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Current Notes

Brexit: negotiating to resist the export of EU tax law and policy

The EU, like any state or group of states with sufficient power, is an effective exporter of its values, policies and laws. How its export activity is regarded will depend upon the political viewpoint which is adopted. For a Member State of the EU, the export activity in which it is engaged through its EU membership can frequently pass unnoticed. A Member State which wishes to withdraw from the EU is bound, however, to pay more attention to it. Such a Member State is choosing to move from being one of the exporters to, potentially, being one of the importers.

It seems likely that a withdrawing Member State would not want to be an involuntary importer of EU law. It is reasonable to assume, therefore, that it will consider itself strong enough to resist the importation of those EU values, policies or laws which it finds unattractive. This resistance will express itself differently in different contexts. In the context of taxation, it may express itself in a form of, what may be called, tax competition. It follows that the withdrawing state must ensure that the agreements it enters into with the EU permit it to engage in the degree of tax competition which may prove necessary in the immediate or distant future.

Competition in relation to tax law and policy has always existed between EU Member States within the limits set by EU membership. Once those limits are removed and so long as they are not replaced by subsequent agreements, there is likely to be scope for the intensity of the competition to increase. So far as may concern the UK outside the EU, on the one hand its goals in relation to tax may well continue to coincide with those of the EU, especially where they are linked to the OECD and international initiatives. On the other hand, particularly if the UK Government wishes to stimulate and attract economic activity by establishing a corporation tax regime more favourable to business than at present, an increased level of tax competition between it and other EU Member States, such as the Republic of Ireland, may be inevitable.

The comparison between the position of the Republic of Ireland and the UK after withdrawal from the EU may be of considerable interest. It may be that there will be two geographically close countries pursuing relatively similar corporate "low tax" policies. Time may tell whether such policies are more easily implemented by being within an EU which exports its tax law and policy or by being outside the EU resisting the importation of tax law and policy.[1]

[1] Of course, corporation tax is not the most important of the issues arising from the UK's withdrawal from the EU in relation to the Republic of Ireland. Far more important could be the withdrawal of the UK from the EU customs territory with the consequence that the boundary of that customs territory would necessarily divide the Republic of Ireland from Northern Ireland. More generally, there are implications of withdrawal for the "Belfast" or "Good Friday" Agreement, signed on 10 April 1998, which is available at: *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/136652/agreement.pdf* [Accessed 7 September 2016]. The Agreement assumes both the Republic of Ireland and the UK are EU Member States. One of a number of consequences of this can be seen in Strand Two headed: "North/South Ministerial Council". The Council is "to consider the European Union dimension of relevant matters, including the implementation of EU policies and programmes and proposals under consideration in the EU framework" (para.17). Although EU tax policies may not have been foremost among the parties' concerns when

In order to resist the importation of tax law and policy the UK will, first of all, need to identify the methods which the EU uses to export its tax law and policy. Secondly, it will need to negotiate its agreements with the EU with a view to preserving its freedom of action in the field of tax. Thirdly, it will need to examine carefully the increasingly detailed autonomous external policy which the EU has developed concerning tax. Each of these three elements is considered briefly in turn below.

1. Two methods of export: agreements and autonomous action

Export by the EU of law and policy in tax as in other fields may be achieved in at least two ways. The first method is to establish an agreement between the EU and the third country in question. It may be either a wide-ranging trade agreement or one with a narrow scope. The second method is to export without making any agreement, that is by autonomous action.

A recent proposal which amounts to autonomous action, in a field outside tax, is the proposal for an EU regulation on an International Procurement Instrument. It seeks to ensure that the EU policy of allowing open access to public procurement contracts is implemented also by third countries. Under the proposal, failure to follow the policy may lead to the imposition of penalties on third-country bidders in certain circumstances.[2] There are other methods of autonomous action in addition to passing laws. Policy positions may be developed in Commission recommendations or communications, or as a result of activity in the Council or the European Parliament.

In relation to the UK's prospective withdrawal from the EU both methods of export need to be taken into account in negotiating the necessary agreements. In considering what these may be it is essential to keep in mind that, according to article 50.2 of the Treaty on European Union (TEU) the agreement to be negotiated between the EU and the UK as a withdrawing state is one "setting out the arrangements for its withdrawal".[3] Arrangements for withdrawal and arrangements for a relationship after withdrawal, particularly in the fields of trade and commerce, are two different things. The authors of a House of Commons Briefing Paper on the process of withdrawal have said:

> "Many experts believe the detailed future relationship between the withdrawing State and the EU would be negotiated alongside the withdrawal agreement using the processes set out in the EU Treaties and put in a separate agreement, probably similar to an association agreement. Ideally, the two agreements would enter into force at the same time."[4]

Of course, in the real world what is ideal does not always happen. As will be seen later, negotiations in relation to tax law and policy have caused significant delays in the negotiation of trade agreements. It is, perhaps, asking a lot for negotiations over two different but related

negotiating this provision, such policies are not excluded from its scope and may be of considerable significance in the context of relations between the Republic of Ireland, Northern Ireland in particular and the UK in general.

