Instead, if the ECJ—and this seems the most legally correct solution—abandons the option provided by State aid law, it might (in the long-term) contribute to the exploration of other available mechanisms for tackling harmful regulatory competition and boosting recovery in the pandemic aftermath.

Indeed, provided that technical remedies have so far failed in granting harmony and uniformity, the main available alternative is represented by institutional solutions. It is possible to think of *(i)* the introduction of direct taxation within the scope of EU competence—such a solution would require an amendment of the Treaties—or, alternatively, *(ii)* a new legal basis for harmonisation in the field of taxation within the current framework of the treaties.

As regards the first solution, *(i)* the introduction of an EU competence in the field of direct taxation would substantially eliminate fiscal sovereignty of the Member States, but at the same time it would prevent tax competition—or at least its negative effects—within the Union by eliminating decentralisation, which is one of the key elements of regulatory competition. If the lack of democracy often found in EU institutions could be filled, then the sense of loss deriving from the abolition of fiscal sovereignty would be less relevant, and probably compensated by the enhancement of efficient redistributive policies and legal certainty across the Union[145].

Indeed, if the actual situation is carefully analysed, it appears that Member States are free to follow their own tax policies only to the extent to which they are still complying with the *Fiscal Compact*[146] and the other austerity measures

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[145] In A. PERRONE, G. SCOGNAMIGLIO (eds.), *The new EU monetary and fiscal policy: an international discussion*, in *Orizzonti del Diritto Commerciale*, 3, 2020, p. 918, E. LETTA argues that tax harmonisation is a crucial mission for the current EU legislature, as he notices that *'it's incomprehensible for the people to see that we are in the same Euro area but that there are so many fiscal havens'* and he believes that *'it is inconceivable to continue like that'*. Indeed *'it is very important to give entrepreneurs the opportunity to say that being in the same Euro area gives me the benefits of harmonization, a simplification of procedures, of tax procedures. That is not the case today—it is a mess today if you work in multiple countries in the Euro area. […] this is an issue about how to be competitive at the global level and how to take advantage of being united in the Euro area at the EU level'*.

[146] *Treaty on Stability, Coordination and Governance in the Economic and Monetary Union*, 2012.

concerning Member States' administration of public debt (through the implementation of the 'Balanced Budget Rule') in the context of the European Stability Mechanism (ESM). Those measures have deemed to be the only suitable remedies against the 2008 financial crisis[147]. That shows that the EU has already opted in the past for a unionised instrument to fight an economic crisis and that Member States have already accepted to give up on some of their ultimate economic rights in order to regain economic strength on a global level[148].

Once it is clear that tax competition in the present framework of the internal market is a danger for the social and economic policies of the Member States, and that Member States themselves have already given up their full fiscal sovereignty, then it is hard to see why a European tax policy should be an obstacle for Member States' wealth. Thanks to the impulse of a stronger democratisation of EU institutions, it is possible to imagine a common CIT rate—or a 'European common range' for CIT rate providing a maximum and a minimum rate—and the implementation of the CCTB and the CCCTB already proposed by the Commission. Not only would this approach lead to an improvement of social justice through redistribution of wealth, but it would also allow the EU to invest in small and medium-sized enterprises and start-ups, strategic assets of the European economy against the supremacy of extra-EU multinationals[149].

Nevertheless, it might be argued that some Member States—champions of tax competition—will never be willing to participate in this collective battle against

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[147] See MOAVERO MILANESI, *The Importance of State Aid Rules*, cit, p. 1, where the author observes that *'the crisis represented an unprecedented, uncertain challenge for the European Union's reaction capacity'* as at the beginning of the global crisis fiscal and economic policies of the Member States within the EMU were *'still largely decided and implemented at national level'*.

[148] A critical analysis of the process of integration in relation to the implementation of the EMU is provided by T. BEUKERS, *The Eurozone Crisis and the Autonomy of Member States in Economic Union: Changes and Challenges*, in KOUTRAKOS, SNELL (eds.), *Research Handbook on The EU's Internal Market*, cit, pp. 285-288, where the author holds that, even though *'the euro area crisis has painfully highlighted several internal market challenges of economic and monetary union'*, the choice between *'the extreme options of either a fully-fledged fiscal federal union or a (complete) return to sovereign Member States'* is not to be expected in in the short and medium term.

