The Market Distortion Provisions of Articles 116-117 TFEU: An Alternative Route to Qualified Majority Voting in Tax Matters?

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Urged by the European Parliament’s ongoing pressure to make full use of the market distortion provisions of Article 116-117 TFEU to end prolonged veto deadlocks in tax matters, the Commission is currently exploring how to reactivate this instrument to fully deliver on the EU’s fair tax agenda. This article sets out why the market distortion rules do not seem appropriate for any far-reaching EU tax integration initiatives, but could complement the diplomatic EU Code of Conduct Group’s work, as well as the Commission’s use of the State aid rules, in addressing national internal market distorting tax measures and tax ruling practices of Member States.

Keywords: market distortion, State aid, tax competition.

1. Introduction

The Von der Leyen Commission has an ambitious and broad policy agenda, including comprehensive tax policy proposals that would fundamentally change the taxation of multinational companies, such as the introduction of a C(C)CTB (a Common (Consolidated) Corporate Tax Base)3 and a digital services tax, as well as policies focussed on the environment under the umbrella of a European Green deal, such as the introduction of a carbon border tax and a plastic tax and a reform of the Energy Tax Directive.4, 5 However, as in tax matters unanimity is still required for any legislative action at EU-level, each Member State has a veto right and is, therefore, able to pursue its own fiscal policy objectives or at least block the Commission’s ambitions which it considers contrary to its interests. Traditionally, Member States are reluctant to harmonize their tax systems, especially in the direct tax area. They wish to retain as much competence as possible in designing their own corporate tax systems, notably to be able to internationally compete for economic activity by offering a competitive tax system. As long as unanimity is required for harmonizing taxation, these reluctant Member States may bog down the Commission’s tax integration initiatives.

Former Commission President Juncker therefore started a new push to transition to qualified majority voting (QMV) in tax policy matters while increasing the powers of the European Parliament in tax matters, which currently only has an advisory role on tax files.6 The initiative was formally kicked off by a Communication adopted early 2019, entitled ‘Towards a more efficient and democratic decision

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2 The analysis set out in this article is partially based on Chapter 9 (‘The market distortion provisions and harmful tax competition’) of my dissertation entitled ‘Inside the EU Code of Conduct Group: 20 years of tackling harmful tax competition within the EU’ (see: https://dare.uva.nl/search?identifier=3a790e71-6b84-422c-922c-cc1941d87ed6), for which I obtained the doctoral degree at the Amsterdam Law School of the University of Amsterdam on 11 June 2020. My dissertation will soon be published by the IBFD in its Doctoral Series.
5 See also Commission Communication, Europe’s moment: Repair and prepare for the next generation, 27 May 2020, COM(2020) 456 final, in which the Von der Leyen Commission emphasized that the introduction of new (EU) taxes play a crucial role in funding the corona recovery.
making in the EU tax policy.\textsuperscript{7} The latter was coupled with an analysis how the general passerelle clause in Article 48(7) TEU could be used to introduce QMV in tax matters. However, the chances are slim of this procedure to be engaged any time soon, because its activation requires, in itself, unanimity in the European Council and, thus, requires consent of all Heads of States. The plan was, not surprisingly, swiftly rejected by a substantial number of Member States, overwhelmingly peripheral and small, such as Ireland, Malta, Sweden, Hungary and Cyprus, indicating they did not support any change being made on how tax matters are decided at EU-level.\textsuperscript{8}

Against this background, several inquiry committees of the European Parliament urged the Commission to also explore the more radical path of basing tax legislation proposals on the market distortion rules of Articles 116 and 117 TFEU.\textsuperscript{9} This procedure is a ‘safety valve’ for veto deadlocks where market distortions require EU-intervention. They can be considered as a lex specialis vis-à-vis the general (tax) harmonisation provision of Articles 113, 114(2) and 115 TFEU. Their application does not require unanimity, but only a qualified majority, which suffices to overrule any single unwilling Member State, whatever its size. In 1986, the Commission’s Legal Service observed that this legal instrument has “remained a dead letter.”\textsuperscript{10} It also observed that “this situation is obviously unsatisfactory” and that “it is very likely that there are distortions – but the Commission is not addressing them.”\textsuperscript{11} This state of affairs has not improved noticeable since then, probably because both the Commission and the Member States consider the market distortion provisions a political “nuclear option”\textsuperscript{12} to strip a Member State of its veto right in a politically extremely sensitive area.

However, urged by the Parliament’s ongoing pressure to reactivate this instrument to end prolonged veto deadlocks in tax matters, the Commission is again considering this hard law possibility. In its Communication of 15 January 2019\textsuperscript{13}, the Junker Commission stated that, although this procedure “cannot address all the shortcomings that arise from unanimity today”\textsuperscript{14}, it is “ready to employ it should the specific necessity arise”\textsuperscript{15}. This observation seems to have triggered the European Parliament’s TAXE 3-Committee, in March 2019, to request the Commission to “issue a new [legislative] proposal


\textsuperscript{11} See note of the Commission’s Legal Service of 7 May 1986, doc. no. JUR(86)D/2755, par. 9, p. 4: “Cette situation est évidemment insatisfaisante. Il est en effet très probable qu’il y ait des distorsions – mais la Commission ne s’en occupe pas”.


\textsuperscript{13} See Commission Communication, Towards a more efficient and democratic decision making in the EU tax policy, 15 January 2019, COM(2019) 8 final.


based on Article 116 TFEU, [...] should the Council fail to adopt a unanimous decision on the proposal to establish a CCCTB?". In response, the then Commissioner for Taxation Moscovici, however, underlined that the market distortion rules do not seem “an appropriate legal basis for wider harmonisation” and, concluded, as regards the C(C)CTB-proposal, that “the requirements for the activation of Article 116 TFEU are not met”. Moscovici thus toned down the enthusiasm of the Parliament for using the market distortion provisions as a legal base for EU tax integration.

Shortly after, the newly elected Commissioner for Economy Gentiloni, however, said to Parliament that “Article 116 [TFEU] offers an alternative route for the use of qualified majority voting”. On 7 April 2020, Gentiloni informed Parliament that the Commission’s services are reflecting on opportunities to make use of the market distortion rules in tax matters. In its Communication of 15 July 2020, the Von der Leyen Commission reaffirmed that, to fully deliver on the EU’s fair tax agenda, the Commission will explore how to make full use of article 116 TFEU. The proposal would still be at a technical preliminary stage and would not yet have reached a political level. It remains, therefore, unclear what type of tax policies the Commission envisages to propose on the basis of the market distortion rules. Prof. English, in the meantime, has concluded in an editorial that environmental taxes, such as an EU-wide tax on flight tickets, could well be EU tax legislation to be proposed on the basis of the market distortion rules, even under a narrow application of the Treaty provisions.

