STATE AID AND THE PRIMAROLO LIST

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Introduction

In an earlier article in this *Journal*[2] the present writer suggested that most of those tax advantages likely to be identified as "harmful", according to the criteria identified by the Code of Conduct on Business Taxation,[3] appeared to be already prohibited under the EC Treaty provisions on state aid.[4] A number of other writers have reached essentially similar conclusions with respect to several of the measures that have since been examined by the group of experts set up under the Code of Conduct.[5] The publication, in February 2000, of the group's final list of harmful tax measures makes it possible to test the validity of those propositions.

The Code of Conduct

The Code of Conduct,[6] adopted at the ECOFIN Council meeting of 1st December,

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2 Vol.3 (1998), Issue 1, at pp.6-7. See also the editorial comment in that issue, at p.vii.

3 Doc.COM(97) 564 final.

4 Arts. 87-89/EC (ex-arts.92-94).

5 See, for example, L Hinnekens, "Is Belgian Tax Legislation Compatible with EU State Aid Rules?", (2000) 21 *Tax Notes International*, 1513 [2000 WTD 184-6]; C.Pinto, EC State Aid Rules and Tax Incentives: a U-Turn in Commission Policy?", (1999) 39 *European Taxation* 295, 343; T.Rosembuj, "Harmful Tax Competition", (1999) 27 *Intertax* 316; W.Schon, "Tax Competition in Europe - the Legal Perspective", 2000-2 *EC Tax Review*, p.90.

6 For discussion of the Code, see M Ellis, "Are Measures to Curb Harmful Tax Competition Necessary?", (1999) 39 *European Taxation*, 78; J Malherbe, "Harmful Tax Competition and the European Code of Conduct", (2000) 21 *Tax Notes International* 151; E.Osterweil (1999) 3 *EC Tax Journal* 89; C.Pinto, "EU and OECD to Fight Harmful Tax Competition: Has the Right Path been Undertaken?" (1998) 26 *Intertax* 386; W Schon, supra, n. 4.

1997, is not a legally binding and enforceable instrument: as its Preamble emphasizes, it "is a political commitment and does not affect the member states' rights and obligations or the respective spheres of competence of the member states and the Community resulting from the Treaty." The principal goals of the Code are to impose a freeze on the introduction of new business tax incentives in the member states and to eliminate existing "harmful" measures as soon as possible, and not later than 1st January 2003. The Code establishes five criteria for determining whether or not a particular tax regime falls within its scope. According to the Code, a tax regime is regarded as potentially harmful if it leads to effective taxation that is significantly lower than the taxation that normally applies in the member state concerned. The following criteria are then to be taken into account in assessing the harmful character of a particular tax regime:

- Are the benefits exclusively granted to nonresidents or with respect to transactions concluded with nonresidents?
- Are the benefits "ring-fenced" from the domestic economy so that they have no impact on the national tax base?
- Are the benefits granted in a situation in which no real economic activity or substantial economic presence exists in the state granting tax benefits?
- Are the rules that determine the taxable profit of an entity performing services for a multinational group of companies different from the internationally accepted general principles, especially those adopted by the OECD? or
- Do the fiscal measures lack transparency, including situations whereby statutory rules are practically applied in a non-transparent way?

The task of examining existing national tax measures in the light of those criteria was given to a group of experts, constituted in March 1998, and chaired by UK Paymaster General, Ms Dawn Primarolo. The Primarolo Group presented interim reports to the ECOFIN Council in December 1998 and May 1999, and completed its final report in November 1999.[7] That document was released on 28th February 2000: according to the Council it had "decided to make the report available to the

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[7] The report is "final' only in the sense that it concludes this stage of the group's work. There are other measures (e.g. special arrangements for employees, treatment of collective investment undertakings) that may be examined at a later stage.

public without taking any position on its content."[8]

The group divided its work into five categories:

- intragroup services;
- financial services and offshore companies;
- other sector-specific regimes;
- regional incentives; and
- other measures.