[149] On the Commission's website, available at <https://ec.europa.eu/growth/smes_en>, SMEs are described as *'central to the EU's twin transitions to a sustainable and digital economy'* and *'essential to Europe's competitiveness and prosperity, industrial ecosystems, economic and technological sovereignty, and resilience to external shocks'*.

those practices and those regimes that highly contribute to their wealth[150]. Even though this is a concrete and delicate argument, it must be kept in mind that those (usually smaller) Member States benefit in the first place from freedom of movement of nationals of other (normally larger) Member States. If freedom of movement, and especially corporate mobility, becomes unsustainable for larger Member States, the internal market might collapse and those benefits might quickly evaporate for smaller Member States[151].

A possible rebuttal for the argument of the convenience for small countries thus lies in the balance between the advantage they gain from corporate mobility and the disadvantage they would incur because of the implementation of a common direct tax policy. Indeed, small Member States could still be allowed to retain their attractiveness, but such an attractiveness should be based on harmless factors of regulatory competition, like the ones related to matters of corporate governance.

In that sense, the most convincing path for integration appears to be the one followed by the ECJ regarding exit taxation. Accordingly, *'as long as these tax borders remain standing, exit taxes have to be considered as a necessary consequence of the fact that companies cross these borders'*[152]. Corporate mobility cannot become a free ride ticket for tax avoidance and, in the framework of cooperation and mutual recognition, Member States that gain many individual benefits from freedom of movement should be ready to incur a few losses from the enhancement of a collective policy.

As regards the second proposed solution, *(ii)* the directives (issued or proposed) analysed in this chapter have been so far introduced under Article 115 TFEU, that allows the *'approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning*

[150] For instance, when abolishing the controversial 'Double Irish' tax structure in 2014, the Irish Finance Minister said: *'The 12.5% tax rate never has been and never will be up for discussion. The 12.5% tax rate is settled policy. It will not change'*. See J. CAMPBELL, *Irish budget: Michael Noonan is to abolish 'Double Irish' tax structure*, in *BBC News*, 14 October 2014, available at <https://www.bbc.com/news/world-europe-29613065>.

[151] In Q. SLOBODIAN, *Globalists: the End of Empire and the Birth of Neoliberalism*, Harvard: Harvard University Press, 2018, p. 6, the author observes that *'if we place too much emphasis on the category of market fundamentalism, we will fail to notice that the real focus of neoliberal proposals is not on the market per se but on redesigning states, laws, and other institutions to protect the market'*.

[152] S. PEETERS, *Exit Taxation on Capital Gains in the European Union: A Necessary Consequence of Corporate Relocations?*, in *European Company and Financial Law Review*, 10, 4, 2013, p. 522.

of the internal market' only when the Council is *'acting unanimously'*. There are two instruments, instead, that do not require unanimity and might be explored in the future as tools to tackle HTC: Article 151 and Article 116 TFEU.

Especially after the Treaty of Lisbon, a further criterion of legitimation for harmonisation in the field of taxation may indeed come from Article 151 TFEU[153], where it provides that *'the Union and the Member States, having in mind fundamental social rights […] shall have as their objectives the promotion of employment, improved living and working conditions, […] proper social protection […]'*, as *'they believe that such a development will ensue not only from the functioning of the internal market, which will favour the harmonisation of social systems, but also […] from the approximation of provisions laid down by law, regulation or administrative action'*.

If this ordoliberal view of Article 151 is accepted, harmonisation would not anymore be only a tool for the enhancement of the internal market, but it would also become an instrument aimed at the protection of those fundamental social rights which are clearly endangered by harmful tax competition. Alternatively, it might still be possible to argue that equality and fairness of fiscal systems across the Member States should be regarded as a fundamental precondition for an equal and fair internal market.