This article analysis why the market distortion rules do not seem appropriate for any far-reaching EU tax integration initiatives, but could complement the diplomatic EU Code of Conduct Group’s work, as well as the Commission’s use of the State aid rules, in tackling market distorting tax measures and tax ruling practices of Member States. On the basis of the travaux préparatoires of the E(E)C Treaties and unpublished notes of the Commission’s Legal Service outlining its market distortion provisions policy, Sections 2-3 clarify the reach and possibilities of the market distortion rules. Section 4 provides an overview of the practical effect of this instrument in tax and non-tax cases. Section 5 analyses legal basis issues impeding effective use of the market distortion rules to achieve far-reaching EU tax integration. Section 6 assesses what kind of market distorting fiscal regimes – which are (currently) not adequately

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25 See M. Thompson, EU may use treaty article to end Counties’ veto on tax matters, Law360 Tax Authority, 19 February 2020. See also T. Buell, EU Tax Chief Says High Bar For Invoking Treaty To Change Law, Law360 Tax Authority, 8 June 2020.
27 These policy notes have been provided by the Commission’s Legal Service to the author of this article on the basis of Regulation (EC) No 1049/2001 of the European Parliament and of the Council of 30 May 2001 regarding public access to European Parliament, Council and Commission documents, OJEU L/145/2001, p. 43-48. They have been made available by the author on: https://www.uva.nl/profiel/u/o/m.f.nouwen/m.f.nouwen.html.
addressed within the framework of the Code of Conduct, nor by the State aid rules – could legally be addressed by the Commission under the market distortion rules. Section 7 contains concluding remarks.

2. The notion of a market distortion in Article 116 TFEU

Article 116 TFEU contains three stringent criteria to be satisfied before the market distortion rules may be activated by the Commission. First, there must be a disparity (“a difference between […] provisions […] in Member States”). The Commission defines disparities as the result of legislative or administrative differences between two or more national jurisdictions. In tax terms, they are differences between the tax systems and administrative tax practices of Member States. The Commission’s interpretation of disparities indicates that a mere difference between the laws or practices of Member States does not in itself produce a disparity within the meaning of Article 116 TFEU. There must be a difference in norms, i.e., a considerable divergence (“une divergence sensible”) in (tax) legislation or administrative (tax) practice between two or more Member States.

Second, the disparity should “distort the conditions of competition in the internal market”. The Commission’s notes clarify this condition by referring to the Court’s interpretation of the antitrust rules (Article 101 TFEU) and the State aid rules (Article 107(1) TFEU) which address any selectively advantageous measure that “distorts or threatens to distort competition”. The CJEU has consistently held that this is a wide criterion: competition does not need to be actually distorted, it is sufficient that the national measure is liable to distort competition (potentially distorts competition; may discourage competitors). It seems doubtful, however, that such a wide interpretation of ‘distorting’ also applies to the market distortion rules. The text of Article 116 TFEU clearly indicates that conditions of competition should actually be distorted. Also, according to settled State aid case law, it is not required that the (potential) distortion of competition is significant or material, whereas for the application of Article 116, the Commission correctly considers an actual and significant effect on competition to be required.

Third, the distortion must be such that it ‘needs to be eliminated’. As rightly pointed out by English, for the possible use of Article 116 TFEU it is crucial to know how broadly or narrowly this term must be interpreted. In practice, however, it is unclear what constitutes a ‘distortion that needs to be eliminated’ within the meaning of Article 116 TFEU. Unlike the term disparity, the concept of a market distortion is not clarified in the Treaty (provisions). Legal scholars, not surprisingly, therefore advocate divergent interpretations. Article 116 TFEU only specifies that the distortion must be such that it “needs to be eliminated”. The market distortion should – given the apparent character of Article 116 TFEU of a ‘safety valve’ for veto deadlocks – go beyond mere de minimis distortions of competition in the internal market. The Commission’s notes underline that the market distortion addressed in Article 116 is not already unlawful in the sense that the distorting (tax) measure is already prohibited by other

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28 See note of the Commissions’ Legal Service of 16 April 1991, doc. no. JUR(91)02385, p. 3-4.
29 See the text of Article 116 TFEU.
31 See note of the Commissions’ Legal Service of 16 April 1991, doc. no. JUR(91)02385, p. 3-4.
34 See Article 116 TFEU.
35 See, e.g., note of the Commission’s Legal Service of 16 April 1991, doc. no. JUR(91)02385, par. 3.3, p. 4.
Treaty provisions, in particular the State aid rules and the free movement rights, as obviously, in those cases no safety valve is needed: the Commission can use its (other) Treaty powers to issue a State aid decision or start an infringement procedure against the Member State(s) involved without having to consult anyone and without having to submit a directive proposal.36

Understanding ‘market distortion’ in Article 116 in the same sense as this concept is understood in economics would seem most appropriate for the purposes of application of Article 116 TFEU, given its aim of promoting a level playing field for economic operators within the EU internal market. Online law dictionaries provide the following definition used in economics: “a governing body intervention in a specific market tied to one or more events, like price ceilings, price floors, or tax subsidies. It can enhance the welfare of society, but usually leads up to an ultimate effect of a market failure.”37 The first part of this definition clarifies that a market distortion is an economic scenario following a market intervention by a governing body, such as price ceilings, price floors, or tax subsidies. The second part indicates that a market distortion is usually the result of government policies aimed at enhancing the welfare of society. This shows that economic policymakers make a trade-off when they intervene in a market, weighing the general well-being of society against market equality, efficiency and discipline. While such government interventions are thus often aimed at improving the welfare of society, they, nonetheless, may cause market failures, particularly within an integrated market as established within the EU since 1958.

Distortions may occur at different levels of the EU internal market between Member States’ national economies. Global distortions occur at macro level and manifest themselves, for example, in high labour costs and prices, leading to a structural current account deficit and rising unemployment. Nowadays, Member States typically address global distortions by recourse to their macroeconomic policy instruments and by multilateral EU supervision of financial economic policy and a uniform monetary policy within the EMU,38 at least for the 17 Euro currency States. Generic distortions occur at intermediate or sectoral level, mostly traceable to disparities in (systems of) legislation.39 They should be addressed by positive tax integration in the form of harmonization, or tax policy coordination, or by spontaneous policy convergence. Specific market distortions may occur in specific parts of industry or in specific regions. Such distortions stem from specific government interventions imposing exceptional charges on or providing extraordinary benefits to certain undertakings or branches or regions in a Member State, thus affecting the comparative cost of production of enterprises in different Member States.

The Commission’s understanding of the concept of distortion within the meaning of Article 116 TFEU has traditionally been based on the definition used in the so-called Spaak Report of 1956.40 41 This rather outdated report reflects the negotiations between the six founding Member States preceding the adoption of the Treaty of Rome in 1957. According to the Spaak report, the market distortion rules of (now)
Articles 116 and 117 TFEU were intended to tackle specific distortions. In the 80’s and 90’s of the previous century, following parliamentary questions, the Commission’s Legal Service re-examined its hitherto restrictive interpretation of the concept of distortion based on the Spaak report, but concluded on both occasions that it would not be appropriate to drop the requirement of a specific distortion. The Commission thus limits ‘distortions’ to ‘specific distortions’ and sets three criteria for a national measure to create a specific distortion within the meaning of Article 116 TFEU:

- a group of companies or (sector of) industry in a Member State is subject to higher or lower charges than average in that Member State (internal derogation criterion);
- no similar extra burden or advantage exists for the (potentially) competing group of companies or (sectors of) industry in one or more other Member States; the national intervention must have an external effect on competition between these groups or sectors from different Member States, i.e., it must have a (significant) cross-border effect on competitive relationships (‘external effect’ criterion); and
- the positive or negative derogation is not neutralised by other targeted measures in the derogating Member State (‘net-effect’ or ‘balancing’ criterion).

