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**Harmful tax competition in the East African community:
the case of Rwanda with reference to EU and OECD
approaches**

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4 OECD AND EU APPROACHES TO HARMFUL TAX PRACTICES

Because of the negative consequences associated with harmful tax practices, it is agreed-upon that they should be avoided as much as possible. Such negative consequences include undermining the integrity and fairness of tax systems, discouraging tax compliance, and shifting the tax burden to less mobile tax bases.⁶⁰ In response to these negative consequences, strategic measures have been developed globally, aimed to combat harmful tax practices. Many institutions and organizations have also united to curb harmful tax practices. For example, the OECD and the EU are constantly engaged in developing measures to curb harmful tax practices. Their efforts are the subject of this chapter.

The aim of this chapter is to provide an overview of the OECD's and EU's assessments of harmful tax practices. It begins with the OECD works against harmful tax practices, with a focus on the 1998 Report on harmful tax competition and other reports that followed. It then analyses the EU's approaches to harmful tax practices, followed by a comparison of the factors of harmful tax competition between the two institutions. The chapter ends with an examination of the OECD and EU contributions to the study of harmful tax practices and their merits and demerits for developing countries.

4.1. OECD 1998 Report on harmful tax competition

As part of its mandate to address international economic issues, the OECD has undertaken several works in the field of international taxation and has studied many tax topics, including harmful tax competition. The OECD's preoccupation with harmful tax competition began in the early 1970s with its works on tax havens.⁶¹ Its works continued with the 1998 Project and were recently expanded with the 2013 BEPS Project. The focus of this section is on the 1998 Report on harmful tax competition. In this respect, the following paragraphs discuss the 1998 Report itself, its praise and criticism, the reports that followed it, and the key factors developed by the OECD to identify tax havens and HPTRs.

⁶⁰ OECD (1998), *Harmful Tax Competition: An Emerging Global Issue*, OECD Publishing, p. 16; A W Oguttu, 'Tax Base Erosion and Profit Shifting in Africa: Africa's Response to the OECD BEPS Action Plan' (2016) ICTD WP 54, p. 9 <https://opendocs.ids.ac.uk/opendocs/bitstream/handle/20.500.12413/12802/ICTD_WP54.pdf> accessed 24/10/2019.

⁶¹ A P Morriss and L Moberg, 'Cartelizing Taxes: Understanding the OECD's Campaign against Harmful Tax Competition' (2012) *CJTL* 4(1), p. 33.

4.1.1. OECD 1998 Report in brief

The 1998 OECD Report is the result of a project that began in May 1996.⁶² The project was completed in January 1998, and the OECD Council endorsed it in April 1998.⁶³ The project's main objective was to develop a better global understanding of harmful tax practices.⁶⁴ It was triggered by concerns about the emergence of harmful tax competition between countries that use tax schemes to attract financial and mobile activities, leading to risks of trade and investment distortions along with the erosion of national tax bases.⁶⁵ Considering tax base erosion as a threat to tax revenues, tax sovereignty, and tax fairness,⁶⁶ the project's goal was:

To develop a better understanding of how tax havens and harmful preferential tax regimes affect the location of financial and other service activities, erode the tax bases of other countries, distort trade and investment patterns and undermine the fairness, neutrality, and broad social acceptance of tax systems generally.⁶⁷

The project was based on the fact that countries' tax bases were at risk of being eroded. In this regard, it was said that:

Governments cannot stand back while their tax bases are eroded through the actions of countries which offer taxpayers ways to exploit tax havens and preferential regimes to reduce the tax that would otherwise have been payable.⁶⁸

Thus, the 1998 OECD Report identified six problems caused by harmful tax competition, namely:

(1) distortion of the financial, and, indirectly real investment flows; (2) undermining the integrity and fairness of tax structures; (3) discouraging compliance by all taxpayers; (4) re-shaping the desired level and mix of taxes and public spending; (5) causing undesired shifts of the tax burden to less mobile tax bases, such as labor, property, and consumption; and (6) increasing the administrative costs and compliance burdens on tax authorities and taxpayers.⁶⁹

⁶² M Littlewood, 'Tax Competition: Harmful to Whom?' (2004) *MichJIntlL* 26(1), p. 417.

⁶³ *Id.*, p. 419.

⁶⁴ J G Salinas, 'The OECD Tax Competition Initiative: A Critique of its Merits in the Global Marketplace' (2003) *Hous.J.Int'lL*. 25(3), p. 539; H M Liebman, W Heyvaert and V Oyen, 'Countering Harmful Tax Practices: BEPS Action 5 and EU Initiatives – Past Progress, Current Status and Prospects' (2016) *Euro.Tax.*, p. 102.

⁶⁵ Communiqué issued by G7 Heads of State at their 1996 Lyon Summit, in OECD 1998 Report (n 60) p. 7.

⁶⁶ Oguttu, BEPS in Africa (n 60) p. 6.

⁶⁷ OECD 1998 Report (n 60) p. 8; F Boulogne, 'Reviewing the OECD's and the EU's Assessment of Singapore's Development and Expansion Incentive' (2019) SMU Sch. of Accountancy Research Paper 7(1), p. 12 <<http://dx.doi.org/10.2139/ssrn.3349404>> accessed 14/08/2019.

⁶⁸ OECD 1998 Report, *Id.*, p. 37.

⁶⁹ *Id.*, p. 16.

The report also elaborated on the components of harmful tax practices, namely tax havens and HPTRs. It also identified the factors that determine whether a regime is harmful or not.

The Report's geographic scope was worldwide with respect to tax havens and OECD members' territories with respect to HPTRs.⁷⁰ Even so, the Report encouraged non-OECD members to embrace the OECD's campaign against HPTRs.⁷¹ This makes the geographic scope of application wider in the cases of tax havens than in the cases of HPTRs. This difference is partly due to the weight given to the fight against tax havens compared to HPTRs. Indeed, tax havens look worse than HPTRs.

Regarding the scope *ratione materiae*, the 1998 OECD Report covers only 'geographically mobile activities, such as financial and other service activities, including the provision of intangibles'.⁷² The Report considers the location of financial and other service activities as the top problems or consequences of harmful tax practices.⁷³ In contrast, tax measures that favor manufacturing activities and tax measures in relation to indirect taxation are outside the scope of the 1998 OECD Report.⁷⁴ Similarly, the OECD, through the Forum on Harmful Tax Practices, has continued to exclude non-geographically mobile activities, whose risk of base erosion is low.⁷⁵

Moreover, a PTR given to promote activity in a particular economic sector, even if it includes geographically mobile activities, is not harmful as long as it is not ring-fenced.⁷⁶ That is, if the primary objective of a particular regime is not to aggressively bid for other countries' tax bases, the regime is not harmful.⁷⁷ Thus, the OECD's main objective is not and has not been

⁷⁰ Id., p. 37; I Calich, *The Impact of Globalization on the Position of Developing Countries in the International Tax System* (Ph.D Thesis, LSE 2011), p. 64; J Englisch and A Yevgenyeva, 'The Upgraded Strategy against Harmful Tax Practices under the BEPS Action Plan' (2013) *British L.Rev.* 5, p. 626.

⁷¹ OECD 1998 Report (n 60) p. 37; OECD (2004), *Consolidated Application Note in Applying the 1998 Report to Preferential Tax Regimes*, OECD Publishing, p. 20 [OECD CAN].

⁷² OECD CAN, *ibid*; C Pinto, 'EU and OECD to Fight Harmful Tax Competition: Has the Right Path Been Undertaken?' (1998) *Intertax* 26(12), p. 390; R S Avi-Yonah, 'Bridging the North/South Divide: International Redistribution and Tax Competition' (2004) *MichJIntlL* 26, p. 385; H J Ault, 'Tax Competition and Tax Cooperation: A Survey and Reassessment' in J Monsenego and J Bjuvberg (eds), *International Taxation in a Changing Landscape* (Wolters Kluwer 2019), p. 2.

⁷³ OECD 1998 Report (n 60) p. 8.

⁷⁴ Pinto, EU and OECD (n 72) p. 390; Avi-Yonah, Bridging the north/south divide (n 72) p. 385.

⁷⁵ OECD (2019), *Harmful Tax Practices – 2018 Progress Report on Preferential Regimes: Inclusive Framework on BEPS Action 5*, OECD Publishing, p. 13; W Gilmore, 'The OECD, Harmful Tax Competition and Tax Havens: Towards an Understanding of the International Legal Context' (2001) *Commonwealth Law Bulletin* 27(1), p. 551.

⁷⁶ OECD CAN (n 71) p. 20.

⁷⁷ Englisch and Yevgenyeva (n 70) p. 626.

to discourage countries to introduce or maintain PTRs.⁷⁸ Indeed, tax regimes are not a problem as long as they are not ring-fenced.

Separate from this, but closely related, is the OECD's that harmful tax competition negatively affects global welfare. Thus, the OECD believes that eliminating harmful tax competition would contribute positively to global welfare.⁷⁹ This view justifies the OECD's efforts in adjusting tax rates by restraining countries from lowering their rates as well as encouraging low-tax jurisdictions to raise their rates.⁸⁰

Nevertheless, the OECD's focus was not on statutory tax rates, but on low effective tax rates. This focus justifies the OECD's consideration of transparency and effective EoI as important tools in the fight against harmful tax regimes.⁸¹ Even though, transparency and the right to privacy are at odds with each other. The same is true for EoI vis-à-vis state tax sovereignty. Such issues and other criticisms were raised against the 1998 OECD Report. However, it also received some praise.

4.1.2. Praise and criticism of the 1998 OECD Report

The 1998 OECD Report was highly divisive,⁸² with ups and downs,⁸³ and extremely controversial⁸⁴ with two diverging views: success (praise) and failure (criticisms).⁸⁵ Both are discussed below.

4.1.2.1. Praise

In general, and not surprisingly, the project was widely supported and welcomed by the OECD members. This is quite understandable given that the Project was commissioned by a group of powerful countries, all members of the OECD. Indeed, one trigger of the project is a communiqué issued by the G7 Heads of State at the 1996 Lyon Summit. The communiqué stated:

⁷⁸ OECD CAN (n 71) p. 20 and 24; S Bond et al., *Corporate Tax Harmonization in Europe: A Guide to the Debate* (2000) The Institute for Fiscal Studies, London, p. 62 <www.ifs.org.uk/comms/r63.pdf> accessed 24/08/2019; L B Samuels and D C Kolb, 'The OECD Initiative: Harmful Tax Practices and Tax Havens' (2001) *Taxes* 79(231), p. 232.

⁷⁹ OECD 1998 Report (n 60) p. 16.

⁸⁰ Morriss and Moberg (n 61) p. 1.

⁸¹ Samuels and Kolb (n 78) p. 234.

⁸² Salinas (n 64) p. 552.

⁸³ Morriss and Moberg (n 61) p. 62.

⁸⁴ M Orlov, 'The Concept of Tax Haven: A Legal Analysis' (2004) *Intertax* 32(2), p. 104; B J Arnold, *International Tax Primer* (3rd edn, Kluwer Law International 2016), p. 185.

⁸⁵ R S Avi-Yonah, 'The OECD Harmful Tax Competition Report: A Tenth Anniversary Retrospective' (2009) *BrookJIntlL* 34(3), p. 783.

Finally, globalization is creating new challenges in the field of tax policy. Tax schemes aimed at attracting financial and other geographically mobile activities can create harmful tax competition between states, carrying risks of distorting trade and investment and could lead to the erosion of national tax bases. We strongly urge the OECD to vigorously pursue its work in this field, aimed at establishing a multilateral approach under which countries could operate individually and collectively to limit the extent of these practices.⁸⁶

Although not all OECD members are part of the G7, the fact that all G7 members are members of the OECD is significant to the OECD's dominance. In this sense, it has been said that, historically, the G7 always influences the OECD.⁸⁷ This close relationship between the OECD and the G7 was also seen in a meeting of OECD ministers and G7 Heads of State held in 1997, before the publication of the Report, where the importance of tackling harmful tax competition was reiterated.⁸⁸

After the Report was published in 1998, it received numerous praise. For example, following its 15th recommendation, the Forum on Harmful Tax Practices was established to monitor further harmful tax practices. This Forum is praised for coordinating and furthering knowledge in the fight against harmful tax practices.⁸⁹ It is also believed that, if the OECD had not put pressure on tax havens, many of the OECD citizens would have transferred their funds to tax havens.⁹⁰

The 1998 OECD Report is also praised for being the first to identify the problems of tax havens and HPTRs.⁹¹ It also provided the basis for the international community to develop the rules of the international tax game, such as the rules on effective EoI and transparency.⁹² In addition, the 1998 OECD Project has been described as a reasonable response⁹³ and is

⁸⁶ S Jogarajan and M Stewart, 'Harmful Tax Competition: Defeat or Victory?' (2007) *Austl. Tax. F.* 22, p. 5; K van Raad, *Materials on International & EU Tax Law* (13th edn, International Tax Center 2013), p. 1309; OECD, Confidential draft Recommendation on Counteracting Harmful Tax Competition, C(98)17 (17 Feb. 1998), p. 3, <[https://one.oecd.org/document/C\(98\)17/en/pdf](https://one.oecd.org/document/C(98)17/en/pdf)> accessed 29/08/2021.

⁸⁷ Morriss and Moberg (n 61) p. 41.

⁸⁸ OECD 1998 Report (n 60) p. 7; Littlewood (n 62) p. 418.

⁸⁹ H M Liebman, W Heyvaert and V Oyen, 'Countering Harmful Tax Practices: BEPS Action 5 and EU Initiatives – Past Progress, Current Status and Prospects' (2016) *Euro. Tax.*, p. 103.

⁹⁰ Avi-Yonah, OECD HTC Report (n 85) p. 792.

⁹¹ *Id.*, p. 783.

⁹² Orlov (n 84) p. 104 and 108.

⁹³ Orlov, *Id.* p. 95; Samuels and Kolb (n 78) p. 255; A Townsend, 'The Global Schoolyard Bully: The Organization for Economic Cooperation and Development's Coercive Efforts to Control Tax Competition' (2001) *FordhamInt'l L.J.* 25(1), p. 234; A W Oguttu, *Curbing Offshore Tax Avoidance: The Case of South African Companies and Trusts* (Ph.D Thesis, UNISA 2007), p. 32 and 43.

considered having gained the status of soft law.⁹⁴ The OECD was also commended for having played a leading role among other international initiatives, and its work was lauded as a proper, direct onslaught on tax havens⁹⁵ and a general assault on tax competition.⁹⁶

Moreover, the OECD project on harmful tax competition played an important role in waking up the world that noticed harmful tax competition as a serious issue. In this context, the OECD openly fought against harmful tax practices and laid down factors to determine whether a regime is harmful. Another achievement of the Report is that the Forum on Harmful Tax Practices review processes have abolished or amended some harmful tax practices. Not only that, but the Forum on Harmful Tax Practices review processes might have aborted some embryonic harmful tax practices. In addition, the OECD project has sparked academic discussions on harmful tax practices, which have contributed to research on the topic. However, although the OECD project gained widespread support, it also received some criticisms as detailed below.

4.1.2.2. Criticisms

Considering its origins, the OECD project on tax competition is said to have been designed primarily to satisfy the interests and benefits of the G7 and other like-minded OECD members.⁹⁷ Similarly, the project has been accused of manipulation by the high-tax OECD members.⁹⁸ Connected to that, the Report was seen as a way for high-tax jurisdictions to eliminate competition from low-tax jurisdictions by forcing them to raise their tax rates.⁹⁹ However, the OECD categorically objected to that allegation and insisted that it had no intention to impose

⁹⁴ J McLaren, 'The OECD's Harmful Tax Competition Project: Is it International Tax Law' (2009) *Austl. Tax. F.* 24, p. 436 and 452.

⁹⁵ Orlov (n 84) p. 95; Oguttu, *Curbing Offshore Tax Avoidance* (n 93) p. 32 and 43.

⁹⁶ Townsend (n 93) p. 234.

⁹⁷ Littlewood (n 62) p. 418 and 442; Calich (n 70) p. 67.

⁹⁸ Morris and Moberg (n 61) p. 3; R Sanders, 'The Fight against Fiscal Colonialism: The OECD and Small Jurisdictions' (2002) *The Round Table* 365, p. 330; A F Abbott and D R Burton, 'Apple, State Aids, Tax Competition, and the Rule of Law' (2017) *Backgrounders* 3204, p. 8.

⁹⁹ Samuels and Kolb (n 78) p. 254.

tax rates on sovereign states or to prescribe how a tax system should be structured.¹⁰⁰ Rather, it emphasized the promotion of an environment of free and fair tax competition.¹⁰¹

The 1998 OECD report was also criticized for not gaining support from some of its members, as both Switzerland and Luxembourg opposed it. Their opposition was mainly due to their economic reliance on their secrecy reputation built on confidentiality, which could be jeopardized if they committed to the 1998 OECD report.¹⁰² Not only these two countries, but also the US gave no support, even though they signed it.

Indeed, some Americans, despite being a member of the OECD and the G7, voiced their criticisms mostly in the name of protecting tax sovereignty. They argued that the OECD has no right to dictate tax policy to sovereign nations and saw the OECD's acts as a threat and encroachment to countries' fiscal sovereignty to determine their own tax affairs.¹⁰³ Similarly, some members of the US Congress expressed negative views about the OECD report, and called it a major threat to national sovereignty.¹⁰⁴ The US officially recognized that the OECD Project's aim was to harmonize world tax systems and declared its defiance to that aim.¹⁰⁵ More specifically, the US Secretary of the Treasury stated:

The United States does not support efforts to dictate to any country what its own tax rates or tax system should be, and will not participate in any initiative to harmonize world tax systems

.....¹⁰⁶

¹⁰⁰ OECD (2001), *The OECD's Project on Harmful Tax Practices: The 2001 Progress Report*, OECD Publications, p. 4; OECD (2004), *The OECD's Project on Harmful Tax Practices: The 2004 Progress Report*, OECD Publications, p. 4; OECD (2006), *The OECD's Project on Harmful Tax Practices: The 2006 Progress Report*, OECD Publications, p. 3; OECD (2015), *Countering Harmful Tax Practices More Effectively Taking into Account Transparency and Substance: Action 5 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, p. 14; R M Hammer and J Owens, 'OECD: Promoting Tax Competition' (2001) *Int'l Tax Rev.* 12(5), p. 46; D Mitchell, 'Between the Lines: Havens can wait' (2002) *Foreign Policy* 131, p. 71; P Lampreave, 'Fiscal Competitiveness versus Harmful Tax Competition in the European Union' (2011) *BFIT* 65(6), p. 5.