The option provided by Article 116 appears, however, more concrete. Pursuant to this provision, *'where the Commission finds that a difference between […] Member States is distorting the conditions of competition in the internal market and that the resultant distortion needs to be eliminated'*, if an agreement cannot be found with the Member State for *'eliminating the distortion in question, the European, Parliament and the Council, acting in accordance with the ordinary legislative procedure, shall issue the necessary directives'*. Thus, the 'market distortion rule' provided by Article 116 would allow harmonisation based on a qualified majority voting. It can be considered as a *lex specialis* vis-à-vis Articles 113, 114(2) and 115 TFEU, and it permits repressive, but not preventive, legislation.

Literature has argued that engaging Article 116 would be *'the perfect legal*

[153] This solution is also proposed by PERRONE, *Tax Competition,* cit, pp. 344-351.

basis for curbing excessive tax competition and BEPS within the EU' and *'the most appropriate base to tackle unfair tax competition'*, which *'needs to be eliminated to avoid fiscal degradation'* and *'is clearly a serious market distortion caused by disparities between national tax legislations'*[154].

In May 2017, President Juncker committed before Parliament to using Article 116 and the Commission mentioned Article 116 in its communication of 15 January 2019[155]. Notwithstanding this, on 27 June 2019, Commissioner P. Moscovici declared that *'Article 116 TFEU is not a possible legal basis for proposals on tax harmonisation'* and that only *'Articles 113 and 115 TFEU are the only legal bases allowing the Council to adopt measures of approximation of Member States' laws, regulatory or administrative provisions concerning taxation'*[156].

The Commission has never relied on this legal basis so far[157], but in its *Action Plan for Fair and Simple Taxation Supporting the Recovery Strategy*,

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[154] WATTEL, *Comparing Criteria*, cit, 2016, p. 61.

[155] See EUROPEAN COMMISSION, Communication from the Commission to the European Parliament, the European Council and the Council. *Towards a more efficient and democratic decision making in EU tax policy*, COM/2019/8 final, 2019, para 3 where the Commission held *that 'Article 116 TFEU has not been used so far, although the Commission is ready to employ it should the specific necessity arise'* but also that *'this provision is subject to the strict conditions above, however, and cannot address all the shortcomings that arise from unanimity today'*. Thus, the Commission analysed the 'passerelle' clause provided by Article 48(7) TEU, in order to shift to qualified majority voting in tax matters. This option, however, was rejected by Ireland, Malta, Sweden, Hungary, and Cyprus. See J. BRENNAN, *Ireland rejects Brussels plan to kill national vetoes on tax*, in *Irish Times*, 15 January 2019, available at < https://www.irishtimes.com/business/economy/ireland-rejects-brussels-plan-to-kill-national-vetoes-on-tax-1.3759027>. In GALLO, *La concorrenza fiscale tra Stati*, cit, p. 57, the author wishes the overtaking of the unanimity principle in tax matters, and concludes that it would bring to new levels of integration and distributive justice.

[156] Answer given by Mr Moscovici on behalf of the European Commission to Parliamentary Question E-001797/2019 on 27 June 2019. Commissioner for Economic and Financial Affairs, Taxation and Customs P. MOSCOVICI was addressing questions related to the potential use of Article 116 for the proposals regarding the CCCTB and the DST.

[157] WATTEL, *Comparing Criteria*, cit, 2016, p. 61, where the author suggests that *'the Commission has never engaged Article 116 in direct tax matters (and hardly in other matters) possibly because it estimated that no qualified majority is attainable because no member State fancies to be the next one to be tackled by all others, and all member States will vote against any such proposal from the Commission, even if they are in favour of its content'* and thus describes Article 116 as a *'paper tiger'*. On the same line of reasoning, see M. NOUWEN, *The Market Distortion Provisions of Articles 116-117 TFEU: An Alternative Route to Qualified Majority Voting in Tax Matters?*, in *Intertax*, 49, 1, 2021, p. 28: *'[...] in reality, i.e. politically, it is not very likely that the market distortion rules will be engaged successfully. Most Member States will probably vote against a Commission anti-distortion proposal requiring elimination of the fiscal regime, not because of disagreement with its content, but to avoid the anti-distortion weapon being turned against themselves at a future time'*. See also the note of the COMMISSION'S LEGAL SERVICE, doc. no. JUR(86)D/2755 (7 May 1986), para 8, at 4, where Article 116 is described as *'dead letter'*.

adopted in July 2020 in the context of the pandemic crisis, the Commission expressly mentions its own intention to explore the option provided by Article 116[158].