The Commission, however, broadened its market distortion policy after 1991 by (i) acknowledging that a specific distortion can result from both specific and generic measures if, in practice, the effects of the measure deviate from average as regards a particular group of companies or (sector of) industry in a Member State and (ii) admitting that there is no legal obstacle to drop the requirement that the measure affects the cost structure of the companies or the industry concerned, which until then had led to a very limited applicability of the market distortion rules. The Commission thus concluded that not the nature of the measure or practice, but its distorting effect on the conditions of competition determines the (type of) distortion, and hence whether or not the market distortion rules may be activated by the Commission. Another important Commission policy relaxation was the acknowledgement that the examination of possible neutralization of the distorting advantages or disadvantages might be confined to the question of whether the Member State concerned has taken any ad hoc measure(s) to compensate for the (dis)advantages.

To reanimate the market distortion rules from a dead letter to effective hard law in tax matters, it would seem vital that the Commission also relaxes its ‘internal derogation’ criterion. As correctly stated by Englisch, a strict application of this criterion seems to restrict the scope of these rules to an area already covered by the State aid prohibition. Indeed, a specific distortion attributable to a targeted intervention by one Member State, thus selectively conferring an advantage to certain companies, will generally constitute unlawful State aid, to be addressed under Articles 107 et seq. TFEU. By contract, distortions stemming from tax disparities fall outside the scope of the State aid rules. However, as observed above, an obstacle for using the market distortion rules in addressing market distorting fiscal disparities may

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42 See Comité Intergouvernemental Créé par la Conférence de Messine, Rapport Des Chefs de Délegation aux Ministres des Affaires Etrangères, 21 April 1956, p. 60-64.
45 These criteria are derived from the Spaak-report; see Comité Intergouvernemental Créé par la Conférence de Messine, Rapport Des Chefs de Délegation aux Ministres des Affaires Etrangères, 21 April 1956, p. 60-64.
46 See the note of the Commission’s Legal Service, doc. no. JUR(91)03219, of 16 April 1991, par. 3.
be the type of market distortion. The Spaak Report and the Commission's market distortion policy notes distinguish only between *global* and *specific* distortions. The intermediate category of *generic* distortions is not mentioned. Many commentators, including Englisch and Kapteyn and VerLoren van Themaat, have rightly argued that the Commission should consider reforming its market distortion policy on this particular point. According to these authors, the notion of ‘distortion’ should be interpreted less restrictively, so that the market distortion rules could also be used to address generic distortions caused by generic national measures affecting sectorally, regionally or categorically certain groups of companies.

Interestingly, the CJEU did in fact observe, already in Case C-173/73 (*Italy v Commission*), that the Treaty provisions on market distortions could be used to eliminate generic distortions caused by tax measures. The Court held: “[m]oreover, Article 92 to 102 of the Treaty Provide for detailed rules for the abolition of generic distortions resulting from differences between the tax and social security systems of the different Member States whilst taking account of structural difficulties in certain sectors of industry.” Given the Commission's Legal Service's own observation that the Court generally attaches very limited legal weight to the “by now also quite outdated - Spaak report when interpreting Treaty provisions,” a reconsideration of the Commission's market distortion policy in respect of generic tax distortions seems called for. However, even a modernized and wider market distortion curbing policy cannot tackle all types of generic distortions, considering the subsidiary character (a ‘safety valve’) and the specific character of the market distortion provisions vis-à-vis the market harmonisation provision of Articles 113, 114(2) and 115 TFEU (see Section 5).

**3. Market distortion procedure and enforcement**

Even though the Commission is currently not using its powers under the market distortion rules, Article 116 TFEU places the Commission, in cooperation with the Member States, in principle, under an obligation to eliminate existing market distortions (*rollback procedure*). The procedure stands as a *lex specialis* – as a safety valve – in relation to the special legislative procedure of Articles 113 and 115 TFEU, which apply to harmonization of national tax laws (see Section 5). The Commission must, therefore, first of all, ascertain whether an existing disparity creates a market distortion in the sense of Article 116 TFEU). Secondly, it must decide whether the distortion in question is significant enough to require elimination. The Spaak report of 1956 emphasized that the Commission could and should not act against all market distorting measures. It must be convinced that the distortion “has a truly severe impact on the conditions of competition” (in the original French language: “*une incidence effective sérieuse sur les conditions de concurrence*”). This implies that the distortion should have significant effects on the functioning of the internal market and that a *de minimis* rule – as applied in the field of State aid law – could be applied within the framework of the market distortion rules.

From this, it can be inferred that the Commission should carefully assess the necessity and appropriateness of initiating this procedure, the decisive factor ultimately being not the *motives* of the Member State concerned for introducing the distorting measure, but rather the extent of its *effects* on the conditions of competition in the EU internal market. Logically, this assessment should look at the

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49 See J. Englisch, Article 116 TFEU – *The nuclear option for qualified majority tax harmonization?*, EC Tax Review, 2020/2, p. 61
51 See Case C-173/73 (*Italy v Commission*), ECLI:EU:C:1974:71, par. 17.
52 See note of the Commission's Legal Service of 16 April 1991, doc. no. JUR(91)02385, 16 April 1991, par. 3.3, p. 7.
53 This procedure has been clarified in the Commission’s market distortion policy notes; see, e.g., note of the Commission’s Legal Service of 16 April 1991, doc. nr. JUR(91)02385, p. 8-9.
difference between the market conditions with and without the measure complained of, as well as at the (un)likelihood of spontaneous policy adjustments in the Member State(s) concerned. The above also implies that, if the Commission has identified a market distorting measure of a certain significance, it still has a margin of discretion as to the need and the desirability of eliminating its distorting effect. The Commission’s market distortion policy clearly distinguishes between confirming the existence of a distortion and the need for EU action to eliminate it. This means that, if the distorting measure is effectively safeguarding essential public interests (the general well-being of society) compatible with the Treaty, such as, for example, public health, public safety, consumer protection, protection of the environment and fair trade practices, the Commission could decide that the resulting distortion does not need to be eliminated. If other Member States share that view of public interest, it would indeed be more appropriate to harmonize national law in the field concerned at EU level.