¹⁰¹ OECD 2001 progress report, *ibid.*

¹⁰² Morriss and Moberg (n 61) p. 47; Sanders (n 98) p. 330; J Owens and R McDonell, 'Inter-agency Cooperation and Good Tax Governance in Africa: An Overview' in J Owens et al. (ed.), *Inter-agency Cooperation and Good Tax Governance in Africa* (PULP 2017), p. 3.

¹⁰³ Owens and McDonell, *ibid.*; D M Ring, 'What's at Stake in the Sovereignty Debate: International Tax and the Nation-State' (2008) *Va.J.Int'l L.* 49(1), p. 27; G Nicodème, 'On Recent Developments in Fighting Harmful Tax Practices' (2009) *Nat'l Tax J.* 62(4), p. 763.

¹⁰⁴ Ring, *id.*, pp. 192-93.

¹⁰⁵ A Hishikawa, 'The Death of Tax Havens' (2002) *BCInt'l&CompLRev.* 25(389), p. 412; P O'Neil, 'Commentary: Confronting OECD's 'Harmful' Tax Approach' *The Washington Times* (11/05/2001), A17 <www.uniset.ca/microstates/oneill.pdf> accessed 25/08/2019; US Department of the Treasury, 'Treasury Secretary O'Neill Statement on OECD Tax Havens', 10/05/2001 PO-366 <www.treasury.gov/press-center/press-releases/Pages/po366.aspx> accessed 17/04/2020.

¹⁰⁶ O'Neil, *ibid.*; US Department, *ibid.*

To a greater or lesser extent, the lack of support from the three countries could be associated in one way or another with the fact that they also engage in behavior similar to that condemned by the OECD. This gave rise to another criticism of the OECD, which condemns the behavior of some countries while its members engage in the same behavior. An example of this is the US, which is considered by some to be the world's largest tax haven, as several of its states, such as Delaware, Nevada, and Wyoming, are known for offering secret services and favorable tax treatment to non-resident foreigners.¹⁰⁷

The OECD has also been criticized and accused of attempting to form a system of global tax cartels in which countries would all tax at the same rate and in the same way, which would be a disaster for taxpayers.¹⁰⁸ However, the OECD has on several occasions denied any intention to promote tax harmonization, and has contended that there is no reason for two or more countries to have the same level of taxation.¹⁰⁹ Moreover, the OECD project against harmful tax competition has been seen as a form of neo-colonialism by the world's wealthiest countries, attempting to dictate their will to powerless poor nations, bludgeoning them into submission.¹¹⁰ This was further described as, if successful, a kind of forced concession of autonomy and a subversive attack on the sovereignty of poor nations.¹¹¹

Another criticism of the OECD Report is its failure to adequately explicate the problem of tax competition, alongside other non-determinant elements such as a low-tax rate.¹¹² On this account, the 1998 Report was criticized for its vagueness in not specifying what a nominal tax

¹⁰⁷ Morriss and Moberg (n 61) p. 44; Mitchell (n 100) p. 71; R A Johnson, 'Why Harmful Tax Practices will Continue after Developing Nations Pay: A Critique of the OECD's Initiative Against Harmful Tax Competition' (2006) *BCThirdWorldL.J.* 26(2), p. 365.

¹⁰⁸ Abbott and Burton (n 98) p. 1; K Carlson, 'When Cows Have Wings: An Analysis of the OECD's Tax Haven Work as it Relates to Favor, Sovereignty and Privacy' (2002) *J.MarshallL.Rev.* 35(163), pp. 174-75.

¹⁰⁹ OECD 1998 Report (n 60) p. 5 and 15; OECD (2000), *Towards Global Tax Co-operation: Progress in Identifying and Eliminating Harmful Tax Practices*, Report to the 2000 Ministerial Council Meeting and Recommendations by the Committee on Fiscal Affairs, OECD Publications, p. 5; Samuels and Kolb (n 78) p. 235; W S Clark, 'Tax Incentives for Foreign Direct Investment: Empirical Evidence on Effects and Alternative Policy Options' (2000) *CTJ/RFC* 48(4), p. 1175; J M Mintz and M Smart, 'Recent Developments in Tax Coordination: A Panel Discussion by Bev Dahlby, Robert Henry, Michael Keen, and David E. Wildasin' (2000) *CTJ/RFC* 48(2), p. 401.

¹¹⁰ Sanders (n 98) p. 326; Arnold (n 84) p. 185; J Dabner, 'The Legacy of the OECD's Harmful Tax Practices Initiative: Implications for Australia and Vanuatu' (2004) *APJT* 8(4), p. 77; B Maurer, 'From the Revenue Rule to Soft Law and Back Again: The Consequences for 'Society' of the Social Governance of International Tax Competition' in F V Benda-Beckmann, K V Benda-Beckmann and J Eckert (eds), *Rules of Law and Laws of Ruling: On the Governance of Law* (Ashgate Publishing 2009), p. 226.

¹¹¹ Morriss and Moberg (n 61) p. 3; W B Vlcek, *Small States and the Challenge of Sovereignty: Commonwealth Caribbean Offshore Financial Centers and Tax Competition*, (Ph.D Thesis, Univ.London 2006), p. 135.

¹¹² W B Barker, 'Optimal International Taxation and Tax Competition: Overcoming the Contractions' (2002) *Nw.J.Int'lL. & Bus.* 22(161), p. 170.

rate is or an exact figure or range of low-tax rates that qualify as harmful tax competition.¹¹³ In response, the OECD clarified that there is no explicit or implicit general minimum effective tax rate below which it would constitute harmful tax competition.¹¹⁴ Nevertheless, the lack of an exact explanation was considered crucial, considering that the Report identifies a low-tax rate as the most important element to qualify a regime as a tax haven or HPTR.¹¹⁵

By the same token, the lack of substantial economic activities was qualified as not determinative.¹¹⁶ The OECD has largely accepted this and in its 2001 progress report dropped the criterion of requiring substantial activity for the reason of being difficult to find out when and whether local activities are substantial.¹¹⁷ The 1998 OECD report was also criticized for failing to define what harmful tax competition is. This was described as a case of ‘confusion and puzzle’.¹¹⁸

Furthermore, the OECD Report was criticized for talking about base erosion as a result of harmful tax practices without providing numerical evidence on the alleged erosion. In this regard, it was described as ‘unfortunate’ that the OECD does not provide numerical data to bolster the claim of tax base erosion.¹¹⁹ It seems that the OECD anticipated this criticism by mentioning the unavailability of data as a limitation.¹²⁰ However, this excuse does not invalidate the criticism.

Another criticism concerns the scope of application of the 1998 OECD Report. In the Report, the OECD itself extends its scope to include its members, non-members, and their dependencies.¹²¹ Although the OECD justifies its extension on the basis of the global nature of tax competition,¹²² extending the scope to a non-member sovereign country may violate state

¹¹³ Salinas (n 64) p. 555; Townsend (n 93) p. 239.

¹¹⁴ OECD 2018 Progress report (n 75) p. 20.

¹¹⁵ OECD 1998 Report (n 60) p. 21-22 and 25; OECD 2001 progress report (n 100) p. 5; Littlewood (n 62) p. 424; M F Ambrosanio and M S Caroppo, ‘Eliminating Harmful Tax Practices in Tax Havens: Defensive Measures by Major EU Countries and Tax Haven Reforms’ (2005) *CTJ/RFC* 53(3), p. 689.

¹¹⁶ Salinas (n 64) p. 555.

¹¹⁷ OECD 2001 progress report (n 100) p. 10; C Pinto, *Tax Competition and EU Law* (Ph.D Thesis, UVA 2002), p. 226; J Akhtar and V Grondona (2019), ‘Tax Haven Listing in Multiple Hues: Blind, Winking or Conniving?’, South Centre Research Papers 94, p. 5 <https://southcentre.int/wp-content/uploads/2019/04/RP94_Tax-Haven-Listing-in-Multiple-Hues-Blind-Winking-or-Conniving_EN.pdf> accessed 16/05/2019.

¹¹⁸ Pinto, Id., p. 217.

¹¹⁹ R S Avi-Yonah, ‘Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State’ (2000) *HarvLRev* 113(7), p. 1597.

¹²⁰ OECD 1998 Report (n 60) p. 17.

¹²¹ Id., p. 8.

¹²² Salinas (n 64) p. 548.

sovereignty.¹²³ This consideration motivated to call the OECD's actions as tyrannical.¹²⁴ In this context, it is worth noting that the OECD itself was skeptical that non-members would disagree with its report.¹²⁵ In addition to issues of sovereignty violation, it was claimed that the EoI and transparency also violate privacy rights.¹²⁶

Another criticism of the 1998 OECD Report concerned its enforcement mechanisms. Without a legally established legal order with legal enforcement mechanisms, the OECD used the strategy of blacklisting combined with coordinated threats of sanctions, as a way of coercing states that engage in harmful tax practices to adopt compliant behavior.¹²⁷ This enforcement mechanism has been negatively labeled with words and phrases such as 'naming and shaming', 'stigmatizing', 'threatening', 'coercing', etc.¹²⁸

Despite these criticisms, the OECD Report on harmful tax competition has generally gained success worldwide, and it is frequently referred to in the regulation of tax competition. Following this Report, the OECD's works continued through the Forum on Harmful Tax Practices, whose progress reports are discussed below.

4.1.3. OECD progress reports and BEPS Project

The OECD's work on harmful tax practices did not end with the 1998 Report. It continued with further reports, called progress reports. In this context, two years after the 1998 Report, the OECD published a report on progress in identifying and eliminating harmful tax practices.¹²⁹ This Progress Report was a follow-up to the 1998 Report's recommendations to establish a forum to review jurisdictions with harmful tax competition features in order to counter their proliferation. That Report identified 35 jurisdictions as tax havens,¹³⁰ and 47 jurisdictions as HPTRs.¹³¹ The Report itself mentioned that it was not definitive and called upon the named jurisdictions to make a public political commitment to avoid being listed as uncooperative

¹²³ Carlson (n 108) p. 177; McLaren, OECD's Harmful Tax Competition (n 94) p. 450; Samuels and Kolb (n 78) p. 255; Orlov (n 84) p. 95.

¹²⁴ Hishikawa (n 105) p. 416.

¹²⁵ OECD 1998 Report (n 60) p. 10

¹²⁶ Samuels and Kolb (n 78) p. 254.

¹²⁷ Johnson (n 107) p. 354; Akhtar and Grondona (n 117) p. 28.

¹²⁸ Johnson, Id., p. 357; Bond et al. (n 78) p. 63; Sanders (n 98) p. 338; R Palan, 'Tax Havens under Attack' (2013) *The World Today* 69(3), p. 46.

¹²⁹ OECD 2000 progress report (n 109); H J Ault, 'Reflections on the Role of the OECD in Developing International Tax Norms' (2009) *BrookJIntlL* 34(3), p. 772.

¹³⁰ OECD 2000 progress report, Id., p. 17.

¹³¹ Id., pp. 12-14.

jurisdictions.¹³² The details of the commitment were set out in a 2000 MoU and included mainly issues of transparency and EoI.¹³³

In 2001, the OECD published another progress report.¹³⁴ Unlike the 2000 Report, which had set the deadline for the next review at 31 July 2001,¹³⁵ the 2001 report extended the new deadline to 28 February 2002.¹³⁶ The extension was intended to give the reviewed jurisdictions sufficient time to comply with their commitments. The 2001 report also revised the criteria for identifying tax havens, by dropping the ‘no substantial activity requirement’ due to its limited practical significance.¹³⁷

The next progress report was published in 2004.¹³⁸ Referring to the list of tax havens and HPTRs in the 2000 Report, the 2004 Report reviewed the progress of each identified jurisdiction. The Report concluded that there had been abolishment or process of abolishment in 18 regimes, amendment in 14 regimes, and 13 regimes were found not harmful.¹³⁹

A similar process was carried out again with the 2006 report.¹⁴⁰ This Report showed that of the potentially harmful regimes identified in 2000, 20 had been abolished, 13 had been amended, 13 had been reviewed as not harmful, and only one had been reviewed harmful.¹⁴¹ The 2006 Report also found that three regimes had been introduced after 2000, but were found not harmful.¹⁴²

It is worth noting that the OECD’s work on progress reports slowed down after 2006,¹⁴³ but did not stop completely. For example, the OECD published further progress reports in 2017 and 2018.¹⁴⁴ Moreover, the slowdown was interrupted in 2013 when the OECD, together with the G20, embarked on a homologous but broader project on BEPS. Motivated by the need to

¹³² *Id.*, p. 6.

¹³³ Pinto, Tax competition (n 117) p. 222.

¹³⁴ OECD 2001 progress report (n 100).

¹³⁵ OECD 2000 progress report (n 109) p. 18, 24, 25, 29 and 30

¹³⁶ OECD 2001 progress report (n 100) p. 10 and 11.

¹³⁷ *Ibid.*, p. 10; Ault (n 129) p. 770.

¹³⁸ OECD 2004 progress report (n 100).

¹³⁹ *Id.*, pp. 6-9.

¹⁴⁰ OECD 2006 progress report (n 100).

¹⁴¹ *Id.*, p. 5.

¹⁴² *Id.*, p. 6.

¹⁴³ Liebman, Heyvaert and Oyen (n 89) p. 103.

¹⁴⁴ OECD (2017), *Harmful Tax Practices – 2017 Progress Report on Preferential Regimes: Inclusive Framework on BEPS Action 5*, OECD Publishing; OECD 2018 Progress Report (n 75).

align the place of taxable profits with the location of economic activity and value creation,¹⁴⁵ the BEPS project's report was released on 5 October 2015 with a plan of fifteen actions to be implemented at different levels by OECD members and non-members.

Action five of the fifteen actions is about tackling harmful tax practices more effectively. The intent of this Action was stated as follows:

To counter harmful tax practices with respect to geographically mobile activities such as financial and other service activities, including the provision of intangibles... that unfairly erode the tax bases of other countries, potentially distorting the location of capital and services.¹⁴⁶

This Action aims to address harmful tax practices more effectively, including tax havens, HPTRs, and highly favorable aggressive tax rulings.¹⁴⁷ In doing so, the OECD reiterated its concerns as:

Revamping the work on harmful tax practices with a priority on improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes, and on requiring substantial activity for any preferential regime.¹⁴⁸

Although new, the BEPS Action 5 does not stand as a replacement for the OECD reports on harmful tax practices. Rather, it stands as a continuation, and both complement each other. In this respect, BEPS Action 5 has been seen as an attempt to revive the OECD reports on harmful tax practices, whose value is not lost.¹⁴⁹ The use of words such as 'revamp', 'priority', and 'renewed focus' was also interpreted as reinforcing the 1998 OECD Report on harmful tax competition.¹⁵⁰ In this regard, the completion lies in the focus on intangibles, such as the

¹⁴⁵ OECD BEPS Action 5 (n 100) p. 3; UNECA, 'Base Erosion and Profit Shifting in Africa: Reforms to Facilitate Improved Taxation of Multinational Enterprises' (2018) p. VI; A W Oguttu, 'International tax competition, Harmful tax practices and the 'Race to the bottom': a special focus on unstrategic tax incentives in Africa' (2018) *CILJSA* 51(3), p. 298; C Panayi, 'The Globalization of Tax Good Governance' (2018) SMU Sch. of Accountancy Research Paper 6(1), p. 1 <<http://dx.doi.org/10.2139/ssrn.3104977>> accessed 01/04/2020; I J Mosquera Valderrama, D Lesage and W Lips, *Tax and Development: The Link between International Taxation, The Base Erosion Profit Shifting Project and The 2030 Sustainable Development Agenda* (2018) UNU WP Series W-2018/4, p. 3 <<http://cris.unu.edu/sites/cris.unu.edu/files/W-2018-4.pdf>> accessed 06/12/2019.

¹⁴⁶ OECD BEPS Action 5 (n 100) p. 11 and 13.

¹⁴⁷ Liebman, Heyvaert and Oyen (n 89) pp. 102-03.

¹⁴⁸ Ibid.; OECD BEPS Action 5 (n 100) p. 9 and 13; OECD, Background Brief: Inclusive Framework on BEPS, Jan. 2017, p. 19.

¹⁴⁹ OECD BEPS Action 5, Ibid; Boulogne (n 67) p. 16; Y Brauner, 'What the BEPS?' (2014) *Fla. Tax. Rev.* 16(2), p. 76.

¹⁵⁰ Boulogne, Id., p. 17.

intellectual property regimes and rulings along with the emphasis on transparency, EoI, and the substantial activity requirement.

Still regarding BEPS Action 5, while recognizing the role of intellectual property industries for economic growth and development, the OECD insists on the freedom of countries to fiscally incentivize research and development (R&D) activities in respect of the Forum on Harmful Tax Practices' principles.¹⁵¹ Thus, part of ensuring that intellectual property rights, which are highly volatile in nature, comply with the substantial economic presence requirement factor, along with halting the use of patent boxes to harmfully compete, the nexus approach has been preferred over the value creation and transfer pricing approaches.¹⁵² The nexus approach seeks to ensure that an intellectual property regime's benefits are proportional to real and concrete R&D activities that have an actual link with the intellectual property derived income benefiting the preferential treatment.¹⁵³

It is also worth noting that all the fifteen actions are not equal in terms of implementation. Four of them, including Action five, have been raised to the level of minimum standards. The four minimum standards form what is called the BEPS Inclusive Framework. The Framework aims at a global inclusion of all interested non-OECD members in the implementation of the minimum standards on an equal footing with the members.¹⁵⁴ Here, 'interested' means a commitment by explicit agreement to comply with the minimum standards, including the requirements of Action 5.