An additional category covered dependent or associated territories of the member states. The report deals with all of these categories. It lists a total of 308 measures which were considered - 246 from member states and a further 62 from dependent or associated territories.[9] Of these, some 66 were found to be harmful, according to the terms of reference prescribed by the Code - 40 from member states and 26 from dependent or associated territories.[10] A brief description of each of the measures examined is annexed to the report.

The State Aid Rules

The provisions on state aid are found in Title VI, Chapter 1, Section 2 of the EC Treaty and comprise three articles, 87 - 89 (originally 92 - 94). Title VI is headed "Common Rules on Competition, Taxation and Approximation of Laws", and Chapter 1 is entitled "Rules on Competition": that is to say, the state aid provisions form a part of the competition rules, and not the rules on taxation. Nevertheless, it is well established that state aids may take the form of tax privileges as well as other

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8 For discussion of the report, see H Hamaekers, "Tackling Harmful Tax Competition - a Round Table on the Code of Conduct", (2000) 40 *European Taxation* 398, and the further comments of F Parly, "The Code of Conduct and the Fight against Harmful Tax Competition", B Hendricks, "A View on Tax Harmonization and the Code of Conduct", and M J Ellis, "The Code of Conduct in 2000: Cracking the Code or Coating the Crack?", at pp. 406, 413,414.

9 An initial list of measures that should be examined was provided by the Commission. Additional measures were brought to the attention of the group by member states (usually complaining about measures of other members.)

10 Only those measures that are applied in member states will be considered further in this paper.

more direct forms of assistance.[11]

Article 87, paragraph (1), provides:

> "Save as otherwise provided in this Treaty, 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, insofar as it affects trade between Member States, be incompatible with the common market."

Paragraph (2) goes on to provide that certain types of aid (e.g. to make good damage caused by natural disasters) are regarded as compatible with the common market, and paragraph (3) lists further types of aid that *may* be considered compatible, including aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious unemployment, aid to facilitate the development of certain economic activities or of certain economic areas "where such aid does not adversely affect trading conditions to an extent contrary to the common interest", and other categories of aid specified by the Council. Article 88 requires the Commission to keep under constant review all systems of aid existing in member states. If it finds that a particular aid is not compatible with the common market it may require the offending state to eliminate or modify the aid and, if the state does not comply, may refer the matter to the Court of Justice. Member states are further required to notify the Commission of any plans to grant new aids.

Although it was recognised at a relatively early stage that Article 87 (ex-92) applied to both financial and fiscal aids,[12] it has only been in quite recent years that the Commission has attempted to apply the prohibition against state aid to tax measures in any systematic way.[13] In November 1998, in a communication to the Council, the Commission outlined its "new" approach to fiscal aids, in particular in the field of direct business taxation.[14] That approach involves assessing - and in some cases re-assessing - all special tax schemes in the member states to determine whether they comply with the state aid rules. According to the Commission's communication, "a tax advantage which is specific in the sense that it benefits certain enterprises or

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11 For analysis of the state aid rules and their application to tax measures, see Pinto, supra n.5; P Valente and F Roccatagliata, "Fiscal Aids: (In) Compatibility with EU Rules?, (1998) 17 *Tax Notes International*, 259 [98 TNI 143-14]; W Schon, "Taxation and State Aid Law in the European Union", (1999) 36 *Common Market Law Review* 911.

12 See Case 173/73, *Italy v Commission* [1974] ECR 709.

13 See Schon, supra n.11, at 911-12.

14 RAPID, November 11th, 1998, Press Release; IP: 98/983.

certain productions, falls under the state aid discipline. The tax advantage may be given in various forms, including lower rates of taxation, tax breaks, accelerated depreciation or debt cancellation".