If the Commission finds that the market is unduly distorted, it must, in principle, consult the Member State(s) concerned to balance the different interests at stake carefully. If this consultation procedure does not result in the removal of the distortion, and the Commission is still convinced the distortion needs to be eliminated, the Commission must submit a proposal for a directive (or for any other appropriate measure; see this Section below) under the ordinary legislative procedure (Article 294 TFEU) to the European Parliament and the Council. The Commission’s market distortion policy notes stress that such a directive could be either generic or specific, i.e., it could be addressed to one single Member State, to a limited number of Member States, and even to all Member States, although questions can be raised regarding the latter view, as the procedure of Article 113 or 115 TFEU (unanimous harmonization) would seem more appropriate in that case (see Section 5). The ordinary legislative procedure implies qualified majority voting, and the European Parliament and the Council acting as co-legislators with equal rights, jointly having to adopt the directive aimed at eliminating the market distorting tax disparity. As explained, unanimity is not required, as the Member State(s) causing the distortion must not be able to obstruct decision-making with a veto. Alternatively, other appropriate measures provided for in the Treaties may be adopted, including non-binding measures, such as a recommendation addressed at a particular Member State.

Furthermore, Article 117(1) TFEU states that any plans to introduce a measure or practice which might create a market distortion should be notified by the Member State concerned to the Commission (standstill procedure). This consultation is mandatory, but - as further discussed below - has no direct effect, meaning, among others, that national authorities and judicial authorities are not required to disapply a domestic distorting fiscal measure which has been put into effect in contravention of this standstill obligation. After having been notified, the Commission may decide (i) that the measure does not constitute a significant market distortion, or (ii) to initiate a consultation procedure where the Commission, after a preliminary examination, has doubts as to the compatibility of the measure with the market distortion rules. If this consultation procedure leads to the conclusion that the measure is incompatible with the internal market, the Commission must, in principle, recommend the Member State concerned to take appropriate measures to prevent the market distortion. Such a recommendation may propose, in particular, amendments to or abolishment of the measure. If the Member State, nonetheless, implements the measure, the Commission is, in principle, required to initiate the procedure laid down in Article 116 TFEU.

The possibilities for affected companies to rely on the market distortion rules seem rather limited. If, for example, a company considers its competitive position harmed by a market distorting tax measure or practice, it may complain to the Commission. However, if a complaint is not (adequately) handled by the Commission, the company cannot appeal this failure to act before its national court. This can be

59 In the past, this has been facilitated by organising a meeting with representatives of the Member States and the Commission; see, e.g., Commission Recommendation of 31 July 1967 on the Italian (draft) law on rules for controlling the advertising and marketing of olive oil and seed oil, OJEU 67/563/EEC of 17 August 1967 and Commission Recommendation of 11 December 1968 on the German (draft) wine law, OJEU 69/14/EEC of 24 January 1969, both discussed in Section 5.
inferred from Case C-6/64 (Costa v ENEL)\(^{60}\) and Case C-134/94 (Esso Española v Comunidad Autónoma de Canarias)\(^{61}\), in which the CJEU held that the obligations on the part of Member States under Article 117(1) TFEU do not confer any rights on citizens which national courts must protect. The discretion the Commission enjoys under Article 117 TFEU precludes any direct effect of that provision. For the same reason, it may be expected that Article 116 TFEU does not have direct effect. Nonetheless, the market distortion rules place the Commission under a positive obligation to eliminate market distortions, and any failure to act may, in principle, render the institution liable to an action for failure to act before the CJEU under Article 265 TFEU.

In fact, one could argue that the Commission is already applying the market distortion rules in direct tax matters, by guiding, supporting and facilitating the diplomatic EU Code of Conduct Group’s work in tackling harmful tax policy competition (see for elaboration Section 6), as this could be conceived as the Commission ‘consulting the Member States concerned’ within the meaning of Article 116. The Code Group’s work in the area of ‘pseudo-case law’\(^{62}\) (one-country issues) seems to constitute an adequate (political) consultation procedure based on the basis of an Open Method of Coordination\(^{63}\) where Member States – supported by the Commission – discuss and assess many different types of (potential) market distorting fiscal measures and tax ruling practices, which, if considered harmful by the Group, should be eliminated, i.e., not implemented (standstill) or eliminated (rolled back) by the Member State concerned\(^{64}\). Likewise, the Group’s development of soft law policies for competition sensitive tax issues (‘pseudo-legislation’\(^{65}\); two-or-more-country issues), like mismatches, can also be seen as a consultation procedure where Member States try to eliminate a wide variety of generic fiscal distortions, for which no single Member can be blamed. The Commission simply never took the next step (submitting a special Directive proposal to eliminate the distortion; see Paragraph 2 of Article 116 TFEU), probably because it considered the political Code and the diplomatic Code Group a (more) adequate ‘other appropriate measures’ as envisaged in the last sentence of Paragraph 2 of Article 116, even though it may not be easy to consider the Code, considering its informal, diplomatic character, to be ‘provided for by in the Treaties’.

4. **Practical effect of the market distortion rules in tax and non-tax cases**

The practical effect of the market distortion rules in tax matters has been very limited so far.\(^{66}\) However, this does not mean that the Treaty provisions have never been used by the Commission. In the ’60s and ’70s of the previous century, the Commission initiated no less than fifty-four formal investigations into (potentially) market distorting tax and non-tax measures. This appears from official Commission publications summarising the main internal market integration successes in this period. In twenty-two out of fifty-four investigations carried out by the Commission, a formal investigation was initiated of which the outcome does not appear to have been adequately documented in official Commission publications. In twenty-six cases, the Commission concluded that the functioning of the internal market was not unduly distorted. In one case, the scrutinized potentially distorting measure was repealed by the Member State concerned during the investigation. In five cases, the Commission decided that the market

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\(^{60}\) See Case C-6/64 (Costa v ENEL), ECLI:EU:C:1964:66, in particular, the Courts observation on the interpretation of Article 102 EEC (now article 117 TFEU).


\(^{64}\) See M.F. Nouwen, Inside the Code of Conduct Group: 20 years of tackling harmful tax competition, Dissertation, University of Amsterdam, 11 June 2020, Chapter 4 ‘The governance and working methods of the Code of Conduct Group’.


\(^{66}\) See also, e.g., note of the Commission’s Legal Service of 16 April 1991, doc. no. JUR(91)02385, 16 April 1991 and note of the Commission’s Legal Service of 31 May 1991, doc. no. JUR(91)03219.
distorting measure needed to be eliminated. In three of these cases, the Member State concerned implemented the Commission’s Recommendation to repeal the distorting measure.

In 1968, Germany followed the Commission’s Recommendation not to implement a Weingesetz (Wine Law)\(^67\)\(^68\). On the basis of Article 117 TFEU, the Commission considered that the prohibition in that law to produce, store, rack or bottle foreign wines in the same premises as where German wines were produced would lead to a market distortion. Under the proposed law, German companies both importing foreign wines and producing German wines would be required to build separate facilities for their wine operations. German companies which only *produced* wines or only *imported* foreign wines would not be affected. Furthermore, this obligation did not exist in any other European country. This disparity would create an internal market distortion affecting German companies engaged in both production and importation of wines. The conditions for activating the market distortion rules appeared to be met, but with the benefit of hindsight, the question arises, however, how such a market distortion should now be addressed by the Commission. Since the 1960s, the CJEU has adopted a broad interpretation of the scope of the free movement rights. Consequently, nowadays, the Commission (or German importers/producers themselves) would address this kind of unlawful market distorting measures under the free movement of goods (currently Article 34 TFEU). The German scheme de facto protected German wine production.

