

Governance Arenas in EU Direct Corporate Taxation

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1. Introduction

The emergence of new modes of governance has been explained in different ways. New modes—it has been argued—provide flexible alternatives to the classic community method, responses to the legitimacy crisis of EU regulation, or platforms for experimental learning via socialization. In the case of European tax policy these explanations have limited mileage. Thus, instead of using functionalist explanations (that is, new modes of governance are more efficient, more legitimate, more effective in producing learning) we look at the politics of instruments selection. We ask 'How do constellations of actors involved in EU direct tax policy decide to cooperate instead of competing, and how do they select policy instruments?'

2. Governance Arenas in EU Taxation

In answering this research question, we enter a rich specification of the constellation of actors, and we combine the strategic pursuit of interests with ideational analysis—based on the role of knowledge, ideas, and discourse in the policy process. Policy ideas provide the definition of the EU tax policy problems and enable actors to articulate their interests. The ideational dimension does not determine policy outcomes in a crude cause-effect relationship; it rather enables some actors and constrains others. Finally, knowledge enters the policy process via actors that push strategically alternative definitions of tax policy problems. Thus, we go back to actors and the strategic dimension of policy making.

To explain cooperation and the selection of modes of governance, we look at direct tax policy as a set of governance arenas rather than a single entity. We do not focus on tax

rates, tax bases, and the other properties of tax policy instruments. Instead, we look at the governance dimension of tax policy, covering arenas in which actors interact, modes of governance, and the interplay between ideas about the direction of EU tax policy and strategic behavior.

The major actors are the Member States, the European Commission, and the business community. The revenue authorities want to preserve the revenue base, but member states also want to attract corporations and mobile capital. The European Commission has a process goal (that is, to make progress

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on direct tax cooperation). This is more important than the outcome goal (what type of trajectory should tax cooperation take). The Commission can secure its process goal only if power relations between Brussels, the Member States and the business community are balanced. The business community has different preferences about tax competition, depending on whether firms are exposed to international trade or not. On tax cooperation, business favors reforms that eliminate obstacles to business in the single market. The European Court of Justice is another major player in the tax arena but we consider the ECJ case law as part of the exogenous context constraining and enabling other actors. We do not think that, at this point in time at least, the Court has a political strategy about the trajectory of EU direct taxation that goes beyond the treaty freedoms.

Overall coordination of direct taxes is politically impossible. True, the creation of a dedicated tax body within ECOFIN has been proposed more than once. But the ideological, institutional, and distributive conflicts of interests among the Member States, the business community and the Commission (and among the different Member States) are powerful obstacles to cooperation. Thus, the Commission has orchestrated the creation of two different governance arenas to balance the power relations between Brussels, the Member States, and the business community. Preferences are accommodated, and the outcome goal of the Commission is secured, by segmenting tax cooperation into two more manageable governance arenas, which select actors and modes of governance according to their internal logic.

3. Harmful Tax Competition

We call one arena ‘harmful tax competition’ and the other ‘corporate tax reform’. Revenue authorities are the dominant actor in the harmful tax competition arena, whilst in corporate tax reform both Member States and the business community play an important political role. Neither the Commission nor the Member States have controlled the emergence of a third arena dominated by the European Court of Justice. The arena of harmful tax competition has emerged around the policy narrative of the negative

effects of unbridled tax competition in the EU, and the consequences for employment and the welfare state. It appeals to the revenue authorities’ goal to guard the revenue base. It provides a specific meaning to the otherwise vague notion of direct tax policy coordination. It makes interests actionable by showing what should be done to avoid the doomsday scenario of the race-to-the-bottom. Finally, it pre-selects the main actors engaged with cooperation — the business community is a policy-taker.

This arena contains a code of conduct, the 2003 directive on the taxation of savings, and the provision for fiscal aids contemplated in the 1997 tax package. In terms of mode of governance, there is a combination of hard and soft, often to the benefit of the Commission. The procedure against state aids with a tax component has been used successfully to put pressure on Member States in the context of the negotiation of the savings directive. There is no clear preference for one mode of governance over another. What matters is the political result of combining different modes.

4. Corporate Tax Reform

This arena emerged later, as part of the Commission’s strategy to first create political momentum for coordination at the level of the Member States, and then recalibrate the relationship between Brussels and the business community by attending to the tax problems encountered by multinationals in the single market. As soon as the Commission felt that some progress was being made on harmful tax competition, it attended to the orchestration of this arena. In October 2001 the Commission published the results of a comprehensive study in the communication *Towards an Internal Market without Tax Obstacles*. Since then, the Commission has launched several initiatives for corporate tax reform that all fall outside the classical Community method.