The debate on the appropriateness of Article 116 is thus rising again[159]. It has been pointed out that its potential *'depends crucially on how narrowly or broadly the notion of "distortions of competition to be eliminated" is construed'*[160], also considering that the Court of Justice has not provided its own interpretation yet[161].

On the one hand, a narrow interpretation would lead to only consider sector-specific distortions, as the *Spaak Report* seemed to suggest[162], thus increasing the risk of an unnecessary and inefficient overlaps with State aid rules.

On the other hand, a more extensive interpretation, that would *'provide the Commission with significant leverage in the pursuit of some of its core taxation projects'*[163], might collide with the principles of subsidiarity and proportionality laid down by Article 5 TEU[164]. This would be especially true if the other available instruments, such as the *Code of Conduct,* are deemed more appropriate to face the

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[158] On page 2, the Commission includes the potential use of Article 116 in the agenda: '*to fully deliver on the EU's fair tax agenda, all existing policy levers have to be activated. It is in this context, that the Commission will explore how to make full use of the provisions of the Treaty on the functioning of the EU (TFEU) that allow proposals on taxation to be adopted by ordinary legislative procedure, including article 116 TFEU'*.

[159] See also M. KHAN, S. FLEMING, *Brussels plans attack on low-tax Member States*, in *Financial Times*, 14 July 2020, available at <https://www.ft.com/content/4068b83a-2c64-43e9-b82a-0b77c454164b>.

[160] J. ENGLISCH, *Article 116 TFEU – The Nuclear Option for Qualified Majority Tax Harmonization?*, in *EC Tax Review*, 2, 2020, p. 59.

[161] However, see case 173/73 *Italian Republic v Commission of the European Communities* [1974] ECLI:EU:C:1974:71, para 17, where the Court observes that *'Articles 92 to 102 of the Treaty provide for detailed rules for the abolition of generic distortions resulting from differences between the tax and social security systems of the different Member States whilst taking account of structural difficulties in certain sectors of industry'*.

[162] *Spaak Report*, paras 60-64.

[163] Ibid, p. 61. On the concept of 'distortion' see also NOUWEN, *The Market Distortion Provisions of Articles 116-117 TFEU*, cit, p. 17, where the author argues that the broad interpretation of antitrust rules (namely Article 101 TFEU), which are applicable also where the distortion is only potential, is not applicable to Article 116, which should be interpreted as requiring an *'actual and significant effect on competition'*.

[164] Article 5(3) provides that '*under the principle of subsidiarity, in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level'*, whereas Article 5(4) provides that *'under the principle of proportionality, the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties'*.

matter. Even though the analysis carried out in this work suggests that those tools have not proved to be efficient enough, some Member States might still claim that generic harmonising interventions with a too broad scope (e.g. interventions aimed at tackling 'general tax competition') shall only be put in place through the *lex generalis* provided by Articles 113, 114, and 115 TFEU.

In conclusion, the decisive element is probably a political one[165]. Only if Member States opt for a path of loyal cooperation, the adoption of directives under Article 116 could become a feasible reality. The EU seems aware[166] that the pandemic crisis might be the ideal opportunity to fully explore all the possibilities provided by the Treaties in order to strengthen the internal market.

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[165] In PERRONE, SCOGNAMIGLIO (eds.), *The new EU monetary and fiscal policy: an international discussion*, cit, pp. 904 et seq., G. TREMONTI argues that *'the real question here is whether or not the European partners continue to envision a political project (which cannot be reduced merely to the articles of the current TFEU). If they do, we should discuss the future, keeping in mind that TFEU is the result of a hope for a political perspective, and, by definition, should not be considered binding if that perspective is no longer relevant'*, and adds that *'a contract stands until the interest of the parties overwhelms it. I think Europe should be more than a contract'*. See also SLOBODIAN, *Globalists*, cit, p. 207, where the author observes that *'from the moment of signing, it was clear that the Treaty of Rome was only a framework of law to be shaped by political direction'*.