With regard to a French 20% tax exemption for Belgian residents purchasing goods in French border regions\(^69\) and an alleged price-fixing on sulphur\(^70\), the Commission considered in 1967 that both measures created a market distortion which needed to be eliminated on the basis of Article 116 TFEU. Both measures seem to have been repealed by France. Even though no details were disclosed on these cases, the question arises whether other negative integration mechanisms could have been used by the Commission. In the case of price-fixing, the measure might have constituted an unlawful (i) State aid (Article 107 TFEU) or (ii) cartel agreement (Article 101 TFEU).

In the two other cases, the Member State concerned failed to implement the Commission’s Recommendation. In 1967, the Commission concluded that implementation of an Italian draft law laying down rules on the advertisement and trade in olive oil and seed oil would lead to a serious market distortion which needed to be avoided.\(^71\) On the basis of Article 117 TFEU, it addressed a Recommendation to Italy holding that the Italian product requirement to decolorize seed oil would lead to a significant increase in production costs for seed oil manufacture, whereas such an obligation did not apply for (manufacturers of) seed oil equivalent products, in particular, olive oil.\(^72\) A similar significant increase in the production costs of seed oil could not be observed in other Member States. Italy, however, disregarded the Commission's Recommendation not to implement the measure. While in such a case, the Commission, in principle, should activate the procedure in Article 116 TFEU - after all, it had already established that the distorting measure needed to be eliminated - this did not happen for unclarified reasons. As in the German *Weingesetz* case, the conditions for activating the market distortion rules appeared to have been met, but nowadays, the Commission would consider such restricting measures under the free movement prohibition. Even though the Italian measure was applicable in both

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\(^{67}\) See Recommandation de la Commission du 11 décembre 1968 en ce qui concerne le projet de loi viticole allemande (69/14/CEE), OJEU L/18/1969, p. 3-4


domestic and cross-border situations, as both imported seed oil and seed oil of Italian origin fell within the scope of the scheme, it constituted a manifest restriction to the free movement of goods.

In the same year, the Commission concluded - on the basis of Article 117 TFEU - that a proposed amendment to the German Turnover Tax Act73 aimed at increasing turnover tax on imports of specific goods - including certain types of paper, leather products, textile products, metal products, etc74 - would create a market distortion which needed to be avoided.75 Despite the fact that the Commission adopted a Recommendation urging the German authorities not to implement the law, the latter nonetheless implemented it. In contrast to the Italian seed oil case, this time the Commission decided to activate Article 116 TFEU, which resulted in a re-consultation of the Member States. As this consultation did not lead to the elimination of the distortion either, the Commission submitted a proposal for a special Directive to the Council76, which, however, for unknown reasons, has never been adopted. Like the two non-tax cases discussed above, the Commission could probably better have started an infringement action against Germany for violating the free movement of goods as the German tax increase on imports appears to have had the same effect as import duties.

It seems that the market distortion rules have not played any meaningful role any more after the '70s.77 Over the past fifty years, Parliament has urged the Commission to use the market distortion rules many times to address perceived market distortions in tax and non-tax cases78, but these interventions did not succeed in having the Commission use the market distortion rules. As observed in Section 2, it merely resulted in a relaxation of the Commission’s conditions for activating the market distortion rules.

5. Legal basis issues impeding effective use of the market distortion rules to achieve far-reaching tax integration

77 Post-1972 Commission publications are silent on the use of the market distortion rules.
This Section explains why even a modernized market distortion policy cannot simply be unleashed to address a broad range of generic fiscal distortions, considering the character of Article 116 TFEU as a subsidiary ‘safety valve’ where other Treaty provisions prove to be inadequate to take away the market distortion. As further clarified below, it seems that Article 116 TFEU (the lex specialis) was never meant to encroach upon the predominance of the Treaty provisions for harmonizing national legal (tax) systems (Articles 113, 114(2), and 115 TFEU) which, in most cases, should be used to overcome distortions caused by disparities through EU-wide tax integration. On the contrary: Article 116 TFEU is a residual provision if the possibilities of all other provisions have been exhausted and still market distortions remain which need to be eliminated.

Legal basis litigation in the EU has challenged the CJEU on multiple occasions due to the rather great amount of competing competences within the EU Treaties in combination with divergent preferences of the different institutional actors (Commission, Parliament, and Member States in the Council), which often strive to maximize their own influence in the EU legislative process, whilst trying to avoid full scrutiny by the other institutions involved.79 Case law of the CJEU in this area underlines that the choice of the Treaty basis for any legislative EU-action must be taken seriously. In order to solve legal basis conflicts, as well as to provide some legal clarity, the CJEU has developed several criteria which help to make a choice between two or more legal basis for a contested measure, of which the ‘centre of gravity’ approach can (still) be considered the most commonly applied criterion in legal basis litigation.80

In Case C-300/89 (Commission v Council; ‘Titanium dioxide’), the Court explicitly specified for the first time that the legal basis must be based on objective factors, including the aim and the content of the legislative measure.81 If the measure pursues two aims, or has two parts, one of which is identifiable as the main one, and the other is incidental, the measure must be based on one single legal basis, the one required by the main or predominant aim or part (‘centre of gravity’ approach).82 If, on the other hand, the measure simultaneously pursues a number of objectives, or contains several parts which are inseparably linked without one being incidental to another, making several Treaty provisions applicable, it must, in principle, be based on all of these Treaty bases.83 This means that all requirements of all of these Treaty provisions must be complied with for the measure to be valid. This may not always be possible, however. In the Titanium dioxide case, the Court concluded that a dual legal basis is not possible where the legislative procedures for each substantive field involved are incompatible.84 The (then) cooperation procedure between the Council and Parliament (Article 100a EEC - now Article 114(1) TFEU, providing for qualified majority voting in the Council under the ordinary legislative procedure) was considered incompatible with unanimous Council decision-making and mere consultation of the European Parliament (Article 130s EEC (now Article 192 TFEU, providing for a special legislative procedure)).85 According to the Court, the cumulation of these legal bases would jeopardise the purpose of the then cooperation procedure, which – like the current ordinary legislative procedure – was aimed at increasing Parliamentary involvement in EU law-making. The Court, therefore, decided that the legislative measure should have been based on the then cooperation procedure.86

