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SOFT LAW AND TAXATION: EU AND INTERNATIONAL ASPECTS

Hans Gribnau*

“We compensate, we reconcile, we balance.”¹

Abstract

The EU increasingly uses diversified (new) governance mechanisms in order to improve its performance and legitimacy. In tax matters, various kinds of soft law are used, in indirect as well as in direct taxation. One such instrument, the Code of Conduct for Business Taxation, is deployed to tackle harmful tax competition with respect to direct taxation. Though legally non-binding but relying on peer pressure for its effectiveness, the Code of Conduct is generally regarded to be quite an effective political instrument. There is a subtle interplay between the Code of Conduct and existing hard law in the EU, the State aid provisions providing an important stick, and also between the Code and OECD's soft law instruments. Though the Code's effectiveness is limited, producing negative integration only, it still is significant in facilitating an ongoing dialogue on harmful tax competition between the Member States. However, the Code of Conduct does not score well in terms of stakeholders involvement. The Member States are involved, not civil society. More inclusive and transparent public participation and consultation may enhance the responsiveness and legitimacy of EU tax coordination.

Keywords

Taxation, soft law, Code of Conduct for Business Taxation, EU market integration, harmful tax competition, new governance, legitimacy, communicative regulation, public consultation and participation, transparency.

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¹ E Burke, *Reflections on the Revolution in France* (1790) (Londen, Penguin Books, 1968), 280.

A. INTRODUCTION

Since the 1990s, soft law has become a rather popular regulatory device. The main reason for this popularity seems to be the shift to new governance in public administration and the growing importance of horizontal networks in the context of international and transnational organizations. In this respect, soft law is generally considered to be an important instrument to enhance the legitimacy and responsiveness of policy-making and regulation.

In a previous article in this journal, I have analysed governance aspects of two forms of regulation by the Dutch tax administration, more specifically: law made by way of administrative policy rules and, with regard to its law enforcement task, by way of the recently introduced horizontal supervision approach.² Both forms of soft law, policy rules and enforcement covenants are related to a change in thinking about governance and corporate governance. These changes resulted in shifting attitudes, on the one hand, of the Dutch tax administration towards taxpayers and, on the other hand, of multinational corporations towards tax compliance.

In this second part of this diptych on soft law, I will now elaborate on the European and international use of soft law in taxation matters, such as the EU Code of Conduct for Business Taxation, and the OECD model tax treaty convention and transfer pricing guidelines. In this article, I will try to assess the use of soft law in European tax law in the broader perspective of soft law being used as an alternative to more formal measures such as regulations, decisions, and directives. There are many forms of EU soft law, eg, communications, recommendations, guidelines, codes of conduct. Here, I will focus on the EU Code of Conduct for Business Taxation. What conception of governing and law-making accounts for the use of soft law? To answer this question, some reflections on the notion of governance and soft law, as an alternative to European legislation, are necessary. I will continue by setting out the varieties of EU soft law and their complex relationship to hard law. Then, I will review the use of soft law instruments in the light of a communicative style of regulation. However, to prepare the ground, I will start and set out the main characteristics of tax law in the European Union and its relation to the EU's fight against harmful tax competition. I will add some observations on the OECD's soft law instruments to tackle this problem, harmful tax competition being a global phenomenon. The EU and OECD will prove to be brothers in arms on the harmful tax competition battlefield.

I will assess the Code of Conduct for Business Taxation as a soft law instrument to enhance tax coordination. I will argue that the communicative

² H Gribnau, "Soft Law and Taxation: The Case of The Netherlands" (2007) 1 *Legisprudence* 291-326.

quality of soft policy-making and regulation may be enhanced by involving stakeholders by way of public consultation and participation, the involvement of civil society being an essential condition for more responsive and legitimate EU tax coordination policies.

B. EU MARKET INTEGRATION AND TAX LAW

1. EU Market Integration

Before analysing the Code of Conduct for Business Taxation and, more generally, the use of soft law in the context of European tax law, I will make a few remarks with regard to some salient characteristics of tax law in the European Union. Without any knowledge of these characteristics, it is hard to assess the use of soft law in European tax matters.

Taxation in the European Union is part of a larger picture. The Union has set itself several objectives, among which the objective “to promote economic and social progress” and “a high level of employment.” These objectives are to be realized through the creation of an area without internal frontiers, through the strengthening of economic and social cohesion, and through the establishment of an economic and monetary union (see art 2 of the EC Treaty). This establishment of a common market and of an economic and monetary union is an important means to reach the integration of national economies, ie, market integration. More specifically, the common market includes the establishment of an internal market which is “characterized by the abolition, as between Member States, of obstacles to the free movement of goods, persons, services and capital” (art 3, para 1 (c), and 14, para 2 of the EC Treaty).

