



<http://www.fse-agire.com>

# **The Impact of Fiscal Policies on Restructurings**

*AgirE Project Contribution*

**Barbara Gabor**

*Ph.D. candidate  
European University Institute*

**September 2007**

## Table of contents

<i>1. Introduction: the scope of research</i> .....	2
<i>2. Economic theory of tax competition and trends in competing for foreign direct investment</i> .....	3
2.1. Fiscal federalism theory.....	3
2.2. Competition for foreign direct investment.....	5
2.3. Empirical evidence from corporate tax and foreign direct investment data.....	7
2.4. Conclusions.....	9
<i>3. European harmonization and its influence on tax competition</i> .....	10
3.1. The EC Treaty.....	10
3.2. Secondary legislation.....	11
3.3. Soft-law: The Code of Conduct on Business Taxation.....	13
3.4. Recent European proposals in the field of corporate income taxation.....	13
3.5. The role of the European Court of Justice in shaping tax competition.....	14
3.6. Conclusions.....	16
<i>4. Conclusions with regard to European policies' impact on relocations</i> .....	16
<i>List of references</i> .....	19
<i>Annex</i> .....	21

# The Impact of Fiscal Policies on Restructurings in the EU

Barbara Gabor \*

## Abstract

This paper provides an overview of the main economic arguments for and against decentralized taxation, examining whether European action in the field of corporate taxation is justified and what impact it has on corporate relocations. It is argued here that economic theory and empirical data does not provide convincing evidence to favour tax harmonization, neither in order to tackle under-provision of public goods, nor to achieve a higher level of social protection. A legal assessment demonstrates that in line with this conclusion, currently European policy measures aim to increase corporate mobility rather than harmonizing taxes or expanding national powers to prevent companies from relocating. It is argued that this approach promotes corporate mobility and may increase relocations in the future. However this does not change the conclusion that the current distribution of powers to tax and European policy action is efficient in terms of balancing social protection and industry competitiveness.

## 1. Introduction: the scope of research

The AgirE project aims to better understand the strategies of companies with regard to restructurings. The goal of the project is to identify what factors might influence firms' innovative strategies in order to be able to anticipate the occurrence of restructurings. Research into these questions is expected to facilitate the design of European policies to meet the challenge of balancing competitiveness of European companies and social protection of European workers. Within the framework of the AgirE Project, and in line with its goals, this paper examines the impact European policies in the field of taxation may have on restructurings.

The research question posed here is whether European action in the field of tax policy should be targeted at better social protection or at enhancing firms' competitiveness. Within this analysis two preliminary issues have to be addressed at the outset. The first one is the definition of restructurings to be covered by this study, the second is the role of taxation in firms' decision to relocate.

Legal and finance literature does not offer one universally adopted definition for what constitutes a corporate restructuring. In order to provide an insight into the relationship between taxes and restructurings that may have an impact on employees, this paper defines restructurings in a functional manner, following the line of the European debate. The working definition of restructuring of this paper therefore adopts the definition set up by the European Economic and Social Committee in its 2005 opinion on delocalisations.<sup>1</sup>

“Delocalisation occurs when a business activity is totally or partially ceased, to be reopened abroad by means of direct investment. In the European Union we can distinguish between two

---

\* Ph.D. candidate, European University Institute, Florence, Italy. Contact: Barbara.Gabor@eui.eu

<sup>1</sup> European Economic and Social Committee (2005), “The Scope and Effects of Company Relocations” Own initiative opinion. CCMI/014. Brussels, 14 July 2005.

types of relocation. Internal: Total or partial transfer of business activity to another Member State; External: Total or partial transfer of business activity to non-EU countries.”

This paper will thus look at “internal delocalisations”, hereinafter called relocations, which involve intra-EU relocation of business activities.

With regard to the role of taxation in corporate locational decisions, it should be noted that taxation is only one of several elements that have an influence on firms’ decisions to relocate within the Union, such as the vicinity of markets, the cost of labour, the flexibility of labour law, among others. Thus the influence of taxes will be limited and potentially altered by other factors. This study does not aim at the identification of cases of restructurings which were exclusively triggered by tax policies; instead it serves to highlight the role of taxes in the *mix of countries’ economic and legal features* that have an influence on firms’ decisions.

In examining the impact of national tax policies on corporate relocations, and the scope for potential European action in balancing competitiveness and social protection within the field of taxation, this article examines first economic arguments and empirical data, then carries out a legal analysis of present European policies.

The paper is structured as follows. Section 2 provides a brief overview of the economic theory of fiscal federalism and the broader framework of international competition for foreign direct investment, together with a review of recent empirical studies in the field of taxation. The section concludes that there is presently no sufficient evidence to justify European harmonizing measures to prevent firms’ relocation. Section 3 continues with an analysis of European Community law and its impact on national tax policies, drawing some conclusions on the present trend in tax competition. Finally section 4 offers the conclusion that within the field of tax policy European action has encouraged corporate mobility, rather than restricting it, and that social protection is not pursued in this policy field. The paper argues that this approach is in line with theoretical predictions and empirical results on tax competition and federalism.

## **2. Economic theory of tax competition and trends in competing for foreign direct investment**

The phenomenon of tax competition is described by the economic theory of fiscal federalism, examining the efficient allocation of regulatory power at the European (in economic parlance also called “federal”) or Member State (national) level to set taxes and provide public services.

The main arguments of fiscal federalism are presented below (section 2.1.). Economic theory is then enriched with the current debate on states’ competition for foreign direct investments, examining states’ incentives for attracting foreign firms into their jurisdiction (section 2.2.). Finally this section provides a review of empirical evidence from recent studies, analyzing whether there is a shift of tax burden towards labour income and whether there is a relocation of investments to low tax jurisdictions (section 2.3.). The section concludes that neither theoretical nor empirical evidence supports harmonizing measures in order to prevent firm relocations in specific or tax competition in general.

### **2.1. Fiscal federalism theory**

Economic analysis is a powerful tool to examine the phenomenon of tax competition. Under the economic approach that aims to achieve efficiency, the market is the best mechanism of allocating limited resources within an economy. However, market failures in certain cases necessitate regulatory intervention. Certain goods and services, due to these market failures,

are best provided by the state rather than by markets. Taxes can be explained in economic terms as the necessary financing for the provision of public goods by the state. In these cases therefore both the provision of such public goods and the taxes necessary to finance it can be regarded as a policy design which is optimal within the economy. Different states may however offer such public goods and services at more competitive prices.

There is abundant literature examining the economic effects of tax competition, whereby states compete with each other in levying taxes and offering public goods. Studies on this phenomenon differ in their conclusions on whether such fiscal decentralisation is beneficial or detrimental for the economy as a whole. Accordingly, fiscal federalism literature can be divided into two groups: one describing tax competition as efficient and another one viewing tax competition as detrimental for overall welfare.

The first line of literature predicting positive outcomes from fiscal decentralisation and state competition is known after the model set up by Tiebout,<sup>2</sup> demonstrating that different jurisdictions with different demand for public goods should tax at different levels in order to provide the optimal level of public goods and services within the given territory. According to this theory, one potential benefit of tax competition stems from the divergence of jurisdictions in citizens' demand for what the state should be providing and how much people are willing to pay. In other words decentralised fiscal policies will better satisfy diverse demands.

Another argument favouring fiscal decentralisation is demonstrated by the Leviathan model of governments. The Leviathan model, as worked out by Brennan and Buchanan,<sup>3</sup> describes the government as maximising its size by an inefficiently high level of taxation and public goods provision. This model predicts another form of potential benefits from tax competition, as it holds that this type of competition among states will restrain the Leviathan, i.e. tax competition will limit over-taxing and over-spending by governments.

The other line of literature, estimating negative overall effects from tax competition, can be best described by the model developed by Zodrow and Mieszkowski.<sup>4</sup> This stream of literature predicts an inefficient outcome from fiscal decentralisation,<sup>5</sup> pointing out that, in contrast with the Leviathan model, states will have an incentive to lower their taxes in order to attract mobile resources (mainly capital and firms) and this will result in a lower than optimal level of public goods provision.

The main difference between the models predicting negative outcomes and those predicting positive ones is in their assumptions. The Zodrow-Mieszkowski model assumes welfare maximising (benevolent) governments, acting to achieve efficient allocation of resources. Such a government can only deliver optimal outcome if the taxed resources are immobile. The mobility of factors, as well as mobility of only capital, in these models lead to externalities and inefficiently low taxation and provision of public services.