The call to join the BEPS Inclusive Framework was launched in 2016. As of August 2021, 139 countries have joined the Inclusive Framework.¹⁵⁵ Among them, only one, namely Kenya, was from the EAC,¹⁵⁶ which shows the general reluctance of EAC Partner States to join. Some reasons for the reluctance may be: First, informed participation in the Inclusive Framework requires countries to have a sophisticated knowledge of international tax law. Most, if not all, EAC Partner States, have a limited number of qualified staff capable of handling

¹⁵¹ OECD BEPS Action 5 (n 100) p. 28.

¹⁵² Ibid.

¹⁵³ Id., p. 29; Liebman, Heyvaert and Oyen (n 89) p. 103; I Zammit, 'Centralized Intellectual Property Business Models: Tax Implications of EU Patent Box Regimes' (2015) *BFIT*, p. 544; D Fabris, 'To Open or to Close the Box: Patent Box Regimes in the EU between R&D Incentives and Harmful Tax Practices' (2019) *Amsterdam Law Forum* 11(1), p. 45 and 50.

¹⁵⁴ UNECA (n 145) p. 19; OECD Inclusive framework brief (n 148) p. 7; Mosquera Valderrama, Lesage, and Lips (n 145) p. 6.

¹⁵⁵ OECD, Members of the OECD/G20 Inclusive Framework on BEPS <<https://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf>> accessed 30/07/2021.

¹⁵⁶ Ibid.

Inclusive Framework matters at an international standard. Second, there may be a lack of trust in the effectiveness of participation in the Inclusive Framework. This could be due to reliance on powerful African countries to express their interests first, thereby pushing others to follow the lead. Such additional participation would show unity on common interests. It can also be explained by the fear that the framework will end up not being inclusive at all. Third, some countries may fear that participation in the Inclusive Framework may require giving up some systems for intra-EAC tax competition. Fourth, a lack of understanding of the BEPS Project may fuel reluctance to join. Fifth, joining the Inclusive Framework requires payment of an annual membership fee,¹⁵⁷ which may be a burden, especially if the country does not understand the benefits of joining the Inclusive Framework. These worries couple with the real challenges that face developing countries that have already joined the Inclusive Framework.¹⁵⁸

Back to the 1998 OECD Project on harmful tax competition, two constitutive elements have been laid out as detailed below.

4.1.4. Components of harmful tax practices

The 1998 OECD Report on harmful tax competition identified two components of harmful tax competition, namely tax havens and HPTRs.¹⁵⁹ Thus, to understand harmful tax practices, it is necessary to understand each component.

4.1.4.1. Tax havens

The OECD's work on tax havens began before the 1998 project. More than a decade before this project, the OECD issued a report in 1987 on measures to prevent the abuses of tax havens and another on the abuse of bank secrecy.¹⁶⁰ At that time, however, tax havens issues were not

¹⁵⁷ OECD Inclusive framework brief (n 148) p. 8.

¹⁵⁸ See details in 6.5.2.

¹⁵⁹ OECD 2018 Progress Report (n 75) p. 41; OECD 1998 Report (n 60) p. 7; Littlewood (n 62) p. 413 and 419; Jogarajan and Stewart (n 86) p. 8; J McLaren, *Will Tax Havens Survive in the New International Legal Environment?* (Ph.D Thesis, RMIT Univ. 2010), p. 91; Fabris (n 153) p. 47; D S Smit, *Freedom of Investment between EU and non-EU Member States and its Impact on Corporate Income Tax Systems within the European Union* (Ph.D Thesis, Tilburg Univ. 2011), p. 195; M Seeruthun-Kowalczyk, *Hard Law and Soft Law Interactions in EU Corporate Tax Regulation: Exploration and Lessons for the Future* (Ph.D Thesis, Edinburgh Univ. 2011), p. 195; M Wróblewska, 'Harmful Tax Competition in a Globalized World: Does the World Trade Organization Deal with this Issue?' (2016) *Studia Iuridica* 1, p. 17; J B Kiprotich, *Income Tax in the East African Community: A Case for Harmonization and Consolidation of Policy and Law with a Focus on Corporate Income Taxation* (Ph.D Thesis, UoN 2016), p. 52; H Gribnau, 'The Integrity of the Tax System after BEPS: A Shared Responsibility' (2017) *ELR* 1, p. 20;

¹⁶⁰ Morriss and Moberg (n 61) p. 38; Orlov (n 84) p. 106; M C Webb, 'Defining the boundaries of legitimate state practice: Norms, transnational actors and the OECD's project on harmful tax competition' (2004) *Review of international political economy* 11(4), p. 798.

associated with harmful tax competition. It is the 1998 OECD Report that described tax havens as a component of harmful tax practices.

Despite their long existence, the definition of tax havens is still technically problematic.¹⁶¹ Indeed, tax haven has been described as a controversial fluid concept with no standard or consensus on what it means.¹⁶² Moreover, the development of a universally accepted definition has been found to be practically impossible.¹⁶³ Consequently, the absence of an official or agreed-upon definition of tax havens has led to a divergence in the listing of tax havens.¹⁶⁴ Even so, some attempts have been made to describe tax havens.

Broadly considered, tax havens are referred to as the territories where tax competition is fiercest.¹⁶⁵ Tax havens also refer to countries with the lowest tax rates designed to attract financial services and profit reallocation from high-tax countries.¹⁶⁶ Tax havens also seek to attract foreign capital without seeking real investment, and are characterized by lenient tax laws and high-level secrecy for investors, low or zero CIT rate, bank secrecy laws and no restrictions on financial transactions.¹⁶⁷

In addition, tax havens refer to jurisdictions that facilitate non-residents, individuals or corporations, to avoid taxes that they would otherwise have to pay in their resident

¹⁶¹ OECD 1998 Report (n 60) p. 20 and 22; van Raad (n 86) p. 1314; Boulogne (n 67) p. 13; Gilmore (n 75) p. 550; T V Addison, 'Shooting Blanks: The War on Tax Havens' (2009) *Ind.J.Glob.Leg.Stud.* 16(2), p. 705; G Tobin and K Walsh, 'What Makes a Country a Tax Haven? An Assessment of International Standards Shows Why Ireland Is Not a Tax Haven' (2013) *Economic and Social Review* 44(3), p. 402-03; O Stasiunaityte, *Tax Havens: Friends or Foes?*, (Master Thesis, CBS 2014), p. 34; J G Gravelle, 'Tax Havens: International Tax Avoidance and Evasion' (2015) CRS Report, p. 3 <www.globaltaxjustice.org/sites/default/files/Tax-Havens-Jane-Gravelle.pdf> accessed 17/05/2019.

¹⁶² Calich (n 70) p. 63; P Repyeuski, *Free Zones in the Commonwealth of Independent States: A Proposed Regulatory Model*, (Ph.D Thesis, Manchester Univ. 2008), p. 78; D Dharmapala, 'What Problems and Opportunities are Created by Tax Havens?' (2008) *Oxford Review of Economic Policy* 24(4), p. 662; A Sanni, 'Sovereign Rights of Tax Havens and the Charge of Harmful Tax Competition' (2011) <www.thesait.org.za/news/96869/Sovereign-Rights-Of-Tax-Havens-And-The-Charge-Of-Harmful-Tax-Competition.htm> accessed 30/07/2019.

¹⁶³ Orlov (n 84) p. 96.

¹⁶⁴ Tobin and Walsh (n 161) p. 402-03.

¹⁶⁵ R Teather, 'The Benefits of Tax Competition' (2006) IEA Hobart Paper No. 153, p. 62 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=878438> accessed 03/08/2019.

¹⁶⁶ B Persaud, 'The OECD Harmful Tax Competition Policy: A Major Issue for Small States', in R Biswas (ed), *International Tax Competition: Globalization and Fiscal Sovereignty* (Commonwealth Secretariat 2002), p. 17; R J Jr Hines, 'How Serious is the Problem of Base Erosion and Profit Shifting?' (2014) *CTJ/RFC* 62(2), p. 445.

¹⁶⁷ Addison (n 161) p. 706; Nicodème (n 103) p. 758; L Eden and R T Kudrle, 'Tax Havens: Renegade States in the International Tax Regime?' (2005) *Law & Policy* 27(1), p. 101; P Genschel and T Rixen, 'Settling and Unsettling the Transnational Legal Order of International Taxation', in T C Halliday and G Shaffer (eds), *Transnational Legal Orders* (CUP 2015), p. 168; Akhtar and Grondona (n 117) p. 28.

jurisdictions.¹⁶⁸ This reference seems complete as it encompasses most of the main characteristics of tax havens. These have been attempted to by the OECD as factors identifying tax havens.

Without actually defining what a tax haven is, the OECD has established the following four factors to determine whether a particular jurisdiction is a tax haven:

- (a) having no or only nominal taxes either in general or in special circumstances for non-residents, (b) having laws and/or administrative rules and/or practices which prevent the effective exchange of relevant information with other governments on taxpayers benefiting from the low or no tax jurisdictions, (c) lack of transparency, and (d) absence of any requirement for substantial activity.¹⁶⁹

Among the four factors, the most important factor and a necessary minimum condition is ‘no or only nominal taxes’.¹⁷⁰ The OECD refers to this factor as the gateway criterion,¹⁷¹ i.e. the starting point for identifying tax havens.¹⁷² This consideration explains why tax havens are sometimes simply defined as territories with nil or very low tax rates. In other words, the non-imposition of an income tax or only a nominal income tax is widely accepted as the most important characteristic of tax havens.¹⁷³ In this regard, most writings, academic or otherwise, include zero or low-tax rate as one of tax havens’ characteristics.¹⁷⁴

By the same token, tax havens are often considered synonymous with offshore financial centers¹⁷⁵ or bank secrecy jurisdictions.¹⁷⁶ However, a tax haven is far more than these two terms. For example, one characteristic of a tax haven is that it has, among other things, bank

¹⁶⁸ OECD 2000 progress report (n 109) p. 10; van Raad (n 86) p. 1314; Orlov (n 84) p. 105; Littlewood (n 62) p. 414; Carlson (n 108) p. 165; G M Melo, ‘Taxation in the Global Arena: Preventing the Erosion of National Tax Bases or Impinging on Territorial Sovereignty (A Critique of the OECD’S Report: Harmful Tax Competition: An Emerging Global Issue)’ (2000) *Pace International L.Rev.* 12(183), p. 185; M Hearson, ‘Developing Countries’ Role in International Tax Cooperation’ (2017), p. 12 <www.g24.org/wp-content/uploads/2017/07/Developing-Countries-Role-in-International-Tax-Cooperation.pdf> accessed 31/08/2018).

¹⁶⁹ OECD 1998 Report (n 60) p. 22.

¹⁷⁰ Id., p. 21; Samuels and Kolb (n 78) p. 235; Calich (n 70) p. 60; Ambrosiano and Caroppo (n 115) p. 689.

¹⁷¹ OECD 2001 progress report (n 100) p. 5; Pinto, Tax competition (n 117) p. 226; Calich (n 70) p. 63.

¹⁷² OECD 1998 Report (n 60) p. 22; OECD 2001 progress report, *ibid*.

¹⁷³ Littlewood (n 62) p. 420 and 460.

¹⁷⁴ Akhtar and Grondona (n 117) p. 5.

¹⁷⁵ Id., p. 1; Barker (n 112) p. 177.

¹⁷⁶ Oguttu, Curbing Offshore Tax Avoidance (n 93) p. 23; G Schjelderup et al., ‘Tax Havens and Development: Status, Analyses and Measures’ (2009) Official Norwegian Reports, p. 15 <www.regjeringen.no/contentassets/0a903cdd09fc423ab21f43c3504f466a/en-gb/pdfs/nou200920090019000en_pdfs.pdf> accessed 17/11/2017.

secrecy. It would, therefore, not be correct to consider one constitutive element as synonymous with the whole set of elements.

Still in relation to tax havens' features, the OECD, as well as the UN, largely regard tax havens as a threat.¹⁷⁷ This is due to their appeal to wealthy corporations and individuals to avoid paying taxes in their countries of residence.¹⁷⁸ Indeed, tax havens provide such taxpayers with locations to hold their passive investments, record their paper profits, and shield their affairs and bank accounts from their home tax authorities.¹⁷⁹ Consequently, tax havens actively erode the tax base of other countries and are unwilling to fight harmful tax competition.¹⁸⁰ Tax havens are also accused of causing fiscal degradation and the race to the bottom.¹⁸¹ It is in this context that tax havens have developed a bad reputation.

The tax havens' reputation test was developed as a result of the 1987 OECD Report, which asked the question '*Does the country or territory offer itself or is it recognized as a tax haven?*' to identify tax havens.¹⁸² In this question, the phrase 'recognized as' is interpreted to mean that tax havens are identifying by the jurisdiction's reputation and nothing else. This means that the recognition of tax havens is not a question of objective factors but rather a subjective personal consideration. This subjective approach was noted in the Report submitted by the Special Counsel for international taxation to the US Commissioner of Internal Revenue as follows:

The term 'tax haven' may also be defined by a 'smell' or reputation test: a country is a tax haven if it looks like one and if it is considered to be one by those who care. Many

¹⁷⁷ Eighth Meeting of the Ad Hoc Group of Experts on International Cooperation in Tax Matters: Report of the Secretary General, U.N. ESCOR, 1998 Sess., 8th mtg, Agenda Item 13(d), T 2-3, U.N. Doc. E/1998/100 (1998) cited in Carlson (n 108) p. 187.

¹⁷⁸ OECD 1998 Report (n 60) p. 20 and 22; van Raad (n 86) p. 1315; Akhtar and Grondona (n 117) p. 1; Pinto, EU and OECD (n 72) p. 391; Calich (n 70) p. 63; Boulogne (n 67) p. 13.

¹⁷⁹ OECD 1998 Report, Id., p. 22.

¹⁸⁰ Pinto, EU and OECD (n 72) p. 391; T Rixen, 'Taxation and Cooperation: International Action against Harmful Tax Competition', in S A Schirm (ed), *Globalization: State of the Art and Perspectives* (Routledge 2007), p. 72-73; A Sanni, 'Sovereign Rights of Tax Havens and the Charge of Harmful Tax Competition' (2011) <www.thesait.org.za/news/96869/Sovereign-Rights-Of-Tax-Havens-And-The-Charge-Of-Harmful-Tax-Competition.htm> accessed 30/07/2019.

¹⁸¹ Sanni, *ibid*.

¹⁸² Boulogne (n 67) p. 13.

publications identified jurisdictions as tax havens, and the same jurisdictions generally appear on all of the lists.¹⁸³

In the same vein, the former German finance minister Waigel applied the ‘smell’ test when asked what harmful tax competition is and replied, ‘*Precisely, I don’t know, but when I see it, I recognize it.*’¹⁸⁴ In his response, he extended the reputation test beyond tax havens to broadly encompass harmful tax competition.

The twin component of tax havens in a set of harmful tax practices is the HPTR. The OECD has also provided details on it, and scholars have widely elaborated on it too.

4.1.4.2. Harmful preferential tax regimes

As noted earlier, tax havens together with HPTRs, constitute harmful tax practices. Like it did for tax havens, the OECD has not provided a definition of HPTR. Again, as it did for tax havens, the OECD has set out factors to determine whether a regime is a HPTR. These factors are grouped into two categories.

The first category consists of four factors, which the OECD refers to as ‘key factors’, namely:

- (a) low or zero effective tax rate on specified kinds of income such as movable sources of income, (b) ring-fencing from the domestic economy, (c) lack of transparency, and (d) no effective exchange of information with other governments.¹⁸⁵

The second category consists of eight factors that the OECD refers to as other factors. These factors play a support role to the key factors.¹⁸⁶ They are:

- (a) an artificial definition of the tax base, (b) failure to adhere to international transfer pricing principles, (c) exemption of foreign source income from residence-country taxation, (d) negotiable tax rates or tax bases, (e) existence of secrecy provisions, (f) access

¹⁸³ R A Gordon, *Tax Havens and their Use by United States Taxpayers: An Overview* (1981) A Report to the Commissioner of Internal Revenue, the Assistant Attorney General (Tax Division) and the Assistant Secretary of the Treasury (Tax Policy), p. 14.

¹⁸⁴ R A Sommerhalder, ‘Harmful Tax Competition or Harmful Tax Harmonization’ (1999) *EC T.Rev.* 8(4) p. 247 cited in Barker (n 112) p. 171.

¹⁸⁵ OECD 1998 Report (n 60) pp. 26-30; Joint Committee on Taxation, *Background, Summary and Implications of the OECD/G20 Base Erosion and Profit Shifting Project*, JCX-139-15, Nov. 2015, p. 18; OECD 2018 Progress Report (n 75) pp. 40-41.

¹⁸⁶ van Raad (n 86) p. 1320; OECD 2018 Progress Report, Id., p. 52.

to a wide network of tax treaties, (g) promotion of the regime as a tax minimization vehicle, and (h) encouragement by the regime of purely tax-driven operations or arrangements.¹⁸⁷

Among these factors, the OECD considers ‘low or zero effective tax rate’ as the gateway criterion¹⁸⁸ and necessary starting point.¹⁸⁹ However, to assess whether a jurisdiction has a HPTR, the four factors are overall taken into consideration and, if relevant, the other eight factors are also considered.¹⁹⁰ This means that the tax rate factor alone is not enough to conclude that a preferential regime is harmful.¹⁹¹ Rather, to qualify as a HPTR, it is necessary for a regime to have a low or zero effective tax rate plus one or more other key factors.¹⁹²

From the above factors established by the OECD to characterize tax havens and HPTRs, it becomes apparent that the two are closely related. In fact, they both share two of their four key indicators, namely lack of transparency and lack of effective EoI. Moreover, tax havens and HPTRs have in common the facilitation of tax minimization, and both involve ring-fencing.

Even though close, they are distinct. The main distinguishing element between tax havens and HPTRs has been elaborated as follows:

Tax havens have no interest in preventing the race to the bottom, are actively contributing in the tax base erosion of other countries and are unlikely to cooperate in curbing harmful tax competition, whereas countries with harmful preferential regimes may have a significant amount of revenues which are at risk, therefore have an interest in eliminating harmful tax competition on a concerted action.¹⁹³

¹⁸⁷ OECD 1998 Report (n 60) pp. 30-34; OECD 2018 Progress Report, Id., pp. 40-41; Joint committee on taxation (n 185) p. 18; van Raad, Id., p. 1320-1322; Littlewood (n 62) pp. 423-24; Liebman, Heyvaert and Oyen (n 89) pp. 102-03.