In order to achieve the objectives of article 2 of the EC Treaty, both the Member States and the Community are obliged to adopt “an economic policy which is based on the close coordination of Member States’ economic policies, on the internal market and on the definition of common objectives, and conducted in accordance with the principle of an open market economy with free competition”, thereby “favouring an efficient allocation of resources” (art 4, para 1, art 98 of the EC Treaty, respectively). This efficient allocation serves the goal of improving the welfare of the peoples of Europe by opening the internal borders to persons, goods, services and capital while setting competition rules which guarantee the free play of market forces. Nobody may interfere with this aim of an optimal allocation of resources. Thus both the internal market as a whole and the respective national markets are committed to the principle of open competition.³

³ W Schön, “Tax Competition in Europe—The Legal Perspective” (2000) 9 EC Tax Review 91.

This open competition requires an internal market with free movement of goods, services, persons, and capital and a level playing field, ie, conditions of competition which are not distorted by specific tax measures or tax privileges.

The nexus between taxation and market integration is twofold. On the one hand, substantial differences between national tax laws may constitute important obstacles to the common market. Moreover, only a Europe capable of optimizing market conditions within the Common Market will be able to survive in the competition with the economies of Asia and the US. “Harmonization can thus also be necessary to survive in the international competition of tax systems.”⁴ On the other hand, provisions of a discriminatory and restrictive nature in national tax laws may constitute such obstacles, for example, because of their differential treatment of residents and non-residents. Thus, in the field of taxation market, integration may be achieved in a positive and in a negative way. Positive integration is achieved by tax harmonisation or at least coordination between Member States. This is integration by way of coordination of national policies, common policy-making, and approximation of national laws. Negative integration is integration through legally enforceable prohibitions on discriminatory measures and restrictive features of national tax systems; here, the case law of the EC Court of Justice (ECJ) is of major importance. However, non-binding instruments, notably the Code of Conduct on Business Taxation, have been introduced, in addition to these legally enforceable instruments,.

2. Indirect Taxes: Positive Integration

Taxation may have distorting effects on the internal market, for tax differences may constitute impediments to the proper functioning of the internal market. In 1957, at the moment of the constitution of the European Economic Community, solely the distorting effects of indirect taxes was envisaged. This is not a surprise since, among tax impediments, customs duties and discriminating domestic taxations of foreign good and services are the most conspicuous ones. They visibly and directly affect the freedom to trade.⁵

As for indirect taxes, the EEC treaty already contained an explicit instruction to the Community’s legislator to harmonise indirect taxes to the extent necessary for the establishment and functioning of the internal market (now art 93 of the EC Treaty). Consequently, the Community adopted an abundance of secondary law in the field of indirect taxes. The EEC treaty contained provisions with regard to a customs union (art 23 of the EC Treaty), and a specific harmonisation and non-discrimination provision for customs duties and turnover taxes (art 90 of the EC

⁴ Ibid, 105. Thus, competition in tax laws is a species of competition in laws, one important aspect of globalisation.

⁵ B J M Terra and P Wattel, *European Tax Law* (Deventer, Kluwer, 2007), 91.

Treaty). Article 23 of the EC Treaty states that the Community is based upon a customs union, which means the total prohibition of customs duties between Member States on import and export and of equivalent border-crossing charges (art 25 of the EC Treaty). This customs union also entails a common customs tariff in their relation with third countries. In the years 1992-1993, the far-reaching Community Customs Code, Regulation (EEC) 2913/92 and the implementing code, Regulation (EEC) 2454/93, were introduced.⁶ As for customs, article 90 of the EC Treaty is also relevant: discriminatory and protective taxes are forbidden. Consequently, this article leaves the Member States discretion to levy product taxes within certain limits.

With regard to indirect taxes, specific harmonisation and non-discrimination provisions are to be found in the already mentioned article 90 and in articles 91-93 of the EC Treaty.⁷ The legal basis for the harmonisation of indirect taxes, ie, turnover taxes and excise duties, is article 93. To reach the goal of the harmonisation in so far as necessary for the establishment and the functioning of the internal market, the necessary powers are conferred on the Community, according to this article.⁸ Turnover taxes have to be harmonised because Member States could use these as an escape, ie, a substitute for import and export duties.⁹ The many directives on value added tax that have been issued limit or sometimes entirely discard national sovereignty as regards the system, the base, the exemptions, and the rates of turnover taxation. To name just one example, any other system of turnover taxation than value added taxation is excluded. The harmonisation of excise duties on the other hand is less advanced; so far, only those on alcohol, mineral oils, and tobacco have been affected. The Member States governments apparently insist on retaining as much of their tax sovereignty as possible. "Even the eminently rational abolition of duty-free shopping between EU countries took ten years to achieve and then with considerable oppositions from some of the larger EU countries."¹⁰ This is a nice example of the more general phenomenon that governments are reluctant to take particular

⁶ For a discussion of the Community Customs Code, see *ibid*, 125-134.