The Tiebout model, on the other hand, is a model assuming non-distortionary taxes and full mobility of households, suggesting that efficient provision of public services (the so-called

---

<sup>2</sup> Tiebout, Ch. (1956), "A Pure Theory of Local Expenditures" *Journal of Political Economy*, vol.64. no.5. pp.416-424.

<sup>3</sup> Brennan, G. and Buchanan, J. (1980), *The Power to Tax: Analytical Foundations of a Fiscal Constitution* (Cambridge: Cambridge University Press).

<sup>4</sup> Mieszkowski P. and Zodrow, G. "Pigou, Tiebout, Property Taxation and Under-Provision of Local Public Goods," *Journal of Urban Economics*, Vol. 19, no. 3. pp.356-370.

<sup>5</sup> Here in simplification the term "fiscal decentralisation" is used as interchangeable with the concept of "tax competition", however the incentives of local decision makers to engage in competition cannot be assumed in all cases.

Samuelson condition) will be achieved when power to provide such services is vested with local decentralised levels of the government and when mobility of economic actors is unlimited.

Recent studies also deliver differing results concerning the welfare effects of tax competition. While some commentators argue that tax competition should be eliminated to avoid the shift of tax burden from capital income to labour income, others assessing the potential welfare gains from tax harmonisation arrive to the conclusion that there is only weak and unconvincing evidence that the elimination of tax competition would deliver positive effects for the economy.

With regard to redistribution through taxes, it has to be pointed out that social policies can only be assessed by taking account of the external competitive pressure on Europe. Also relating to the redistributive function of taxes, the claim that tax competition would have detrimental effect on social policies is discussed below through empirical results concerning tax burden shift from capital income to labour income.

## **2.2. Competition for foreign direct investment**

The discussion on tax competition focuses on a specific type of the general international competition for foreign direct investment. States have indeed more incentives to attract companies than just the taxes they pay and therefore tax competition cannot be assessed without taking account of the various parallel incentives.

Competition for investments is described according to the effects of foreign direct investment on the host state. National tools applied to encourage investment inflows include among others taxes, subsidies and provision of public goods (such as attractive infrastructure, etc.). This subsection reviews the main features of foreign direct investment which make it desirable for states to attract investors, and which are relevant to the discussion of tax policies' effects on corporate locational decisions.

The desirability of foreign direct investment for a country is determined by its effect on that country's economy. Foreign direct investment is therefore (or, at least, should be) a tool to an end and not an end in itself. FDI does not have the same effect in each case, and so there is no single general conclusion on the effects it can have on the host country's economy.

Instead there is a typology of foreign direct investments, and a typology of the impacts it can have in the host state. These typologies provide some useful insights to the question why states engage in competition for FDI.

As for the categorisation of FDI, the literature distinguishes between *export oriented* and *market oriented* foreign direct investments. Export oriented FDI behaves differently from market oriented investments, and the two will have very different impact on the host economy.

Market oriented investment is motivated primarily by the proximity of markets, i.e. the demand for the goods or services produced by the firm. The locational decision for this type of investment is therefore less sensitive to tax burden and it is more likely that the investor will stay in the country as long as the firm can serve a substantial market there.

Export oriented FDI, on the other hand, is motivated by the features of the economic-, business- and legal environments that make production cheaper in a given location as compared to other locations. This type of investment is also likely to be more easily influenced by the tax burden. Therefore the distinction between market and export oriented FDI is highly relevant for this analysis.

Besides the two types of foreign direct investment described above, the literature also distinguishes different types of impacts of FDI.<sup>6</sup> So-called *primary impacts* of foreign direct investment denote the aggregate costs and benefits that accrue to an economy as a result of the bundle of resources brought in by the investing firm. Primary effects include effects on employment, on capital flows, technology transfer or organisational knowledge transfer from foreign to domestic enterprises. *Secondary impacts* mean the spill-over effects from foreign firms to local firms. Secondary effects occur through the development of linkages, and tertiary effects include the development of institutional infrastructure. *Tertiary impacts* consist of effects on the host country's infrastructure or utilization of natural resources. Figure 1 in the Annex illustrates this categorisation.

Out of these three layers of impact, the primary effects of foreign direct investment are the most relevant for developed economies. With regard to these primary effects, the desirability of FDI is determined by simple factors such as the size of the firm (the bigger the firm the more beneficial its effects are presumed to be), the value added of the industry (high value added is preferable to low value added), the function of firm (R&D and local headquarters better than mere assembly operations), the form of entry (green-field investment more desirable than mergers and acquisitions).<sup>7</sup> Nationality might also influence the desirability of FDI.<sup>8</sup> Moreover, countries with different factor endowments and at different levels of development will benefit from different types of foreign investment.<sup>9</sup>

In addition to the above described nature and impact of different types of FDI, competition within the European Community shows specific characteristics. The European Community established an internal market, which offers easy access to all other Member States once a firm established itself in any EU country.

This has two major implications in the context of foreign direct investment. First, due to higher level of market integration, there is a higher level of cross-border trade and accordingly less need for companies to establish subsidiaries abroad. Secondly, non-European firms that try to reach the European market only have to establish themselves in one Member State to serve all others. This implies also that the choice in which Member State to set up the establishment may resemble to an export oriented foreign direct investment type, and be relatively strongly influenced by taxes and other factors affecting after tax corporate profits.<sup>10</sup> It should be noted however, that the choice between a branch and a subsidiary and the choice of locating the production site and the headquarter will be primarily influenced by locational advantages described in the literature as industrial clusters.

To conclude, this analysis shows that the incentive for states to attract foreign direct investment depends on the impact on the host country economy, and can vary according to the features of the investment and according to the features of the host economy. Furthermore,

---

<sup>6</sup> See: Dunning, J.H. (1993). *Multinational Enterprises and the Global Economy* (Wokingham: Addison-Wesley); and Enderwick, P. (2005), "Attracting Desirable FDI" *Transnational Corporations* vol. 14. no.2. pp.93-120.

<sup>7</sup> Enderwick, P. (2005), "Attracting Desirable FDI" *Transnational Corporations* vol. 14. no.2. pp.93-120., referring to: Poynter, T.A. and White, R.E. (1984), "The strategies of foreign subsidiaries: responses to organisational slack", *International Studies of Management and Organisation*, 14(4), pp. 91-106.

<sup>8</sup> See Enderwick (2005).

<sup>9</sup> Enderwick, P. (2005), "Attracting Desirable FDI" *Transnational Corporations* vol. 14. no.2. pp.93-120. at p.97.

<sup>10</sup> See e.g. Easson, A. (2004), *Tax Incentives for Foreign Direct Investment* (The Hague: KLI).

due to the specific nature of the European Community as an internal market, there is a higher sensitivity of FDI to non-market related factors (export-oriented type of FDI is more likely to occur).

The following sub-section of this paper will look at some of the latest empirical evidence with regard to the assessment of tax competition, examining tax and FDI data, analyzing evidence on whether there is a flow of investments to low tax jurisdictions and shift of tax burden from capital towards labour income, and how FDI in general reacts to tax burden.

### **2.3. Empirical evidence from corporate tax and foreign direct investment data**

In order to better understand the extent and direction of tax competition this section will present the results of some recent empirical studies. Two sources of empirical evidence will be considered.

First, data on tax rates, tax revenues and overall tax burden on firms and labour will be discussed. This data provides information on whether there is a decrease in corporate income taxes, as predicted by the race to the bottom argument in tax competition literature, and whether there has been a shift of overall tax burden from companies to labour.

Second, data on foreign direct investment stock and flows will be examined, which should tell us about how strong the influence of tax burden differentials is on the allocation of capital investment. It is debated whether FDI stock or flows are a useful source for the assessment of tax competition; therefore, evidence drawn from FDI data has to be treated with caution. Here it will be used to provide a rough approximation on the current trends.

An argument often made in favour of European policy action in the field of taxation is that corporate income tax rates decrease due to tax competition. This claim however has two possible interpretations: either the decrease in tax burden has a positive effect by restraining governments in over-spending (increasing efficiency consistently with the economic model of “constraining the Leviathan”) or, to the contrary, the decrease in taxes is due to governments’ struggle to attract companies even at the price of inefficient low level of taxation (in line with the predictions of inefficient tax competition models).

In addition an argument for pursuing social policy through European action in the tax field is based on the claim that tax burden is shifting from capital income (corporate taxes) to labour income, having a socially undesirable, negative impact.

However a closer examination of corporate income tax rates reveals interesting results in regard with both claims.