[166] See the answer given by Mr GENTILONI on behalf of the European Commission on 8 December 2020 to parliamentary question E-005215/2020: *'President von der Leyen has been clear that the Commission should make full use of the provisions in the Treaties that allow taxation proposals to be adopted through the ordinary legislative procedure. The Commission is exploring how to make use of provisions that provide for that procedure, including Article 116 of the Treaty on the Functioning of the EU (TFEU). An initiative under Article 116 TFEU could be used, under certain conditions, to address a distortion of competition in the internal market derived from differences in Member States' legislations'*.

CONCLUSIONS

This thesis aimed to gauge the phenomenon of regulatory competition triggered by corporate mobility across the EU, with specific regard to matters of corporate governance and business taxation.

In the context of the political debate for the implementation of the EU Recovery Plan, the purpose of this research was, in the first place, to address two questions: which are the elements that are more likely to influence the mobility choices of corporations? and to what extent has their influence caused a *'race to the top'* or a *'race to the bottom'* in the regulatory framework?

In addition, this work aimed to assess the strategy adopted so far by the Commission to face the critical issues arising from the phenomenon.

Preliminarily, it was noticed that there are three fundamental preconditions for the existence of regulatory competition: decentralisation, mutual recognition, and freedom of movement.

The main example of a system having all of those requirements and thus allowing a *'market for corporate charters'* is probably provided by the case of Delaware. There are two main takeaways from the analysis of such a case. First, the situation of Delaware is not fully comparable to the situation of the EU, mainly because of the existence in that State of a franchise tax, which is instead prohibited by an EU Directive. Second, the case of Delaware suggests that there cannot be a sole and exhaustive response for the assessment of the effects of regulatory competition. Instead, several factors should be taken into account when assessing regulatory competition in each sector of law. In particular, the legal debate seems to be necessarily intertwined with economic, social, and political considerations.

Within the EU internal market, and with specific regard to companies, free movement is granted by fundamental freedoms which are aimed at granting the optimal allocation of the factors of production: freedom of establishment and free movement of capital.

The case law of the European Court of Justice seems to show that Article 49 TFEU should be interpreted as having the broadest conceivable scope. In particular, the Court shows a shift towards the theory of incorporation, as companies should be allowed to exercise their right to mobility regardless of the place where they

carry out a *'genuine economic activity'*. Indeed, notwithstanding that the limit constituted by the concept of 'abuse' has been inconsistently interpreted by the Court within the last twenty years, *Polbud* case seems to mark a further and definitive confirmation of the endorsement of regulatory arbitrage for the choice of the *lex societatis*.

As regards free movement of capital, it has been noticed that it shows a strong interconnection with freedom of establishment. In particular, the combination between the two freedoms triggers a mechanism that allows companies to exercise their mobility in order to benefit from the most favourable conditions provided by certain Member States.

The analysis carried out in the field of corporate governance suggests that mobility choices of companies can be influenced only to a certain extent by the pursuit of more favourable governance structures.

Indeed, many aspects of the life of a business which have a significant impact on its governance are not necessarily determined by the *lex societatis* applicable to the company. Conflict of laws may create a certain degree of legal uncertainty in fields like insolvency law and tort law. When the risks deriving from legal uncertainty, together with the administrative costs of mobility, outweigh the benefits deriving from reincorporation, regulatory arbitrage in the field of corporate law becomes disadvantageous.

However, cases of (limited) regulatory arbitrage in the sectors of companies' legal forms, minimum capital requirements, and control-enhancing mechanisms have been described in Chapter II. Those phenomena seem to ensure the achievement of more adequate governance structures, as they are capable of taking into account the economic contexts within which businesses operate. Indeed, the path dependence of corporate governance seems to preclude the implementation of an effective strategy of harmonisation across the EU.