The main actors in this arena are the business community, the Commission, and, often but not always reluctantly, the member states. The business community has invested in the ideational dimension of this arena, by supporting task forces, studies, pilot projects, research leaves for tax experts and the emergence of practical ideas to lower tax

barriers and administrative burdens for companies. The narrative surrounding this notion of tax coordination draws on the exploration of issues of corporate tax reform at the EU level (such as home state taxation, solutions to transfer pricing problems, and a possible common consolidated tax base). The competitiveness agenda for ‘growth and jobs’ has provided momentum, although the catalogue of problems and policy solutions that characterizes this arena has been developed independently of Lisbon. The dominant style of interaction is facilitated coordination based on benchmarking, technical exercises on the creation of a common tax base, and exchange of best practice. Although some member states are concerned that too much ‘technical’ work on a common consolidated EU tax base may lead to ‘political’ decisions to carry on with harmonization of both rates and base, so far there has been no evidence of hard modes of governance in this arena. The choice of soft governance is the result of the political logic prevalent in this domain—based on exploration, pragmatic solutions, and, as mentioned, the concern of more than one member states that any deviation from soft exploratory governance could be used to start planning directives for the harmonization of tax rates.

5. The legal arena

This emerging arena dominated by the Court of Justice (ECJ) is characterized by hierarchy. The Commission has tried to steer the reaction of the governments to the ECJ jurisprudence by producing communications and recommendations on how to coordinate the response. DG TAXUD issued Communications on the tax treatment of occupational pensions (2001c), investment funds (2000), and dividend taxation (2003). They also published recommendations on thin capitalization rules (2006a), controlled foreign company legislation (2006b), and exit taxation (2006c)—all issues targeted by important ECJ cases. But the reaction of revenue authorities has been lukewarm. Finance ministers have also tried to react to the ECJ jurisprudence via soft intergovernmental cooperation, but this has produced more discussions than concrete results. One partial innovation concerns ECJ hearings. Even

though ECJ cases target one specific tax provision or a given member state, revenue authorities from more than one country show up at the hearings, addressing different points, and thus defending the tax legislation of the government under ECJ attack from different perspectives. This may well be a first result of more cooperation across member states on ECJ matters. But for now, the result is that neither the Member States nor the Commission are in control of the third arena, and pressure groups often win. At least so far the jurisprudence of the ECJ has favored the taxpayer—future decisions may be more erratic.

Further reading

This policy brief is based on research carried out within the NEWGOV project no. 22 on “Changing Governance Architecture of International Taxation (TAXGOV)”. The aims of this project were to produce original research on the governance of European Union (EU) and international tax policy, explain why specific modes of governance emerge in the process of international and EU tax coordination, discuss the stability and institutionalization of tax governance and its legitimacy in relation to different notions of the public interest in international tax policy. The project is completed.

Further information can be found on the NEWGOV Website in the [special section](#) of project no. 22

6. Outlook

What about the future then? The code is already considered by some participants to be an experience of the past. With the review of harmful regimes in the new Member States, some revenue authorities feel that the future of the code lies in technical analysis of stand-still, that is, making sure that governments notify potentially harmful regimes and accept to peer review them. The directive on savings was watered down during the negotiations, especially in 2003. With its limitations, it represents a tool to implement rather than a template for a new series of

initiatives against tax avoidance and tax evasion in the EU. Overall, it is hard to see where the political fuel for this arena may come from, especially after the red lines on direct tax coordination in the treaties.

The idea of re-launching a large-scale debate on taxation with a dedicated ECOFIN body, the European Tax Committee mentioned in some discussions, has been ditched for the time being. At the same time, the ambitious plans that characterize the corporate tax reform arena are projected in the future. The Lisbon agenda propels this arena. However, the main issue is one of technical difficulties compounded by diverging political views. France and Germany have made no mystery of their intention to look at tax base coordination under the condition that this might go hand in hand with a common minimum rate. In 2004, the then French Minister Sarkozy sounded his EU colleagues on the idea of making the provision of structural funds to the new Member States conditional on the increase of their tax rates. This contrasts with the position of the UK, Ireland, and Estonia. Member States approach the 'technical' working group on common base coordination with considerable political differences.

With one arena already seen by some as a legacy of the past and the other being a

project with some degrees of political uncertainty about the outcome, the current state of affairs looks bleak. But the present is not 'politically empty'. In fact, it is dominated by an emerging third arena, where the ECJ plays a major role. The question is whether this will produce the political determination to either revive the arena of harmful tax competition or to move quickly, with concrete results, in the arena of corporate tax reform. Otherwise Member States may well end up locked in a situation where tax harmonization in Europe is inevitable, but steered by judicial rather than political action.

Bibliography

- Radaelli, Claudio and Ulrike S. Kraemer (2008), *Governance Areas in EU Direct Tax Policy*, in: *Journal of Common Market Studies*, Vol. 46:2, pp. 315-336.
- Relevant Communications and Court decisions can be found on the DG TAXUD web site http://ec.europa.eu/taxation_customs/taxation/company_tax/key_documents/index_en.htm