Table 1 in the Annex illustrates the change in corporate income tax rates in the 25 European Member States every 5 years over a period of 25 years. The data suggests that there has indeed been a decrease in the statutory rates. Especially the EU 15 average shows this decrease very clearly. It is also apparent from the table that the ten new Member States have substantially lower tax rates on average than the old Member States.

Commentators note, however, that, parallel with the decrease in statutory rates, a noticeable broadening of the *tax base* took place, which is not expressed by data showing only *tax rates*. This balances somewhat the effects of the drop in statutory rates, and it means that the overall tax burden did not decrease to the extent tax rates did.

For a closer examination of changes in Member States’ tax policies, Figure 2 in the Annex demonstrates the changes in corporate income tax revenues as a percentage of the GDP. The data shows a period of significant gap between the percentage of the EU 15 and that of the new EU 10 states. However, this difference seems to decrease since 2000, a trend which is continuing even until now. It is also interesting to note that in 1995 the tax revenues as

percentage of GDP were similar in the old and the new Member States, and the change did not occur in the new candidate states, but instead in the EU 15. There the ratio rose from around 2.7% in 1995 to 3.5% in 1998, peaking at 3.8% in 2000.

A comparison is presented in Figure 3 in the Annex showing the change in statutory tax rates as a function of tax revenues as percentage of GDP. Nicodème notes that there is “no obvious relationship between the cuts in corporate statutory tax rates between 1995 and 2000 and the evolution of revenues collected from this tax. [The above mentioned Figure] suggests that – broadly speaking – the newly accessed Member States that have cut their tax rates have lost corporate tax revenues in percentage of GDP, while the opposite holds for most EU-15 countries.”<sup>11</sup>

As for empirical results concerning the shift of tax burden from capital to labour income in European Member States, Nicodème<sup>12</sup> demonstrates that the data does not show a clear tendency in this direction. As Figure 4 in the Annex demonstrates, when tax revenues are measured as a percentage of GDP, the proportion of tax revenues per GDP from labour taxes is higher than the tax revenues from capital. However in the last ten years the trend is not the above discussed shift from capital income tax towards labour taxes, but just the opposite: labour taxes are decreasing while capital income taxes, although somewhat fluctuating, on average are increasing.<sup>13</sup>

Besides the literature on tax rates another line of literature uses data on foreign direct investment stock and flows to examine the effect of taxes on investment decisions. In a study that surveys a great number of the available empirical literature on the taxation of FDI, De Mooij and Ederveen drew some insightful conclusions with regard to the responsiveness of foreign direct investment to taxation.

The studies reviewed by the two authors varied in the specifications they used and in their definitions as well. Therefore the study by De Mooij and Ederveen transformed the coefficients of each of the studies into a uniformly defined elasticity, a so-called semi-elasticity or tax rate elasticity, to make the outcomes of the different studies comparable. Their interpretation of tax rate elasticity measures the percentage change in FDI in response to a 1%-point change in the tax rate (e.g. a decline from 35% to 34%).<sup>14</sup> Table 2 in the Annex demonstrates their main results.

As it appears from the semi-elasticities in the table, the majority of empirical studies surveyed by the authors, when brought to a common definition, show that FDI responds negatively to a positive change in taxes, or, to turn around this argument, that 1% drop on tax rates would induce an increase in FDI by the percentage of the semi-elasticity shown in the table.

When the results are added up, the median tax rate elasticity, which expresses the average of all the studies surveyed, is -3.2. This means that it can be concluded from the various empirical studies on FDI, that 1% point drop in tax rates will be accompanied by 3.2% point increase in foreign direct investment in that country. However it should be remembered that these results do not show causality, but simply correlation between tax rates and investment.

---

<sup>11</sup> Nicodème, G. (2006), “Corporate Tax Competition and Co-ordination in the European Union: What Do We Know, Where Do We Stand?” Working paper June 2006.

<sup>12</sup> Idem.

<sup>13</sup> Nicodème also notes that “the different levels of tax-to-GDP” ratios are due to the different proportions of each economic function in GDP and hence do not necessarily reflect a higher taxation on labour. When reported to their own tax base (instead of GDP), the same trends emerge, although less pronounced (the ratio for labour for example does not diminish as fast). In addition, the implicit rates on labour and on capital appear much closer. These rates are called the backward-looking macro effective tax rates (or sometimes called implicit tax rates).

<sup>14</sup> De Mooij, R.A. and Ederveen, S. (2003), “Taxation and Foreign Direct Investment: A Synthesis of Empirical Research” *International Tax and Public Finance*, vol. 10, pp. 673-693.

To conclude, empirical studies do not provide unambiguous evidence for negative effects of tax competition neither by way of decreasing tax burden on companies and corresponding decreasing corporate income tax revenues of states, nor through a shift of tax burden from companies to workers.

At the same time empirical studies using foreign direct investment data find significant effect of taxes on investment decisions.<sup>15</sup> As it has been pointed out above, the methodology of using FDI data can be debated, and therefore these studies should be used with caution in assessing the relationship between national tax policies and relocation of production activities. The outcome seems to be dependent on the starting point, the assumptions and the methodology of each study; however it can be concluded that strong evidence of broad-range negative impacts that would necessitate European level harmonization is not presently available.

## **2.4. Conclusions**

In examining the economics of decentralisation and its impact on corporate relocations it is important to consider the entire package of taxes and public expenditures, rather than only the taxes imposed. Taxes may be used either to finance public goods and services, or to implement social policies through redistribution of income. In the first case firms that are taxpayers also benefit from the public spending in the form of developed infrastructure, highly educated labour force, etc. With regard to social policies, mobile taxpayers, such as firms, may leave the jurisdiction if they do not benefit from such redistribution, but have the opportunity to pay lower taxes or benefit more from taxes paid in another country.

With regard to competitiveness of the industry, the first function of taxes, financing public expenditure is relevant, while for social protection the redistributive function of taxes comes into play. Restricting firms' relocation within Europe for reasons of social protection would only lead to lower international competitiveness or more "external delocalisations", i.e. more firms moving outside of Europe. The balancing of social policy and competitiveness requires a rigorous examination of all relevant factors, with special regard to international competitive pressure, before policy conclusions can be drawn. The current trends that can be observed should be assessed in the light of global considerations affecting overall efficiency rather than as a segregated policy issue of taxation, and it should also be taken into account that unified federal taxes, should they be introduced, would also have to be set with regard being had to the global competitiveness of the industry. Therefore harmonization of taxes does not necessarily lead to higher social protection.<sup>16</sup>

When looking at the empirical data, it appears that, although taxes imposed on labour are higher than capital income taxes, there is no clear evidence that proves a significant shift of tax burden to labour.

Apart from the above question of social policy and redistribution, another question to be answered, along the lines drawn up by the Tiebout model, is whether harmonized taxation would satisfy local preferences and whether public expenditure would not be excessive without competitive pressure from horizontally arrayed jurisdictions. Economic theory and empirical evidence does not prove a clear race to the bottom in tax competition in this regard. In the light of this finding, the following section describes the present European policy approach to national taxation. The analysis will address the impact on relocations of the

---

<sup>15</sup> See De Mooij and Ederveen (2003).

<sup>16</sup> The potential future introduction of federal - or even harmonized national - taxes also has a political significance, an issue not assessed within this analysis.

present European approach to taxation, and draw conclusions for future policy direction at the European level.

### **3. European harmonization and its influence on tax competition**

The assessment of the impact European law has on national tax policies and relocations requires an examination of European primary and secondary legislation, as well as soft law and the case law of the Court of Justice.

For this assessment mention has to be made of the specific features of the European economy. European integration has created an internal market where goods and services, capital, firms and workers can freely move across national borders.<sup>17</sup> Obviously capital has a significantly higher mobility than labour and this difference in mobility has an impact on how tax policy affects the economy and the allocation of resources.

This section starts by examining the provisions of the EC Treaty with regard to direct taxation and competences of the European legislator to enact further legislation (section 3.1.), then looks at secondary legislation (section 3.2.), soft-law (section 3.3.), current legislative proposals (section 3.4.), and finally the case law of the European Court of Justice (section 3.5.). Section 3.6. concludes with the finding that current European policy measures in the field of taxation increase cross-border mobility of firms, thus enhancing competitiveness.

#### **3.1. The EC Treaty**

The EC Treaty (hereinafter also referred to as the “Treaty”) does not introduce a harmonized system of taxation, but leaves significant autonomy with Member States to set their tax policies.