[2] Amended Proposal for a Regulation of the European Parliament and of the Council on the access of third-country goods and services to the Union's internal market in public procurement and procedures supporting negotiations on access of Union goods and services to the public procurement markets of third countries COM(2016) 34 final, 29 February 2016.

[3] Consolidated version of the Treaty on European Union [2016] OJ C202 (07.06.2016), art.50.2.

[4] V. Miller and A. Lang, House of Commons Briefing Paper No.7551, *Brexit: how does the Article 50 process work?* (30 June 2016), para.5.1 headed: "A separate agreement?"

agreements to interlock neatly. Not everyone thinks that two agreements are to be anticipated. Łazowski has suggested that the withdrawal agreement could be a single complex mixed agreement.[5] For the purposes of this note the final form of the negotiations matters rather less than their substance. In one way or another, negotiators will have to confront the two methods by which the EU exports its tax law and policy. The second part of this note addresses the use of agreements with third countries as a means of export.

2. EU/third state agreements: about more than commerce

Given that an agreement may be a means of importing EU law and policy, a former Member State which wishes to set out its relationship with the EU in an agreement must be careful not to import by agreement the very laws and policies from which it has withdrawn. The danger of doing this is not much diminished by characterising the agreement it enters into as an agreement about "trade" or "commerce".

Two basic observations are worth making here. The first is that trade has implications for an enormous range of policies affecting, for example, conditions of labour, social benefits, health and welfare, standards of environmental protection, product quality, and government activity in promoting efficient and effective markets,[6] supporting producers and protecting consumers. Joseph Chamberlain, apparently "a hero" of Mr Nicholas Timothy, one of Mrs Theresa May's joint chiefs of staff,[7] is said to have commented: "You cannot have free trade in goods, and at the same time have protection of labour."[8] An awareness of the broad effects of free trade is one reason why the EU has always been said to be "based upon a customs union"[9] which required duty-free internal trade and a common external tariff. The broader economic and social effects of creating that base were provided, and were intended to provide, the impetus for further integration.

The second is that, as the decision to base the EU on a customs union indicates, from the beginning of the European project, trade and commerce have never been viewed by the EU in isolation from other policy areas. The heading of Title III, in Part 3 of the Treaty of Rome, "Social policy",[10] makes that clear even to the casual reader. Externally, the EU generally places its agreements about trade and investment in a broad political and social context. Two examples of this can be seen in the agreements that the EU has negotiated with Singapore and Ukraine.

So far as concerns Singapore, the recently initialled free trade agreement of May 2015 between Singapore and the EU "constitutes a specific agreement giving effect to the trade provisions of

[5] Miller and Lang, above fn.4, 32–33.

[6] An example of such activity is the obligation imposed on local authorities to "… promote the efficient and effective operation of a market in services for meeting care and support needs" in the Care Act 2014 s.5(1).

[7] As reported by A. Gimson, *Profile: Nick Timothy, May's thinker-in-chief and co-Chief of Staff* (15 July 2016), available at: *http://www.conservativehome.com/highlights/2016/07/profile-nick-timothy-mays-thinker-in-chief-and-co-chief-of-staff.html* [Accessed 7 September 2016].

[8] G.R. Searle, *A New England? Peace and War 1886–1918*, The New Oxford History of England (Oxford: OUP, 2004), 340.

[9] Regulation (EU) No 952/2013 of the European Parliament and of the Council of 9 October 2013 laying down the Union Customs Code (recast), recital (9) [2013] OJ L269/1 and the EC Treaty art.23.1.

[10] The Treaty of Rome, 25 March 1957, Pt 3, Policy of the Community, Title III.

the Partnership and Cooperation Agreement".[11] Those trade provisions are given a specific context and should not be removed from it if they are to be fully appreciated.

So far as concerns Ukraine, the Deep and Comprehensive Free Trade Area of the EU and Ukraine (DCFTA), applicable from 1 January 2016,[12] derives from the more general Association Agreement established between the parties in 2014.[13] The first three titles of the association agreement deal with, first, general principles, secondly, political dialogue and thirdly, justice, freedom and security. Trade and trade-related matters are reached only in Title IV.[14]

Of course, the fact that trade cannot be isolated from broader social, economic and political concerns, is not simply because agreements concerning commerce form part of a larger agreement or framework. The specific terms of the agreements governing trade and commerce themselves demonstrate a strong awareness of these broader considerations. Taking the Comprehensive Economic and Trade Agreement with Canada (CETA)[15] as an example, Chapter 23 is headed "Trade and Labour". Article 23.2 commits each of the parties to "provide for and encourage high levels of labour protection" and to strive to continue to improve their relevant laws and policies so as to achieve a high level of protection. Chapter 24 is entitled "Trade and Environment". Both chapters demonstrate a clear concern to place trade and commercial relations in a broad context.