¹⁸⁸ OECD 2001 progress report (n 100) p. 5; OECD BEPS Action 5 (n 100) p. 23; OECD 2018 Progress Report, Id., p. 43; Pinto, Tax competition (n 117) p. 226; K Dirix, ‘Harmful Tax Competition: Six Belgian Tax Incentives under the Microscope’ (2013) *EC T.Rev.* 5, p. 236.

¹⁸⁹ OECD 2018 Progress Report, Id., pp. 13-14; Littlewood (n 62) p. 424; OECD 1998 Report (n 60) p. 25; Samuels and Kolb (n 78) p. 237; Ault (n 72) p. 2.

¹⁹⁰ OECD BEPS Action 5 (n 100) p. 23; Littlewood, Id., p. 424.

¹⁹¹ OECD 2018 Progress Report (n 75) pp. 13-14; Dirix (n 188) p. 236; Ault (n 72) p. 3.

¹⁹² OECD 1998 Report (n 60) p. 26; OECD BEPS Action 5 (n 100) p. 23; Ault, Id., p. 2; F Wishlade, ‘When Policy Worlds Collide: Tax Competition, State Aid, and Regional Economic Development in the EU’ (2012) *Journal of European Integration* 34(6), p. 589.

¹⁹³ OECD 1998 Report, Id., para. 43; van Raad (n 86) pp. 1314-15; Boulogne (n 67) p. 12; Genschel and Rixen (n 167) p. 174; B J Arnold and M J McIntyre, *International Tax Primer* (2nd edn, Wolters Kluwer 2002), p. 139 and 141; N Nikolakakis, *The International Legal Ramifications of the OECD’s Harmful Tax Competition Crusade* (LL.M Thesis, McGill Univ. 2006), p. 59.

Another difference is that the terms ‘tax haven’ refer to a jurisdiction, while the terms ‘harmful preferential tax regime’ refer to a system. Thus, the presence of common and distinguishing factors motivates additional details below.

4.1.5. OECD’s key factors and their interpretation

Among the OECD’s key factors to determine whether a jurisdiction has harmful tax practices, some are common to tax havens and HPTRs while others are not, as described below.

4.1.5.1. Two common factors

The OECD uses two common factors to identify tax havens and HPTRs. These factors are a lack of transparency and a lack of effective EoI. Not only are these common factors for harmful tax practices, but they also characterize sound tax policies.¹⁹⁴ These factors are key in determining whether a tax practice is harmful and attract much attention in the fight against harmful tax practices.¹⁹⁵

The purpose of the transparency requirement is two-fold. One, it addresses the need for clear conditions of equal treatment and application among similarly situated taxpayers through open and consistent application of law.¹⁹⁶ Two, is to ensure that the home tax administration has the necessary information on the taxpayer’s situation.¹⁹⁷ These two are respectively referred to as the internal context and external context of transparency.¹⁹⁸

Lack of transparency is a broad concept¹⁹⁹ and some of its indicators relate to the design and/or administration²⁰⁰ of the tax system’s legislative and/or administrative provisions. Examples of lack of transparency include favorable application of laws and regulations, negotiable tax provisions, subjective favorable administrative rulings, and deliberate lax audits.²⁰¹ Other examples indicating non-transparency include non-publication of administrative practices on transfer pricing, unclear rules, inconsistent application of rules, and

¹⁹⁴ A Christians, ‘Sovereignty, Taxation and Social Contract’ (2009) *Minn.J.Int’lL.* 18(1), p. 124.

¹⁹⁵ Seeruthun-Kowalczyk (n 159) p. 196; Calich (n 70) p. 68; Repyeuski (n 162) p. 149.

¹⁹⁶ OECD 2001 progress report (n 100) p. 5; Boulogne (n 67) p. 53.

¹⁹⁷ OECD 2001 progress report, *ibid.*; Boulogne, *ibid.*

¹⁹⁸ Englisch and Yevgenyeva (n 70) p. 632.

¹⁹⁹ Ault (n 72) p. 2.

²⁰⁰ OECD 2018 Progress Report (n 75) p. 14; OECD (2011), ‘The OECD’s Project on Harmful Tax Practices Consolidated Application Note Guidance in Applying the 1998 Report to Preferential Tax Regimes’, in *Implementing the Tax Transparency Standards: A Handbook for Assessors and Jurisdictions*, 2nd edn, OECD Publishing, p. 211.

²⁰¹ OECD CAN (n 71) p. 10 and 29; OECD 1998 Report (n 60) p. 28; Sanders (n 98) p. 327; van Raad (n 86) p. 1316 and 1319; Pinto, Tax competition (n 117) p. 218; Samuels and Kolb (n 78) p. 236.

administrative discretion to apply rules departing from the normal and proper application of the legislation.²⁰² A regime that offers the possibility to negotiate the tax burden, i.e. negotiable tax rate or tax base, is also an indicator of non-transparency.²⁰³ Secrecy laws and the prevention of effective EoI also show a lack of transparency.²⁰⁴

Thus, to ensure the transparency of a regime, the OECD recommends eliminating secret advance rulings and negotiable tax rates and tax bases.²⁰⁵ Similarly, the OECD recommends that jurisdictions properly maintain information on their preferential regimes and publish the prerequisites for a taxpayer to benefit from favorable tax measures.²⁰⁶ An example of a jurisdiction that did not follow those recommendations is Singapore, which has been criticized for failing to publish the conditions required to be granted a Development and Expansion Incentive (DEI) certificate alongside the Minister's discretion to grant such certificates.²⁰⁷

Furthermore, the OECD recommends that jurisdictions, through regulations and actual practices, audit, and file financial accounts in accordance with generally accepted accounting standards that require keeping accurate and reliable accounting books and records, beneficial ownership information, and the like.²⁰⁸ Exceptions to the record-keeping requirement are cases of *de minimis* transactions or *de minimis* entities, i.e. those engaged solely in local activities with no foreign element, such as foreign ownership, beneficiaries, or management.²⁰⁹

As far as the lack of effective EoI is concerned, this refers to the EoI between tax administrations on taxpayers benefiting from favorable tax measures. The lack of EoI is a powerful indicator and a common technique of tax competition.²¹⁰ In this respect, a regime which does not enter into EoI agreements appears *prima facie* harmful.²¹¹

²⁰² OECD CAN, Id., p. 41.

²⁰³ OECD 2018 Progress Report (n 75) p. 52.

²⁰⁴ OECD Handbook on Tax Transparency (n 200) p. 211.

²⁰⁵ Carlson (n 108) p. 168; Pinto, Tax competition (n 117) pp. 226-227.

²⁰⁶ Carlson, Ibid; Pinto, Tax competition, Ibid; OECD Handbook on Tax Transparency (n 200) p. 214.

²⁰⁷ Boulogne (n 67) p. 42.

²⁰⁸ OECD 2001 progress report (n 100) p. 11; OECD CAN (n 71) p. 10-12; Pinto, Tax competition (n 117) p. 227; OECD Handbook on Tax Transparency (n 200) p. 215; OECD (2013), Global Forum on Transparency and Exchange of Information for Tax Purposes Peer Reviews: Republic of Korea 2013: Phase 1 + Phase 2, incorporating Phase 2 ratings, OECD Publishing, p. 57 <<http://dx.doi.org/10.1787/9789264205802-en>> accessed 22/04/2020.

²⁰⁹ OECD 2001 progress report, *ibid.*; Pinto, *ibid.*

²¹⁰ Sanders (n 98) p. 328; Ring, Sovereignty Debate (n 103) p. 21.

²¹¹ P Baker (2004), 'The World-Wide Response to the Harmful Tax Competition Campaigns', *GITC Review*, 3(2), p. 16.

Like the lack of transparency, the lack of EoI results from the design of the tax regime or its administration.²¹² Examples include, but are not limited to, favorable application of laws and regulations, negotiable tax provisions, and secrecy laws.²¹³ Secrecy laws prevent the transfer of information for tax purposes,²¹⁴ and are thus a typical case of lack of EoI. A lack of effective EoI also results in the inability of other tax administrations to effectively enforce their tax rules.²¹⁵

Thus, to ensure effective EoI, banking secrecy laws should be abolished and tax authorities should have access to financial information on beneficial owners, if need be in collaboration with banks and financial institutions.²¹⁶ To this end, legal mechanisms, in the form of bilateral or multilateral agreements, as well as administrative measures, are necessary to ensure the confidentiality of the information exchanged.²¹⁷

Besides the two common factors mentioned above, harmful tax practices are identified by other factors that are specific to each component, as elaborated on below.

4.1.5.2. Specific factors to tax havens

Besides the lack of transparency and effective EoI, the OECD has identified other factors to determine whether a particular jurisdiction is a tax haven. These other factors are: no or only nominal taxes and the absence of substantial activities.

Starting with no or only nominal taxes, the situation occurs because the tax rate itself is very low or it results from the way the tax base is defined.²¹⁸ Even so, the OECD has made it clear that each sovereign jurisdiction has the right to determine its tax rates and tax base.²¹⁹ The 1998 OECD Report further clarified that there is no explicit nor implicit general minimum effective tax rate below which would be considered as engaging in harmful tax competition.²²⁰

²¹² OECD CAN (n 71) p. 10.

²¹³ Ibid.; OECD 2018 Progress Report (n 75) p. 52.

²¹⁴ Pinto, Tax competition (n 117) p. 218.

²¹⁵ OECD 2018 Progress Report (n 75) p. 14.

²¹⁶ Pinto, Tax competition (n 117) p. 227.

²¹⁷ OECD CAN (n 71) p. 14.

²¹⁸ OECD 1998 Report (n 60) Para. 61; OECD CAN (n 71) p. 6; Boulogne (n 67) p. 14; Sanders (n 98) p. 327; Salinas (n 64) p. 540.

²¹⁹ OECD 2001 progress report (n 100) p. 7.

²²⁰ OECD 2018 Progress Report (n 75) p. 20; K B Brown, 'Harmful Tax Competition: The OECD View' (1999) *GeoW.J.Int'lL.&Econ.* 32(2), p. 316.

Moreover, the no or only nominal tax factor is important in identifying tax havens. It is the starting point, i.e. an opening factor labeled as gateway, although not the sole factor to determine whether a particular jurisdiction is a tax haven.²²¹ In this regard, it is necessary to combine the factor of no or only nominal taxes with one or more other factors. One is the substantial activity requirement.

Regarding the requirement of substantial activities, it has been opined that without the requirement for substantial activity, it becomes blatant that the regime is aimed at attracting investments which are purely tax-driven.²²² This would imply that the country's purpose is to attract mobile business activities at the expense of other countries.²²³ This explains why the OECD excludes from harmful tax practices the tax advantages that are given to attract manufacturing and real activities such as plants, buildings, and equipment.²²⁴

As noted above, besides the two specific factors that add to the common factors to characterize tax havens, HPTRs have two specific factors too. These are the subject of the following paragraphs.

4.1.5.3. Specific factors to harmful preferential tax regimes

Similar but slightly different to the no or only nominal tax rate criterion of tax havens, HPTRs are identified by the criterion of no or low effective tax rate, among others. The OECD recommends that no or low effective tax rate be assessed with other informative factors, such as an artificial definition of the tax base, a negotiable tax rate or tax base, and non-compliance with international transfer pricing principles.²²⁵

The no or low effective tax rate factor is very important in identifying HPTRs. It is the principal or starting point, i.e. a gateway factor, to the extent that its combination with just one other factor suffices to qualify a regime as harmful.²²⁶ Yet, its presence alone is not sufficient

²²¹ OECD 2000 progress report (n 109) p. 10; OECD 2001 progress report (n 100) p. 5; van Raad (n 86) p. 1316; Arnold and McIntyre (n 193) p. 139; Seeruthun-Kowalczyk (n 159) p. 196; McLaren, Will Tax Havens Survive (n 159) p. 5; Nicodème (n 103) p. 757; OECD, Confidential draft Recommendation (n 86) p. 5.

²²² OECD 2001 progress report, *Ibid*; van Raad (n 86) p. 1316; Carlson (n 108) p. 166; Pinto, Tax competition (n 117) p. 162; Dirix (n 188) p. 235.

²²³ Pinto, *ibid*.

²²⁴ OECD 1998 Report (n 60) p. 8; Carlson (n 108) p. 165; Samuels and Kolb (n 78) p. 234; Pinto, EU and OECD (n 72) p. 390; Wilde, Tax Competition within the EU (n 142) p. 28; Baker (n 211) p. 16.

²²⁵ OECD 2018 Progress Report (n 75) pp. 51-52.

²²⁶ OECD 1998 Report (n 60) p. 21, 25, and 26; OECD 2001 progress report (n 100) p. 5; Sanders (n 98) p. 327; Wishlade (n 192) p. 589; Englisch and Yevgenyeva (n 70) p. 627; OECD BEPS Action 5 (n 100) p. 23; Littlewood

to qualify the regime as harmful, and harmful tax competition does not simply mean no or low-taxes.²²⁷ It, therefore, requires consideration of other factors, among which is ring-fencing.

Ring-fencing occurs when favorable tax measures are limited to foreigners (non-residents), i.e. discriminate against and exclude residents. For this reason, there is no ring-fencing if a measure, even if favorable, is available to both residents and non-residents.²²⁸ There are several ways in which a regime may be ring-fenced. Examples include, but are not limited to, restricting favorable tax measures to non-residents, excluding residents, limiting the measure to international transactions, and prohibiting the benefiting taxpayers from accessing domestic markets.²²⁹ All these are summarized as (a) explicit or implicit exclusion of residents from benefiting from the favorable tax measures, and (b) explicit or implicit prohibition of the benefiting enterprises from accessing the domestic markets.²³⁰

From the above, there are three types of ring-fencing: explicit ring-fencing, implicit ring-fencing, and *de facto* ring-fencing. Explicit ring-fencing occurs when a regime explicitly excludes residents through a law.²³¹ Implicit ring-fencing occurs when the law does not explicitly exclude residents, but administrative or legal barriers inhibit residents from taking advantage of the regime.²³² This occurs when a country develops criteria to restrict benefits to non-residents or foreign transactions or activities.²³³ An example of implicit ring-fencing is the requirement for the regime beneficiaries to transact only in foreign currency.²³⁴ However, if the foreign currency is in general circulation to the extent that residents have access to it, the regime is not ring-fenced.²³⁵

A regime becomes *de facto* ring-fenced if there is neither an administrative nor a legal barrier to residents, but in practice no or only a small percentage of residents benefit from the

(n 62) p. 424; Samuels and Kolb (n 78) p. 235 and 237; Ambrosanio and Caroppo (n 115) p. 689; Seeruthun-Kowalczyk (n 159) p. 196.

²²⁷ OECD CAN (n 71) p. 6; Ault (n 129) p. 766; Repyeuski (n 162) p. 149; D Deák, 'Illegal State Aid and Harmful Tax Competition: The Case of Hungary' (2002) *Society and Economy* 24(1), p. 26.

²²⁸ OECD CAN, Id., p. 23 and 27.

²²⁹ Id., p. 20; Sanders (n 98) p. 338; Dirix (n 188) p. 234; Nikolakakis (n 193) p. 65.

²³⁰ OECD 1998 Report (n 60) para. 62; OECD CAN (n 71) p. 22, 26, and 27; OECD 2018 Progress Report (n 75) p. 14 and 53; Boulogne (n 67) p. 14; Englisch and Yevgenyeva (n 70) p. 629; Sanders (n 98) p. 327; Barker (n 112) p. 176.

²³¹ OECD 2018 Progress Report, Id., p. 54.

²³² Ibid.

²³³ OECD CAN (n 71) p. 22.

²³⁴ Id., p. 24; OECD 2018 Progress Report (n 75) p. 56.

²³⁵ OECD 2018 Progress Report, *ibid.*

regime.²³⁶ On the point of *de facto* ring-fencing, the absence of residents in the preferred sector does not make the regime ring-fenced as long as there are no restrictive legal measures. This means that a regime is not ring-fenced if domestic companies qualify for preferential regime, but in practice do not take advantage of it.²³⁷

It is worth noting that ring-fencing is central to the issue of harmful tax competition. The OECD, the EU, and scholars have singled out ring-fencing as particularly noxious.²³⁸ This is because ring-fencing intends to erode other jurisdictions' tax bases and interferes with their fiscal policies.²³⁹ A continued practice of ring-fencing also invites other countries to do the same, which fuels more harmful tax competition.

All in all, the OECD's work to curb harmful tax practices is colossal. Due to the global nature of tax competition, the OECD is not alone on the front line. Other organizations are also engaged in the fight against harmful tax practices, one is the EU.

4.2. EU Code of Conduct on business taxation

Like the OECD, European Union, one of the world's strongest regional organizations, has played and continues to play an important role in regulating harmful tax practices. Harmful tax practices have traditionally been discussed in EU forums of politicians and academics²⁴⁰ with a focus on the EU territory. However, for one reason or another, including the importance of the developed tools and political influence, the works of the EU in this area has also reached and influenced other jurisdictions that are not EU members. The Code of Conduct illustrates the EU's prominent role in this area.

On 1 December 1997, the ECOFIN Council of the European Union agreed on a package of measures to tackle harmful tax competition. The package comprised three components, namely the Code of Conduct on business taxation, the measures to eliminate distortions in the taxation of capital income, and the measures to eliminate WHT on cross-border interest and royalty payments between companies. Among the three, the Code of Conduct is key in terms of harmful tax competition, which justifies its focus in this book. In sequence, the main aspects of the Code of Conduct are presented below. Thereafter follows a presentation on the two tests

²³⁶ Id., p. 54.

²³⁷ Id., pp. 54-55.

²³⁸ D C Elkins, 'The Merits of Tax Competition in a Globalized Economy' (2006) *Indiana LJ* 91(3), p. 947.

²³⁹ OECD CAN (n 71) p. 20; Elkins, Id., p. 915.

²⁴⁰ L Cerioni, 'Harmful Tax Competition Revisited: Why not a Purely Legal Perspective under EC Law?' (2005) *Euro.Tax.*, p. 267.

that are extensively referred to in the Code, namely the derogation test and the location test. Afterward, come the details on the Code's criteria of harmful tax competition.