⁷ These taxes and duties partly provide the Community with its own resources, the most important of which are a percentage of the national bases of the value added tax, the revenue from customs duties at the outside borders of the EC, and agricultural levies.

⁸ For empirical evidence of the importance of harmonisation of laws and regulations for enterprises, ie, private equity, see S Johan, *The Law and Economics of Private Equity Financing: Empirical Essays* (Tilburg, Tilburg University, 2007).

⁹ Terra and Wattel, *European Tax Law*, *supra*, n 5, 135-206, deals with value added tax in Europe (on the basis of Council Directive 2006/112/EC of 28 November 2006, which replaces the Sixth VAT Directive).

¹⁰ K Messere, F de Kam and C Heady, *Tax Policy: Theory and Practice in OECD Countries* (Oxford University Press, 2003), 221.

coordinating, let alone harmonizing, decisions that would be unpopular in their own countries.

3. Direct Taxes: Mainly Negative Integration

Unlike indirect taxes, direct taxes are hardly referred to in the EC Treaty. Consequently, considerably few powers in the field of direct taxation are conferred on the Community. Compared to indirect taxes, therefore, the harmonization of direct taxes rests on a considerably narrower Treaty basis. Any attempt to harmonize direct taxes has to fall back on the general harmonization provisions (arts 94 and 95).¹¹ However, the legal basis provided for by the general harmonization provisions is not as promising as it seems to be. Article 95, para 2 states that article 95, para 1, demanding qualified majority decisions on matters concerning the establishment and the functioning of the internal market, is not applicable in the field of direct taxation. Consequently, the legal basis in the EC Treaty for direct tax harmonisation is not very broad because the Member States are not prepared to confer any part of their sovereignty in matters of direct taxation. The remaining legal basis for harmonization of direct taxation, article 94, deals with the approximation of domestic laws directly affecting the establishment or the functioning of the common market. Unanimous decision-making is required, which gives Member States the power to veto EC measures in the field of direct taxation. This unanimity requirement is also to be found in article 93, on indirect taxes. As a result, direct and indirect tax measures can only be adopted unanimously.

Especially in the field of direct taxes, the unanimity requirement has been a serious impediment to harmonisation.¹² States treasure their sovereignty in the field of taxation, because taxation is a fundamental sign of national sovereignty and because taxation nowadays is an important instrument to collect money for the treasury, to fund redistributive policies, and all kinds of other government policy goals. Therefore, the constraint on national sovereignty in indirect tax matters made the EU Member States all the more reluctant to yield their tax sovereignty in the other field of taxation, ie, direct taxation. Limited harmonisation is achieved by a few directives, eg, the Directive on the common system of taxation applicable in the case of parent companies and subsidiaries of

¹¹ Cf Terra and Wattel, *European Tax Law*, supra, n 5, 10-11.

¹² Schön, "Tax Competition in Europe—The Legal Perspective", supra, n 3, 104: "More than learned writings concerning the fundamental freedoms and more than any discussion about necessity and subsidiarity of approximation of laws or than the diverse economic contributions for and against tax harmonization, it has been this unanimity requirement which, in recent decades, has characterized the practice of European tax policy, has prevented harmonization and led to institutional competition in the tax area."

different member states and the Directive on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different member states.¹³ Furthermore, the Commission is currently working on two main comprehensive approaches to remove tax obstacles which companies face in the Internal Market: the Common Consolidated Corporate Tax Base (CCCTB) and a possible pilot scheme for Home State Taxation for Small and Medium-Sized Enterprises (HST).¹⁴

Consequently, far less positive integration having been achieved in direct taxation than in indirect taxation, the Member States remain free in principle to regulate direct taxation matters according to their own views. They may take policy decisions they deem to be necessary, with regard to the structure of their tax system. However, negative integration emerges here, for the national sovereignty of the Member States is restricted by negative integration. It is based on the EC Treaty provisions, especially the free movement rules (arts 23-31 and 39-60). According to settled case law, although direct taxation falls within their competence, Member States must nonetheless exercise that competence consistently with Community law.¹⁵ Thus, the Member States may not enact or maintain direct tax laws or administrative practices which discriminate against or restrict enterprises, employees or capital of other Member States. According to these Treaty freedoms, the Member States must abstain from covert or overt discrimination by nationality. Beside these measures with distinction on the basis of nationality, measures without distinction, which nonetheless hinder or make less attractive the exercise of the Treaty Freedoms for cross-border economic activity, are also prohibited.¹⁶ Even so, they may not enact or maintain tax incentives which amount to aid to certain producers or sectors, as State aid distorts open market competition.