Thus, it appears that regulatory competition in this field is more likely a race to the top, and that corporate governance is the ideal context for the development of a process of *'reflexive harmonisation'*. Hence, the phenomenon is in line with the general aim of the internal market, as it entails a better allocation of resources across the EU.

On the contrary, the chance to opt for a more favourable fiscal regime seems to play a key-role in stimulating corporate mobility. Indeed, tax competition shows relevant differences when compared to regulatory competition in matters of corporate governance. First, tax preferential regimes, unlike corporate governance options, are often offered only to foreign investors, increasing the room for harmful practices. Second, administrative secrecy and lower taxes bring an advantage that is objective and directly measurable in monetary terms, without suffering from any path dependence.

Apparently, tax matters should not influence the choice of a business to establish a letterbox company in another country. Indeed, tax law follows the real seat doctrine. Thus, tax residence is in theory closely linked to the physical presence—permanent establishment—of a business in a certain country. Moreover, no franchise tax is allowed in the EU.

However, the asymmetries amongst the Double Tax Conventions signed between Member States and the presence of secrecy jurisdictions allow the implementation of aggressive tax planning. In particular, that behaviour is normally realized through the distorted exploitation of tools like hybrids mismatches arrangements, transfer pricing, and the ambiguous notion of permanent establishment.

This is not all. Indeed, tax competition is implemented within the EU also through the lowering of the general CIT rate *per se*. Such a 'general' tax competition seems to be allowed in the first place by the different sizes of Member States.

Even though it is possible to think of theoretical benefits of tax competition, in practice it has proved harmful for both economic and social reasons: tax competition can reduce public expenditure, affect labour taxation, amplify social disparities, and produce regressive effects.

Given that HTC is a phenomenon with a clear global dimension, the EU has prioritised the solutions offered in the framework of the OECD, in particular in the context of the BEPS Project. However, the limited cooperation of a crucial player like the U.S. seems to undermine the OECD work.

Furthermore, the lack of competence of the EU in the field of direct taxation

has allowed only a limited response by means of negative integration. The scanty success of the *Code of Conduct*, a non-binding instrument, has been followed by the adoption of directives based on Article 115 TFEU, which requires unanimity.

Moreover, the Court of Justice has shown a certain degree of reluctance in justifying limitations of free moment on the ground of the fight against double non-taxation and tax avoidance. In the most recent cases, the concept of abuse has been narrowly construed, leaving room for the broadest interpretation of Articles 49 and 63 TFEU.

Most prominently, specific challenges have been brought by the harmful practices of base erosion and profit shifting carried out by several multinationals. This is particularly true for several U.S. corporations in the digital sector. Those companies have been the target of a strategy implemented by the Commission and based on the use of EU State aid law.

It seems that, in the first place, the Commission prepared its strategy thanks to the teachings of a couple of landmark cases (*Belgium* and *Gibraltar*) in the early 2000s. Later on, in the 2010s, the Commission implemented such a strategy through a number of investigations and negative decisions, finding breaches of Article 107 TFEU in several tax rulings granted to multinationals by national tax authorities.

The currently ongoing tax ruling saga has raised important questions about the interpretation of Article 107. In general, the most problematic issues appear to be again those related to cross-border activities in the absence of a *'genuine economic activity'*.

On the one hand, the Commission believes that such rulings fall within the scope of Article 107, as they confer a selective advantage on the undertakings with which they are negotiated. On the other hand, however, the protagonists—mainly Ireland, Luxembourg, the Netherlands, and the concerned multinationals—argue that the Commission is forcing the interpretation of Article 107, seeking for *'harmonisation in disguise'*. Most scholars seem to join the latter view.

It appears from the analysis carried out in Chapter IV that Article 107 is not the appropriate tool to tackle harmful competition. The reason lies probably in the very logic behind the introduction of State aid rules in EU law. Indeed, the aim of State aid rules is to grant that the correct level playing field is not altered by public

intervention. However, the Commission seems to be trying to use it in order to limit free competition.