EU/third state agreements and tax[16]

The precise means by which tax law and policy is exported by an agreement may vary. It may, for example, be by means of a specific agreement in relation to tax transparency. Within the EU, the policy of automatic exchange of tax information is implemented pursuant to Council Directive 2011/16/EU.[17] That policy may be exported to third countries by way of a specific tax transparency agreement. An example of such an agreement is the one between the EU and Switzerland signed

[11] Free Trade Agreement between the European Union and the Republic of Singapore, May 2015, Ch.17, art.17.17, para.1, available at: *http://trade.ec.europa.eu/doclib/press/index.cfm?id=961* [Accessed 7 October 2016].
[12] EU-Ukraine Deep and Comprehensive Free Trade Agreement (DCFTA), 1 January 2016.
[13] Association Agreement between the European Union and its Member States, of the one part, and Ukraine, of the other part [2014] OJ L161/3.
[14] Association Agreement between the European Union and its Member States, of the one part, and Ukraine, of the other part [2014] OJ L161/3 arts 25–336.
[15] The Comprehensive Economic and Trade Agreement between Canada of the one part, and the European Union and its Member States, of the other part (CETA), available at: *http://ec.europa.eu/trade/policy/in-focus/ceta/index_en.htm* [Accessed 7 September 2016].
[16] For a more general discussion than is possible here of the impact of trade and investment agreements on taxation see T. Lyons, *Tax Protectionism and Tax Discrimination: Relevance of Multilateral and Bilateral Trade and Investment Agreements*, presented to the David R. Tillinghurst Research Program Conference, São Paolo (October 2013), available at: *www.39essex.com* [Accessed 7 September 2016], pending publication; T. Lyons, "Treaty arbitration: the limited role of tax carve-outs in BITs" (30 July 2015) *Global Arbitration Review*, available at: *http://globalarbitrationreview.com/article/1034642/treaty-arbitration-the-limited-role-of-tax-carve-outs-in-bits* [Accessed 7 September 2016]; and T. Lyons, "The Modernisation of EU state aid law" [2014] BTR 113, 113–116.
[17] Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC [2011] OJ L64/1. A proposal for a Council Directive amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation of 28 January 2016, COM(2016) 25 final was presented as part of the European Commission's Anti-Avoidance Package 2016.

in May 2015.[18] The EU has also signed tax transparency agreements with Liechtenstein in October 2015,[19] with San Marino in December 2015,[20] with Andorra on 12 February 2016[21] and with Monaco on 12 July 2016.[22] The UK may take the view that it shares the policy of tax transparency. If so, it would be wise to ensure the phrase is carefully defined in future. More care, perhaps, will need to be devoted to the possible export of EU tax law and policy by means of a more general agreement.

It is possible for wide-ranging agreements between the EU and third countries to contain specific provisions dealing with the export of EU tax law and policy. In the association agreement between the EU and Ukraine, articles devoted to tax are contained in Title V (Economic and Sector Cooperation) and Chapter IV (headed "Taxation") articles 349 to 354. Article 350 includes the statement that

> "the Parties recognise and commit themselves to implementing the principles of good governance in the tax area, i.e. the principles of transparency, exchange of information and fair tax competition, as subscribed to by Member States at EU level".[23]

This is a clear acknowledgement that the EU is exporting to Ukraine the principles of good tax governance which it applies internally and which may, of course, develop over time.

The relevance of tax good governance to the negotiation of agreements is something of which the European Commission has been aware for a number of years. In 2009, for example, it said that:

> "In cases where it is known in advance that discussion of the principles of good governance in the tax area will be contentious, or where such principles are not understood, political dialogues between the EU and third countries should address the issue in advance of trade related-negotiations, so as to facilitate those negotiations."[24]

No one would suggest that the UK has an inadequately administered tax system by international standards. The concept of tax good governance, the developing content of which is considered below in the context of autonomous EU action, is not, however, limited to such matters. It covers fair tax competition too. It may, therefore, cover issues such as the provision of state aid to multi-national enterprises by means of tax rulings, the provision of tax incentives in the form of

[18] European Commission press release, *Fighting tax evasion: EU and Switzerland sign historic tax transparency agreement* (Brussels: 27 May 2015) IP/15/5043.
[19] European Commission press release, *Fighting tax evasion: EU and Liechtenstein sign new tax transparency agreement* (Brussels: 28 October 2015) IP/15/5929.
[20] European Commission Statement, *Fighting tax evasion: EU and the Republic of San Marino sign new tax transparency agreement* (Brussels: 8 December 2015) 15/6275.
[21] European Commission press release, *Fighting tax evasion: EU and Andorra sign new tax transparency agreement* (Brussels: 12 February 2016) IP/16/288.
[22] European Commission press release, *Fighting tax evasion: EU and Monaco sign new tax transparency agreement* (Brussels: 12 July 2016) IP/16/2456.
[23] Association Agreement between the European Union and its Member States, of the one part, and Ukraine, of the other part [2014] OJ L161 art.350.
[24] Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee, *Promoting Good Governance in Tax Matters* COM(2009) 201 final, 28 April 2009 (Promoting Good Governance in Tax Matters), available at: *http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2009:0201:FIN:EN:PDF* [Accessed 7 September 2016], 11 at para.4. vi).