A tax advantage is regarded as "specific" if it derives from an exception to the "general" tax rules that are applicable, or from a discretionary practice on the part of the tax authorities. According to the Commission, "tax rules that are - for example - aiming at a certain region or a certain sector or a certain function within an enterprise (such as financial services) will be regarded as specific". If a tax measure is specific, and is not justified by the nature or economics of the particular tax system,[15] it falls under the state aid rules. It then will be deemed incompatible with the common market unless it qualifies for one of the exemptions provided for in the Treaty. By contrast, tax rules that are technical in nature and tax incentives that aim at general economic policy objectives, if applied indiscriminately to all enterprises, are considered general and therefore are outside the scope of the state aid rules.[16]

Thus, in determining whether a particular tax measure falls foul of the state aid rules, three questions are raised:

- is the measure "specific" or "general"?
- is it justified by the nature or economics of the particular tax system?
- does it fall within one of the exemptions provided for in the Treaty?[17]

15 By way of explanation, the communication states that "the specific nature of these tax rules does not automatically turn them into state aid. If there is an economic rationale that makes them necessary to the functioning and effectiveness of the tax system then these specific tax rules will not be regarded as state aid. This may for instance be the case for some specific tax provisions that take account of different accounting requirements in certain sectors."

16 Examples of tax rules that are technical in nature are the general rate of taxation, normal depreciation rules and rules for the prevention of double taxation or tax evasion. Examples of economic policy objectives that may be pursued through general fiscal measures are environmental protection, the promotion of research and development, and the creation of employment.

17 Or under Reg.994/98 of May 7th, 1998, which sets out additional categories in which exemptions may be granted. A measure may also escape the prohibition if it does not affect trade between member states.

The Relationship Between the Code and the State Aid Rules

It is clear that there exists a degree of overlap between the Code of Conduct and the Treaty provisions on state aid. That possibility is recognised in the Code itself, paragraph (J) of which provides:

> "The Council notes that some of the tax measures covered by this Code may fall within the scope of the provisions on state aid in Articles 92 to 94 of the Treaty. Without prejudice to Community law and the objectives of the Treaty, the Council notes that the Commission....commits itself to the strict application of the aid rules concerned, taking into account, inter alia, the negative effects of aid that are brought to light in the application of this Code. The Council also notes that the Commission intends to examine or re-examine existing tax arrangements and proposed new legislation by member states case by case, thus ensuring that the rules and objectives of the Treaty are applied consistently and equally to all."

What is the situation if a measure is found to be contrary both to the principles of the Code and to the provisions of the Treaty?[18] The Code was specifically designed to deal with business taxation that produces harmful tax competition, whereas the state aid rules are more in the nature of *lex generalis*, applying to both financial and fiscal aids and not restricted to business taxation. However, the Code is not a legal instrument and, though it may be *specialis*, cannot be described as *lex*. The Commission has the duty, under Article 211 (ex-155) of the EC Treaty, to ensure that the provisions of the Treaty are applied. Thus, if a tax provision of a member state is perceived to be contrary to Article 87, the Commission is bound to take action. This is clearly the view taken by Commissioner Monti, who recently stated, in connection with the work of the Primarolo Group:

> "I have instructed the Commission's Competition Department to examine all the relevant cases of fiscal state aids in business taxation, so as to allow the Commission to comply fully and promptly with its own institutional obligations..."[19]

To the extent that a tax provision is contrary to the state aid rules, therefore, the Code of Conduct does not provide a "soft" alternative, under which member states have a period of grace until 2003 to dismantle their fiscal aids: in such cases the

18 For further discussion of this issue see A Carlos Santos, "Point J of the Code of Conduct or the Primacy of Politics over Administration", (2000) 40 *European Taxation* 417.

19 Statement by Commissioner Monti concerning the control of fiscal state aids: RAPID, February 23rd, 2000, Press Release; IP: 00/182.

Commission has the power, and the duty, to order the immediate removal of the offending provision and, where appropriate, to require illegal aid to be repaid. That, at any rate, is the theory. In practice, if action against harmful tax measures were to be taken only under the state aid rules, on a case-by-case basis, it would probably be considerably more than another two years before all such measures were eliminated, especially if the Commission's actions were disputed and had to be contested before the Court. And, as the following analysis will seek to demonstrate, not all of the harmful tax measures listed in the Primarolo report fall within the scope of the state aid rules.

The "Primarolo List"

The aim of this section is to examine the 40 member states' measures found in the report of the Primarolo group to be contrary to the Code and to seek to establish whether those measures might also fall within the scope of the state aid provisions. (No attempt will be made to discuss the actual findings of the group or to suggest whether the group's classification of particular measures - as contrary, or not contrary, to the Code - was correct.) The numbering adopted in the report is retained, but the classification of the measures has been revised in order to facilitate comparison between the Code and the state aid rules.