4.2.1. Key aspects of the EU Code of Conduct

The Code of Conduct on business taxation has some key aspects that need to be highlighted. These are the Code's scope of application, its political nature, its success, and its failure to define harmful tax competition.

Starting with the Code's scope of application, the Code's application *ratione materiae* concerns business taxation and excludes individual and indirect taxation.²⁴¹ It does so with regard to laws, regulations, and administrative practices.²⁴² Regarding its coverage *ratione loci*, the Code of Conduct applies to EU Member States, their dependencies and associated territories.²⁴³ Thus, any jurisdiction which falls out of that scope is not covered by the Code of Conduct. Even so, the Code contains a call to promote its principles in third countries.²⁴⁴ The use of the term 'promotion' means that the EU does not expect non-member states to respect the Code in the same way as members, but encourages non-members to follow it. To this end, the EU uses blacklisting as a strategy to compel third countries to comply with European standards on tax good governance,²⁴⁵ including harmful tax competition matters.

The Code's nature is not legal; it is rather a non-legally binding instrument.²⁴⁶ This means that a member's failure to follow the Code is not actionable before the Court of Justice

²⁴¹ EU Code of Conduct 1997: Conclusions of the ECOFIN Council meeting of 1/12/1997 concerning taxation policy DOC 98/C2/01, *OJEC* (6.1.98), C 2/3; Pinto, Tax competition (n 117) p. 160; Pinto, EU and OECD (n 72) p. 389 and 392; R Szudoczky and J L van de Streek, 'Revisiting the Dutch Interest Box under the EU State Aid Rules and the Code of Conduct: When a 'Disparity' is Selective and Harmful' (2010) *Intertax* 38(5), p. 274; M F Nouwen, *Inside the EU Code of Conduct Group: 20 Years of Tackling Harmful Tax Competition* (Ph.D Thesis, UVA 2020), p. 111 and 410.

²⁴² EU Code of Conduct, *ibid.*; Pinto, EU and OECD, *Id.*, p. 389; Wishlade (n 192) p. 588; Ambrosiano and Caroppo (n 115) p. 691; C Biz, 'Countering Tax Avoidance at the EU Level after 'Luxleaks' A History of Tax Rulings, Transparency and BEPS: Base Erosion Profit Shifting or Bending European Prospective Solutions? (2015) *DPTI XII*(4), p. 1042; P Boria, *Taxation in European Union* (2nd edn, Springer 2017), p. 169; E Traversa and P M Sabbadini, 'State Aid Policy and the Fight against Harmful Tax Competition in the Internal Market: Tax Policy Disguise', in W Haslener, G Kofler and A Rust (eds), *EU Tax Law and Policy in the 21st Century* (Kluwer Law International 2017), p. 110; R Snoeij, *International Tax Aspects of Sovereign Wealth Investors: A Source State Perspective*, (Ph.D Thesis, EUR 2018), p. 121.

²⁴³ EU Code of Conduct, *Id.*, C 2/5; EU Com., Communication from the Commission to the Council, The European Parliament and the European Economic and Social Committee on Promoting Good Governance in Tax Matters, COM(2009) 201, 28/04/2009, p. 8.

²⁴⁴ EU Code of Conduct, *ibid.*; EU Com. Communication on good governance in tax matters, *ibid.*

²⁴⁵ Nouwen (n 241) pp. 101-102.

²⁴⁶ Bond et al. (n 78) p. X and 58; Pinto, EU and OECD (n 72) p. 389 and 406; Wilde, Tax Competition within the EU (n 142) p. 28; Harris and Olivier (n 158) p. 110; Biz (n 242) p. 1043; Radaelli, CoC against HTC (n 14) p. 513 and 521; Devereux (n 35) p. 632; G Meussen, 'The EU-fight against Harmful Tax Competition: Future Developments' (2002) *EC T.Rev.* p. 158; S Drezgić, 'Harmful Tax Competition in the EU with Reference to

of the European Union (CJEU). Indeed, the Code itself acknowledges that it is politically oriented. In the preamble, the Code mentions that it is a political commitment and does not affect the Member States' rights and obligations.²⁴⁷ This makes it a political instrument rather than a legal one.²⁴⁸ Its non-binding legal nature is also implicit in the title itself, which refers to guidelines intended to inform the conduct of members, without the intention of creating legal obligations.

The Code's non-binding nature is criticized as a major weakness in the fight against harmful tax competition.²⁴⁹ The absence of legally binding force is also counted among the drawbacks of the Code.²⁵⁰ This is true because the success of the Code's implementation relies only on the political will of the Member States, and not on legal enforcement.

However, there is also a view that the non-binding nature of the Code is not a weakness, but rather a strength. The Code's soft approach has been commented upon as successful and it has been said to have reached where hard approaches have failed to reach.²⁵¹ Indeed, the Code has been taken seriously and has been largely complied with.²⁵² One driving force lies in its

Croatia' (2005) *Journal of Economics and Business* 23(1), p. 80; B I Bai, 'The Code of Conduct and the EU Corporate Tax Regime: Voluntary Coordination without Harmonization' (2008) *Journal of International and Area Studies* 15(2), p. 115 and 119; M Nouwen, 'Highlights & Insights on European Taxation: Growth-friendly tax policies in Member States and better Tax Coordination in the EU' (2012) H&I 2012/2.3, p. 7 <file:///C:/Users/HP/Downloads/H&I2012-2-3.pdf> accessed 02/04/2020; S Douma, 'BEPS and European Union Law' (2017) *Cahiers de Droits Fiscal International* 102(a), p. 5; M Nouwen and P J Wattel, 'Tax Competition and the Code of Conduct for Business Taxation' in P J Wattel, O Marres, and H Vermeulen (eds), *European Tax Law* (7th edn, Wolters Kluwer 2019), p. 931.

²⁴⁷ EU Code of Conduct (n 241) C 2/5.

²⁴⁸ Wróblewska (n 159) p. 18; Ambrosiano and Caroppo (n 115) p. 691; Drezgić (n 246) p. 83; Boria (n 242) p. 168 and 170; Smit (n 159) p. 181; Snoeij (n 242) p. 121; Szudoczky and van de Streek (n 241) p. 274; Wishlade (n 192) p. 587; H Gribnau, 'Soft Law and Taxation: EU and International Aspects' (2008) *Legisprudence* 2(2), p. 67 and 83; B J M Terra and P J Wattel, *European Tax Law* (5th edn, Kluwer 2008), p. 111; M Nouwen, 'Highlights & Insights on European Taxation: Report from the Code of Conduct Group, Abuse, Third States, Double non-taxation, Interest on profit participating loans' (2012) H&I 2012/2.1, p. 5 <file:///C:/Users/HP/Downloads/H&I2012-2-1.pdf> accessed 02/04/2020; P J Wattel, 'Forum: Interaction of State Aid, Free Movement, Policy Competition and Abuse Control in Direct Tax Matters' (2013) *WTJ*, p. 135 and 143; E Traversa and A Flamini, 'Fighting Harmful Tax Competition through EU State Aid Law: Will the Hardening of Soft Law Suffice' (2015) *EStAL* 3, p. 326; V Moutarlier, 'Reforming the Code of Conduct for Business Taxation in the New Tax Competition Environment', in I Richelle, W Schön, and E Traversa (eds), *State Aid Law and Business Taxation* (Springer 2016), p. 77; M Nouwen, 'The European Code of Conduct Group Becomes Increasingly Important in the Fight against Tax Avoidance: More Openness and Transparency is Necessary' (2017) *Intertax* 45(2), p. 139; A Beckers, 'The Creeping Juridification of the Code of Conduct for Business Taxation: How EU Codes of Conduct Become Hard Law' (2018) *YEL* 37(1), p. 579 and 581; Nouwen (n 241) p. 44, 45, 406.

²⁴⁹ Pinto, Tax competition (n 117) p. 164; Pinto, EU and OECD (n 72) p. 389.

²⁵⁰ Pinto, Tax competition, Id., p. 304.

²⁵¹ Gribnau, Soft law and taxation (n 248) p. 83; Beckers (n 248) p. 580; Nouwen and Wattel (n 246) p. 929; Nouwen (n 241) p. 44, 406.

²⁵² Gribnau, Id., p. 84; P Dietsch, *Catching Capital: The Ethics of Tax Competition* (OUP 2015), p. 116.

dissuasive effect that encourages jurisdictions to comply with it to avoid being listed as non-cooperative jurisdictions.²⁵³ Moreover, thanks to the members' peer pressure,²⁵⁴ the Code scored long-standing effectiveness in addressing tax competition within the EU.²⁵⁵ In this respect, the Code served its purpose well, as its implementation abolished some harmful measures along with holding back others.²⁵⁶ This also confirms the extent to which the Code has been taken seriously and complied with.

Regarding the definition of harmful tax competition, the Council of the EU, like the OECD, did not define harmful tax competition. This has also been raised as a criticism of the Code.²⁵⁷ Still like the OECD, the EU in the Code of Conduct focused on the criteria of harmful tax competition. The guiding element has been the tax measure's ability to significantly affect, or potentially affect, the location of business activity, as a result of significantly lowering the level of taxation compared to the levels that generally apply in the Member States.²⁵⁸ In this view, the conclusive element in determining whether the measure is harmful is the purpose of the measure, which is to influence the location of business activity, in other words, to attract business activity. Thus, if a measure is adopted, but it is not likely to influence the location of the business, that measure is *prima facie* harmless. The business location is determined using the location test, while lowering the level of taxation is determined using the derogation test.²⁵⁹ The two tests are detailed below.

4.2.2. Location test and derogation test

The Code refers to the location test and derogation test and the two have been further developed in the literature. With regard to the location test, the Code is concerned with the measures that

²⁵³ CEU, The EU list of non-cooperative jurisdictions for tax purposes, FISC 345 ECOFIN 1088, 15429/17, 5/12/2017, *OJEU*, Vol. 60, 19.12.2017, C 483/13.

²⁵⁴ EU Com., *A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action*, Communication from the Commission to the European Parliament and the Council, COM(2015) 302 final {SWD(2015) 121 final}, 17/06/2015, p. 14; Gribnau, *Soft law and taxation* (n 248) p. 67; Terra and Wattel (n 248) p. 112; Wilde, *Tax Competition within the EU* (n 142) p. 28; H Gribnau, 'Improving the Legitimacy of Soft Law in EU Tax Law' (2007) *Intertax* 35(1), p. 30.

²⁵⁵ EU Com. Communication on a fair and efficient Corporate Tax System, Id., p. 3; Wilde, *Ibid*; F G Morina, 'The Legal Aspect of the Tax Competition in EU: Case of Kosovo' (2019) *Sriwijaya L.Rev.* 3(1) p. 3.

²⁵⁶ Wilde, *Ibid*; Snoeij (n 242) p. 121; Smit (n 159) p. 184.

²⁵⁷ Pinto, *Tax competition* (n 117) p. 165.

²⁵⁸ EU Code of Conduct (n 241) C 2/3; Traversa and Flamini (n 248) pp. 325-26; Nouwen and Wattel (n 246) p. 932-33; M Nouwen, 'The Gathering Momentum of International and Supranational Action against Aggressive Tax Planning and Harmful Tax Competition: The State of Play of recent Work of the OECD and European Union' (2013) *Euro.Tax.* 53(10), p. 12.

²⁵⁹ Wattel (n 248) p. 136.

significantly affect, or may affect, the location of business activities.²⁶⁰ The COCG confirms this in its Agreed Guidance²⁶¹ and in its assessment report on the Belgian notional interest deduction (NID) regime (BE018).²⁶² The phrase ‘significantly affect’ means that the measure must have sufficient weight to influence the business location. This means that a tax measure that cannot affect the business location falls outside the scope of the Code of Conduct. For example, in Portugal’s NID regime assessment, the COCG held the regime was outside the scope of the Code of Conduct as it could not significantly affect the business location.²⁶³ Similarly, if the measure’s effect is minimal, it also falls outside the scope of the Code of Conduct.²⁶⁴ The COCG applied the same thinking to Poland’s 15% CIT rate for small and start-up taxpayers.²⁶⁵ With respect to small taxpayers, the COCG stated that although the measure resulted in a significantly lower effective tax rate, it did not pass the gateway criterion because, when applied to small companies, it could not affect ‘*in a significant way the location of business activity in the Community.*’²⁶⁶

In the same vein, business location is the key element that determines the measure’s effect or potential effect. The measure must either affect the location of the business or must have the potential to do so. Nevertheless, it is difficult to prove that the measure has influenced the business location considering a variety of other factors that may come into play. That is why consideration of the potential effect on business location is important to palliate the challenges of demonstrating an actual effect on business location.

Regarding the derogation test, the Code refers to it by stating:

²⁶⁰ EU Code of Conduct (n 241) C2/3; Pinto, EU and OECD (n 72) p. 389; Englisch and Yevgenyeva (n 70) p. 636; Wishlade (n 192) p. 588; Ambrosanio and Caroppo (n 115) p. 691; Moutarlier (n 248) p. 78; Wattel (n 248) p. 136; EU Com. Communication on good governance in tax matters (n 243) p. 6; Boria (n 242) p. 169; P J Wattel, ‘Comparing Criteria: State Aid, Free Movement, Harmful Tax Competition and Market Distorting Disparities’, in I Richelle, W Schön, and E Traversa (ed.), *State Aid Law and Business Taxation* (Springer, 2016), p. 63.

²⁶¹ CEU, Agreed Guidance by the Code of Conduct Group (business taxation): 1998-2018, FISC 44 ECOFIN 75, 5814/4/18 REV 4, 20/12/2018, p. 16.

²⁶² CEU, Report on COCG assessment of Belgium’s NID regime (BE018), 14364/18 ADD 1, FISC 481 ECOFIN 1059, 20/11/2018, p. 39.

²⁶³ CEU, Report on COCG assessment of Portugal’s NID regime (PT018), 14364/18 ADD 8, FISC 481 ECOFIN 1059, 20/11/2018, p. 16.

²⁶⁴ Seeruthun-Kowalczyk (n 159) p. 170.

²⁶⁵ CEU, Report on COCG assessment of Poland’s 15% CIT rate for small taxpayers (PL006), 14364/18 ADD 7, FISC 481 ECOFIN 1059, 20/11/2018, pp. 2-4.

²⁶⁶ Ibid.

Tax measures which provide for a significantly lower effective level of taxation, including zero taxation, than those levels which generally apply in the Member State in question are to be regarded as potentially harmful and therefore covered by this Code.²⁶⁷

Thus, derogation refers to a deviation from the general level of taxation in the country.²⁶⁸ Derogating the generally applicable tax rate to give a lower effective level of taxation has been set by the Code as a gateway criterion, the presence of which gives a green light to evaluate other criteria, while the opposite puts a stop to further inquiry. In other words, if the gateway criterion is present, the regime is regarded as potentially harmful. This has been reiterated in several assessments carried out by COCG, whose reports state that deviating from the ordinary applicable rate to offer a significantly lower rate makes up a ‘potentially harmful’ situation. Examples include, but are not limited to, Malta’s NID regime,²⁶⁹ France’s new intellectual property regime,²⁷⁰ Costa Rica’s manufacturing activities under the Free Zones regime,²⁷¹ Cyprus’ NID regime,²⁷² Malta’s patent box regime,²⁷³ Belize’s fiscal incentives act,²⁷⁴ Belize’s commercial free zones,²⁷⁵ and Mongolia’s remote areas regime.²⁷⁶

Although a lower level of taxation is a key indicator, it is not sufficient on its own. In this regard, the Code lists five criteria to consider before concluding whether a measure is harmful.

4.2.3. The Code’s five criteria and their interpretation

The measures in the Code of Conduct have three purposes: reduction of market distortions, prevention of excessive tax revenue losses, and development of tax structures in a more

²⁶⁷ EU Code of Conduct (n 241) C 2/3.

²⁶⁸ Ibid; Wattel (n 248) p. 136; Ambrosiano and Caroppo (n 115) p. 691.

²⁶⁹ CEU, Report on COCG assessment of Malta’s NID regime (MT014), 14364/18 ADD 6, FISC 481 ECOFIN 1059, 20/11/2018, p. 16.

²⁷⁰ CEU, Report on COCG assessment of France’s new IP regime (FR054), 9652/19 ADD 2, FISC 274 ECOFIN 515, 27/05/2019, p. 15.

²⁷¹ CEU, Report on COCG assessment of Costa Rica’s manufacturing activities under the Free Zones regime (CR002), 9652/19 ADD 8, FISC 274 ECOFIN 515, 27/05/2019, p. 3.

²⁷² CEU, Report on COCG assessment of Cyprus’ NID regime (CY020), 9652/19 ADD 1, FISC 274 ECOFIN 515, 27/05/2019, p. 21.

²⁷³ CEU, Report on COCG assessment of Malta’s patent box regime (MT015), 14114/19 ADD 1, FISC 444 ECOFIN 1005, 25/11/2019, p. 16.

²⁷⁴ CEU, Report on COCG assessment of Belize’s fiscal incentives act (BZ003), 14114/19 ADD 4, FISC 444 ECOFIN 1005, 25/11/2019, p. 2.

²⁷⁵ CEU, Report on COCG assessment of Belize’s commercial free zone (BZ005), 14114/19 ADD 6, FISC 444 ECOFIN 1005, 25/11/2019, p. 2.

²⁷⁶ CEU, Report on COCG assessment of Mongolia’s remote areas regime (MN002), 14114/19 ADD 8, FISC 444 ECOFIN 1005, 25/11/2019, p. 2.

employment-friendly way.²⁷⁷ In this context, the Code has elaborated five criteria to determine whether a tax competition regime is harmful. These are:

- (1) whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents; or (2) whether advantages are ring-fenced from the domestic market, so they do not affect the national tax base; or (3) whether advantages are granted without any real economic activity or substantial economic presence; or (4) whether the rules for profit determination in respect of activities within a multinational group of companies depart from internationally accepted principles, notably the rules agreed upon within the OECD; or (5) whether the tax measures lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way.²⁷⁸

The above factors are summarized as lower level of taxation, ring-fencing, lack of substantial activity, lack of arm's length dealing, and lack of transparency.²⁷⁹ Accordingly, a measure becomes harmful if it grants a significantly lower level of taxation and is ring-fenced, does not respect the arm's length principle, lacks substantial activity, or lacks transparency.