The EC Court of Justice has struck down many national regulations on the grounds of violation of the free movement rules.¹⁷ The tax case law has followed

¹³ Council Directive of 23 July 1990, 90/435/EEC, OJ L 225, 20.8.1990, 6 (Parent-Subsidiary Directive), and Council Directive of 23 July 1990, 90/434/EEC, OJ L 225, 20.8.1090, 1 (Merger Directive). See also the Interest and Royalty Directive and the Interest Savings Directive.

¹⁴ This policy was established in 2001 (COM(2001) 582, 23.10.2001) and confirmed in 2003 (COM(2003) 726, 24.11.2003).

¹⁵ See already ECJ 11 August 1995, Case C-80/94 *Wielockx*, para 16.

¹⁶ Terra and Wattel, *European Tax Law*, supra, n 5, 43-57.

¹⁷ Terra and Wattel, *European Tax Law*, supra, n 5, 337-424. The ECJ has adopted a “much more robust concept of discrimination than that found in international tax and trade law (...), members states’ claims that a provision is necessary to maintain the coherence of their income taxes have generally been rejected by the court”; M Graetz and A C Warren, “Income Tax Discrimination and the Political and Economic Integration of Europe”, in R S Avi-Jonah, J R Hines Jr, and M Lang (eds), *Comparative Fiscal Federalism: Comparing the European Court of Justice and the US Supreme Courts’ Tax Jurisprudence* (Alphen aan den Rijn, Kluwer Law

a pattern similar to some other areas, balancing the Community's interest in free movement with potentially conflicting national interests. This is no easy job for the Court, because, on the one hand, it is working in a largely unharmonized area on a case-by-case basis (eventually hearing enough cases to get a better feel for where the balance should lie) and, on the other hand, the treatment of a taxpayer in a cross-border situation depends on the interaction of more than one system, in some cases many more. Indeed, "there is nothing approaching the complex interaction of Member State rules that exists in the direct tax area."¹⁸

Negative integration – constraining domestic direct tax policy – is also based on the competition rules, in particular, in the field of taxation, the ban on State aid to enterprises (arts 87-89). The EC Court of Justice has also struck down many national regulations which violated these State aid rules.¹⁹ The State aid regime is aimed to regulate the granting of financial support by Member States to enterprises. They could do this by means of a tax benefit, which may have similar effects as a state subsidy despite their different labels. National governments may thus pursue their own industrial policies using subsidies and other incentives to provide enterprises and entrepreneurs with a competitive advantage over similar enterprises in other Member States. Consequently, such financial support may keep inefficient enterprises in business, which is contrary to the goal of free competition in the common market, ie, survival of the most efficient producers of goods and services.²⁰ According to the Court, the effects rather than the objectives of a state measure count.²¹ Tax measures, therefore, in principle constitute State aid if their effects favour certain enterprises or productions.²² Of

International, 2007), 263-320, 279, 300. See also F Vanistendael (ed), *EU Freedoms and Taxation* (Amsterdam, IBFD, 2006).

¹⁸ P Farmer, "Tax Law and Policy in an Adolescent European Union", (2007) 2 *Bulletin for International Taxation* 42. He continues: "The closest—although not a complete analogy—is perhaps the social security area, but there, of course, we have a comprehensive set of Community coordinating provisions."

¹⁹ See C Pinto, *Tax Competition and EU Law* (The Hague/London/New York, Kluwer Law International, 2003), 97-193. He concludes: "At the moment, the application of the fiscal State aid rules seems the, most effective tool to counter harmful tax competition in the EU." See also D Wolf, "State Aid Control at the National, European and International Level", in M Zürn and Ch Joerges (eds), *Law and Governance in Postnational Europe: Compliance beyond the Nation-State* (Cambridge University Press 2005), 86: "The European regulatory controls on State aid must be considered to be one of its more or less silent success stories."

²⁰ For the relationship between tax incentives and its economic background, see R H C Luja, *Assessment And Recovery of Tax Incentives in the EC and the WTO: A View on State Aids, Trade Subsidies and Direct Taxation* (Antwerp, Intersentia, 2003), 3-23.

²¹ Case 173/73, *Italy v Commission* ECJ 2 July 1974.

²² An example is the recent approval by the Commission of a French tax credit aimed at encouraging video game creation. This tax credit may be granted only to video games that meet the criteria of quality, originality, and contribution to cultural diversity. After an in-depth investigation that began in 2006, the Commission concluded that this measure qualified for the

course, scrutinizing particular tax benefits is nothing like harmonizing the tax systems of the states, since this does not affect the core of the national tax systems. Note that, like taxation, State aid is at the heart of state sovereignty, and therefore an extremely politicized EU policy area.²³

As will be shown below, important negative integration was achieved through soft law, ie, the adoption of the Code of Conduct for Business Taxation. However, before elaborating on the phenomenon of soft law, I will briefly deal with tax competition and the concept of harmful tax competition which lies at the basis of the introduction of the Code of Conduct for Business Taxation. The Code is a soft law instrument to tackle harmful tax competition, and therefore to enhance negative integration of the corporate income tax laws of the Member States.