1. Location-specific regimes

As noted above, measures that are aimed at a particular region are considered to be specific and thus within the scope of the state aid provisions. The following listed measures seem to fall clearly within that category:

A004 Basque Country Co-ordination Centres - Spain
A005 Navarra Co-ordination Centres - Spain
B001 International Financial Services Centre (Dublin) - Ireland
B002 Trieste Financial Services and Insurance Centre - Italy
B006 Madeira and Sta Maria (Azores) Free Zones - Portugal
B008 Aland Islands Captive Insurance - Finland
D017 Shannon Airport Zone - Ireland

In all of the above cases, the tax concessions in question are restricted to enterprises or activities within a specific region. (The group also examined special tax regimes applicable to designated enterprise zones in Belgium, Denmark, France and the United Kingdom, to industrial free zones in Portugal, and to special regimes applicable to the Canary Islands, Corsica, some French overseas territories, the

Greek small islands and the Italian Mezzogiorno. None of those was held to amount to harmful tax competition, though all of them merit scrutiny under the state aid rules.)

Paragraph (G) of the Code of Conduct provides that, insofar as tax measures are used to support the economic development of particular regions, an assessment is to be made of whether the measures are in proportion to, and targeted at, the aims sought. That is to say, tax incentives must be compatible with Community regional policy. But since regional tax measures are clearly within the scope of the Treaty, and are specifically referred to in Article 87(3), it would seem to make more sense for the question of their proportionality to be assessed under the Treaty provisions alone, rather than for a separate assessment to be made under the Code.[20]

2. Sector-Specific Regimes

The prohibition in Article 87 applies to aid "favouring certain undertakings or the production of certain goods." Thus, tax measures that favour a particular sector of economic activity fall within its scope. The following measures on the Primarolo list appear to fit in this category:

C024 10% Manufacturing Rate - Ireland
C025 Petroleum Taxation - Ireland
CAM025 Investigation and Exploitation of Hydrocarbons - Spain
CAM058 Provisions for Renewal of Mineral Reserves - France
CAM059 Provisions for Renewal of Oil and Gas Reserves - France

The special reduced rate of Irish corporate income tax for companies engaged in manufacture was examined in 1998 by the Commission, which ruled that it constituted operating aid. Ireland has already agreed to eliminate the preferential rate (and lower the general rate) by 2005. The four other regimes listed above all relate to the resource sector and provide tax reductions for firms engaged in exploration, extraction or exploitation of petroleum, natural gas or other minerals.

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20 Most of the listed measures have, in fact, been examined by the Commission under the state aid rules, and in some cases approved. In recent months the Commission has examined special tax schemes in the Canary Islands, Madeira and the Italian Mezzogiorno. The appearance of the Madeira free trade zone regime on the Primarolo list came as a particular surprise, since it had previously been approved (on a temporary basis) by the Commission: see Carlos Santos, supra n.18, at p.417.

Two of the measures on the Primarolo list relate to the insurance sector. Those are:

B007 Provisions for fluctuations in reinsurance - Luxembourg
B008 Aland Islands Captive Insurance - Finland

The Finnish provision has already been listed as a location-specific measure. The Luxembourg reinsurance regime can more conveniently be considered in a later section, since it involves a "presumptive" rule.

The group also examined a number of other tax regimes applicable to specific sectors, in particular the film-making and shipping sectors. Rather surprisingly, the various incentives for film-making were not found to be harmful despite the fact that tax competition in that sector is especially fierce.[21] With respect to shipping, the report had this to say:

> "The Group took account of the acknowledgement in the Council Resolution of 1st December 1997 of the need to consolidate the competitiveness of the European Union and the Member States at international level. In its discussion the Group recognised the great importance of this issue to its assessment of certain of the measures related to the shipping industry. The Group agreed that shipping was a global market and that the Community faced strong global competition.