Regarding the list of criteria, the Code is silent on whether the list is exhaustive. Even so, the plain language of the Code shows that it is not, a view which is shared by scholars.²⁸⁰ Indeed, the Code's use of the words '*inter alia*', i.e. among other things, directly preceding the list of criteria constructs an assumption that the list includes only examples of criteria to determine if a tax measure is harmful.

In addition to the criteria for determining harmful tax competition, the Code introduced and applied standstill and rollback clauses. The two clauses have been described as key features of the Code.²⁸¹ The standstill clause prevents Member States from introducing new harmful measures.²⁸² The rollback clause compels Member States to review, amend, and dismantle existing harmful measures or their harmful features as soon as possible.²⁸³ Thus, the prohibition to Member States is three-fold: refrain from introducing a new harmful tax measure, refrain

²⁷⁷ EU Code of Conduct (n 241) C 2/1.

²⁷⁸ EU Code of Conduct, Id., C 2/3; Seeruthun-Kowalczyk (n 159) p. 172.

²⁷⁹ Terra and Wattel (n 248) p. 112.

²⁸⁰ Szudoczky and van de Streek (n 241) p. 275; Nouwen and Wattel (n 246) p. 933; Nouwen (n 241) p. 109 and 123.

²⁸¹ COCG Agreed Guidance (n 261) pp. 31-32.

²⁸² EU Code of Conduct (n 241) C 2/4; Lampreave (n 100) p. 8; A C Santos and C M Lopes, 'Tax Sovereignty, Tax Competition and the Base Erosion and Profit Shifting Concept of Permanent Establishment' (2016) *EC T.Rev.* 5/6, p. 300.

²⁸³ COCG Agreed Guidance (n 261) pp. 31-32; EU Code of Conduct (n 241) C 2/4; Lampreave, *ibid*; Santos and Lopes, *Ibid*; Bai (n 246) p. 119.

from broadening the scope of an existing harmful tax measure, and refrain from replacing a measure that contains harmful features.²⁸⁴

Getting back, the Code's five criteria to determine harmful tax competition are detailed below, starting with the gateway criterion, i.e. the lower level of taxation criterion.

4.2.3.1. Lower level of taxation

Under the EU Code of Conduct, an effective lower level of taxation is a key factor to assess the harmfulness of a regime. It has been described as 'a significantly lower effective level of taxation than those levels which generally apply', including the payment of no tax at all or zero taxation.²⁸⁵ On several occasions, the COCG assessed measures that, in benefit of some taxpayers, fully or partially exempt or reduce the tax rates from the rates that generally apply as providing a significantly lower level of taxation.²⁸⁶ This means that a favorable tax measure that does not lead to a lower level of taxation, is excluded from harmful tax measures. Equally, general low-tax rates, i.e. applicable to all taxpayers, are excluded from the Code's interest.²⁸⁷ In other words, the Code is not concerned with the overall rate or level of CIT in Member States. Rather, it is concerned with measures that substantially reduce the level of tax payable compared to the usual level of taxation in the concerned state.²⁸⁸ The lower level may be by virtue of the nominal tax rate or the tax base or any other relevant factor.²⁸⁹

This criterion is very important in determining whether a regime is potentially harmful. It is described as a defining character, major identifier, major indicator, gateway criterion, initial

²⁸⁴ COCG Agreed Guidance, Id. p. 7; Pinto, Tax competition (n 117) p. 220; Bond et al. (n 78) p. 58; Boria (n 242) p. 169; Drezgić (n 246) pp. 87-88; Moutarlier (n 248) p. 78.

²⁸⁵ EU Code of Conduct (n 241) C 2/3 para. B; Teather, The Benefits of Tax Competition (n 165) p. 135; Bond et al. (n 78) p. 55; H Nijkamp, 'EU Stands up to Harmful Regimes' (2001) *Int'lT.Rev.* 12(3), p. 35.

²⁸⁶ CEU, Outcome of proceedings on COCG assessment of Morocco's Offshore holding companies regime (MA005), 7549/19 FISC 195, 15/03/2019, p. 3; CEU, Outcome of proceedings on COCG assessment of Morocco's Offshore banks regime (MA004), 7548/19 FISC 194, 15/03/2019, p. 3; CEU, Outcome of proceedings on COCG assessment of Dominica's Offshore banking regime (DM002), 7520/19 FISC 185, 15/03/2019, p. 3; CEU, Outcome of proceedings on COCG assessment of Panama's Foreign-owned call centers regime (PA005), 15117/18 FISC 520 ECOFIN 1164, 04/12/2018; CEU, Outcome of proceedings on COCG assessment of Armenia's governmentally approved projects outside Armenia (AM002), 12772/18 FISC 392 ECOFIN 871, 04/10/2018, p. 3.

²⁸⁷ Smit (n 159) p. 181.

²⁸⁸ Seeruthun-Kowalczyk (n 159) p. 170; Bond et al. (n 78) p. 55; Genschel, Kemmerling and Seils (n 140) p. 587; O Pastukhov, 'Counteracting Harmful Tax Competition in the European Union' (2010) *Sw.JIL* 16, p. 162.

²⁸⁹ CEU, The EU list of non-cooperative jurisdictions for tax purposes - Letters seeking commitment on the replacement by some jurisdictions of HPTR with measures of similar effect, FISC 95 ECOFIN 98, 5981/19, 1/02/2019, p. 7 and 22.

criterion, etc.²⁹⁰ Nevertheless, it is not determinative on its own; it must be combined with at least one other factor to qualify a regime as harmful. One factor with which the gateway criterion can be combined to create a harmful tax regime is ring-fencing, which is discussed in the next paragraphs.

4.2.3.2. Ring-fencing

Criteria 1 and 2 of the Code of Conduct are about ring-fencing. This is a mechanism designed to protect one's own tax base from the consequences of tax competition. The departing point is the difference in treatment between domestic companies and foreign companies or companies owned by non-residents or companies that do not have any link with the domestic market. With ring-fencing, foreign investors are favorably treated compared to domestic investors by offering tax advantages to foreign investors but not to domestic investors.²⁹¹ In this respect, to eliminate ring-fencing, the COCG recommends closing the favorable tax measure or extend it to residents.²⁹²

The key element in ring-fencing is the distinction between residents and non-residents in terms of the measure's advantage. This explains why the COCG's Agreed Guidance recognizes as ring-fencing those situations where the measure's beneficiaries are only non-residents.²⁹³ Domestic companies with foreign shareholding are also classified as non-residents.²⁹⁴ Prohibiting benefiting companies from trading in the local currency is also a characteristic of ring-fencing.²⁹⁵

Following the above, under the Code of Conduct, ring-fencing has two aspects, and each aspect can be *de jure* or *de facto*. The first aspect of ring-fencing is when the advantage is granted only to non-residents or to transactions carried out with non-residents. That is, the measure is only open to, and can only be accessed, by non-residents, while residents are

²⁹⁰ EU 2017 List of non-cooperative jurisdictions (n 253) p. 32; Barker (n 112) p. 170; Calich (n 70) p. 60 and 63; W Bratton and J A McCahery, 'Tax Coordination and Tax Competition in the European Union: Evaluating the Code of Conduct on Business Taxation' (2001) *CMLRev.* 38, p. 685; Nouwen (n 241) p. 108 and 109; Snoeij (n 242), p. 121.

²⁹¹ Baker (n 211) p. 176; Rixen (n 180) p. 73.

²⁹² CEU, Outcome of Proceedings on COCG Standstill review process on Luxembourg's draft law relating to the tax regime for intellectual property (LU017), 10931/18 FISC 299 ECOFIN 715, 6/07/2018, p. 14.

²⁹³ COCG Agreed Guidance (n 261) p. 118.

²⁹⁴ *Ibid.*

²⁹⁵ Barker (n 112) p. 176.

excluded from the measure either *de jure* or *de facto*. Under the EU Code of Conduct, this is criterion 1.

Criterion 1 of the EU Code of Conduct contains two elements. The first element, criterion 1a, is whether the measure is by law and/or regulation, exclusively available to non-residents or to transactions with non-residents.²⁹⁶ If this is the case, it is a *de jure* ring-fencing and is determined using literal interpretation. The second element, criterion 1b, is *de facto* ring-fencing, which happens when the advantage is not explicitly granted to non-residents by law or regulation, but is in practice enjoyed only or almost only or mainly by non-residents or for transactions with non-residents.²⁹⁷ This is determined using statistical data, and the measure qualifies as harmful if all or nearly all or most of the beneficiaries, taxpayers or transactions, are non-residents.²⁹⁸ Examples of the *de facto* ring-fencing include measures that restrict access to the local market, or are restricted to a specific business license, or to activities that are undertaken only by non-residents.²⁹⁹

The second aspect, which is criterion 2 of the EU Code, is where the advantages are ring-fenced from the domestic market. In this context, an assessment is done to determine whether the advantages are ring-fenced from the domestic market so that they do not affect the national tax base.³⁰⁰ Like criterion 1, criterion 2 is also sub-divided into two, namely criterion 2a on *de jure* interpretation and criterion 2b on *de facto* analysis.³⁰¹ The COCG has noted that

²⁹⁶ COCG Agreed Guidance (n 261) p. 117; EU 2017 List of non-cooperative jurisdictions (n 253) C 483/22; COCG assessment of Belgium BE018 (n 262) p. 32; COCG assessment of Poland PL006 (n 265) p. 4; CEU, Report on COCG assessment of Slovakia's patent box regimes (SK007), 14364/18 ADD 9, FISC 481 ECOFIN 1059, 20/11/2018, p. 9; CEU, Report on COCG assessment of Poland's IP regimes (PL012), 9652/19 ADD 5, FISC 274 ECOFIN 515, 27/05/2019, p. 24; CEU, Report on COCG assessment of Italy's NID regime (IT019), 14364/18 ADD 4, FISC 481 ECOFIN 1059, 20/11/2018, p. 19; COCG assessment of Cyprus CY020 (n 272) p. 21; CEU, Outcome of proceedings on Code of Conduct (Business Taxation) – Scoping paper on criterion 2.2 of the EU listing exercise, 10421/18, FISC 274 ECOFIN 657, AR/mf DG G2B, 22/06/2018, p. 17.

²⁹⁷ COCG Agreed Guidance (n 261) 118; EU 2017 List of non-cooperative jurisdictions, *ibid.*; COCG assessment of Belgium BE018 (n 262) 32; COCG assessment of Italy IT019, *ibid.*; COCG assessment of Cyprus CY020, *Ibid.*; COCG assessment of Poland PL006 (n 265) p. 5; COCG assessment of Poland PL012 (n 296) 17; COCG assessment of Slovakia SK007 (n 296) p. 9; Scoping Paper on criterion 2.2, *Id.*, p. 18.

²⁹⁸ EU 2017 List of non-cooperative jurisdictions, *ibid.*; COCG assessment of Belgium BE018, *ibid.*; COCG assessment of Poland PL006 (n 265) p. 5; COCG assessment of Slovakia SK007 (n 296) p. 9; COCG assessment of Poland PL012 (n 296) p. 17; COCG assessment of Italy IT019, *ibid.*; COCG assessment of Cyprus CY020, *Id.*, p. 22.

²⁹⁹ COCG Agreed Guidance (n 261) p. 118.

³⁰⁰ COCG assessment of Belgium BE018 (n 262) 32; COCG assessment of Poland PL006 (n 265) p. 5; COCG assessment of Slovakia SK007 (n 296) p. 9; COCG assessment of Cyprus CY020 (n 272) p. 21.

³⁰¹ COCG assessment of Belgium BE018, *Ibid.*; COCG assessment of Poland PL006, *ibid.*; COCG assessment of Slovakia SK007, *ibid.*; COCG assessment of Cyprus CY020, *ibid.*

measures that satisfy criterion 1 also satisfy criterion 2 in most cases, which motivates the application of the analogy.³⁰²

For clarification, the COCG considered several regimes not ring-fenced because the regimes apply to both residents and non-residents. For example, Poland's 15% CIT rate for small taxpayers was found not ring-fenced. That decision was due to the measure's availability to small taxpayers with sales revenues not exceeding 1,200,000 euros; taxpayers who start a business activity for that tax year; and foreign companies' permanent establishments that fulfill those conditions.³⁰³ Thus, there was no *de jure* exclusion of residents or transactions with residents.

By the same token, the COCG decided that Poland's intellectual property regime was not *de jure* ring-fenced because of the measure's applicability to all taxpayers who create, develop, or improve the qualified intellectual property rights as part of their R&D activity, while *de facto* application was deferred due to a lack of complete information.³⁰⁴ The COCG also decided the Slovak intellectual property regime was not *de jure* ring-fenced because the tax measure was available to all taxpayers with qualifying intellectual property assets.³⁰⁵ Similarly, the COCG concluded the Italian NID not *de jure* ring-fenced because of its availability to all companies based in Italy without restriction in terms of shareholding or business sector.³⁰⁶ The COCG also found it not *de facto* ring-fenced because the regime was predominantly used by residents.³⁰⁷ Other examples include, but are not limited to, the cases of Vietnam's export processing zones, Saint Lucia's free trade zones regime, Mauritius' partial exemption regime, Dominica's general incentive regime, and Antigua and Barbuda's free trade and special economic zone.³⁰⁸

³⁰² COCG assessment of Belgium BE018, *ibid*; COCG assessment of Poland PL006, *ibid*; COCG assessment of Slovakia SK007, *ibid*; COCG assessment of Costa Rica CR002 (n 271) 3; CEU, Outcome of proceedings on COCG assessment of Mauritius' Partial exemption regime (MU010), 13208/19, FISC 396, 16/10/2019, p. 3.

³⁰³ COCG assessment of Poland PL006, *Id.*, pp. 4-5.

³⁰⁴ *Ibid.*

³⁰⁵ COCG assessment of Slovakia SK007 (n 296) p. 9.

³⁰⁶ COCG assessment of Italy IT019 (n 296) p. 19.

³⁰⁷ *Ibid.*

³⁰⁸ CEU, Outcome of proceedings on COCG assessment of Vietnam's export processing zones (VN001), 12775/18 FISC 395 ECOFIN 874, 04/10/2018, p. 3; CEU, Outcome of proceedings on COCG assessment of Saint Lucia's Free Trade Zones regime (LC003), 7546/19 FISC 192, 15/03/2019, p. 1; COCG assessment of Mauritius MU010 (n 302) p. 2; CEU, Outcome of proceedings on COCG assessment of Dominica's General incentive under the Fiscal Incentives Act - FIA regime (DM003), 7521/19 FISC 186, 15/03/2019, p. 2; CEU, Outcome of proceedings on COCG assessment of Antigua and Barbuda's Free trade and special economic zone (FTZ) regime (AG003), 7416/20 FISC 83, 30/04/2020, p. 3.

In contrast to the above regimes, the COCG found some other regimes to be harmful based on their ring-fencing character that discriminates against residents and/or domestic markets. For instance, the COCG found the Cyprus' NID regime not *de jure* ring-fencing under criterion 1a, deferred for the criterion 1b, but ring-fencing under criterion 2. This was explained as '*the fact that the taxpayer benefit from a higher interest rate from foreign investment means the full advantages of this measure are ring-fenced from the domestic market.*'³⁰⁹ The COCG also qualified harmful the Costa Rica's manufacturing activities under the Free Zone regime simply because the law excluded resident companies from companies that the regime beneficiaries could transact with.³¹⁰

In the same vein, the COCG found Cook Islands' overseas insurance regime *de jure* ring-fenced under criterion 1 because it targeted foreign-owned enterprises, therefore granting advantages only to foreign companies and also *de facto* ring-fenced under criterion 2 because by targeting foreigners, the advantages became ring-fenced from the domestic market, without affecting the national tax base.³¹¹ Similarly, the COCG found Tunisia's export promotion incentives regime ring-fenced under criterion 2 because its holiday's reduction applies only to profits from exports, i.e. realized outside the domestic market.³¹² Other examples of regimes concluded ring-fenced because of targeting non-residents or foreign markets include Malaysia' headquarters, Korea's free trade/economic zones, Grenada's export processing, Grenada's international trusts, and Saint Vincent and Grenadine's international trusts.³¹³ Other examples are Saint Kitts and Nevis' offshore companies, Korea's foreign investment zone, Belize's EPZ enterprises, Antigua and Barbuda's international business corporations, Hong Kong's offshore private equity, Hong Kong's offshore funds, Morocco's offshore holding companies, Morocco's offshore banks, Aruba's transparency, Dominica's offshore banking, Tunisia'

³⁰⁹ COCG assessment of Cyprus CY020 (n 272) p. 22.

³¹⁰ COCG assessment of Costa Rica CR002 (n 271) p. 3.

³¹¹ CEU, Report on COCG assessment of Cook Islands' Overseas insurance regime (CK003), 9652/19 ADD 7, FISC 274 ECOFIN 515, 27/05/2019, p. 5.

³¹² CEU, Outcome of proceedings on COCG assessment of Tunisia's Export promotion incentives regime (TN001), 7550/19 FISC 196, 15/03/2019, p. 4.