C. HARMFUL TAX COMPETITION

1. The European Union

The basic assumption underlying the idea of competition on a free and open market is the most efficient production of goods and services for the benefit of the consumers. The removal of all kind of barriers, such as technical, physical, administrative and cultural barriers, makes it easier to set up many economic activities in Member States which are thought most attractive. In an age of increasing mobility of undertakings and especially capital investments, companies and entrepreneurs consider low tax costs an important factor in deciding where to set up undertakings and invest capital. States are aware of this, of course, and they will try to compete with their tax system in order to attract economic activities from other Member States or from third countries.²⁴ Member States see corporation tax as an important instrument in this bid for economic

exemption provided for by the EC Treaty for state aid to promote culture; IP/07/1908, 12.12.2007.

²³ The State aid policy area “pits the Commission directly against the member states, with governmental authorities rather than firms, targets of Commission regulation”; M Cini, “The Soft Law Approach: Commission Rule-Making in the EU’s State Aid Regime” (2001) 8 *Journal of European Public Policy* 198.

²⁴ For an analysis of the concept, methodology, and economic aspects of tax competition, see Pinto, *Tax Competition and EU Law*, supra, n 19, 1-52. Though business may profit from low tax costs as a result of tax competition, tax competition may seriously complicate national tax systems and therefore lead to higher compliance costs for multinational corporations. Disparate tax systems can create obstacles to cross-border economic activities. Therefore, businesses operating in the internal market will mostly have a preference for tax coordination aimed at the elimination of tax obstacles.

activity, for example, lower corporate taxes might induce multinational corporations not to allocate their profits to other countries.²⁵

This tax competition may force national governments to search for an optimal mix of public goods and services, on the one hand, and low tax costs, on the other. If economic opportunities and activities are created the internal market will flourish. “Such policy competition between overall national tax systems, leading to budgetary and tax efficiency, is in principle good for everyone”, Terra and Wattel argue.²⁶ However, this tax competition may also be economically counterproductive. The forms and features of tax incentives which the sovereign states commonly use in order to attract investment and capital from abroad can often have harmful effects. Such special tax schemes as tax holidays, selective base or rate reductions, and tax breaks may be designed solely to undercut competition. However, such harmful tax competition has little to do with tax efficiency and healthy jurisdictional competition, and it leads to “fiscal degradation”,²⁷ unfair tax advantages for multinational corporations over smaller local enterprises, overtaxation of labour, and a radical reduction of public goods and services and negative consequences for distributive justice.²⁸ Tax competition is commonly labelled harmful when Member States merely damage each other’s budget, no creation of economic activity being at issue, but rather “artificial cross-border shifts of activities (or at least profit-reporting for those activities), causing a tax loss for the EC as a whole.”²⁹ It should be noted, however, that there is no scientific consensus on the theoretical definition of harmful tax competition and that even “empirical evidence is somewhat disputed by both economists and political scientists.”³⁰

In the 1990s, harmful tax competition became a hotly debated topic in the European Union. I will briefly deal with a few moments in this debate to point out the growing sense of urgency to fight harmful tax competition and the subsequent choice for a soft law instrument in the form of the Code of Conduct for Business Taxation.

²⁵ For a view on the political dimension of corporation tax issues, see J Snape, “Corporation Tax Reform—Politics and Public Law” (2007) 103 *British Tax Review*, 382-89.

²⁶ Terra and Wattel, *European Tax Law*, supra, n 5, 110. Cf F Vanistendael, “Fiscal Support Measures and Harmful Tax Competition” (2000) 9 *EC Tax Review* 152-61.

²⁷ Fiscal degradation is “the loss of tax revenue borne by countries engaged in the lowering of taxes on income derived from inbound investment or, in other words, the excessive erosion of their taxable bases on such income”; Pinto, *Tax Competition and EU Law*, supra, n 19, 11.

²⁸ A J Menéndez, “The Purse of the Polity”, in E O Eriksen (ed), *Making the European Polity: Reflexive Integration in the EU* (London, Routledge, 2005), 208. He points to “the connection between corporate taxation and distributive justice (tax dumping leads to social dumping).”

²⁹ Terra and Wattel, *European Tax Law*, supra, n 5, 111.

³⁰ C M Radaelli, “The Code of Conduct against Harmful Tax Competition: Open Method of Coordination in Disguise?” (2003) 81 *Public Administration* 522.