Opinion was divided between members of the Group as to whether or not such shipping measures should be found harmful. Some Member States considered that these measures should not be found harmful and that the application of the rollback provision in Paragraph D of the Code would have a detrimental effect on EU based shipping business and on the competitiveness of the EU and Member States at an international level. Others thought that the measures should be assessed as harmful but that in its deliberations the Council should take account of the issues of competitiveness by requiring rollback only if wider international action was taken on similar measures."[22]

In the end, shipping measures were excluded from the list.

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21 See, for example, N Adler et al., "International Film Production – Incentives and Tax Issues in France, Germany, Italy and Spain", (2000) 11 Journal of International Taxation 46. The Commission has recently announced that funds amounting to EUR 1 billion would be made available to support the European film and audiovisual industry: RAPID, Press Release IP: 01/717, May 18th 2001.

22 Paras.61, 62.

3. Activity-Specific Regimes

A third category of regimes comprises those governing special types of company that perform particular activities. The listed regimes that seem to fall into this category are:

A001	Co-ordination Centres - Belgium
A002	Distribution Centres - Belgium
A003	Service Centres - Belgium
A004	Basque Country Co-ordination Centres - Spain
A005	Navarra Co-ordination Centres - Spain
A006	Headquarters and Logistic Centres - France
A007	Co-ordination Centres - Luxembourg
AAM019	Control- and Co-ordination Centres of Foreign Companies - Germany
B001	International Financial Services Centre (Dublin) - Ireland
B002	Trieste Financial Services and Insurance Centre - Italy
B003	Finance Companies - Luxembourg
B004	International Financing Activities - Netherlands
B005	Finance Branch - Netherlands
Z002	Finance Branches - Luxembourg

As will immediately be observed, the majority of these special regimes apply to "centres" – co-ordination, distribution, financial, logistic or management centres – that form part of (usually) multinational groups of companies. "Centre" regimes are specifically targeted by both the Code of Conduct and the OECD report as one of the major forms of harmful tax competition, since in recent years more and more countries have vied with each other in offering tax incentives to establish such centres.[23] The activities involved are geographically mobile, in many cases there is little or no real economic activity involved in the country offering the tax advantages, benefits are often granted only to non-residents or with respect to transactions with non-residents, and the benefits are frequently "ring-fenced" from the domestic economy.

Of the regimes listed above, four (Basque Country, Dublin, Navarra and Trieste) have already been listed above as location-specific and are clearly within the scope of the state aid rules. Those are also the only "centre" regimes where a lower (or

23 See, for example, O Teunissen and J Geuther, "Survey of European Distribution Centres", (1999) 19 *Tax Notes International* 845; J Anderson, "French Headquarters and Investment Incentives: a Comparative Analysis", (1995) 49 *Bulletin for International Fiscal Documentation* 417.

zero) rate of corporation tax is charged.[24] In the other cases, enterprises are taxed at the standard rate but special rules apply for computing the tax base. That, of course, raises the factual question whether the special rules for determining taxable profit constitute a tax advantage, and thus an "aid". But even if the regimes do confer an advantage, there is the threshold question whether they are reviewable under the state aid rules at all. That is a question on which opinions differ.[25]

In some cases, the companies that qualify for special treatment are formed under a special legislative regime; in others, the company obtains some form of authorization or certification that entitles it to be taxed under the special regime. Such companies would seem to fall within the expression "certain undertakings", which should suffice to make the tax regimes reviewable under Article 87. More problematic are regular companies that qualify for special treatment if they carry out particular activities and fulfil prescribed conditions.[26] If a company simply happens, among other activities, to engage in providing distribution, financial or management services (and thereby qualifies for some tax advantage), does that constitute it a certain "type" of undertaking? Article 87 applies to provisions that favour "certain undertakings or the production of certain goods", but the companies being considered in this category are almost entirely engaged in the provision of *services*, rather than the production of *goods*.[27] The Commission, in its communication of November 1998, took the view that tax rules that are aimed at "a certain function within an enterprise (such as financial services) will be regarded as specific." That is, perhaps, stretching the meaning of Article 87 a little?