"patent boxes" and other uses of the tax system that the UK, outside the EU, may find attractive. Viewed in that light, the concept of tax good governance may be highly significant in UK/EU negotiations. Political dialogues between the EU and the UK on these issues, of the kind the Commission suggested in 2009, may well be appropriate to facilitate subsequent negotiations.

The need for tax good governance to be given serious attention by negotiators of agreements with third countries is confirmed by the Communication on an External Strategy for Effective Taxation (the Communication).[25] This makes clear that tax good governance clauses should be inserted into all relevant agreements with third countries and regions and that these should include all three elements which are identified in the EU/Ukraine agreement (transparency, information exchange and fair tax competition) and which are considered in more detail in the third section of this note.[26] The Communication also records that in the 2015 "Trade for all" strategy the Commission confirmed that trade agreements should support the international standards of transparency and good governance which address "aggressive corporate profit shifting and tax avoidance strategies".[27]

In addition to containing a tax good governance commitment the EU/Ukraine agreement contains other features of potential interest to Brexit negotiators. Annex XXVIII to the association agreement contains commitments by Ukraine gradually to approximate its tax legislation to that of the EU within specified time frames. Those negotiating on behalf of the UK may need to consider that if countries which never have been EU Member States agree to limits on the permitted level of disalignment between their law and that of the EU in return for certain advantages, countries which have been EU Member States but seek to withdraw from it may also be asked to place the extent of their disalignment within certain limits. It may be that just as EU integration was achieved with the use of transitional periods culminating, for example, in a customs union, disintegration could equally well be achieved with the use of transitional periods. What would not be acceptable to UK negotiators permanently may be acceptable for certain limited periods.

So far, the export of tax law and policy has been examined in the light of provisions in agreements expressly concerned with tax matters. It is, however, possible for the EU to export its tax law and policy without expressly referring to either of them. For example, article 23 of the agreement of 1972 between the EEC and Switzerland, prohibited "public aid".[28] The European Commission said that "its wording mirrors Article 87 of the EC Treaty"[29] and it construed "public aid" as "state aid" as understood for the purposes of the EC Treaty. The result was that elements of the Swiss corporate tax regime were found to constitute impermissible state or public aid. The contention of the Swiss Government that the agreement it had entered into was a trade agreement and so did not affect tax matters was easily dismissed.[30] The EEC had successfully

[25] Communication from the Commission to the European Parliament and the Council on an External Strategy for Effective Taxation (Communication on an External Strategy) COM(2016) 24 final, 28 January 2016.
[26] Communication on an External Strategy, above fn.25, see especially Annex 2.
[27] Communication on an External Strategy, above fn.25, para.3, p.5.
[28] EC Switzerland Free Trade Agreement 22 July 1972 [1972] OJ L300/189 art.23(iii).
[29] The Commission Decision of 13 February 2007 on the incompatibility of certain Swiss company tax regimes with the Agreement between the EEC and the Swiss Confederation of 22 July 1972 (C2007 411 final), para.65 (The Commission Decision of 13 February 2007).
[30] The Commission Decision of 13 February 2007, above fn.29, para.60.

exported to Switzerland its concept of state aid in general and of state aid provided via a tax system in particular. In the future no third state should be in any doubt about the fact that an agreement with the EU will be likely to cover state aid provided through the tax system. The EU's new external strategy for effective taxation expressly states that:

> "The Commission will … work to include state aid provisions in negotiating proposals for agreements with third countries, with a view to ensuring fair tax competition with its international partners."[31]

The UK's negotiators have been warned.

Having seen that agreements between the EU and third countries concern tax law and policy we can now turn to note the attempts contained in modern agreements to control their impact in these areas. Provisions of agreements between the EU and Canada, Singapore and South Korea, for example, are all worth noting and are referred to very briefly below. The provisions which limit the impact of an agreement on tax law and policy can be seen from the perspective of the non-EU party as, in some circumstances, limitations on the ability of the EU to export its tax law and policy. Their precise terms are, therefore, of considerable importance.

Article 28.7 CETA is an extensive provision which sets out a series of tax-related matters upon which the agreement as a whole is not to impinge. For example, it provides that tax conventions take priority over CETA in the event of a conflict.[32] It also provides that CETA is not to be construed so as to prevent a party from adopting or maintaining any taxation measure that distinguishes between persons who are not in the same situation, in particular with regard to their place of residence or with regard to the place where their capital is invested.[33] Another provision ensures that a Party can adopt or maintain any taxation measure aimed at preventing the avoidance or evasion of taxes pursuant to its tax laws or tax conventions.[34] "Taxation measure" is subsequently defined at least to some extent, but "avoidance" and "evasion" are not. It is not possible in this note to discuss article 28 CETA in any detail, but it is clear that its interpretation and application is a matter of considerable importance and rather less clarity than may appear at first sight.