The Treaty makes a distinction between direct and indirect taxation, and specific provisions require harmonisation of indirect taxes only. The provisions relating to the specific issue of taxation are Articles 90 to 93 that deal with the case of indirect taxation, while Article 293 aims at the elimination of double taxation. For direct taxation no specific provisions can be found in the Treaty, although it is often argued that Article 293 on double taxation is not limited to indirect taxation, but covers direct taxes as well.

The Treaty provisions on the economic freedoms are significant in defining the limits of national tax policies. The European Court of Justice, as it will be explained below, has given a broad interpretation to these freedoms which prevail over several national policy considerations.

Besides the free movement of goods, which concerns more indirect taxes than direct income taxes, Articles 39 and 43 of the EC Treaty provide for the free movement of workers and the freedom to provide services across the EU. These provisions leave a possibility for national law to limit free movement on the basis of public policy, public security and public health. The freedom of establishment grants companies mobility across borders under Article 48. Article 56 lays down the principle of free capital movement and Article 58 (1) (a) completes that provision by providing that the free movement of capital is without prejudice to the rights of Member States to adopt and apply tax law provisions that treat taxpayers who are not in the same situation regarding their place of residence or place of capital differently.

---

<sup>17</sup> See in general Craig, P. and De Búrca, G. (2007), *EU Law: text, cases and materials* 4<sup>th</sup> edition (Oxford: OUP).

Due to the lack of Treaty provisions on direct taxation, the competence of the European legislator to enact secondary legislation in this field has become all the more significant and debated issue. The harmonisation of company taxation has been a controversial issue within Europe due to its recognised importance in creating a single internal market on the one hand and its sensitive nature for Member States as budget revenue on the other hand.

The Treaty lays down provisions conferring powers on the EC institutions to enact secondary legislation in general. Articles 94, 96 and 97 set the requirements for such harmonizing measures. The European directives on taxation adopted until now indicate Article 94 as their legal basis. This provision confers legislative power on the European Council, with the consultation of the European Parliament and the Economic and Social Committee to issue directives if Member States' national laws impede the creation or the functioning of the common market.

This provision, read together with Article 2 and Article 3(1)g, and the provision on subsidiarity laid down in Article 5 of the EC Treaty means that Member States are free to choose their tax policies as long as this does not distort competition in such a way that would impede the creation or functioning of the internal market.<sup>18</sup> It has to be noted however, that it is rather difficult for the Council to exercise the legislative powers conferred on it by Article 94, due to the fact that it needs unanimity for adopting such harmonizing directives. However the European legislator has further legal bases in the Treaty to harmonize, adopting legislation with only qualified majority, such as Article 95 described above, or Article 96 in cases where the differences in national provisions distort the conditions of competition in the common market.

The following sub-section summarizes the existing European secondary legislation in the field of corporate taxes.

### **3.2. Secondary legislation**

While the EC Treaty does not elaborate on the specific issue of corporate taxation, secondary legislation covers parts of company taxation in the form of directives. However these harmonizing measures have very narrow coverage and leave substantial legislative powers at the national level.

Presently company taxation issues regulated at the EU level are covered by the Parent Subsidiary Directive,<sup>19</sup> the Mergers Directive,<sup>20</sup> the Interest and Royalty Directive,<sup>21</sup> the Savings Directive,<sup>22</sup> and the Mutual Assistance Directive<sup>23</sup>. The Commission's proposal for a directive on cross-border loss compensation was not accepted by the Council and was consequently withdrawn for revision. Outside the scope of these directives, but within the scope of the EC Treaty requirements, Member States are free to set national tax rules. The exact scope of these harmonizing measures is summarized below.

---

<sup>18</sup> See e.g. point A paragraph 6 of the Commission Notice on the application of state aid rules to measures relating to direct business taxation (98/C OJ 384/03).

<sup>19</sup> 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, 20 August 1990 OJ L 225, p. 0006 – 0009.

<sup>20</sup> Directive on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different member states, Council Directive 90/434/EEC, of 23 July 1990, OJ L 225. Hereinafter referred to as Mergers Directive.

<sup>21</sup> Directive 2003/49/EC on a common system of taxation applicable to interest and royalty payments made between associated companies of different member states.

<sup>22</sup> European Union Savings Directive, council directive 2003/48/EC, effective from 1 January 2004.

<sup>23</sup> Amendment of 1977 Directive on Mutual Assistance to combat tax fraud (2004/56/EC).

The Parent Subsidiary Directive was enacted in order to prevent double taxation of corporate income in cross-border corporate groups. When a subsidiary established in one Member State pays out dividends to its parent company in another Member State, the parent company is liable to income tax after the amount received. However the state of the subsidiary also taxes this dividend payout that leaves its jurisdiction in the form of a non-recoverable withholding tax. The Directive abolished withholding taxes paid to the parent company situated in another EU Member State, and today these dividend payments are free of withholding tax. This directive therefore has relevant implications for corporate organizational decisions, since it places cross-border group structures on a more level playing field with national corporate structures.

The Directive on taxation of cross-border mergers (Mergers Directive) lays down provisions that are highly relevant to the present study on corporate restructurings. Four types of transactions, legal mergers, legal divisions, exchange of shares and transfer of assets are covered by the Directive. The legal merger of companies can take three forms. The first possibility is that two or more existing companies merge into one, with the original companies ceasing to exist, establishing a new entity. The second form of mergers is when a company merges into another, previously existing entity and this entity will carry on business as a merged company. The third form of legal merger is when the wholly owned subsidiary is merged into the parent company.

The Mergers Directive apparently contains restrictions to corporate mobility. One of the conditions to the application of the Directive is that the assets that are merged into another entity in another jurisdiction stay within the emigration state in the form of a permanent establishment.

This practically means that deferral of the capital gains tax upon cross-border mergers will only be available if the state of the transferring company will maintain its tax jurisdiction over the assets.<sup>24</sup> This requirement in practice restricts companies' freedom to affect reorganizations and to choose its form: it has an effect of "conserving" the original structure (or at least place) of assets.

It should also be noted here that the Mergers Directive does not provide explicitly for free emigration of companies; instead, it tacitly implies that for transactions not covered by the directive member states have the possibility to impose exit taxes that prevent companies from leaving their jurisdiction.

Finally, with regard to the scope of application of the Mergers Directive, the recent adoption of a significant European company law directive on cross-border mergers should be mentioned.<sup>25</sup> As many European Member States did not recognize cross-border mergers in their national company law before the directive was adopted, the Mergers Directive on the taxation issues was rendered moot. With the adoption of the company law directive on cross-border mergers, reorganizations of this form can be expected to rise across Europe – with the above described influence of the Mergers Directive on tax considerations.

As it is clear from this analysis, EC directives are aimed at facilitating cross-border transactions of companies by neutralizing the tax treatment of these transactions. The EC

---

<sup>24</sup> The P.E. is not resident in the emigration state, but the state maintains its right to tax any profits created by the P.E. as a tax at the source of income, and also maintains the right to tax the assets upon exiting the state in the future.

<sup>25</sup> Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies [Official Journal L 310 of 25.11.2005, p. 1]. Mention has to be made also of the decision of the European Court of Justice in the CLT-UFA case on the same issue. C-253/03 CLT-UFA SA v. Finanzamt Köln-West [2006] ECR I-1831.

secondary legislation in the field of taxation therefore facilitates mobility of firms across the EU.

### **3.3. Soft-law: The Code of Conduct on Business Taxation**

The Code of Conduct on Business Taxation<sup>26</sup> lays down soft-law principles which define the scope of “fair competition” among Member States with regard to special tax provisions. Although the Code does not have a legally binding force, it identified several tax regimes as “harmful” within the European Union and its dependent territories, which exerts pressure on these governments to change their policies.

This instrument distinguishes between special and general tax provisions. Special tax provisions are those rules which relate only to a sub-group of subjects, and as such these rules are more likely to lead to discrimination and distortions of incentives. General tax provisions on the other hand concern all taxable subjects of the same kind without distinction. The general nature of a tax provision does not mean in itself that it may not prove to be distorting or discriminative. Nevertheless, a distinction is made between general and specific provisions in the Code of Conduct to define and condemn “unfair tax competition” and “harmful tax measures”.

The treatment of special tax provisions is relevant for the purposes of this study on tax policy and restructurings, since many EU countries attract foreign investment through the use of such special tax rules.<sup>27</sup> The fact that these arrangements are only regulated by soft law signals that some tax competition through specific tax measures can be expected to continue among European Member States, although a Code of Conduct group monitors compliance with the Code.