³¹³ CEU, Outcome of proceedings on COCG assessment of Korea's Free Trade/Economic Zone – FTEZ regime (KR002), 7524/19 FISC 189, 15/03/2019, p. 3; CEU, Outcome of proceedings on COCG assessment of Malaysia's Headquarters (or principal hub) regime (MY012), 10267/19 FISC 289, 12/06/2019, p. 3; CEU, Outcome of proceedings on COCG assessment of Grenada's Export Processing regime (GD006), 7469/19 FISC 178, 14/03/2019, p. 4; CEU, Outcome of proceedings on COCG assessment of Grenada's International Trusts regime (GD004), 7467/19 FISC 176, 14/03/2019, p. 3; CEU, Outcome of proceedings on COCG assessment of Saint Vincent and the Grenadine's International Trusts regime (VC002), 7564/19 FISC 201, 15/03/2019, p. 2.

offshore financial services, Panama's foreign-owned call centers, Morocco's coordination centers, and Armenia's governmentally approved projects.³¹⁴

Additionally, it is evident that the hard-core element in the ring-fencing criterion is the intent. This makes sense because, in setting up a favorable tax measure, the intent is *'to attract additional tax base from other states without negatively affecting the domestic tax revenues.'*³¹⁵ Thus, the element of the country's intent is of great importance with respect to ring-fencing. This means that, setting favorable tax rates is generally accepted unless if it is done to poach other states' tax bases, in which case, it becomes problematic and bad. One scholar explained it as follows:

A country may legitimately adopt whatever tax rate it deems appropriate; may impose different tax rates on different types of income; and may even refrain from taxing certain types of income, but once it does so, it must apply those rates across the board to residents and non-residents alike.³¹⁶

Furthermore, under the EU order, great weight is given to ring-fencing as the primary criterion to distinguish bad tax competition from good tax competition. For illustration, Saint Lucia's exemption of foreign income regime was assessed and found harmful because it was ring-fenced, although it was not harmful when measured against other criteria.³¹⁷ In the same vein, ring-fencing was described as an important sign and most qualifying element of harmful tax competition.³¹⁸ Equally, ring-fencing is described as a predatory form of tax competition, which

³¹⁴ CEU, Outcome of proceedings on COCG assessment of Saint Kitts and Nevis' Offshore companies regime (KN001), 7522/19 FISC 187, 15/03/2019, pp. 4-5; CEU, Outcome of proceedings on COCG assessment of Korea's Foreign investment zone regime (KR001), 7523/19 FISC 188, 15/03/2019, p. 3 and 5; CEU, Outcome of proceedings on COCG assessment of Belize's Export Processing Zones: EPZ enterprises regime (BZ002), 7615/19 FISC 203, 18/03/2019, p. 8; CEU, Outcome of proceedings on COCG assessment of Antigua and Barbuda's International business corporations regime (AG001), 7461/19 FISC 170, 14/03/2019, p. 3; CEU, Outcome of proceedings on COCG assessment of Hong Kong's Offshore private equity regime (HK003), 7516/19 FISC 181, 15/03/2019, p. 3; CEU, Outcome of proceedings on COCG assessment of Hong Kong's Offshore funds regime (HK002), 7470/19 FISC 179, 14/03/2019, p. 3; COCG assessment of Morocco MA005 (n 286) p. 2; COCG assessment of Morocco MA004 (n 286) 2; CEU, Outcome of proceedings on COCG assessment of Aruba's Transparency regime (AW013), 9646/19 FISC 273, 22/05/2019, 3; COCG assessment of Dominica DM002 (n 286) p. 2-3; CEU, Outcome of proceedings on COCG assessment of Tunisia's Offshore financial services regime (TN002), 7560/19 FISC 197, 15/03/2019, p. 2; COCG assessment of Panama PA005 (n 286) p. 2; CEU, Outcome of proceedings on COCG assessment of Morocco's Coordination centers regime (MA001), 7547/19 FISC 193, 15/03/2019, p. 2; COCG assessment of Armenia AM002 (n 286) p. 3.

³¹⁵ J Hey, 'Tax Competition in Europe: The German Perspective' (EATLP Conference, Lausanne, 2002), p. 7 <www.eatlp.org/uploads/Members/Germany02.pdf> accessed 13/08/2019.

³¹⁶ Elkins (n 238) p. 915.

³¹⁷ CEU, Letters seeking commitment FISC 95 ECOFIN 98 (n 289) p. 6 and 24.

³¹⁸ Hey (n 315) p. 7; Deák (n 227) p. 31; Elkins (n 238) p. 947; V Sobotková, 'Revisiting the Debate on Harmful Tax Competition in the European Union' (2012) *Acta Universitatis Agriculturae et Silviculturae Mendelianae Brunensis* 36(4), p. 345; Nouwen (n 241) p. 127.

attempts to get profits at the expense of other countries' treasuries, and from its ability to instigate the race to the bottom that ends up with detrimental repercussions for all.³¹⁹ Nevertheless, other criteria, such as the requirement for economic substance, are also taken into account in determining harmfulness.

4.2.3.3. Lack of substantial activity requirement

Another criterion in the Code is the requirement for substantial activity. The COCG refers to it as criterion 3. It assesses whether a measure grants advantages without there being any actual economic activity and/or substantial economic presence in the country granting the advantage. The COCG has concluded in several assessments that the absence of substantial activity makes the measure harmful.³²⁰ This criterion has two aspects: the real economic activity and the substantial economic presence. The first aspect refers to the nature of the activity, while the second aspect refers to the factual manifestations of the activity.³²¹

According to the Code, a measure that is granted without requiring the beneficiary to engage in real economic activity and/or have a substantial economic presence is harmful.³²² This was the COCG's position in the case of the Cook Islands overseas insurance regime.³²³ In contrast, a measure that requires economic activity or substantial economic presence through job creation is not regarded harmful. To satisfy this criterion, Member States are required to avoid granting advantages to companies with no real economic activity or presence, such as so-called letter-box companies and/or artificial arrangements.³²⁴

By the same token, the COCG directs the consideration of the following elements when assessing this criterion: *'adequate level of employees, adequate level of annual expenditure,*

³¹⁹ Elkins, Id., p. 909 and 915; Pinto, EU and OECD (n 72) p. 393.

³²⁰ CEU, Outcome of proceedings on COCG assessment of Dominica's International business company – IBC regime (DM001), 7519/19 FISC 184, 15/03/2019, p. 5; CEU, Outcome of proceedings on COCG assessment of Liechtenstein's Tax exempt corporate income regime (LI001), 12773/18 FISC 393 ECOFIN 872, 04/10/2018, p. 5; CEU, Outcome of proceedings on COCG assessment of Grenada's International companies regime (GD001), 7464/19 FISC 173, 14/03/2019, p. 4; COCG assessment of Aruba AW013 (n 314) 5; COCG assessment of Antigua and Barbuda AG001 (n 314) 4; COCG assessment of Tunisia TN002 (n 314) 4; COCG assessment of Dominica DM002 (n 286) 4; COCG assessment of Armenia AM002 (n 286) 4.

³²¹ EU 2017 List of non-cooperative jurisdictions (n 253) C 483/23; Scoping Paper on criterion 2.2 (n 296) p. 19; Nouwen (n 241) p. 133.

³²² Hey (n 315) p. 7.

³²³ Ibid.

³²⁴ Beckers (n 248) p. 579.

*physical offices and premises, and investments or relevant types of activities.*³²⁵ To determine what adequate level of employees is, the COCG considers the average number of employees, employees' full-time versus part-time status, employees' qualifications in relation to the nature of activity, quantitative and qualitative aspects of management and administration,³²⁶ etc. An example of the application of this is Saint Lucia that was assumed to satisfy the substance requirement based on its legislative requirement for international business companies benefiting the tax exemption to have '*an adequate number of employees with the necessary level of qualifications and experience, an adequate amount of operating expenses, and an adequate amount of investment and capital that is commensurate with the type and level of company's activity*'.³²⁷

In the same vein, the real economic activity is *a priori* assumed satisfied for regimes that grant tax benefits to manufacturing and/or production activities; activities that are not highly mobile; investment in tangible assets such as buildings, construction, technical equipment and facilities;³²⁸ etc. For such activities, worries to attract mobile tax base are reduced, and the regime does not *a priori* raise concern regarding a lack of substantial economic activity.³²⁹ This is because manufacturing and production activities require tangible assets for long-term investment, such as buildings, equipment, and other technical facilities.³³⁰

The requirement of real economic activity and/or substantial economic presence aims to halt fictitious residences, i.e. legal residencies that differ from the physical places of investment.³³¹ Through a nexus test, it is verified if there is an adequate link, *de jure* or *de facto*, between the measure and the benefiting taxpayer who must undertake income-generating activities.³³² Thus, if a company benefiting from a favorable tax measure does not have a substantial economic presence, it shows that the company has decided to invest only to benefit

³²⁵ COCG Agreed Guidance (n 261) p. 119 and 128; EU 2017 List of non-cooperative jurisdictions (n 253) C 483/23; Scoping Paper on criterion 2.2 (n 296) p. 19; CEU, Letters seeking commitment FISC 95 ECOFIN 98 (n 289) p. 23.

³²⁶ COCG Agreed Guidance, Id., p. 129; Scoping Paper on criterion 2.2, Id., p. 3.

³²⁷ CEU, Letters seeking commitment FISC 95 ECOFIN 98 (n 289) 23.

³²⁸ Id., p. 126.

³²⁹ Ibid; COCG assessment of Costa Rica CR002 (n 271) 5; Nouwen (n 241) p. 137.

³³⁰ CEU, Letters seeking commitment FISC 95 ECOFIN 98 (n 289) 126.

³³¹ Webb (n 160) p. 802.

³³² COCG assessment of Belgium BE018 (n 262) p. 33; CEU, Outcome of proceedings on COCG assessment of Liechtenstein's Interest deduction on equity / NID regime (LI003), 12774/18 FISC 394 ECOFIN 873, 04/10/2018, p. 3; Nouwen (n 241) p. 135 and 410.

from the favorable tax measures.³³³ It may also show that the country that offers the favorable tax measures did so to attract mobile business activities to the detriment of other states' tax bases.³³⁴ This highlights the importance of the requirement of real economic activity or substantial economic presence.

On many occasions, the COCG has used the element of economic substance with great effect. For example, the UAE and Vanuatu were listed as non-cooperative jurisdictions because of their arrangements designed to attract profits without real economic substance.³³⁵ Similarly, Mauritius' partial exemption regime was found clean on other criteria, but identified as not meeting the economic substance criterion and the overall assessment was harmful.³³⁶

Apart from the substance criterion, another criterion in the Code to determine the harmfulness of a measure is the failure to comply with the arm's length principle. This criterion is also referred to as failure to comply with the OECD rules on profit determination, as detailed below.

4.2.3.4. Non-compliance with OECD rules on profit determination

The Code of Conduct criterion 4 assesses whether the rules on profit determination within multinational companies comply with internationally accepted principles. The purpose of this criterion is to prevent multinationals from engaging in transfer mis-pricing in order to shift profits to low-tax jurisdictions.³³⁷ In this respect, the Code of Conduct expressly relies on the OECD rules. Thus, if a measure complies with these rules, it does not qualify as harmful. In contrast, if it is not compliant, it qualifies as harmful. For example, the COCG Agreed Guidance mentions that it is harmful for parent companies if the profit determination is done other than in accordance with the OECD Transfer Pricing Guidelines.³³⁸ Thus, the EU Code of Conduct has explicitly endorsed the OECD guidelines on transfer pricing.

Examples of COCG assessments on this criterion include the Italian NID regime. The COCG concluded that it complied with criterion 4, because '*the measure does not contain such*

³³³ Pinto, Tax competition (n 117) p. 162.

³³⁴ Ibid; Dirix (n 188) p. 235.

³³⁵ CEU, The EU list of non-cooperative jurisdictions for tax purposes (2019/C 176/03), *OJEU*, 22/05/2019, C 176/3.

³³⁶ COCG assessment of Mauritius MU010 (n 302) p. 6 and 9.

³³⁷ Scoping Paper on criterion 2.2 (n 296) p. 21.

³³⁸ COCG Agreed Guidance (n 261) p. 10.

*elements that would be relevant from the point of view of internationally accepted principles.*³³⁹

In contrast, the COCG found regimes with a fixed CIT at a lump sum amount not in line with the OECD's internationally accepted principles and, therefore, not in compliance with criterion 4 of the EU Code of Conduct.³⁴⁰ These examples show the extent to which the COCG relies on the OECD transfer pricing rules in assessing whether a regime is harmful.

The particular focus on profit determination within multinational companies can be justified by the fact that in controlled transactions, companies can manipulate their profits to minimize the amount of tax payable. This is not the case in uncontrolled transactions where prices are determined by market conditions. This gives rise to the need to look more closely at the determination of profits within multinationals. Nevertheless, other criteria, such as the transparency requirement, are also relevant in determining whether a regime is harmful, as discussed below.

4.2.3.5. Lack of transparency

Criterion 5 in assessing the harmfulness of favorable tax regimes relates to transparency. The criterion of transparency aims to promote equality between taxpayers in similar situations. Thus, a lack of transparency is a serious indicator of harmful tax competition.³⁴¹ The importance of this criterion has been explained in two ways. First, a lack of transparency can occur because of unpublished or secret rulings.³⁴² Second, a lack of transparency may result from administrative practices that go beyond the interpretation of tax legislation and exercise discretion in tax treatment in favor of certain taxpayers or certain transactions.³⁴³ Tax burden negotiability, lax recovery, and relaxation of the legal provisions at the administrative level in a non-transparent way also leads to a lack of transparency.³⁴⁴ In brief, lack of transparency includes tax measures that are not transparent, as well as non-transparent administrative relaxation of legal provisions in favor of a particular taxpayer.

The COCG Agreed Guidance states that a measure is *prima facie* not transparent if the details of its existence, scope, and conditions are not published.³⁴⁵ The COCG has provided

³³⁹ COCG assessment of Italy IT019 (n 296) p. 23.

³⁴⁰ COCG assessment of Morocco MA004 (n 286) 4; COCG assessment of Morocco MA005 (n 286) p. 4.

³⁴¹ EU Com. Communication on a fair and efficient Corporate Tax System (n 254) p. 12; Boulogne (n 67) p. 53.

³⁴² Pinto, Tax competition (n 117) p. 162.

³⁴³ *Ibid.*

³⁴⁴ EU Code of Conduct (n 241) C 2/3; Nouwen and Wattel (n 246) 933.

³⁴⁵ COCG Agreed Guidance (n 261) p. 8.

some guidance to improve transparency and ensure compliance with criterion 5. An example of such guidance is the incorporation of tax rulings in public legislation or public administration guidelines.³⁴⁶ The procedures and conditions underlying rulings should also be embedded in a transparent, i.e. publicly accessible, legal, and administrative framework.³⁴⁷ If it is a ruling that may have horizontal application, it should be published or reflected in a guidance document or otherwise made publicly available.³⁴⁸ In addition, the COCG emphasized in several assessments that, for a measure to be transparent, all preconditions thereto pertaining must be clearly set out in publicly available laws, decrees, regulations, or the like.³⁴⁹

For example, in applying the transparency criterion, the COCG assessed Costa Rica's manufacturing activities under the Free Zones regime and concluded that the measure was not harmful under criterion 5 because it was '*fully set out and published in the relevant legislation and the practice does not involve any administrative discretion.*'³⁵⁰ The COCG reached a similar conclusion when assessing Liechtenstein's CIT exempt and Mauritius' partial exemption regime.³⁵¹ In contrast, the COCG found Cook Islands' Development Projects regime not transparent because it granted benefits based on '*the opinion of the Collector.*'³⁵² The COCG also came to the same conclusion about Singapore's DEI regime which did not publish the conditions thereto prevailing along with the Minister's discretion in granting the certificate.³⁵³

The above criteria have often been used by the COCG to assess domestic tax regimes. Such assessments are referred to as one-country issues and have been labeled as quasi-case law or pseudo-case law.³⁵⁴ Besides, other works of the COCG include two-country issues comprising common policies development (quasi or pseudo-legislation), and third-country issues comprising dialogue with non-EU countries on the possible application of the Code's

³⁴⁶ Id., p. 22.

³⁴⁷ CEU, Report from COCG to ECOFIN Council on 08/06/2010, 10033/10, FISC 47, 25/05/2010, p. 11; A Semeta, 'Competitive Tax Policy and Tax Competition in the EU' (2011) Speech/11/712, 2nd Taxation Forum of Diario Economico/OTOC, p. 4 <https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_11_712> accessed 14/08/2019.

³⁴⁸ Semeta, *ibid.*

³⁴⁹ COCG assessment of Poland PL006 (n 265) p. 7; COCG assessment of Costa Rica CR002 (n 271) p. 4; COCG assessment of Liechtenstein LI001 (n 320) p. 8; COCG assessment of Mauritius MU010 (n 302) p. 4; COCG assessment of Morocco MA001 (n 314) 5; CEU, Outcome of proceedings on COCG assessment of Aruba's Special zone San Nicolas regime (AW012), 7518/19 FISC 183, 15/03/2019, p. 5.

³⁵⁰ COCG assessment of Costa Rica CR002, *ibid.*

³⁵¹ COCG assessment of Liechtenstein LI001 (n 320) p. 8; COCG assessment of Mauritius MU010 (n 302) p. 4.

³⁵² CEU, Outcome of proceedings on COCG assessment of Cook Islands' Development Projects regime (CK006), 7422/20 FISC 88, 30/04/2020, p. 5.

³⁵³ Boulogne (n 67) p. 42.

³⁵⁴ Nouwen (n 248) p. 140.

criteria.³⁵⁵ Activities regarding two country-issues aim to develop coordinated tax policies. In this context, a number of topics have been discussed so far, such as common tax ruling policies; information exchange on cross-border rulings; EU-inbound (gatekeeper problem) i.e. participation exemption for payments (dividends) made by a non-EU company in a low-tax jurisdiction to an EU company; EU-outbound profit transfers (reverse gatekeeper problem) about the payments (dividends) made by an EU company to a non-EU company; hybrid mismatches; hybrid entities; and transfer pricing.³⁵⁶ On the issues of transfer pricing and mismatches, alignment approaches were suggested. On transfer pricing, it was said that transfer prices should be aligned with actual value creation, while on mismatches *'no exemption should be given on payments that are deductible by the foreign borrower'*.³⁵⁷ Nevertheless, the discussions have been held on whether these topics are part of harmful tax competition. This is the case, for example, with international financial hybrid mismatches, where opinions are divided.³⁵⁸

That being the case, the purpose of the previous paragraph was to showcase the progress and other activities of the COCG. Although relevant, this book focuses on one-country issues (quasi-case law). Not only because it is the COCG's most-known working area,³⁵⁹ but also because of this book's concern, which is to assess the Rwandan favorable tax measures using the EAC, EU, and OECD approaches, and not to discuss the broader issues of harmful tax competition.

Returning to the Code of conduct, its criterion 4 refers extensively to the OECD rules on transfer pricing. That shows the extent to which the EU Code criteria are in harmony with the OECD factors on harmful tax competition. That harmony, among other things, is the basis of the following comparative section.

4.3. The EU Code criteria vis-a-vis the OECD factors

To a large extent, there is an interface between the OECD factors and the EU criteria on harmful tax competition. Notwithstanding some differences, the criteria established by both are almost

³⁵⁵ Ibid.; Nouwen and Wattel (n 246) p. 932.