4. Holding Company Regimes

Special treatment for holding companies is a common feature of many tax regimes. It can be justified as a means of eliminating double taxation of income and capital

[24] The two Spanish regimes impose the normal rate for the respective provinces, but that rate is lower than the 'general' rate for the remainder of the country.

[25] Contrast the views of Hinnekens (supra n.5), Pinto (supra n.5), Schon (supra n.11, esp.at p.935), and of B Terra and P Wattel, EUROPEAN TAX LAW, 2nd edn (London. 1997: Kluwer International), at p.57.

[26] This, perhaps, makes it questionable whether the last three regimes in the list (B004, B005 and Z002) fall within the scope of the state aid rules. It seems that the advantages in those cases are restricted to finance companies and not simply to companies that engage in intra-group financing activities, in which case they might be considered "certain undertakings".

[27] It is difficult to see why Art.87 should draw any distinction between goods and services in this context.

gains - once in the hands of a subsidiary and again in the hands of its parent. However, special holding company regimes may also result in double non-taxation, which is why they need to be scrutinised in the context of harmful tax competition. The Primarolo report found the following regimes to be potentially harmful: [28]

A013 1929 Holding Companies - Luxembourg
A014 Holding Companies - Netherlands[29]
AAM002b Holdings (Schachtelbegunstigung) Intra-Group Relief - Austria
AAM021 Holding Companies - Denmark.[30]

From the perspective of the state aid rules, the question is whether those regimes are specific or general. Potential double taxation of intra-group income may be relieved in a number of ways: (1) a country might establish a special regime under which holding companies are incorporated; (2) it might apply special rules to all companies meeting certain conditions;[31] or (3) it might simply exempt or apply special rules to certain types of income received by companies from their affiliates. Method (1) might be considered specific, since it applies only to particular types of enterprise; the 1929 Luxembourg regime seems to fall into that category. The second and third methods, which seem more accurately to describe the other regimes listed, should probably be regarded as being part of the general tax system and consequently not within the state aid rules.

5. Particular Types of Income

As suggested in (4), above, special rules that apply to particular types of income, such as dividends received by a holding company from its subsidiary, should probably be considered part of the general tax system and thus fall outside the scope of the state aid rules. The following listed regimes would seem to belong to this category:

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[28] Two further measures placed in the "holding company" category of the report (E007 and EAM 009) will be considered in subsequent sections.

[29] This finding was one of those challenged by the Dutch government and a note of dissent was attached to the report.

[30] The Danish government apparently disagreed with this finding, but has proposed amendments to the existing regime: see T Froebert, "Denmark Proposes Amendments to Favourable Holding Company Regime", (2000) 21 *Tax Notes International*, 2361 [2000 WTD 221-6].

[31] For example, companies that own shares in other companies and carry on no independent business of their own.

A012 Patent Royalty Income - France
A015 Royalties - Netherlands[32]
B011 Offices of Foreign Companies under the Law 89/67 - Greece
E007 Foreign Income - Ireland

The French and Dutch[33] patent royalty regimes would both seem to be properly characterised as general measures. The Greek and Irish regimes, which provide exemption from tax for certain types of foreign-source income, are perhaps more problematic, since they apply only to companies that have obtained appropriate certification and could thus be said to favour "certain undertakings".

6. Rulings and Presumptive Taxation

Probably the most contentious part of the Primarolo report is that which deals with various special methods of taxing income derived from transactions between related companies. In such cases there are usually no comparable "arm's length" transactions and it is a fairly common practice to determine taxable income according to various "presumptive" rules. In some countries, especially the Netherlands, a taxpayer may obtain an advance ruling setting out how such income will be taxed provided various conditions are met. There is no doubt that presumptive rules and advance rulings can, if they are excessively favourable, constitute a form of unfair tax competition, and a number of such regimes, or procedures, feature on the Primarolo list, notably:

A008 Cost Plus Ruling - Netherlands
A009 Resale Minus Ruling - Netherlands
A010 Intra-Group Finance Activities - Netherlands
B007 Provisions for fluctuations in reinsurance - Luxembourg
E001 US Foreign Sales Companies Ruling - Belgium
E002 Informal Capital Ruling - Belgium
E003 US Foreign Sales Companies Ruling - Netherlands
E004 Informal Capital Ruling - Netherlands
EAM009 Tax Exemptions - Austria
Z003 Non-standard rulings (including Greenfield-rulings) - Netherlands

32 These two regimes are described as holding company regimes in the Primarolo report.

33 The Dutch patent regime (A015) might equally well be considered as a presumptive regime, under section (6), below, since it taxes royalty income received from a related company on the basis of a presumed "spread".