A further impact of the Code is that it has an influence on the interpretation of “fair competition” even outside the scope of the Code of Conduct. Some commentators argue that general tax provisions, the rules of the Treaty, together with other secondary legislation and the Code of Conduct as soft law, as well as the decisions of the European Court of Justice have to be interpreted to reach a conclusion as to what constitutes a “fair competition” among Member States.<sup>28</sup>

A more recent action taken by the Commission is the release of a Communication on preventing and combating financial and corporate malpractice.<sup>29</sup> In this Communication the Commission proposes the introduction of more transparency, and information exchange in the company tax area, and aims at ensuring coherent policies on offshore financial centres.

### **3.4. Recent European proposals in the field of corporate income taxation**

Besides the secondary legislative measures and soft-law instruments already adopted, it is also worth looking at recently prepared legislative proposals. The European Community has a long history of unrealised tax harmonisation proposals.

The Ruding Committee Report of 1992 has identified three areas that should be addressed at a European level. The Committee proposed the removal of distorting and discriminatory national tax provisions and within that the elimination of double taxation of cross-border

---

<sup>26</sup> Code of Conduct Group, (1999) Code of Conduct on Business Taxation, Press Release: Brussels (29-02-2000) - Nr: 4901/99

<sup>27</sup> For example Ireland or Poland. See: Easson, A. (2004), *Tax Incentives for Foreign Direct Investment* (The Hague: KLI).

<sup>28</sup> See for this interpretation of the provisions, especially Art 94 and 96, of the EC Treaty: Cerioni, L. (2005), “Harmful Tax Competition Revisited: Why Not a Purely Legal Analysis?” *European Taxation* vol. 45. no.7. pp.267-281.

<sup>29</sup> Communication on preventing and combating financial and corporate malpractice, COM (2004) 611.

investment flows, the setting of a minimum statutory tax rate and a minimum tax base and providing for transparency in tax incentives.

The European Commission considered four alternative approaches to address the issue of distorting effects of national tax systems. The four proposed solutions were the introduction of Home State Taxation, European Corporate Income Tax, harmonization of tax systems in a traditional approach, or introduction of a Common Consolidated Corporate Tax Base. The Commission opted for the latter solution in 2001.<sup>30</sup> Following a document issued in 2004,<sup>31</sup> the Commission issued a Communication in 2006 in which it describes the details of the proposal.<sup>32</sup>

This proposal aims at harmonising the tax base of corporate income tax across the EU, without touching upon statutory tax rates. This solution will grant the option to companies established in more than one Member State to compute the taxable income of the group on the basis of an EU tax base. It is expected that this solution would “reduce the tax-related compliance costs and effectively tackle most of the tax obstacles that are currently still hindering companies in developing their EU-wide activities, e.g. as resulting from transfer pricing rules, the lack of cross-border loss compensation etc. At the same time, it would in many areas effectively reduce the risk that Member States' tax laws are declared to be unlawful restrictions to the fundamental freedoms of the Treaty by the European Court of Justice.”<sup>33</sup>

This proposal therefore will not aim at harmonisation of tax burdens across Europe; instead it will create comparability in the tax burden of companies in different Member States. Presently not only the tax rates but also the tax base of firms is different, making it difficult to compare the actual tax burdens on firms. With the new proposal the comparison will be somewhat easier, however the question of computing the actual tax burden will not be entirely solved due to issues other than corporate tax base.<sup>34</sup>

A question that this new instrument raises is the potential impact on corporate relocations. While the comparison of different national tax regimes becomes easier, the relocation of economic activities may become more rational for firms in order to decrease their tax burden.

### **3.5. The role of the European Court of Justice in shaping tax competition**

As already noted above, the EC Treaty does not elaborate on the specific issue of corporate taxation, and even secondary legislation covers only parts of company taxation in the form of directives, leaving legislative powers concerning taxation at the national level.

However, the general principles of EC law set limits to national legislative competences affecting the economic freedoms laid down in the EC Treaty. The provisions of free movement of persons, covering the right of establishment, and the free movement of capital, already mentioned above, are the two most significant freedoms in relation to corporate

---

<sup>30</sup> Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee: Towards an Internal Market Without Tax Obstacles. COM (2001) 582. This approach was confirmed in a 2003 Communication on An Internal Market without Company Tax Obstacles: Achievements, Ongoing Initiatives and Remaining Challenges. COM (2003) 726.

<sup>31</sup> A Commission non-paper to informal Ecofin Council, 10 and 11 September 2004 “A Common Consolidated EU Corporate Tax Base”

<sup>32</sup> Communication from the European Commission to the Council, the European Parliament and the Economic and Social Committee: Implementing the Community Lisbon Programme: Progress to date and next steps towards a common consolidated corporate tax base (CCCTB), Brussels, 05.04.2006, COM (2006) 157.

<sup>33</sup> European Commission (2004), *A common consolidated corporate tax base*, Commission non-paper to informal Ecofin Council, 10 and 11 September 2004. 7 July 2004. p.1.

<sup>34</sup> Mintz, J. And Werner, J.M. (2003), “Exploring Formula Allocation for the European Union” *International Tax and Public Finance* vol.10 pp. 695-711.

income taxation, and as such they have been subject to extensive interpretation by the European Court of Justice (ECJ).

The free movement principles prohibit discrimination and also ban the application of non-discriminatory restrictions of these freedoms. Non-discrimination is to be interpreted as to include both direct and indirect discrimination.<sup>35</sup> In certain cases the EC Treaty allows for exceptions from these requirements. The exceptions provided for in the Treaty are called explicit exceptions, and only these explicit exceptions can be applied when there is a case of direct discrimination.

In its case law the European Court of Justice has established a list of criteria that needs to be fulfilled by national legislation in order to constrain the Treaty freedoms in a legitimate way by indirectly discriminatory measures. The origins of this case law are in the early *Dassonville*<sup>36</sup> and *Cassis de Dijon*<sup>37</sup> cases, which established that for a national restrictive measure to be in line with the EC Treaty it has to comply with the following criteria: It has to be applied in a non-discriminatory manner; it has to be justified by imperative requirements in the general interest; it has to be suitable for securing the attainment of the objective it pursues; and it should not go beyond what is necessary to achieve that goal.<sup>38</sup>

The case law of the European court of Justice also provides guidance as to the acceptable grounds for restrictions. National tax provisions restricting the freedom of establishment under the case law of the ECJ are acceptable if they are aimed at safeguarding the cohesion of a tax system,<sup>39</sup> the fiscal principle of territoriality,<sup>40</sup> preventing tax evasion<sup>41</sup> or maintaining the effectiveness of fiscal supervision.<sup>42</sup> At the same time the Court rejected justifications such as the lack of harmonization, the lack of Community competence in tax treaty law, the loss of national tax revenues, the presence of counterbalancing advantages, and the possibility to set up a subsidiary in order to attain equal treatment.<sup>43</sup>

According to the case law of the Court, national tax laws can only restrict corporate transactions under tax avoidance provisions if they are motivated by no other valid economic reasons but to avoid tax burden. But as it was already mentioned at the outset, most relocations within the context of tax competition are motivated by a number of reasons, tax considerations being only one of these factors, which means that for purely tax avoidance reasons most restructurings cannot be prevented by national law.

---

<sup>35</sup> Direct discrimination means discrimination based on nationality, while indirect discrimination includes discrimination not referring to nationality itself, but to a relating criterion which will mostly be satisfied only by the nationals of that state (e.g. holding a diploma from a university of a certain Member State).

<sup>36</sup> *Dassonville* Case 8/74 [1974] ECR 00837.

<sup>37</sup> Case 120/78 *REWE-Zentral* ("Cassis de Dijon") [1979] ECR 649.

<sup>38</sup> see Case C-19/92 *Kraus v Land Baden-Württemberg* [1993] ECR I-1663, paragraph 32, and Case C-55/94 *Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano* [1995] ECR I-4165, paragraph 37 and Case C-212/97 *Centros* [1999] ECR I-1459, paragraph 34.

<sup>39</sup> Case C-204/90 *Bachmann* [1992] ECR I-249 and Case C-300/90 *Commission v Belgium* [1992] ECR I-305.

<sup>40</sup> E.g. in C-250/95 *Futura Participations and Singer* [1997] ECR I-249. It should be noted that the Court accepted in theory the fiscal principle of territoriality as an acceptable ground for restricting the Treaty freedoms without upholding the specific national provision on this ground in the given case.