³⁵⁶ Nouwen (n 248) p. 141-43; Nouwen and Wattel, Id., p. 939; Nouwen (n 258) p. 11; Nouwen (n 241) p. 321, 327, 334, 350-352.

³⁵⁷ Nouwen (n 258) p. 16-17; Nouwen (n 248) p. 144.

³⁵⁸ Nouwen (n 248) p. 139.

³⁵⁹ Nouwen (n 258) p. 11; Nouwen and Wattel (n 246) p. 934; Nouwen (n 241) p. 107 and 157.

identical or similar in many respects.³⁶⁰ The extent of their similarity is not surprising, considering that the membership of the two organizations largely overlaps. The 1998 OECD Report also acknowledged the broad compatibility between the two.³⁶¹ The similarity is brought about by the convergence of the same tax message. However, there are also divergences between the two. The following paragraphs elaborate on the points of convergence and divergence between the two.

4.3.1. Points of convergence

The first point of similarity between the OECD factors and the EU criteria is the common criteria that are applied by both institutions to determine the harmfulness of a measure. In fact, most of the factors are broadly the same and interrelate in many ways.³⁶² Such similar factors are ring-fencing, absence of substantial activity, and lack of transparency. The two organizations also place a similar emphasis on ring-fencing³⁶³ and both have declared that a low general tax rate alone does not constitute harmful tax competition.³⁶⁴ The EU criterion on rules departing from internationally accepted principles when determining profits in respect of activities within a multinational group is also similar to the OECD second category factor on failure to adhere to international transfer pricing principles. On this point, the EU has even confirmed the application of OECD rules on profit determination in respect of activities within MNCs and the COCG has often relied on OECD assessments.³⁶⁵ The EU Code of Conduct's gateway criterion of a significantly lower level of taxation also resembles the OECD's main factors of no or only nominal tax rates for tax havens and zero or low effective tax rate for HPTRs.

³⁶⁰ Santos and Lopes (n 282) p. 300; Wróblewska (n 159) p. 18; F Heitmüller and I J Mosquera Valderrama, 'Special Economic Zones facing the Challenges of International Taxation: BEPS Action 5, EU Code of Conduct, and the Future' (2021) *JIEL* 24, p. 481.

³⁶¹ OECD 1998 Report (n 60) p. 11.

³⁶² Pinto, Tax competition (n 117) p. 233; Boulogne (n 67) p. 26; L V Faulhaber, 'The Trouble with Tax Competition: From Practice to Theory' (2018) *Tax L.Rev.* 71(311), p. 329.

³⁶³ Elkins (n 238) p. 914; A Haupt and W Peters, 'Restricting Preferential Tax Regimes to Avoid Harmful Tax Competition' (2005) *Reg.Sci.Ur.Econ.* 35, p. 494.

³⁶⁴ Bond et al. (n 78) p. 55 and 62; Seeruthun-Kowalczyk (n 159) p. 170; P Genschel, A Kemmerling and E Seils, 'Accelerating Downhill: How the EU Shapes Corporate Tax Competition in the Single Market' (2011) *JCMS* 49(3), p. 587.

³⁶⁵ EU Code of Conduct (n 241) C2/3; COCG assessment of Hong Kong HK002 (n 314) p. 3; COCG assessment of Hong Kong's Offshore private equity regime HK003 (n 314) p. 3; CEU, Outcome of proceedings on COCG assessment of Curacao's Manufacturing activities under the eZone regime (CW005), 7423/20 FISC 89, 30/04/2020, p. 3.

The influence on business location enshrined in the EU Code of Conduct³⁶⁶ is also recognized by the OECD, which considers a regime harmful if its primary motivation is the location of business activity.³⁶⁷ The enforcement mechanism of both organizations is also the same, as they both rely on political pressure.³⁶⁸ Furthermore, they both apply to a range of harmful tax measures as these may be provided for in legislation, regulations, and administrative practices.³⁶⁹ Also, both organizations have advocated for a broader application of their principles beyond their respective members.³⁷⁰

From the above, the compatibility, reinforcement, and complementarity of the EU Code of Conduct and the OECD Guidelines is clear. Indeed, the two organizations work in a complementary manner³⁷¹ and have been described as ‘*brothers in arms on the harmful tax competition battlefield*’³⁷² with mutually compatible reinforcement.³⁷³ Even so, each organization remains independent in the interpretation and application of its instruments,³⁷⁴ alongside other differences.

4.3.2. Points of divergence

One divergence between the 1998 OECD Report and the EU Code of Conduct concerns their scope of application. While the EU Code applies to business activities in general, the OECD Report is limited to geographically mobile activities such as financial and other service activities.³⁷⁵ This means that the EU Code has a wider scope *ratione materiae* than the scope of application of the 1998 OECD Report. There is also a difference in geographical scope of application. While some states belong to both organizations, others belong to only one or the other. Thus, the *ratione loci* scope of application of the 1998 OECD Report is wider than the scope of application of the EU Code of Conduct.

³⁶⁶ EU Code of Conduct, *ibid*.

³⁶⁷ OECD 1998 Report (n 60) p. 35.

³⁶⁸ Wishlade (n 192) p. 589.

³⁶⁹ Ambrosanio and Caroppo (n 115) p. 691; L A Mello, *Tax Competition and the Case of Bank Secrecy Rules: New Trends in International Tax Law* (SJD Dissertation, Univ. Michigan 2012), pp. 25-26.

³⁷⁰ EU Code of Conduct (n 241) C 2/5; OECD 1998 Report (n 60) p. 8, 10, and 25.

³⁷¹ Heitmüller and Mosquera Valderrama (n 360), p. 482.

³⁷² Gribnau, *Soft law and taxation* (n 248) p. 68.

³⁷³ Pinto, *Tax competition* (n 117) p. 233; OECD 1998 Report (n 60) p. 11; Englisch and Yevgenyeva (n 70) p. 636; Wishlade (n 192) p. 588; Boulogne (n 67) p. 26.

³⁷⁴ OECD 1998 Report, *ibid*. p. 11

³⁷⁵ OECD 1998 Report, *Id.*, preamble and p. 11; Lampreave (n 100) p. 8; Boulogne (n 67) p. 26; Wishlade (n 192) p. 588; Barker (n 112) p. 169; Ayi-Yonah, *Bridging the north/south divide* (n 72) p. 385; Drezgić (n 246) p. 83; Dirix (n 188) p. 234; Biz (n 242) p. 1054; Nicodème (n 103) p. 758.

Beyond the difference in scope of application, the two also diverge on the implementation of the harmful factors. The OECD addresses harmful tax competition issues by separating tax havens from HPTRs, which is not the case for the EU. In addition, some factors set by the OECD are not mentioned among the EU criteria. One example is EoI, which carries great weight for the OECD but not listed among the EU criteria. Nevertheless, the EU takes EoI into account when listing non-cooperative jurisdictions.³⁷⁶

All in all, both organizations are committed to the fight against harmful tax competition. In this respect, the two organizations have contributed to the global effort to curb harmful tax practices as discussed below.

4.4. OECD and EU contributions in regulating harmful tax practices

Considered globally, the OECD and the EU play a significant role in regulating harmful tax practices. The two organizations have been very active in the fight against harmful tax competition.³⁷⁷ The two are also considered as the main champions against harmful tax competition, and their proposals have generated serious emotions and debates.³⁷⁸ The next paragraphs provide an insight into the role of the two organizations.

4.4.1. OECD contribution in regulating harmful tax practices

The OECD's contribution to the regulation of harmful tax practices is both great and commendable. Most of the issues pertaining to harmful tax practices increased after this organization's report in 1998. This report has played a key role in making the world aware of the problems caused by harmful tax practices. It is also a major achievement as it is the first attempt to curb harmful tax competition³⁷⁹ by providing a regulatory framework to analyze whether a jurisdiction is engaging in harmful tax practices.³⁸⁰

More importantly, pursuant to the 1998 Project on harmful tax competition, the OECD established and implemented a forum on harmful tax practices tasked with providing consistent assessments of tax havens and HPTRs. In this context, the Forum on Harmful Tax Practices

³⁷⁶ EU 2019 List of non-cooperative jurisdictions (n 335) C 176/2.

³⁷⁷ McLaren, *Will Tax Havens Survive* (n 159) p. 89.

³⁷⁸ Baker (n 211) p. 2; Barker (n 112) p. 171.

³⁷⁹ R S Avi-Yonah, 'Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State' (2000) *HarvLRev* 113(7), p. 1662.

³⁸⁰ Wróblewska (n 159) p. 17.

published several reports on tax havens and HPTRs. The publication of these reports has been followed by political pressure on the named jurisdictions to stop their harmful tax practices.

Another contribution of the OECD is that it clarified that not all preferential tax regimes are bad.³⁸¹ For example, the OECD explained that a preferential tax regime can cause little harm to another country and is justified as long as it provides substantial benefits to the host country.³⁸² The OECD also clarified that there is no general minimum effective tax rate below which a regime can be harmful.³⁸³ Similarly, the OECD clarified that it neither prevents nor discourages countries from providing preferential tax regimes.³⁸⁴ These clarifications were necessary and are most noteworthy.

In addition, the OECD has produced many important documents. Among them is the landmark Model Tax Agreement on Exchange of Information in Tax Matters.³⁸⁵ Another significant document resulted from the OECD's joint efforts with the G20: a report on BEPS. Of the 15 actions of the BEPS project, Action 5 is about tackling harmful tax practices, extending the OECD's role in combating harmful tax practices. Those OECD contributions, while not exhaustive, show the OECD's influence in the area of harmful tax practices. The same applies to the contribution of the EU, whose role is highlighted below.

4.4.2. EU contribution in regulating harmful tax practices

The EU has contributed to the regulation of harmful tax practices. With its 1997 Code of Conduct, the EU became the first governmental body to formulate measures against harmful tax competition.³⁸⁶ Initially, the target was its members, members' dependents and associated territories. However, due to the EU's global political influence, its rules and policies have influence beyond its territorial jurisdiction.

Indeed, the EU expressed its intention to go beyond its jurisdiction and reach out to other jurisdictions. The EU Code of Conduct calls for its broad adoption beyond the EU territory.³⁸⁷

³⁸¹ Lampreave (n 100) p. 8.

³⁸² Ibid.

³⁸³ Ring, *Sovereignty Debate* (n 103) p. 23; Bond et al. (n 78) p. 62; OECD, Confidential draft Recommendation (n 86) p. 5.

³⁸⁴ OECD CAN (n 71) p. 20 and 24; Samuels and Kolb (n 78) p. 232.

³⁸⁵ H G Petersen (ed), 'Tax Systems and Tax Harmonization in the East African Community' (2010) Report for the GTZ and the General Secretariat of the EAC, p. 23.

³⁸⁶ T Katsushima, 'Harmful Tax Competition' (1999) *Intertax* 27(11), p. 396.

³⁸⁷ EU Code of Conduct (n 241) C 2/5; EU Com. Communication on good governance in tax matters (n 243) p. 26.

One reason was to dismantle preferential tax regimes worldwide by creating a level playing field seeking at discouraging relocation of mobile business activities outside the EU.³⁸⁸ As long as the principle of state sovereignty is not violated, countries outside EU territory are free to adopt the principles embodied in the Code of Conduct. For instance, the EAC draft Code of Conduct imitates *mutatis mutandis* the EU Code of Conduct.

By the same token, the EU established the COCG to assess and monitor compliance with the Code of Conduct,³⁸⁹ which has played a significant role in slowing down harmful tax competition in the EU and beyond. As a result, harmful tax practices in the EU are restrained compared to other jurisdictions. In this respect, the Code of Conduct has been a major step forward in the fight against harmful tax competition.³⁹⁰ Furthermore, despite being an extremely difficult task,³⁹¹ EU initiatives against harmful tax competition gained success as EU Member States effectively complied with the Code of conduct,³⁹² alongside dismantling many preferential tax regimes within the EU and internationally.³⁹³ One tool to achieve that is the use of the lists of non-cooperative jurisdictions. Even though, the establishment of these lists is controversially discussed as flawed due to their unilateral and discriminatory characters. The European Parliament itself issued a Resolution commending the positive impact of the lists, but regretting that the lists are confusing and ineffective, alongside the lists' focus on third countries,³⁹⁴ more specifically developing countries.

4.5. Merits and demerits of EU and OECD standards for developing countries

The previous section outlined the key contributions of the EU and OECD to regulating harmful tax competition. Taking into account the scope of the study,³⁹⁵ which is not to evaluate the EU and OECD standards, to explore their possible application to developing countries such as

³⁸⁸ Nouwen (n 241) p. 35, 90, 96, 103, 409.

³⁸⁹ CEU Conclusions of 9 March 1998 concerning the establishment of the Code of Conduct Group (business taxation) 98/C 99/1, *OJEC* (1.4.98) C 99/1.

³⁹⁰ Gribnau, *Soft law and taxation* (n 248) p. 81; Moutarlier (n 248) p. 81.

³⁹¹ Pinto, *Tax competition* (n 117) p. 230.

³⁹² CEU, Report from COCG to ECOFIN Council on Code of Conduct, 9655/06 FISC 73 CS/lv DG G I, 19/05/2006, p. 37; Szudoczky and van de Streek (n 241) p. 274; P Dietsch and T Rixen, 'Tax Competition and Global Background Justice' (2014) *The Journal of Political Philosophy* 22(2), p. 170; K M Diaw and J Gorter, 'Harmful Tax Practices: To Brook or to Ban?' (2002-3) *Public Finance Analysis* 59(2), p. 250.

³⁹³ Nouwen (n 241) p. 17, 60, 288.

³⁹⁴ European Parliament Resolution of 21 January 2021 on reforming the EU list of tax havens (2020/2863(RSP)) P9_TA(2021)0022 <https://www.europarl.europa.eu/doceo/document/TA-9-2021-0022_EN.html> accessed 03/07/2021; European Parliament press release 'EU tax haven blacklist not catching worst offenders' <<https://www.europarl.europa.eu/news/en/press-room/20201208IPR93318/eu-tax-haven-blacklist-not-catching-worst-offenders>> accessed 03/07/2021.

³⁹⁵ See 1.4.

Rwanda, this section discusses the merits and demerits of the EU and OECD standards from the perspective of developing countries.

Starting with the merits, the EU has pioneered the regulation of harmful tax competition at the regional level, while the OECD has done the same at the organizational level. Since most developing countries are grouped in regional organizations, the EU and the OECD can serve as models for developing countries on how to regulate tax competition at both the regional and organizational levels. Not only that, but also the OECD's continuous fight against harmful tax competition proves how countries can achieve some goals through international organizations.³⁹⁶ That can serve as a good lesson for developing countries to fight against harmful tax competition through regional organizations. Developing countries' regional organizations can also follow *mutatis mutandis* the models developed by the EU and OECD. Apart from the criticism that developed countries impose their policies on sovereign developing countries, another merit is that the works of the EU and OECD have, in one way or another, slowed down harmful tax competition in developing countries. This is possible on two accounts: either by adopting some of the policies developed by the EU and OECD, or by fearing the political sanctions that the EU and/or OECD can impose.

As for the demerits, a major demerit is the inapplicability of some EU and OECD standards to the situation of developing countries due to several factors. One is the difference in interests between developing countries, which are capital-importers and EU and OECD members, which are developed countries and capital exporters. In this context, the concern of EU and OECD members is mainly about profit shifting and other forms of aggressive tax planning, while the main concern of developing countries is investment attraction. With this dichotomy, there is a risk that pure adoption of EU and OECD standards by developing countries would lead to a huge loss of FDI, which would make the situation of developing countries, which are capital importers, difficult. The technical complexity to understand and apply EU and OECD standards is also another demerit for developing countries, which generally face a shortage of competent personnel to deal with complex international tax matters.³⁹⁷ Another demerit relates to the fact that developed countries, through the EU and OECD, seek to impose policies developed in the interest of developed countries on developing

³⁹⁶ Morriss and Moberg (n 61) p. 63.

³⁹⁷ I Burgers and I J Mosquera Valderrama, 'Corporate Taxation and BEPS: A Fair Slice for Developing Countries' (2017) *ELR* 10(1), p. 32.

countries without giving an opportunity to participate in prior discussions.³⁹⁸ For example, the EU and OECD have developed a culture of blacklisting and shaming jurisdictions, mostly from developing countries, that do not abide by and/or comply with their rules. This is practically a good case of fiscal imperialism through which the EU and OECD, in order to protect their interests, impose the tax rules they have developed on developing countries. Nevertheless, developing countries can learn some lessons from the EU and OECD works on harmful tax competition, as discussed in section four of chapter seven.

Conclusion of chapter four

This chapter summarized different approaches taken by the OECD and the EU to tackle harmful tax practices. The chapter started with the OECD, by examining its role, focusing on the 1998 Report on harmful tax practices, followed by the progress reports and the recent 2015 report on the BEPS Project, Action five on harmful tax practices. The OECD's efforts are commendable for having identified the elements of harmful tax practices, namely tax havens and HPTRs. These components have been widely agreed upon and are now widely used in the study of harmful tax practices. The criteria formulated by the OECD to identify tax havens and HPTRs are also widely used to determine the harmfulness of tax practices worldwide.

Regarding the EU, it published a Code of Conduct on business taxation, which is an effective tool for its members to regulate harmful tax practices. The Code has been widely embraced by EU members and its usefulness has been widely recognized. Similarly, due to the Union's significant political influence, its instruments are referred to worldwide when harmful tax practices are at stake. Moreover, COCG assessment reports have played a significant role in promoting the regulation of harmful tax competition. For this reason, for example, a joint consideration of chapter three and chapter four leads to the use of some of the COCG assessments and OECD evaluation reports to assess Rwanda's regimes in chapter six.

In summary, the issue of harmful tax practices has attracted the attention of many around the world. This chapter has focused on the OECD and EU approaches to dealing with harmful tax practices. Given membership of the OECD and the EU, it is not surprising that their approaches reflect the perspective of developed countries, which may differ from the perspective of developing countries. The perspective of the latter can be seen in the approaches

³⁹⁸ Morriss and Moberg (n 61) p. 62.

of the regional organizations of these countries. In this respect, and in line with the main focus of this book, the EAC serves as a good case study.