The agreement with Singapore, in Chapter 17, also contains a number of provisions which identify what the agreement does not prevent in relation to taxation.[35] Chapter 17 commences with a general provision which states:

> "This Agreement shall only apply to taxation measures insofar as such application is necessary to give effect to the provisions of this Agreement."[36]

It is not difficult to envisage that there may be disagreement over what is necessary for those purposes.

[31] Communication on an External Strategy, above fn.25, para.3.2, p.7.
[32] CETA art.28.7.3.
[33] CETA art.28.7.1.
[34] CETA art.28.7.2.
[35] Free Trade Agreement between the European Union and the Republic of Singapore, May 2015, Ch.17, art.17.6 and Understanding 1.
[36] Free Trade Agreement between the European Union and the Republic of Singapore, May 2015, Ch.17, art.17.6(i).

The agreement between the EU and South Korea[37] contains a number of provisions in Chapter 7 (Trade in Services, Establishment and Electronic Commerce) limiting the impact of the agreement on taxation.[38] So too does Chapter Fifteen (Institutional, General and Final Provisions). Article 15.1 adopts the same terms as article 17.1 of the agreement with Singapore quoted above.

Quite apart from the problems of interpretation and application to which these provisions, especially the general provisions, give rise, it is clear that all these limitation clauses would not be necessary if taxation were wholly outside the scope of the agreements in the first place. The position is similar to that arising under article XIV(d) of the General Agreement on Trade in Services (GATS).[39] This permits measures inconsistent with the national treatment requirement which the agreement contains provided that the resulting difference of treatment

> "is aimed at ensuring the equitable or effective imposition or collection of direct taxes in respect of services or service suppliers of other Members".[40]

As Daly has said:

> "This implies that direct tax measures would generally be covered …; otherwise Uruguay Round negotiators would not have deemed it necessary to create such an explicit exception …."[41]

The problem which arises in the context of agreements with the EU, therefore, is not a specific problem concerning agreements with the EU. It is a general problem concerning tax in relation to agreements with trade and commerce and one which UK negotiators must address.

Having looked at agreements as a means of exporting EU tax law and policy we now turn to the third section of this note which considers the EU's autonomous external tax policy as a means of export.

3. The EU's new external strategy for effective taxation

An EU external tax policy has been developing for some time. It has to a considerable extent been built on the concept of tax good governance. This, in turn, is based on the concept of good governance generally. This was the subject of a Commission Communication on Governance and Development in 2003. Inevitably the context of good governance in this communication ensured that it was placed in an international context. So far as a definition of "good governance" was concerned, the Communication stated that:

> "Whilst there is no clear definition of good governance, the term is generally taken to cover the fundamental interactions between the state and society, i.e. the rules, processes, and

[37] Free trade Agreement between the European Union and its Member States and the Republic of Korea [2011] OJ L127/6.
[38] Free trade Agreement between the European Union and its Member States and the Republic of Korea [2011] OJ L127 arts 7.6, 7.12, and 7.50.
[39] General Agreement on Trade in Services, available at: *https://www.wto.org/english/docs_e/legal_e/26-gats.pdf* [Accessed 7 September 2016].
[40] GATS 1994 art.xiv(d).
[41] M. Daly, "WTO Report" (2008) 93a *IFA Cahiers de droit fiscal international*, "Non-discrimination at the crossroads of international taxation", para.2.5 "GATS" at p.79.

behaviour by which interests are articulated, resources are managed and power is exercised in society. The quality of governance therefore often depends on the state's capacity to provide its citizens with the basic services needed to reduce poverty and promote development."[42]

In 2006 there were further communications dealing with the basic concept of good governance.[43] By 2009, the Commission was able to issue a communication entitled *Promoting Good Governance in Tax Matters*. One of the matters it considered was "the particular tools that the European Community and EU Member States may have at their disposal to promote good governance internationally".[44] The concept of good governance had by now a specific form in the context of tax. The content of tax good governance, as it became known, was based on the contribution of EU Finance Ministers to the G20 Ministerial and Governors' Meeting of 14 March 2009. This stressed the need to strengthen "action to achieve international good governance in the tax area (transparency, exchange of information and fair tax competition)".[45] These were the three elements which article 350 of the EU/Ukraine agreement[46] identified as mentioned above.