<sup>41</sup> Case C-264/96 *Imperial Chemical Industries v. Colmer* [1998] ECR I-4695, paragraph 26, and *Metallgesellschaft and Others v. Commissioners of Inland Revenue and HM Attorney General* case C-397/98, [2001] ECR I-01727, paragraph 57.

<sup>42</sup> Case C-250/95 *Futura Participations SA and Singer v Administration des contributions* ECR 1997 page I-02471, paragraph 31, Case C-254/97 *Baxter and Others* [1999] ECR I-4809, paragraph 18; and Case 120/78 *REWE-Zentral* ('Cassis de Dijon') [1979] ECR 649, paragraph 8.

<sup>43</sup> See in general the following cases: Case 270/83 *Avoir Fiscal*; Case C-307/97 *Saint-Gobain*; Case C264/96 *ICI*.

In interpreting these provisions, the ECJ gave a narrow interpretation to the explicit exemptions to the free movement principles provided in the Treaty, the test for restricting these freedoms being rather stringent. The case law of the ECJ thus points towards a strengthening of corporate mobility rather than acknowledging extensive national sovereignty in the tax field.

### **3.6. Conclusions**

To conclude, the analysis in this section demonstrates that European law facilitates most cross-border transactions from a taxation perspective.

The Treaty does not contain provisions on direct taxation, but it gives powers to the Council and the Parliament to adopt secondary legislation in this field.

It could be expected then, that European harmonization by way of secondary legislation should create homogeneity among national rules, thus restricting tax competition. However, even directives are aimed at facilitating cross-border transactions,<sup>44</sup> rather than harmonizing taxation. Member States have preserved their discretion to set tax rates. This power will remain unchallenged even after the adoption of the Common Consolidated Corporate Tax Base.

Even the case law of the European Court of Justice, in interpreting the Treaty freedoms, does not restrict the scope of tax competition. Instead, EC law's impact through the case law of the Court achieves better market integration by eliminating national barriers to the freedom of establishment and the free movement of capital, leaving Member States with little power to prevent cross-border corporate relocations.<sup>45</sup>

So far the only instrument targeted directly at eliminating tax competition is the Code of Conduct on Business Taxation, a soft law instrument that tackles only special tax provisions, without touching upon the issue of tax competition through general provisions. This approach of harmonization implies that tax competition is not viewed as harmful to the extent it would trigger harmonizing measures at the European level. This finding is in line with previous literature examining the conditions and scope of European tax harmonization.<sup>46</sup>

## **4. Conclusions with regard to European policies' impact on relocations**

To assess the impact of tax policies on corporate restructurings this paper has made an inquiry into the economic literature on tax competition and looked at some empirical data. The analysis has shown that there is no conclusive evidence that would clearly support European harmonizing measures in the field of taxation, neither in order to prevent harmful tax competition leading to under-provision of public goods, nor to achieve a higher level of social protection. Instead, in the balance to be found between competitiveness and social protection, the field of corporate taxation can be instrumental to firms' competitiveness.

---

<sup>44</sup> See above the discussion on the Parent Subsidiary Directive, and the Mergers Directive. The Parent Subsidiary Directive abolished the withholding tax on dividends paid within European cross-border groups of companies. With regard to mergers and acquisitions the burden of paying exit taxes after retained profits was alleviated by the Mergers Directive, facilitating this type of cross-border transactions.

<sup>45</sup> For one example the case law of the ECJ established that transfer of shares to foreign persons or companies cannot be taxed more heavily than share transfers to nationals. See Case C-436/00 X and Y v Riksskatteverket, [2002] ECR I-1082, Judgment of 21 November 2002; and Case C-9/02 Hughes de Lasteyrie du Saillant v Ministère de l'Économie, des Finances et de l'Industrie, [2004] ECR 00000, Judgment of 11 March 2004.

<sup>46</sup> Bratton, W.W. and McCahery, J.A. (2001), "Tax Coordination and Tax Competition in the European Union: Evaluating the Code of Conduct on Business Taxation" *Common Market Law Review*, vol.38. pp. 677-718.

Empirical data indicates that with regard to tax rates a clear case for welfare decreasing tax competition cannot be proven. A review of existing literature on taxes' impact on FDI suggests that on average one percentage point of tax decrease attracts 3.2 percentage points more foreign direct investment to the country. In addition, market integration within the EU implies more export-oriented FDI, which is more sensitive to tax arrangements. Foreign direct investment data however does not perfectly correspond to the transactions relevant for the aims of this study: cross-border relocation of production activities, and cannot thus constitute a reliable tool for measuring tax policies impact on relocations. There is thus no sufficient evidence that tax competition would lead to welfare losses that would justify European harmonization in the field of taxation.

Indeed in balancing industry competitiveness and social protection, in the field of taxation European policy should be favouring the mobility of firms across borders rather than restricting their ability to locate in low tax jurisdictions. A review of European legal and non-legal instruments reveals that the European legislator in fact has taken this direction.

The current soft-legislation aimed at tackling harmful tax competition defines this concept with regard to specific tax measures, leaving the possibility for Member States to set their general tax base at the level they prefer.

With regard to national measures preventing corporate relocations, the case law of the Court of Justice also points in the direction of increased corporate mobility, by rejecting national justifications such as the loss of tax revenue to restrict the free movement of companies.

Although firms that engage in tax avoidance can be caught by national legislation and their free movement may be restricted, the definition of what constitutes tax avoidance does not include the relocation of economic activity. Therefore firms leaving one jurisdiction to locate in another with lower taxes cannot be held back under national (tax or other) legislation on the basis of loss of tax revenue or tax avoidance. The free movement provisions of the EC Treaty prevail in granting mobility to such firms.

The analysis has thus demonstrated that presently tax harmonization measures are not aimed at reducing the effect of taxes on restructurings. Furthermore, the trend of growing cross-border reorganisations is also reinforced by recent developments in company law, such as the adoption of the cross-border merger directive.

This policy approach in the field of taxation may have however unforeseen consequences on corporate relocations. This is due to the fact that there is an inverse relationship between profit shifting<sup>47</sup> and the relocation of economic activities. The explanation for this is that as long as companies can exploit possibilities of profit shifting, which entails the allocation of profit across entities within a cross-border corporate group, they are not induced to relocate their real economic activities. Profit shifting does not require a company to close down its production plant in its home state and locate it instead in another country with a lower corporate income tax rate.

It is likely however that, as the possibilities for profit shifting are being eliminated under national and European policies, more re-location of real economic activity may occur. This suggests that the developments of European policies in fighting profit shifting might induce more re-location of real activities within Europe.

To conclude, the impact of European policies in the field of direct taxation points in the direction of inducing more cross-border mobility of firms, rather than restricting it. Harmful tax competition and tax avoidance are targeted at both national and European level, however

---

<sup>47</sup> Profit shifting occurs when companies set up a new entity or organize their present corporate structure in a way that allows them to pay their taxes in a jurisdiction with lower tax burden.

these do not include relocation of real economic activity to other Member States. This policy direction is in line with the conclusions drawn in this paper that within the dual aims of labour protection and competitiveness tax policy is not the field for social protection measures, but instead the field in which the competitiveness of European firms are to be promoted.

## List of references

### Books and articles

- Bratton, W.W. and McCahery, J.A. (2001), "Tax Coordination and Tax Competition in the European Union: Evaluating the Code of Conduct on Business Taxation" *Common Market Law Review*, vol.38. pp. 677-718.
- Brennan, G. and Buchanan, J. (1980), *The Power to Tax: Analytical Foundations of a Fiscal Constitution* (Cambridge: Cambridge University Press).
- Craig, P. and De Búrca, G. (2002), *EU Law: text, cases and materials* (Oxford: OUP).
- Dahlberg, M. (2005) *Direct Taxation in Relation to the Freedom of Establishment and the Free Movement of Capital* (The Hague: KLI).
- Devereux, M.P. and Griffith, R. (2003), "Evaluating Tax Policy for Locational Decisions" *International Tax and Public Finance*, vol. 10. pp.107-126.
- Dunning, J.H. (1993). *Multinational Enterprises and the Global Economy* (Wokingham: Addison-Wesley).
- Enderwick, P. (2005), "Attracting Desirable FDI" *Transnational Corporations* vol. 14. no.2. pp.93-120.,
- Mieszkowski P. and Zodrow, G. "Pigou, Tiebout, Property Taxation and Under-Provision of Local Public Goods," *Journal of Urban Economics*, Vol. 19, no. 3. pp.356-370.
- Mintz, J. And Werner, J.M. (2003), "Exploring Formula Allocation for the European Union" *International Tax and Public Finance* vol.10 pp. 695-711.
- Nicodème, G. (2006), "Corporate Tax Competition and Co-ordination in the European Union: What Do We Know, Where Do We Stand?" Working paper, June 2006.
- Oats, W. E. (1999), "An Essay on Fiscal Federalism" *Journal of Economic Literature*, vol.37. p. 1120.
- Poynter, T.A. and White, R.E. (1984), "The strategies of foreign subsidiaries: responses to organisational slack", *International Studies of Management and Organisation*, 14(4), pp. 91-106.
- Tiebout, Ch. (1956), "A Pure Theory of Local Expenditures" *Journal of Political Economy*, vol.64. no.5. pp.416-424.
- Zodrow, G.R. (2003), "Tax Competition and Tax Coordination in the European Union" *International Tax and Public Finance*, vol. 10, pp. 651-671.