81 See Case C-300/89 (Commission v Council; ‘Titanium Dioxide’), ECLI:EU:C:1991:244, par. 10, which refers to Case C-45/86 (Commission v Council), ECLI:EU:C:1987:163, par. 11.
82 See Case C-130/10 (Parliament v Council), ECLI:EU:C:2012:472, par. 43.
83 See Case C-300/89 (Commission v Council; ‘Titanium Dioxide’), ECLI:EU:C:1991:244, par. 17, which refers to Case C-165/87 (Commission v Council), ECLI:EU:C:1988:458, par. 11. See also Case C-130/10 (Parliament v Council), ECLI:EU:C:2012:472, par. 44.
84 See Case C-300/89 (Commission v Council; ‘Titanium Dioxide’), ECLI:EU:C:1991:244, par. 17. See also Case C-130/10 (Parliament v Council), ECLI:EU:C:2012:472, par. 45.
85 See Case C-300/89 (Commission v Council; ‘Titanium Dioxide’), ECLI:EU:C:1991:244, par. 18-20.
86 See Case C-300/89 (Commission v Council; ‘Titanium Dioxide’), ECLI:EU:C:1991:244, par. 21-25.
In Case C-338/01 (Commission v Council), the Court underlined that unanimous decision-making in tax matters in the Council does not go hand in hand with qualified majority voting.\(^87\) In this case, the Commission, supported by the European Parliament, failed to demonstrate to the Court that Article 114(1) TFEU (providing for qualified majority in the Council under the ordinary procedure), rather than Articles 113 and 115 TFEU (providing for unanimity voting in the Council under the special legislative procedure), would be the appropriate legal basis for amending the (Tax) Recovery Assistance Directive. This case demonstrates that EU tax law remains a stronghold of unanimity, both in the area of direct and indirect taxation and in the areas of both substantive and procedural tax law.\(^88\) Though, for a moment, it seemed that the CJEU in Case C-166/07 (Parliament v Council; ‘International Fund for Ireland’)\(^89\) had abandoned its Titanium dioxide doctrine, Case C-130/10 (Parliament v Council) underlined that it is still valid in cases on dual legal bases issues.\(^90\)

Considering the above, in particular the ‘centre of gravity’ approach, the following observations can be made as regards the concurrence between, on the one hand, the market distortion rules (adoption of hard law jointly and on an equal footing by the Council (QMV) and the European Parliament) and, on the other hand, the indirect tax harmonization provision in Article 113 TFEU and the direct tax harmonization provisions in Article 114(2) juncto Article 115 TFEU (both providing for unanimity voting in the Council for legislative action on tax matters). It seems that any measure aiming at both tax harmonization and market distortion elimination, without one being incidental to the other, cannot simply be based on Article 116 TFEU. Allowing tax harmonization on the basis of the market distortion rules would undermine the unanimity rule laid down in Articles 113 and 115 TFEU. When a market distortion is too generic in nature, for example, where it is caused by low statutory corporate tax rates, the resulting tax disparity would seem too unspecific to be addressed under the market distortion rules, and can only be remedied on the legal basis of Article 115 TFEU. Based on this assessment, it seems unlikely that Commission will prevail in a Member State challenge of its use of Article 116 TFEU if it attempts to use this QMV-procedure to achieve what is really EU-wide tax harmonization. Article 116 TFEU, therefore, seems not be an adequate legal basis for far-reaching EU tax integration initiatives, such as the still pending C(C)CTB-proposal, a future Digital Services Tax, or an EU-wide air passenger tax.

However, applying the market distortion provisions seems, in any case, appropriate in situations where a fiscal market distortion (i) occurs between only two or a few Member States; (ii) is significant and cannot wait to be eliminated by the adoption of uncertain future harmonization measures, such as the adoption of the C(C)CTB; and (iii) can be overcome by unilateral adaptation of the law(s) or practice(s) of one or only a few Member State(s). In such a case, EU-wide tax harmonization would not make sense and would be quite disproportionate, violating the subsidiarity principle. Moreover, the use of the market distortion rules seems appropriate as a lex specialis to Articles 113, 114(2) and 115 TFEU in order to take effective action against a significant fiscal market distortion where harmonization is both inappropriate and politically quite unattainable. Against this background, the next section analyses to what extent the market distortion provisions could complement the Code of Conduct Group’s work, and the Commission’s use of the State aid rules, in addressing harmful tax practices.

6. **The market distortion rules as a complement to the Code of Conduct and the State aid rules to tackle harmful tax practices**

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\(^{87}\) See Case C-338/01 (Commission v Council), ECLI:EU:C:2004:253.


\(^{90}\) See Case C-130/10 (Parliament v Council), ECLI:EU:C:2012:472, in particular, par. 42-44.
One might suppose that Member States adopted the non-legislative, diplomatic, non-legally binding, Code of Conduct for Business Taxation\textsuperscript{91} in the late ’90s of the previous century to keep the Commission at bay, in particular from using its State aid powers, but possibly also from using the market distortion rules. The gentlemen’s agreement of the Code, politically created a win-win situation for all involved. By cleaning their corporate tax systems themselves through the EU Code of Conduct Group\textsuperscript{92}, bringing together representatives of the Member States, the Commission and the Council Secretariat, the EU Member States retained their much-cherished tax sovereignty (and avoided the ten-year retroactive collection obligation under the State aid provisions), while this saved the Commission considerable State aid and market distortion investigation efforts. Additionally, by facilitating the Code Group in technical matters, the Commission would be well informed automatically about tax competitive measures and about Member States’ progress and effectiveness in tackling excessive tax policy competition themselves. As observed in Section 3, one could even argue that the introduction of the Code and the establishment of the Code Group, in fact, institutionalized a permanent plenary consultation procedure in the area of direct taxation – which may be viewed as application of the consultation requirement in the market distortion rules – where Member States – guided, supported and facilitated by the Commission – quite successfully addressed many internal market distorting fiscal regimes of Member States.

The big stick of hard law, especially State aid, in the background may have been quite convincing to reluctant Member States to eliminate blacklisted tax regimes.\textsuperscript{93} A critical assessment of the effectiveness of the Code Group underlines that it has achieved impressive results in tackling many different types of preferential measures and administrative (ruling) practices, but also that the political nature of the Code and the Group’s ‘broad consensus’ decision-making has led to bogging down and blocking of decision-making by – both small and large – Member States in certain areas. There still are, therefore, loose ends in the form of inconsistent and unsatisfactory results, some forms of unfair tax competition not having been adequately addressed, such as non-transparent transfer pricing mismatch practices.\textsuperscript{94} The Commission’s increasing use of the State aid weapon to address national – transfer pricing – rulings granted by Member States to multinational companies, suggests that it is not very satisfied with the effectiveness of its work in this area either. The political and societal outrage against tax avoidance following the tax scandals may have triggered the Commission to encourage the Member States to clean their own houses, or else. This development also raises the question what room remains for the market distortion rules to complement the Code in tackling harmful tax practices and the State aid rules to address national (selective) regimes.