In 2010, the Commission issued another Communication dealing with tax good governance in relation to third countries in the context of development policy.[47] Then, in December 2012 the European Commission issued a recommendation regarding measures intended to encourage third countries to apply minimum standards of good governance in tax matters.[48] At the same time it also issued a recommendation on aggressive tax planning. This included recommendations for provisions to be inserted in Member States' tax treaties with third countries and a general anti-abuse rule to be applicable both between Member States and between Member States and third countries.[49]

[42] Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee, *Governance and Development* COM (2003) 615 final, 20 October 2003.
[43] For example, Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions Governance in the European Consensus on Development Towards a harmonised approach within the European Union COM (2006) 421final.
[44] Promoting Good Governance in Tax Matters, above fn.24, para.1, p.5. For a more detailed consideration of this communication including its international implications see: T. Lyons, "Promoting good governance in tax matters" [2009] BTR 361.
[45] Promoting Good Governance in Tax Matters, above fn.24, para.1, pp.4–5.
[46] DCFTA, above fn.12.
[47] Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee Tax and Development: Cooperating with Developing Countries on Promoting Good Governance in Tax Matters COM (2010) 163 final, 21 April 2010.
[48] European Commission, Commission Recommendation of 6.12.2012 regarding measures intended to encourage third countries to apply minimum standards of good governance in tax matters C(2012) 8805 final, 6 December 2012.
[49] European Commission, Commission Recommendation of 6.12.2012 on aggressive tax planning C(2012) 8806 final, 6 December 2012. At the same time as issuing this recommendation and the one referred to in fn.39 above, the Commission issued a Communication, *An Action Plan to strengthen the fight against fraud and tax evasion, European Commission, Communication from the Commission to the European Parliament and the Council* COM(2012) 722 final, 6 December 2012, available at: *http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2012:0722:FIN* [Accessed 7 September 2016].

By the time the Anti Tax Avoidance Package was published in January 2016,[50] therefore, the EU had begun to build a meaningful external tax strategy. The tax package of January 2016 has, however, substantially developed the concept of tax good governance into an external strategy for effective taxation.

The EU Communication on an external strategy for effective taxation

The Communication[51] which forms part of the Anti Tax Avoidance Package of January 2016 is not, of course, the only element of the package which concerns third countries. The Commission Recommendation on the implementation of measures against tax treaty abuse also relates to third countries.[52] The recommendation that there be inserted into tax treaties a general anti-avoidance rule based on a principal purpose test and the recommendation related to permanent establishments both affect third countries. The permanent establishments of entities resident in third countries may also be affected by the terms of the proposed anti-tax avoidance directive.[53] Nevertheless, it is the Communication which has the most extensive implications for third countries and which negotiators representing the UK should analyse carefully.

In the Communication, the EU states that it considers its external strategy

> "essential to boost Member States' collective success in tackling tax avoidance, ensure effective taxation and create a clear and stable environment for businesses in the Single Market".[54]

Given the importance which the EU gives to its external strategy it may be assumed that, in any negotiation, attempts to limit its impact on third countries will not be easy. It is also significant that Section 3 of the Communication is devoted to the enhancement of tax good governance co-operation through agreements with third countries.

Annex 2 to the Communication contains an update of the standard provision of tax good governance for insertion into agreements established in 2008. Notwithstanding the existence of standard provisions, however, the Communication acknowledges that the insertion of good governance clauses into agreements with third countries has proved difficult. Unsurprisingly, perhaps, it says that: "Certain negotiations were delayed as third countries found the wording of the clause to be unclear on the scope of the good governance requirements."[55] The fact that other countries have resisted the inclusion of good governance clauses may be encouraging to UK negotiators. They may, however, note that the result of negotiating in this area was that agreement between the parties was delayed. In the context of Brexit negotiations and the possible need to ensure that two agreements come into force together (as noted in the House of Commons

[50] European Commission, *The Anti Tax Avoidance Package* (January 2016), available at: *https://ec.europa.eu/taxation_customs/business/company-tax/anti-tax-avoidance-package_en* [Accessed 7 September 2016].
[51] Communication on an External Strategy, above fn.25.
[52] Commission Recommendation of 28.1.2016 on the implementation of measures against tax treaty abuse C(2016) 271 final.
[53] Proposal for a Council Directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market COM(2016) 26 final, 28 January 2016.
[54] Communication on an External Strategy, above fn.25, 2.
[55] Communication on an External Strategy, above fn.25, 6.

Briefing Paper referred to above[56]) any decision to delay negotiations is one which would have much more significance for the UK as a country withdrawing from the EU than for other third countries.

The three core standards which have formed part of tax good governance: transparency, exchange of information and fair tax competition are retained and updated in the new external tax strategy and considerable attention is paid to G20/OECD BEPS standards. Annex 1 to the Communication sets out what the EU means by fair tax competition. Given the likely importance of that concept to the UK the definition deserves to be quoted in full:

> "Fair tax competition means that a third country should not operate harmful tax measures in the area of business taxation.
>
> Tax measures which provide for a significantly lower effective level of taxation, including zero taxation, than those levels which generally apply in the third country in question are to be regarded as potentially harmful. Such a significantly lower level of taxation may operate by virtue of the nominal tax rate, the tax base or any other relevant factor.
>
> When assessing whether such measures are harmful, account should be taken of the criteria as provided for in the Code of Conduct on Business Taxation endorsed by the Council, as well as practice and guidance agreed by the Code of Council working group."[57]

Fair tax competition

The concepts of tax competition and of fair tax competition have been considered elsewhere.[58] There has been some debate over the notion of fairness in this context. It is worth noting, therefore, that the concept of fair competition has been considered in the context of international trade generally.[59] If the concept has been considered in that context, it is inevitable that it will make its presence felt in the narrower field of tax, particularly when tax is dealt with in the context of agreements concerned with trade and commerce.