### European legislation and other official documents:

- European Economic and Social Committee (2005), "The Scope and Effects of Company Relocations" Own initiative opinion. CCMI/014. Brussels, 14 July 2005.
- Amendment of 1977 Directive on Mutual Assistance to combat tax fraud (2004/56/EC).
- Code of Conduct Group, (1999) *Code of Conduct on Business Taxation*, Press Release: Brussels (29-02-2000) - Nr: 4901/99
- Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee: *Towards an Internal Market Without Tax Obstacles*. COM (2001) 582.
- Communication from the European Commission to the Council, the European Parliament and the Economic and Social Committee: *Implementing the Community Lisbon Programme: Progress to date and next steps towards a common consolidated corporate tax base (CCCTB)*, Brussels, 05.04.2006, COM (2006) 157.
- Communication on *An Internal Market without Company Tax Obstacles: Achievements, Ongoing Initiatives and Remaining Challenges*. COM (2003) 726.

Communication on preventing and combating financial and corporate malpractice, COM (2004) 611.

Council Directive 69/335/EEC concerning indirect taxes on the raising of capital.

Directive on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different member states, Council Directive 90/434/EEC.

European Commission (2004), A common consolidated corporate tax base, Commission non-paper to informal Ecofin Council, 10 and 11 September 2004. 7 July 2004. p.1.

European Commission: Commission non-paper to informal Ecofin Council, 10 and 11 September 2004 “A Common Consolidated EU Corporate Tax Base”

European Union Savings Directive, council directive 2003/48/EC, effective from 1 January 2004.

**Case law:**

Case 120/78 REWE-Zentral (“Cassis de Dijon”) [1979] ECR 649.

Case 8/74 Dassonville [1974] ECR 00837.

Case C-19/92 Kraus v Land Baden-Württemberg [1993] ECR I-1663.

Case C-204/90 Bachmann [1992] ECR I-249.

Case C-212/97 Centros Ltd v Erhvervs-og Selskabsstyrelsen [1999] ECR I-1459.

Case C-250/95 Futura Participations SA and Singer v Administration des contributions [1997] ECR I-02471.

Case C-55/94 Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano [1995] ECR I-4165

Case C-254/97 Baxter and Others [1999] ECR I-4809.

Case C-264/96 Imperial Chemical Industries v. Colmer [1998] ECR I-4695.

Case C-436/00 X and Y v Riksskatteverket, [2002] ECR I-1082.

Case C-9/02 Hughes de Lasteyrie du Saillant v Ministère de l'Économie, des Finances et de l'Industrie [2004] ECR I-02409.

## Annex

### Tables:

**Table 1: Statutory corporate tax rates (including local taxes and surcharges)**

Statutory Corporate tax rates (including local taxes and surcharges)	1980	1990	1995	2000	2005
<b>Austria</b>	55	39	34	34	25
<b>Belgium</b>	48	41	40.17	40.17	33.99
<b>Cyprus</b>	n.a.	42.5	25	29	10
<b>Czech Republic</b>	n.a.	n.a.	41	31	26
<b>Denmark</b>	n.a.	40	34	32	30
<b>Estonia</b>	n.a.	n.a.	26	26	24
<b>Finland</b>	59	41	25	29	26
<b>France</b>	50	37	36.67	36.67	34.93
<b>Germany</b>	52.8	57.7	56.8	51.63	38.29
<b>Greece</b>	43.4	46	40	40	35
<b>Hungary</b>	n.a.	50	19.64	19.64	17.68
<b>Ireland</b>	45	43	40	24	12.5
<b>Italy</b>	36.3	41.8	52.2	41.25	37.25
<b>Latvia</b>	n.a.	n.a.	25	25	15
<b>Lithuania</b>	n.a.	35	29	24	15
<b>Luxembourg</b>	n.a.	39.4	40.9	37.45	30.38
<b>Malta</b>	n.a.	32.5	35	35	35
<b>Netherlands</b>	48	35	35	35	31.5
<b>Poland</b>	n.a.	40	40	30	19
<b>Portugal</b>	n.a.	36.5	39.6	35.2	27.5
<b>Slovak rep.</b>	n.a.	n.a.	40	29	19
<b>Slovenia</b>	n.a.	n.a.	25	25	25
<b>Spain</b>	33	35	35	35	35
<b>Sweden</b>	n.a.	40	28	28	28
<b>United Kingdom</b>	52	34	33	30	30
EU-15 average	n.a.	40.4	38.0	35.3	30.4
new Member States -10 average	n.a.	n.a.	30.6	24.8	18.2

Source: IBFD and own calculations. Estonia: 0% on retained earnings.

/source: Nicodeme, G. (2006)/

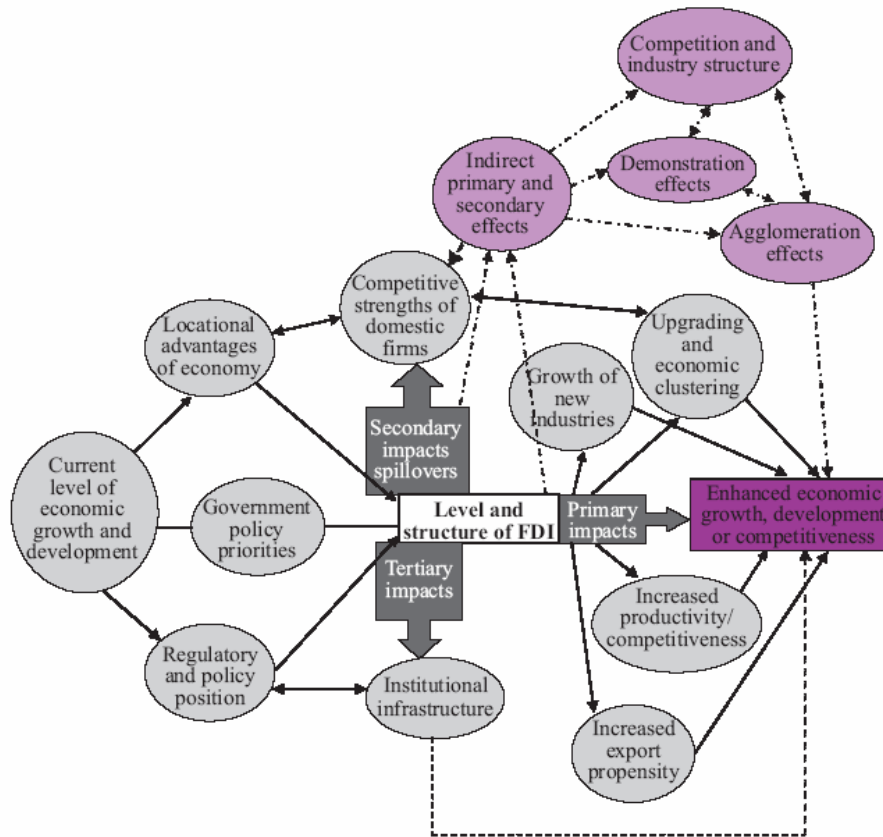
**Table 2: Summary statistics of the studies in the meta sample of De Mooij and Ederveen's study**