On a general note, it is clear that harmful tax policy competition as defined in the Code of Conduct\textsuperscript{95} may constitute a major internal market distortion, inviting tax avoidance by multinational companies. Theoretically, i.e., legally, the market distortion rules could complement the Code Group’s work in addressing national non-selective (and therefore not susceptible to State aid enforcement) preferential

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\textsuperscript{93} See M.F. Nouwen, Inside the Code of Conduct Group: 20 years of tackling harmful tax competition, Dissertation, University of Amsterdam, 11 June 2020, Chapter 7 (‘Summary, conclusion, and outlook’).
\textsuperscript{94} See M.F. Nouwen, Inside the Code of Conduct Group: 20 years of tackling harmful tax competition, Dissertation, University of Amsterdam, 11 June 2020, Chapters 7 (‘Discussion and assessment of the pseudo-case law of the Code of Conduct Group’) and 8 (‘Discussion and assessment of the pseudo-legislation of the Code of Conduct Group’) and 10 (‘Summary, conclusion, and outlook’).
\textsuperscript{95} See M.F. Nouwen, Inside the Code of Conduct Group: 20 years of tackling harmful tax competition, Dissertation, University of Amsterdam, 11 June 2020, Chapter 6 ‘The substantive scope of the Code’.
tax regimes inviting, or even soliciting, (ab)use of fiscal disparities, which may be exploited by internationally mobile taxpayers. Particularly, where a limited number of Member States (one, two, or three) block an otherwise unanimous decision in the Code Group that such a regime is harmful, and should be rolled back (eliminated), the Commission could submit to the Council and Parliament a proposal for a special Directive proposal based on Article 116 TFEU (see also Section 4) calling for the elimination of the harmful regime. This possibility will be illustrated below by a discussion of the proposed, but never introduced, Dutch Group interest box regime, which was clearly aimed at avoiding selectivity (State aid), while at the same time exploiting differences (disparities) between (group) interest deduction measures of different Member States.

In 2007, the Dutch Government informed the Code Group of its intention to introduce an optional Group interest box regime in its corporate income tax system96, which was made compulsory after the Commission had challenged the optional character in a State aid procedure97. As a result, the proposed non-selective regime would become compulsory for all companies, in respect of intra-group interest both received and paid. By reducing the tax base for intra-group interest income and interest expenses, the interest box ensured effective taxation of 5-7% (instead of the standard 25,5% rate) for the balance of intra-group interest received and paid: intra-group interest paid was also only deductible against the 5-7% rate (instead of the standard 25,5% rate).98 After the deletion of optionality, the regime was cleared by the Commission from a State aid prohibition perspective. From a national perspective, the regime was clearly neutral. A Dutch group company paying intra-group interest to another Dutch group company would only deduct it at a rate of 5%. In a purely domestic situation, the interest regime would, therefore, not produce any benefit for an international group of companies. However, if the interest-paying group company would be resident in another Member State with a traditional corporate tax base (without a similar group interest regime), it would deduct the interest paid at the much higher standard corporate tax rate applicable in that other Member State (say 25%). The regime would thus be beneficial in cross-border inbound situations only. Obviously, this could have triggered international companies to organize their mobile intra-group financing activities such that intra-group interest would be paid and deducted in other Member States at high rates and received at the low 5% interest box rate in the Netherlands. That was most probably the very idea behind the regime.

The Code Group never formally assessed this regime. It decided to close the case after the Netherlands announced to abandon the regime after a public consultation revealed that certain foreign investors hesitated to debt-finance their activities in the Netherlands. Nonetheless, it would have been very interesting to see how the Group would have assessed this regime from a harmful tax competition perspective. Although the compatibility of the interest box with the (ring-fencing) criteria of the Code seems questionable99, the Group’s non-decision100 in 2005 on the Hungarian Interest from affiliated companies regime might have been successfully claimed as a favourable precedent by the Netherlands, even though that Hungarian regime101 was not identical to the Dutch regime. While many Member States102 and the Commission had expressed serious doubts about the compatibility of the Hungarian

98 For the agreed description, see room document #2 of the Code Group of 19 September 2007 and room document #2 of the Code Group of 23 September 2009.
101 For the agreed description, see report of the Group of 29 October 2004, doc. no. 14097/04, p. 3-4. See also room document #1 of the Group of 24 May 2005.
102 See informal Commission minutes of the Code Group meeting of 24 February, p. 3-4, informal Commission minutes of the Code Group meeting of 24 May 2005, p. 1, informal Commission minutes of the Code Group meeting of 15 September 2005, p. 1-2 and informal Commission minutes of the Code Group meeting of 18 October 2005. These minutes were
regime with the Code, the Group was not able to reach agreement on the question whether it should be considered harmful.\textsuperscript{103} Probably, therefore, the Code Group would not have been able to reach agreement on the Dutch regime either.

This raises the question of whether the Dutch \textit{Group interest box regime}, had it been implemented, could have been tackled as a fiscal market distortion which needed to be eliminated. In its State aid investigation, the Commission held that any \textit{de facto} advantage for multinational companies resulting from inbound interest payments was not attributable to any selective advantage granted by the interest box, but due to different national rules on deductibility of group interest within the EU.\textsuperscript{104} The Commission, therefore, concluded that the Dutch \textit{Group interest box regime} did not constitute unlawful State aid. The Commission did not say a single word about the regime's compatibility with the market distortion rules. This is all the more striking as the Dutch Government itself and the Dutch employers' association VNO-NCW, in the State aid procedure, emphasized that not the State aid rules, but the market distortion rules provided the Commission with an appropriate instrument to address unwelcome tax disparities created by preferential regimes like the \textit{Group interest box regime}.\textsuperscript{105}

A modernized market distortion policy could offer the Commission an instrument to address harmful tax competition through preferential measures exploiting disparities, like the Dutch \textit{Group interest box regime}. As long as the Commission sticks to the outdated Spaak Report, which has no legal status, and which apparently does not impress the CJEU in any way, a Member State introducing such an interest regime, will probably argue that any \textit{de facto} advantages derived by international companies from cross-border intra-group financing operations are the result of a \textit{generic} distortion, which can only be remedied by positive tax integration on the basis of Articles 114(2) and 115 TFEU (unanimous harmonization; see Section 5). Differences in statutory tax rates between Member States also facilitate arbitration by internationally mobile taxpayers by organizing intra-group interest payments to be deductible in high tax jurisdictions and corresponding interest income to be taxable in low tax jurisdictions. Differences in general corporate tax rates cannot, however, be equated with a preferential group interest regime designed to produce a \textit{de facto} tax advantage – in clear derogation of the general tax system – to internationally mobile taxpayers, deliberately \textit{creating a specific fiscal disparity}. The Dutch \textit{Group interest box regime} would deliberately have widened the gap between the rate at which the interest would be taxed in the Netherlands and deducted in other Member States. It would seem clear that this is a \textit{specific} market distortion due to a designer disparity, significant enough to need elimination. Therefore, application of the anti-distortion rules would have been justified, as, in these circumstances, the use of this \textit{lex specialis} is more appropriate than a harmonisation proposal (\textit{lex generalis}), which would be at odds with the subsidiarity principle as it would clearly be totally unnecessary, and, therefore, disproportionate to harmonize all Member States’ (group) interest regimes to get rid of this specific unilateral market distortion.