The Ruding Report of 1992, commissioned by the EC Commission and named after its chairman, was the outcome of a two-year study carried out by a committee of tax experts.³¹ This report contains a comprehensive study on corporate taxation in the EU, pointing out considerable differences between the national laws of the Member States that have distorting effects.³² The findings were followed by a number of policy recommendations regarding, on the one hand, the elimination of the double taxation of cross-border income flows, and, on the other, the approximation of corporation taxes. One of the recommendations was the alignment of the domestic rules of the EU Member States with the OECD Transfer Pricing Guidelines (see *infra*, section C.2).

The next important step was the Monti Memorandum, named after Mr. Mario Monti the EC Commissioner for the internal market.³³ By publishing this “discussion paper” in 1996, the Commission for the first time put the distorting effects of tax competition high on the political agenda.³⁴ The memorandum created a sense of urgency to increase the coordination of the tax policies of the Member States. In a subsequent report, the Commission stressed the need to curb unfair tax competition by applying the State aid rules more strictly and also the need to enhance coordination in the area of tax incentives granted by the Member States in order to reduce the negative effects of tax competition.³⁵ To achieve this aim, a group of high representatives of Member States had to be involved to discuss the relevant issues and achieve consensus on the tax measures to be considered harmful in the Community context. This group was to formulate common criteria to identify such measures to be laid down into a code of good conduct.

Also interesting is the Commission’s view set out in the already mentioned Communication, “Tax Policy in the European Union - Priorities for the Years Ahead.”³⁶ In this Communication, it is stated that the Community must, in

³¹ Schön, “Tax Competition in Europe—The Legal Perspective”, *supra*, n 3, 95. He points out that the “Neumark report”, presented by the Fiscal and Financial Committee in 1962, already emphasized the necessity of abolishing those differences between the Member States of tax incentives or expenditure policies, whose mere existence induces enterprises, and consequently also capital and labour, to choose other locations than those which would be the most favourable ones from a natural-technical point of view.”

³² *Report of the Committee of Independent Experts on Company Taxation*, Commission of the European Communities, March 1992 (Luxembourg, Office for Official Publications of the European Communities 1992).

³³ Discussion paper for the international meeting of Ecofin Ministers, SEC(96) 487 final, 20.3.1996.

³⁴ For a review of some other studies, see Pinto, *Tax Competition and EU Law*, *supra*, n 19, 37-41.

³⁵ *Taxation in the European Union: Report on the Development of Tax Systems*, COM(1996) 546 final, 22.10.1996.

³⁶ COM (2001) 260 final, 23.5.2001, 10 and 22-24.

addition to continuing the important fight against harmful tax competition, ensure that tax policy is in line with the Lisbon goals. The Commission sets out some general objectives for a future tax policy at Community level. As regards the instruments for achieving these objectives, the Commission also points to non-legislative approaches or “soft legislation” in addition to (hard) legislation, in order to achieve (negative) integration in the field of direct taxation. The peer pressure, which is the basis of the Code of Conduct, could be applied to other areas.

In October 2001, the Commission released its report “Company Taxation in the Internal Market.”³⁷ With regard to tax competition, this study is cautious in drawing conclusions, but points to the lack of harmonisation in the internal market. It is suggested that, given this lack, harmful tax competition occurs, if Member States use direct taxation as an effective competition tool to attract foreign investment. The study concludes, on the one hand, that tax competition has certain positive welfare implications for the EU, and, on the other hand, that special tax incentives and preferential tax regimes must be curtailed to prevent harmful effects on the internal market.³⁸

In the next section, a twofold link will be shown between EU and international soft law. Firstly, the EU and the OECD both use soft law in order to tackle harmful tax competition by way of the EU Code of Conduct on Business Taxation and the OECD model tax treaty convention and transfer pricing guidelines, respectively. Secondly, the EU Code of Conduct on Business Taxation explicitly endorses the OECD transfer pricing guidelines.

2. The OECD

The European Union is not the only organisation that wants to tackle harmful tax competition. The Organisation for Economic Cooperation and Development (OECD) is also an important player in this context. In the framework of this harmful tax competition the OECD Transfer Pricing Guidelines, which, as will be shown, are related to the Code of Conduct for Business Taxation, play an important role.

In May 1996, the Ministers of the Member countries of the OECD called upon the OECD to “develop measures to counter the distorting effects of harmful tax competition on investment and financing decisions and the consequences for

³⁷ SEC (2001) 1661, 23.10.2001. The main findings of this comprehensive study and the consequent recommendations were included in a separate communication: Commission communication, *Towards an Internal Market without Tax Obstacles – A Strategy for Providing Compliance with a Consolidated Corporate Tax Base for their EU-wide Activities*, COM(2001) 582 final, 23.10.2001.