Notwithstanding that the Commission is probably opting for an incorrect instrument, the purpose that the Commission itself is pursuing appears legitimate.

This research suggests that, while the EU generally benefits from regulatory competition in matters of corporate governance, tax competition is instead adversely affecting the internal market through the subtraction of significant resources from Member States' redistributive policies. Such resources should thus be recovered, consistently with pursuit of the optimal allocation of factors of production at the core of the EU integration project.

This need becomes even more evident when cooperation, solidarity, and redistribution of wealth seem the only way to overcome a public health, economic, and social crisis, such as the pandemic one. Indeed, the matter of regulatory competition across the EU has drawn particular attention in the political debate regarding the means through which the *NextGenerationEU* recovery instrument should be financed.

Thus, provided that the State aid strategy seems doomed to fail, the last question regards the available alternatives offered within the framework of EU law.

The most difficult (albeit most desirable) path is the introduction of a direct competence of the EU in matters of direct taxation. Such a reform would indeed require the amendment of the Treaties.

The hypotheses that seem more concrete are instead those which would be available in the current framework of the Treaty. In particular, on the one hand, Article 151 TFEU might allow the adoption of new measures on the ground of the social targets invigorated by the Treaty of Lisbon. On the other hand, it seems that the pandemic crisis might be the ideal opportunity to explore the option provided by Article 116 TFEU in order to address market distortions.

In fact, in the context of the Recovery Plan the EU has already taken some specific steps to tackle market distortions deriving from harmful tax competition. Indeed, *'the strength of Europe's recovery also relies on pursuing social reforms to generate sustainable and fair growth, including through fair tax policies and*

broad and equitable tax bases'[1].

First, in July 2020 the Council addressed *Country Specific Recommendations*[2] to each Member State. In the *Recommendations* to Cyprus[3], Hungary[4], Ireland[5], Luxembourg[6], Malta[7], and the Netherlands[8], the Council recommended those countries to take steps to fully address features of the tax system that facilitate aggressive tax planning.

Second, in its *Action Plan for Fair and Simple Taxation Supporting the Recovery Strategy* adopted in July 2020, the Commission listed 25 actions to

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[1] See COMMISSION STAFF WORKING DOCUMENT, *Identifying Europe's recovery needs*, SWD/2020/98 final, 2020, para 5.

[2] The Commission's *Recommendations for Council Country Specific Recommendations* of May 2020 are available at <https://ec.europa.eu/info/publications/2020-european-semester-country-specific-recommendations-commission-recommendations_en>.

[3] Council Recommendation of 20 July 2020 on the 2020 National Reform Programme of Cyprus and delivering a Council opinion on the 2020 Stability Programme of Cyprus 2020/C 282/13 [2020] OJ C 282, para 26.

[4] Council Recommendation of 20 July 2020 on the 2020 National Reform Programme of Hungary and delivering a Council opinion on the 2020 Convergence Programme of Hungary 2020/C 282/17 [2020] OJ C 282, para 30. Hungary is received a more general recommendation to *'strengthen the tax system'*, as *'the absence of withholding taxes in Hungary on outgoing income to offshore financial centres could provide an escape route for profits to leave the Union without paying their fair share of taxes'*.

[5] Council Recommendation of 20 July 2020 on the 2020 National Reform Programme of Ireland and delivering a Council opinion on the 2020 Stability Programme of Ireland 2020/C 282/07 [2020] OJ C 282, para 23, where the Council points out that *'the high level of royalty and dividend payments as a percentage of GDP suggests that Ireland's tax rules are used by companies that engage in aggressive tax planning, and the effectiveness of the national measures will have to be assessed. Broadening the tax base would make revenue more resilient to economic fluctuations and idiosyncratic shocks and strengthen the functioning of automatic stabilisers. The high concentration of corporate taxes, with the top ten firms accounting for 45 % of corporate taxes, their volatility and potentially transitory nature, along with their rising share in total tax proceeds (record of 18,7 % in 2018) underline the risks of relying excessively on these receipts for the financing of permanent current expenditure'*. By recommending the broadening of the tax base, the Council seems to be willing to tackle general tax competition as well.