If the Commission would have taken this position, then the next question would be whether in the Council a Commission proposal for a such a special Directive eliminating the regime would have fetched the necessary qualified majority needed to adopt that proposal. This is the case, if fifty-five percent of the Member States (16 out of 28) vote in favour and the proposal is supported by Member States representing at least sixty-five percent of the total EU population.\textsuperscript{106} This is called the ‘double majority’-

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\begin{itemize}
  \item obtained from the Commission based on EU Transparency Regulation (EC) No. 1049/2001. It is emphasized that these minutes are not the official (public) progress reports of the Code Group to the Council. They have been drafted by officials of the Commission (for internal use only), reporting on the deliberations in the Code Group. Although the minutes thus merely represent the Commission’s understanding of the deliberations of the Code Group, they are of great informative value given the confidentiality of the Code Group’s deliberations.
  \item For the Commission’s draft assessment, see room document #5 of the Group of 24 February 2005, room document #5 of the Group of 15 September 2005, and room document #2 of the Group of 18 October 2005.
  \item See Article 16(4) TEU and Article 238(2) TFEU and Comments on the Council Rules of Procedure, 2016, p. 55-56.
\end{itemize}
rule. Viewed from the other side, a blocking minority needs to include at least four Member States representing more than thirty-five percent of the EU population. It has been speculated in the introduction of this Article that the required qualified majority would probably not be reached, because no Member State wants to be the next one to be stripped from its veto right by the other Member States, and, therefore, probably most Member States will, for political reasons, vote against a Commission proposal for such a special tax directive addressed at one of them, even if they are in favour of elimination of the harmful regime. This speculation may be supported by the Council's rejection, in 1967, of the Commission proposal for a special Council directive based on the market distortion rules instructing Germany to eliminate a market distortion created by an indirect tax measure (see Section 4). However, let us add some speculation, and let us assume that the Commission would succeed in gathering the necessary qualified majority for its proposal for a special Council directive calling for elimination of the Dutch Group interest box regime. If also the European Parliament would endorse the proposal under the ordinary legislative procedure, this would mean that the special tax Directive would have been adopted, and the Netherlands would have been legally required to eliminate the market distortion created by the interest regime, which would probably imply the repeal of the regime.

Considering the above, the market distortion rules – disregarding external strategic political considerations – could effectively be used by the Commission to eliminate national preferential tax measures and tax ruling practices creating or exploiting (designer) disparities between the corporate tax systems of Member States, which are not adequately addressed within the framework of the Code, nor by the State aid rules. As explained in Section 5, the use of the market distortion rules would be justified in such a case, because (i) one single or only a few Member States cause the fiscal market distortion; (ii) the distortion is clearly significant and cannot wait to be eliminated by adoption of very speculative and uncertain future comprehensive direct tax harmonization; and (iii) it can be eliminated/avoided by unilateral adaptation of the law or practice of the Member State(s) involved.

Given the conceptual, procedural and legal constraints linked to the application of the market distortion provisions, it remains, however, difficult to draw a clear line between the types of fiscal regimes that may and may not be tackled by the Commission under the market distortion provisions. Additionally, many individual competitive tax regimes of Member States, such as preferential interest regimes, patent boxes, notional interest deduction regimes, participation exemptions, free zone regimes, etc., which – under specific circumstances – might have been challenged by the Commission under the market distortion provisions, have been and are being coordinated by the Member States in the Code Group according to the common pseudo-legal principles adopted by it for many types of preferential fiscal regimes. The question arises whether the most problematic remaining tax measures and rulings practices, which might be used for tax avoidance by multinational companies, can be addressed under the market distortion provisions.

For example, what about remaining tax competition by non-transparent transfer pricing mismatch practices? So far, the Code Group has not been very successful at addressing mismatches resulting from Member States’ divergent national arm’s length (adjustments) policies. Like hybrid mismatches, transfer pricing mismatches may be considered the unfortunate result of disparities, for which no specific Member State is to blame. Nonetheless, tax competition by actively offering opportunities to exploit tax disparities through, for example, informal capital rulings, excess profits rulings and other similar rulings, may – in some cases – no longer be considered a mere unfortunate outcome, but rather a deliberate attempt to design de facto preferential regimes that may be considered harmful to the EU internal market. Although Member States are now legally obliged to exchange information on cross-border transfer pricing rulings automatically, that does not mean that all mismatches will be eliminated. Indeed, it is doubtful whether the other Member State concerned will in all cases recognize the need to make a

corresponding adjustment, if its legislation allows it to make such an adjustment in the first place, as the very issue is a legislative or judicial mismatch.

The Commission is currently investigating several transfer pricing rulings of Member States, under its State aid powers, but it remains to be seen whether these cases represent unilateral State aid or merely disparities between Member States’ arm’s length adjustments policies. If these investigations do not lead to negative decisions, I would not be surprised if the Commission would decide to re-assess all EU informal capital regimes, excess profits regimes, and other similar administrative tax ruling practices, possibly jointly with the to be established expert group on transfer pricing110, on the basis of the market distortion rules. If the Commission would conclude that certain practices indeed trigger a market distortion, significant enough to need elimination, it remains to be seen whether in the Council a Commission proposal for a (special or generic) directive to get rid of the market distortion would obtain the necessary qualified majority needed to adopt that tax directive.

7. Conclusion

The market distortion rules do not seem to provide for an adequate legal basis for far-reaching tax integration initiatives, such as a C(C)CTB-proposal, a Digital Services Tax for Big Tech, or a flight ticket tax. Even if the Commission would adopt a wider market distortion curbing policy, it cannot tackle all types of distortions, considering the subsidiary character (a ‘safety valve’) and the specific goal of the market distortion provisions. Where a market distortion is too generic in nature, for example, where it is caused by low statutory corporate tax rates, the resulting fiscal disparity will often be too unspecific to be addressed under the market distortion rules (the lex specialis), and can only be addressed under the Treaty harmonization provisions for harmonizing national legal systems (Articles 113, 114 and 115 TFEU; the lex generalis). However, legally, the market distortion rules could complement the diplomatic EU Code of Conduct Group’s work, as well as the Commission’s use of the State aid rules, in addressing national internal market distorting tax measures and tax ruling practices of Member States inviting, or even soliciting, (ab)use of fiscal designer disparities, which may be exploited by multinational companies. For example, if a small number of Member States blocks an otherwise unanimous Code of Conduct Group decision condemning a harmful (meaning: market distorting) non-selective (and, therefore, not prohibited under to State aid rules) national tax measure or administrative tax ruling practice, the Commission could activate the anti-distortion weapon to address that fiscal regime. In such a case, the use of the market distortion rules seems legally appropriate to take effective action against a significant fiscal market distortion where harmonization across the board would be an unnecessary and, therefore, disproportionate measure. However, in reality, i.e., politically, it is not very likely that the market distortion rules will be engaged successfully. Most Member States probably will vote against a Commission anti-distortion proposal requiring elimination of the fiscal regime, not because of disagreement with its content, but to avoid the anti-distortion weapon to be turned against themselves in future. Thus, all Member States would loyalty seem to adhere to the principle of loyal (non)cooperation, but in the distorted sense that they cooperate with an aim contrary to the interest of the EU as a whole.

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