³⁸ SEC (2001) 1661.

national tax bases, and report back in 1998.”³⁹ This request was subsequently endorsed by the G7 countries, who pointed to the fact that globalisation was creating new problems in the field of tax policy. Tax schemes aimed at attracting financial and other geographically mobile activities, such as financial and other service activities, “can create harmful tax competition between States, carrying risks of distorting trade and investment and could lead to the erosion of national tax bases.”⁴⁰

In 1998, the OECD’s Committee on Fiscal Affairs published a report on harmful tax competition. This report addressed tax havens and harmful preferential tax regimes, collectively referred to as harmful tax practices, in OECD Member countries and non-Member countries and their dependencies. The OECD report was intended to develop a better understanding of how these harmful tax practices “affect the location of financial and other service activities, erode the tax bases of other countries, distort trade and investment patterns and undermine the fairness, neutrality and broad social acceptance of tax systems generally. Such harmful tax competition diminishes global welfare and undermines taxpayer confidence in the integrity of tax systems.”⁴¹ Of course, countries may and usually do use a variety of counteracting measures, typically implemented through unilateral or bilateral action by the countries concerned. However, as the report convincingly argued, there are limits to such a unilateral or bilateral approach to “a problem that is essentially global in nature.”⁴² Therefore, counteracting measures are likely to be most effective if undertaken in a co-ordinated way at the international level.⁴³ International cooperation demands that governments establish a “common framework within which countries could operate individually and collectively to limit the problems presented by countries and fiscally sovereign territories engaging in harmful tax practices.”⁴⁴

With regards to soft law, it should be noted that Recommendation 6 in the report suggested that Member States follow the already existing OECD Guidelines of 1995 on transfer pricing when the arm’s length principle was implemented at the domestic level, thereby refraining from harmful tax competition. Transfer pricing or intercompany pricing is the area of tax law that is

³⁹ Committee on Fiscal Affairs OECD, *Harmful Tax Competition: A Global Issue* (Paris, OECD, 1998), 8.

⁴⁰ Communiqué issued by the Heads of State at their 1996 Lyon Summit, quoted in OECD, *Harmful Tax Competition*, supra, n, 39, 8.

⁴¹ Ibid, 9.

⁴² Ibid, 37.

⁴³ The EU Code and the OECD Guidelines are broadly compatible, particularly as regards the criteria used to identify harmful preferential tax regimes, and mutually reinforcing. However, the scope and operation of the two differ, partially because of the different institutional frameworks. For more details, see *ibid*, 11.

⁴⁴ Ibid, 8.

concerned with ensuring that prices charged between associated enterprises for the transfer of goods, services, and intangible property are in accordance with the arm's length principle. This principle deals with transactions, among associated enterprises, so-called "controlled transactions", which are not like transactions between independent enterprises determined by market forces, whereby these enterprises may seek to manipulate their profits in order to reduce their tax liability. The arm's length principle requires associated enterprises to charge the same prices, royalties and other fees in relation to a transaction among them (a so-called "controlled transaction") that would be charged by independent parties in an uncontrolled transaction in otherwise comparable circumstances.⁴⁵ This principle is meant to prevent that conditions could be made or imposed between the two enterprises to reduce their tax liability in countries with higher tax rates by allocating their profits to countries with low tax rates.

The OECD Council of 9 April 1998 adopted this recommendation 6, which accounts for its soft law character.⁴⁶ This recommendation was adopted by all Member States of the OECD, which means that they have to follow it, unless states have put forward "reservations" with regard to their position to the recommended measures.⁴⁷ Nonetheless, the fact that the recommendations were adopted by agreement of all Member States of the OECD adds to their weight. The normative force of this recommendation was further strengthened by the reference to it in the EU Code of Conduct on Business Taxation (para B4) as a standard to be taken into account.⁴⁸

In the next section I will elaborate on the EU Code of Conduct for Business Taxation, a specific soft law instrument. Then, I will proceed with the question of why soft law is used as an alternative to European legislation in order to explain the introduction of the Code. Then I will turn to the question of what conception of governing and law-making accounts for the use of soft law. To answer this question, some reflections on the notion of governance and soft law, as an alternative to European legislation, are necessary.

⁴⁵ According to this principle, profits which would, but for those conditions, have accrued to one of the enterprises in a state but, by reason of those conditions, have not accrued may be included in the profits of that enterprise and taxed accordingly. See article 9, para 1 of the OECD Model Tax Convention and the elaborated OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations at www.oecd.org (last accessed 18 December 2007).

⁴⁶ The Council is made up by representatives of member countries and of the European Commission.

⁴⁷ States may also have material reasons for not following the guidelines, such as singularities in the domestic law.