It is no part of the purpose of this article to consider whether any of the above measures do in fact constitute harmful tax competition.[34] The sole issue here is whether such practices fall within the state aid rules. In principle, it would seem that they do not,[35] although some of the listed measures (B007, E001, E003) do apply only to particular types of company and could perhaps be considered as specific, rather than general. One should also recall that, according to the Commission's communication of November, 1998, "a tax advantage is regarded as specific if it derives from an exception to the general tax rules that are applicable *or from a discretionary practice* on the part of the tax authorities." (Italics added.) That is to say, although a practice of issuing advance rulings may be considered part of the general tax system, an unreasonably favourable ruling given in a particular case, in the exercise of a discretion, might be considered an aid to the enterprise receiving that ruling.[36]

The OECD List

Quite soon after the publication of the Primarolo report, the OECD's Committee on Fiscal Affairs released its own report identifying harmful tax practices.[37] The part of the report dealing with tax havens has been given a great deal of publicity: the part that reviews harmful tax regimes within the 29 member countries has received far less attention.

As already emphasised, the aim of this article is solely to consider the measures listed by the Primarolo group from the perspective of the state aid rules. However, it is interesting and instructive to compare the two reports and their respective lists. Not surprisingly, there is a substantial degree of overlap. The OECD report lists a total of 47 preferential tax regimes that it identifies as potentially harmful;[38] of these, 14 are from non-EU member countries. Thus, 33 EU regimes are listed, as

34 The Dutch delegation to the Primarolo group requested that a dissenting note be annexed to the report, explaining why various regimes should not be considered harmful. The note is appended to the summary of the description of cost-plus rulings (A008).

35 In 1995 the Commission studied various aspects of Dutch administrative policy, including the issue of rulings, and found no grounds for any element of state aid. That fact is noted in the Dutch note appended to A008.

36 From a policy perspective it is obviously preferable to require changes to an unreasonably favourable rulings system, rather than to review its exercise on a case-by-case basis.

37 "Towards Global Tax Co-operation" - report to the 2000 Ministerial Council meeting, June 2000 (Paris. 2000: OECD).

38 61 measures are listed, but some of these are listed under more than one category.

compared with 40 in the Primarolo report.[39]

A number of regimes listed by the Primarolo group do not appear on the OECD list, for various reasons. The OECD list does not include holding company regimes, which are the subject of an ongoing investigation.[40] It also does not include tax incentives for "substantial" activities, such as the special Irish manufacturing rate. The Primarolo list also contains a number of regimes relating to hydrocarbon taxes, which do not appear on the OECD list. However, the OECD report lists 8 shipping regimes (6 of them from EU countries) which are not listed by the Primarolo group. Shipping regimes apart, almost all EU regimes listed in the OECD report are also on the Primarolo list.[41]

Conclusions and Implications

One conclusion that emerges from this review is that a majority - perhaps as many as three-quarters - of the tax regimes or measures listed in the Primarolo report also seem to fall within the scope of the existing state aid provisions under Articles 87-89 of the EC Treaty. A second conclusion is that some of the listed measures almost certainly lie outside the Treaty rules and can be tackled only under the Code of Conduct, or by harmonisation. A third conclusion is that the precise scope of the Treaty rules is very difficult to define; in particular, the distinction between specific and general tax measures is a difficult one to draw. To complicate matters further, it may be possible to achieve what is essentially the same result, and confer the same tax benefit, either by a specific or a general measure, depending on the way in which it is drafted.[42]

The importance of the first conclusion is highlighted by the present uncertainty surrounding the effects and the future of the Code of Conduct. The Code was one

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39 A direct comparison is difficult to make, since the regimes are not always described in the same way in both reports. For example, the OECD report lists two Dutch rulings regimes, where the Primarolo report lists nine.