[6] Council Recommendation of 20 July 2020 on the 2020 National Reform Programme of Luxembourg and delivering a Council opinion on the 2020 Stability Programme of Luxembourg 2020/C 282/16 [2020] OJ C 282, para 21, where the Council observes that *'the high level of dividend, interest and royalty payments as a percentage of GDP suggests that the country's tax rules are used by companies that engage in aggressive tax planning. The majority of foreign direct investment is held by special purpose entities. The absence of withholding taxes on outbound (i.e. from Union residents to third country residents) interest and royalty payments, and the exemption from withholding taxes on dividend payments under certain circumstances, may lead to those payments escaping tax altogether, if they are also not subject to tax in the recipient jurisdiction'*.

[7] Council Recommendation of 20 July 2020 on the 2020 National Reform Programme of Malta and delivering a Council opinion on the 2020 Stability Programme of Malta 2020/C 282/18 [2020] OJ C 282, para 23.

[8] Council Recommendation of 20 July 2020 on the 2020 National Reform Programme of the Netherlands and delivering a Council opinion on the 2020 Stability Programme of the Netherlands 2020/C 282/19 [2020] OJ C 282, para 23.

'ensure that solidarity and fairness is at the heart of the recovery' and *'step up the fight against tax fraud and other unfair practices'* in order to *'help Member States generate the tax revenue needed to respond to the major challenges of the current crisis'*. In particular, the Commission committed to propose legislation *'to clarify where taxpayers active cross-border in the EU are to be considered residents for tax purposes'*[9], and *'for introducing a common, standardised, EU-wide system for withholding tax relief at source, accompanied by an exchange of information and cooperation mechanism among tax administrations'*[10]. Moreover, the Commission is willing to *'establish an expert group on transfer pricing to elaborate pragmatic, non-legislative solutions to practical problems posed by transfer pricing practices relevant for the EU'*[11]. In addition, the agenda of the Commission includes the search of new means by which the *NextGenerationEU* should be financed. So far, the agenda includes, amongst others: the reform of the *Code of Conduct*; the introduction of a digital levy, a Financial Transaction Tax, and a financial contribution linked to the corporate sector; and the implementation of the CCTB and the CCCTB.

Third, in the *Guidance to Member States*[12] for the drafting of Recovery and Resilience Plans issued in January 2021, the Commission listed three priorities that *'will contribute to a swift implementation of reforms and investments'* which *'should be reflected in the Member States' priority setting'*. Amongst them, the Commission mentions *'the fight against aggressive tax planning, since, more than ever, the upcoming economic recovery requires Member States to secure tax revenues for public investment and reforms and avoid distortion of competition between firms'*.

In conclusion, it appears that the pandemic crisis should be regarded as an opportunity to finally address the issues related to harmful regulatory competition. Whatever path is followed, it seems that its effectiveness will highly depend on political choices. Only if Member States decide to approach the matter in the name

[9] EUROPEAN COMMISSION, *Action Plan for Fair and Simple Taxation Supporting the Recovery Strategy,* Action 7.
[10] Ibid, Action 8.
[11] Ibid, Action 21.
[12] See COMMISSION STAFF WORKING DOCUMENT, *Guidance to Member States. Recovery and Resilience Plans*, SWD/2021/12 final, 2021, pp. 8-9.

of cooperation and solidarity, in line with the original political perspective of the European project, can market distortions be addressed and the integration process strengthened. Indeed, as pointed out by E. Letta, *'the philosophy of the NextGenerationEU […] is not based on transfers of German money to Italy or Dutch money to Spain, for example. The great idea is that we are stronger together. All together, we go to the market, we take money from the market, we take money from Apple or Facebook or Google, we take money from outside, and this money can't be framed as German money or Dutch money, or Spanish, or Italian—it is European money, and that makes the difference'*[13].

[13] See the intervention of LETTA in PERRONE, SCOGNAMIGLIO (eds.), *The new EU monetary and fiscal policy: an international discussion*, cit, p. 904.

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