The definition of fair tax competition quoted above makes clear that, for the purposes of the EU's external strategy, the EU is likely to use it, primarily, to prevent harmful tax measures in the area of business taxation; but what is harmful? Successful and legitimate tax competition may be said to harm those with whom it is intended to compete. Only unsuccessful tax competition leaves a competitor completely unharmed. Any negotiator is bound to be concerned that the concept of harmful tax competition may form a weapon against the legitimate exercise of a state's power to tax. The adoption of a standard clause in an agreement committing states to tax

[56] Miller and Lang, above fn.4.

[57] Communication on an External Strategy, above fn.25, Annex 1.2. Fair Tax Competition.

[58] The literature is extensive but see for an early but still useful introduction, W. Schön (ed.), *Tax Competition in Europe* (Amsterdam: IBFD, 2003).

[59] See, e.g. A.G. Brown and R.M. Stern, "Concepts of Fairness in the Global Trading System" (2007) 12(3) *Pacific Economic Review* 293. The fairness or justice of the policies of one country in relation to another has been placed in an even wider philosophical context. See, for example, Amartya Sen's comment that "… the actions of one country can seriously influence lives elsewhere. This is not only through the deliberate use of forceful means … but also through less direct influences of trade and commerce. We do not live in secluded cocoons of our own. And if the institutions and policies of one country influence lives elsewhere, should not the voices of affected people elsewhere count in some way in determining what is just or unjust in the way a society is organized, typically with profound effects—direct or indirect—on people in other societies?" A. Sen, *The Idea of Justice* (Penguin Books, 2010), 129–130.

good governance may seem innocuous. Once adopted, however, the clause may significantly constrain a third state's taxing powers, either immediately or in the future, as a matter of politics, if not law.

It may be tempting to consider that the link which is made in the quoted definition between fair tax competition and the Code of Conduct on Business Taxation[60] would suggest that the limits of fair tax competition will not, in practice, intrude upon the policy choices open to the government of a country like the UK. If the Code of Conduct has not proved unduly troublesome to the UK then, it may be said, fair tax competition will not prove difficult either. In the writer's view, that would be a somewhat optimistic approach for a number of reasons.

First of all, in general, an EU Member State has open to it negotiating strategies within the Council which are not open to a non-Member State. The past impact of the Code of Conduct internally is not, therefore, necessarily a guide as to how it will be applied externally, particularly in view of the fact that the Code itself is not immutable.

Secondly, the definition of potentially harmful tax measures which fall within the requirement of fair tax competition leaves considerable scope for development. The existence of lower than generally applicable effective levels of taxation is to be prohibited by virtue of "any other relevant factor".[61] The list of relevant factors is not closed. A factor which seems irrelevant today may be highly relevant in five years' time. A negotiator may find the qualities of a prophet useful in this context.

Thirdly, and from the perspective of any negotiator perhaps most concerning of all, the application of fair tax competition externally is bound to be affected by how that concept is understood internally. The more integration there is internally within the EU, the more restrictively the concept of fair tax competition will be understood externally. In this respect the experience of Switzerland in relation to state aid, referred to above, is instructive. Its agreement with the EU prohibiting public aid, was concluded on 22 July 1972 and entered into force in 1973.[62] The judgment in *Italy v Commission*,[63] which is generally taken as establishing that the state aid provisions of the EEC Treaty prohibited fiscal state aid, was given on 2 July 1974. The internal development of EU state aid law led to Switzerland being subjected to restrictions it had not foreseen when it signed its agreement. Similarly, internal developments within the EU, some more readily foreseeable than others, could relatively easily lead to changes in the interpretation and application of the concept of fair tax competition in relation to a country like the UK. Appropriate and possibly novel "stand-still" clauses may need to be inserted into any agreement the UK ratifies to address the issues which may arise. One has only to suggest these to see how contentious negotiation over tax good governance may become.

The Communication makes clear that the application of state aid law in a tax context will continue to be a topic of concern to the EU. It states that:

[60] The Code of Conduct for business taxation was set out in the conclusions of the Council of Economics and Finance Ministers (ECOFIN) of 1 December 1997 concerning taxation policy (98/C 2/01) [1998] OJ C2/1.
[61] Communication on an External Strategy, above fn.25, Annex 1.2. Fair Tax Competition.
[62] The relevant article is EC Switzerland Free Trade Agreement 22 July 1972 [1972] OJ L300/189 art.23.1.iii.
[63] *Italy v Commission* (C-173/73) ECLI:EU:C:1974:71; [1974] ECR 709 (ECJ) at [13].