40 P.G.Vegh, "Tax Haven and Harmful Tax Regime List Published", (2000) 40 *European Taxation* 391. Holding company and similar regimes are being investigated in the following (EU) countries: Austria, Belgium, Denmark, France, Germany, Greece, Ireland, Luxembourg, the Netherlands, Portugal, and Spain.

41 The two exceptions are the Swedish regime for foreign non-life insurance companies, which was examined by the Primarolo group but not found to be potentially harmful, and the Greek regime for taxing mutual funds and portfolio investment companies. The group did not consider investment funds at all.

42 See the discussion of "disguised selectivity" by Schon, supra n.11, at 933.

element of a three-part "package" that also included the proposed directives on savings income and on withholding tax on inter-corporate payments. Some writers have expressed the opinion that, without agreement on the other elements of the package, member states will be unwilling to carry out the measures required under the Code.[43] It remains to be seen whether the "agreement" on the savings directive, announced on November 27th, 2000,[44] will be considered a sufficient implementation of that part of the package to induce member states to implement the Code as well. If not, then the state aid rules will be the only means available to counter harmful tax competition.[45] That may have both advantages and disadvantages - both for those who wish to see tax competition eliminated and for those who would prefer it to continue. The state aid rules, having the force of law and backed by powerful sanctions, provide a more effective means of enforcing member states' obligations than does a mere "gentlemen's agreement" or political commitment. If the Code is to become a dead letter, then the Commission will have no alternative but to enforce the Treaty provisions: it will be aided by the fact that the Primarolo report has highlighted those instances where action is most urgently needed. The end result, in some cases, might be that member states will have to eliminate offending measures immediately, rather than phase them out gradually, and may even be compelled to recover the aid that has been provided illegally.

By contrast, the second and third conclusions drawn above point to the difficulties of countering tax competition with only the state aid rules. Those rules were simply not intended or designed to restrict tax competition, in the sense that that term has come to be used.[46] Tax competition between countries, although it frequently takes the form of offering selective tax privileges that are capable of distorting competition between enterprises, is intended to attract investment and secure additional tax revenues. That result may be achieved by general tax measures as well as by selective measures, as the preceding analysis of the Primarolo list indicates. Thus, whilst some harmful measures may be tackled under the state aid rules, others lie outside their scope. Without the Code of Conduct, there is also the danger that

43 See, for example, Carlos Santos, n.18, at 420; Ellis, n.8, at 415; Hamaekers, n.8, at 399. According to Ellis (at p.416), "in all probability the Code of Conduct will go into quiet retirement".

44 S. Shaughnessy, "France Announces Historic EU Savings Taxation Agreement", *Tax Notes International*, World Tax Daily, November 28th, 2000 [2000 WTD 229-2]. At the time of writing (late-May 2001) it seems that the reluctance of non-member states, especially Switzerland, to join in a comprehensive exchange of information agreement, make it unlikely that the November 2000 compromise will become effective.

45 Especially since the United States has largely withdrawn its support for the OECD initiative on harmful tax competition.

46 See the comments of Carlos Santos, n.18 supra, at 420.

specific measures that offend against the state aid rules may be replaced by general measures, that may achieve the same objective but escape scrutiny.[47]

The Primarolo group has performed a valuable service in examining member states' tax systems in the light of the principles agreed in the Code of Conduct, even if one may disagree with the group's characterisation of some of the measures considered. If harmful tax competition is to be eliminated within the Community, it would seem preferable to proceed by way of a comprehensive scheme of phasing out those measures found by the group to be harmful, rather than to have to resort to the state aid provisions on a case-by-case basis.[48] However, the fact that the state aid rules are available to combat most forms of harmful tax competition, and are backed by powerful sanctions, may provide an incentive for member states to live up to their commitments under the Code, regardless of the completion of the "package".

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47 For a member state to do so would be contrary to the "standstill" commitment under the Code.

48 See Hendricks, n.8 supra, at 413.