	Number of elasticities	Mean semi-elasticity	Median	Maximum	Minimum	Standard deviation
1 Hartman, 1984	6	-2.6	-3.5	2.0	-4.0	2.3
2 Bartik, 1985	3	-6.9	-6.6	-5.7	-8.5	1.4
3 Boskin and Gale, 1987	12	-5.8	-2.7	0.3	-21.2	7.6
4 Newlon, 1987	2	-0.4	-0.4	3.5	-4.3	5.5
5 Young, 1988	12	-1.1	-2.1	5.3	-9.2	4.2
6 Murthy, 1989	4	-0.6	-0.7	0.5	-1.6	1.0
7 Slemrod, 1990	58	-5.5	-3.5	17.8	-84.5	14.4
8 Grubert and Mutti, 1991	6	-1.7	-1.6	-0.6	-3.3	1.2
9 Papke, 1991	2	-4.9	-4.9	-0.9	-8.8	5.6
10 Hines and Rice, 1994	4	-10.7	-5.0	-1.2	-31.7	14.1
11 Jun, 1994	10	-0.5	-1.3	5.9	-5.4	3.2
12 Swenson, 1994	10	1.3	2.7	5.1	-8.1	4.3
13 Devereux and Freeman, 1995	4	-1.6	-1.6	-1.4	-1.7	0.1
14 Hines, 1996	46	-10.9	-10.2	-1.1	-36.7	8.2
15 Pain and Young, 1996	6	-1.5	-1.4	-0.4	-2.8	1.2
16 Cassou, 1997	17	-7.5	-2.8	3.1	-44.7	13.5
17 Shang-Jin, 1997	5	-5.2	-5.0	-4.7	-6.2	0.6
18 Devereux and Griffith, 1998b	10	-0.8	-0.9	0.0	-1.2	0.4
19 Billington, 1999	2	-0.1	-0.1	-0.1	-0.1	0.0
20 Broekman and van Vliet, 2000	3	-3.3	-3.5	-2.5	-4.0	0.8
21 Gorter and Parikh, 2000	15	-4.5	-4.3	4.2	-14.3	4.2
22 Grubert and Mutti, 2000	15	-4.0	-4.2	-1.7	-5.8	1.2
23 Altshuler, Grubert and Newton, 2001	20	-2.7	-2.6	-1.4	-4.0	0.8
24 Benassy-Quere, Fontagne and Lahreche-Revil, 2001	4	-5.0	-5.0	-2.2	-7.9	3.0
25 Swenson, 2001	95	-3.9	-3.2	8.0	-29.9	8.4
	371	-4.7	-3.2	17.8	-84.5	9.0

/source: DeMooij and Ederveen (2003) p.682./

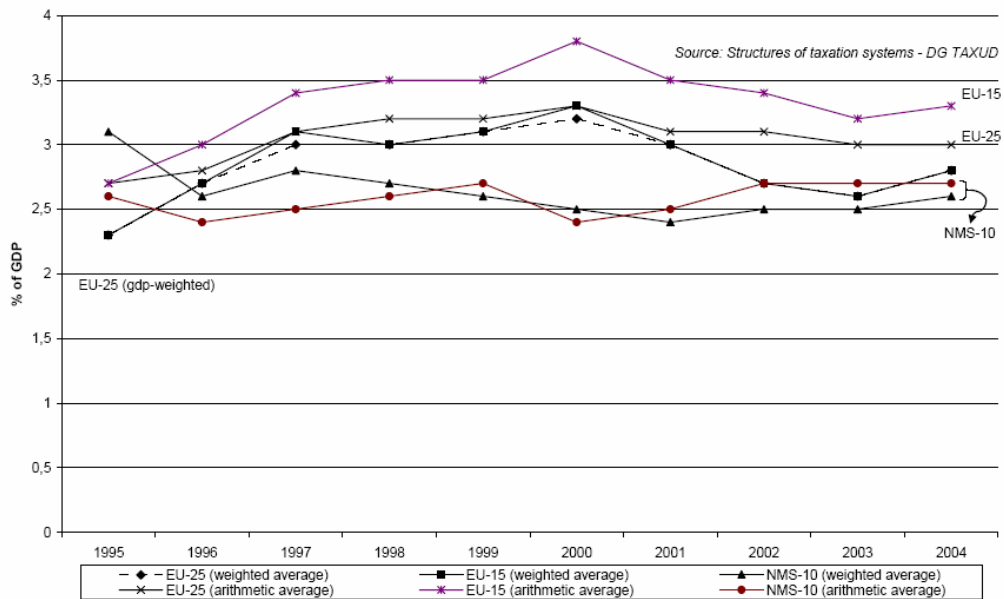
**Figures:**

**Figure 1: The impact of FDI in theory**



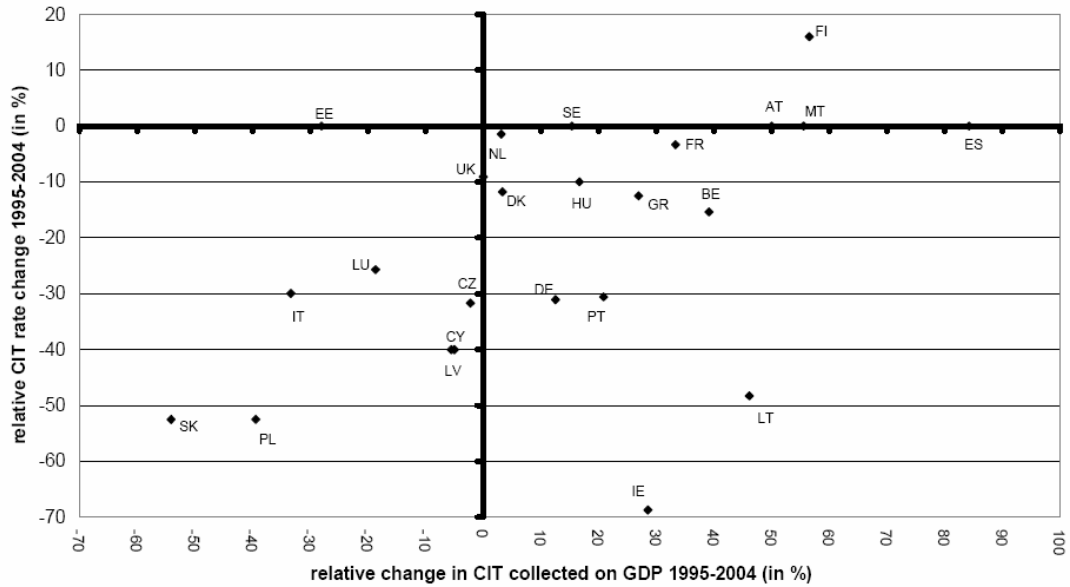
/source: Enderwick, P. (2005) p.102./

**Figure 2: Taxes on incomes of corporations as percentage of GDP 1995-2004**



/Source: Nicodeme, G. (2006)/

**Figure 3: Evolution of corporate tax rates and revenues in percentage of GDP 1995-2004**

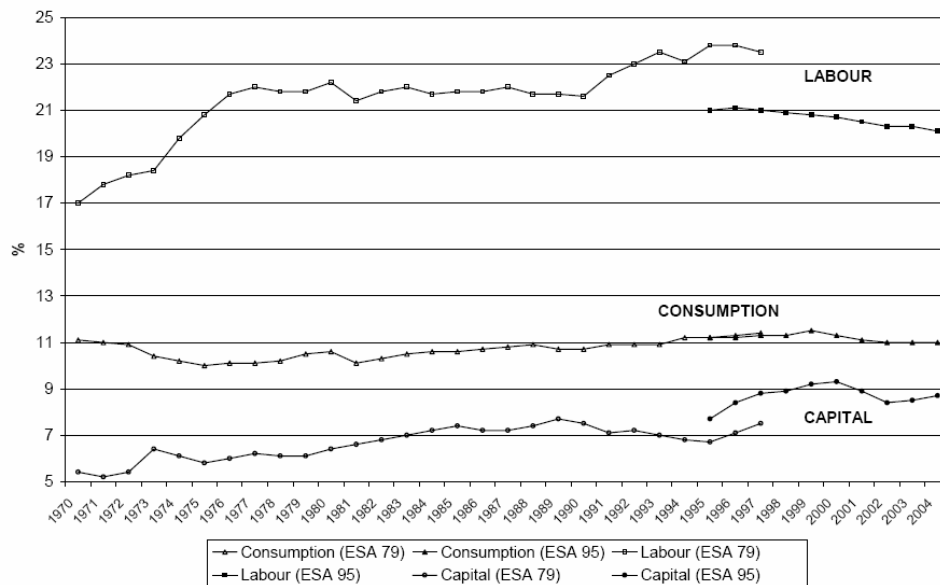


Source: European Commission and own calculations

SI: no change in CIT rate but a 233% increase in revenues

/Source: Nicodeme, G. (2006)/

**Figure 4: Taxes (and social security contributions) as % of GDP according to economic functions**



Source: European Commission (2006a). Statistical break due to a change in classification at Eurostat.

/Source: Nicodeme, G. 2006, p. 9./