> "The Commission will … work to include state aid provisions in negotiating proposals for agreements with third countries, with a view to ensuring fair tax competition with its international partners."[64]

The UK may, therefore, expect to have to deal with state aid and taxation in the context of its negotiations. State aid investigations into the conduct of the UK tax authorities are unlikely to lose their significance in the light of the referendum result.

The Communication devotes considerable space to the sanctions to be imposed when tax good governance criteria are not met. The possible range of sanctions is a matter which is not yet clear. It may become so at some point during negotiations between the UK and the EU. Whether or not it does, the nature of any sanctions that could be imposed and the procedure surrounding their imposition may be something that negotiators could usefully clarify. Any such clarification may, no doubt, be linked to the nature of the rights, if any, which an agreement between the UK and the EU may create and the nature of the dispute settlement provisions which any agreement contains. Given the public attention which has been given to dispute settlement provisions in the proposed Transatlantic Trade and Investment Partnership[65] between the EU and the US, the dispute settlement provisions in any agreement between the UK and the EU are likely to attract considerable public attention and to be highly contentious. The scope for controversy can only be increased by the possibility that the provisions may be used to determine the ability of the UK to exercise its powers of taxation.

Before leaving the Communication it is worth noting that it also draws attention to the fact that third countries have to take account of more than just the EU's ability to export its tax law. They also have to take account of the fact that they are outside the area in which freedom of establishment exists. For those exercising freedom of establishment, controlled foreign company (CFC) rules for example, may be imposed on establishments only in limited circumstances. Those who do not exercise the freedom, such as companies of a country no longer within the EU, may find that CFC rules are more readily applicable. The application of CFC rules is considered in the Communication.[66] For the first time, too, the possibility of UK companies' products being subjected to EU anti-dumping measures arises. The possibility of UK companies having to address either the application of CFC rules or trade protection measures may seem remote now, but negotiators ought to keep them in mind.

Conclusion

In the UK's negotiations to withdraw from the EU, negotiators will need to ensure that the UK is protected, so far as possible, from the export of the EU's tax law and policy, whether the means of export is by agreement or by autonomous measures.

So far as the terms of any relevant agreement is concerned, the UK must determine to what extent, if at all, it is willing to submit its tax system to the constraints of the EU's external tax policy. Then it must decide how its position should be expressed in any agreement. It cannot be

[64] Communication on an External Strategy, above fn.25, 7.
[65] The Transatlantic Trade and Investment Partnership (TTIP), available at: *http://ec.europa.eu/trade/policy/in-focus/ttip/* [Accessed 7 September 2016].
[66] Communication on an External Strategy, above fn.25, 12.

assumed that the approaches taken in existing agreements entered into by the EU and by previous negotiators will be appropriate. This is particularly true in relation to the content of tax good governance clauses, the provisions limiting an agreement's impact on tax and the implications for the UK's tax system of deepening integration within the EU in general or the eurozone in particular.

In any agreement that is reached, both general and specific provisions dealing with tax and the powers of the UK Government and the powers of the devolved governments are likely to be important. In order to identify the precise terms of these provisions, however, all the relevant governmental actors must know how they wish, or may wish in the future, to use their taxing powers. In order for them to know this they must be clear about the detailed nature of their policies in a wide variety of areas which have been significantly constrained by EU law during the UK's time as an EU Member State.

The areas of policy about which there must be clarity for the foreseeable future and for a period well beyond the end of the current EU multi-annual financial framework, which lasts until 2020, include the following: agricultural and fisheries after withdrawal from the EU's common policies in these areas, foreign direct investment once this is removed from the EU's common commercial policy,[67] the activities and location of multi-national enterprises, the activities of the City as a global financial centre, UK regional and industrial policy (the latter may be of particular importance to the present Government), the support of small and medium-sized businesses, scientific research and development now that certain sources of European funding for it are, at best, less accessible and the exploitation of intellectual property. No doubt attention will also have to be paid to certain territories outside the UK, in particular, the position of the Channel Islands, the Isle of Man and Gibraltar.

This is a very broad swathe of policy indeed and additional areas are very likely to require inclusion. Nevertheless, considerable clarity seems to be needed in relation to each of these elements before a notice to withdraw from the EU is served under article 50.2 TEU, and negotiations begin. That is especially so if it is intended that the agreement to withdraw is to be negotiated at the same time as the agreement governing the future relationship between the EU and the UK. In order to protect the UK's interests its negotiators must first know what those interests are. They will know that only once they know what kind of country the UK is to be outside the EU. The challenge is not simply to establish a negotiating position but, to a significant extent, to establish a new national identity, politically and socially as well as economically.

Timothy Lyons

[67] The EU's common commercial policy is an area in which the EU has exclusive competence (TFEU art.3(e)) and following the Lisbon Treaty foreign direct investment was brought within its scope (see TFEU art.207).

Bilateral trade agreements; Brexit; External relations; State aid; Tax administration; Tax authorities; Tax avoidance; Tax competition; Tax policy