⁴⁸ J Calderón, "The OECD Transfer Pricing Guidelines as a Source of Tax Law: Is Globalization Reaching the Tax Law?" (2007) 35 *Intertax* 8.

D. THE CODE OF CONDUCT FOR BUSINESS TAXATION

As shown above, in the 1990s, harmful tax competition became a hotly debated topic in the European Union. However, harmful tax competition is a truly international problem. Therefore, some of the OECD's efforts to tackle harmful tax competition were pointed out and it was shown that the OECD efforts reinforced the EU Code of Conduct for Business Taxation. This Code was a major step forward in the fight against harmful tax competition. This soft law instrument was deemed to be expedient because most Member States felt that a (hard law) directive would erode political sovereignty.

Thus, the unanimity requirement poses a major obstacle to harmonisation in the field of direct taxes. The introduction of the Code of Conduct for Business Taxation was a reaction to the toilsome process of achieving (limited) integration. The Monti Memorandum was instrumental in creating a sense of urgency to increase the coordination of the tax policies of the Member States (*supra*, section C.1). In a subsequent report, the Commission underlined the need for a group of high representatives of Member States which should achieve consensus on the tax measures to be considered harmful in the Community context and on the common criteria for the identification with an eye to the establishment of a "code of good conduct."⁴⁹

These developments resulted in the adoption of a comprehensive package to tackle harmful tax competition by the ECOFIN Council on 1 December 1997.⁵⁰ This package was composed of three linked elements: the Code of Conduct for Business Taxation, measures to eliminate distortions in effective taxation of savings income, and measures to eliminate withholding taxes on cross-border payments of interest and royalties between associated enterprises. Thus, the Code of Conduct for Business Taxation was agreed on by the ECOFIN Council, ie, the Finance Ministers of the (then 15) EU Member States.⁵¹

The Code of Conduct for Business Taxation is an instrument to tackle harmful tax competition. To be sure, the preamble acknowledges the positive effects of fair tax competition and the need to consolidate the competitiveness of the European Union at international level, but it also notes that this competition may lead to tax measures with harmful effects. The adoption of the Code by the Council as a resolution accounts for its non-legal nature. The Code of Conduct is

⁴⁹ *Taxation in the European Union: Report on the Development of Tax Systems*, COM(1996) 546 final, 22.10.1996. For an historic overview, see Pinto, *Tax Competition and EU Law*, *supra*, n 19, 196-199.

⁵⁰ This package was based on a proposal put forward by the Commission: see paper *Towards Tax Co-ordination in the European Union – A Package to Tackle Harmful Tax Competition*, COM(97) 495, 1.10.1997, and *A Package to Tackle Harmful Tax Competition in the European Union*, COM(97) 564 final, 5.11.1997.

⁵¹ OJ No. C 2, 6.1.1998, 1.

not legally binding, which is emphasised by its preamble: “the Code of Conduct is a political commitment and does not affect the Member States’ rights and obligations or the respective spheres of competence of the Member States and the Community resulting from the Treaty.”

The Code embodies a legislative drafting strategy that makes a substantive advance towards tax coordination.⁵² The Code of Conduct concerns those business tax measures that “affect, or may affect in a significant way the location of business activity in the Community.”⁵³ The tax measures covered by the Code include any measure on business – law, regulations as well as administrative practices – whether through the nominal tax rate, the tax base, or any other relevant factor. Not all tax measures are harmful, of course. So, the Code first defines potentially harmful tax measures. The defining characteristic is “a significantly lower effective level of taxation, including zero taxation, than those which generally apply in the Member State in question.”⁵⁴ In identifying measures which are in fact harmful, several other factors are considered. The not exhaustive account of these supplemental factors includes: whether tax measures apply only to non-residents, whether tax benefits available without there being any real economic activity, whether the Member State follows the OECD transfer pricing guidelines (see *supra*, section C.2), and whether the measure lacks transparency (including covert relaxation of rules at the administrative level).

With this “gentlemen’s agreement”, the Member States (politically) committed themselves in the first place to refrain from introducing new potentially harmful tax measures (“standstill”). Furthermore they agreed to re-examine existing laws and practices to identify existing potentially harmful tax measures for elimination, and to roll back the existing tax measures which were labelled harmful within two years (as a general rule). The potential harmful tax measures would be assessed in a review process. Peer review took place by a tax policy group of high representatives of the Member States, the so-called Primarolo group, named after Dawn Primarolo, the UK Paymaster General who chaired the committee.

Any Member State could report possibly harmful tax measures provided by another Member State until 31 January 1999. This “informer” provision proved a great success. Member States put more than 175 measures on the list.⁵⁵ After

⁵² W W Bratton and J A McCahery, “Tax Coordination and Tax Competition in the European Union: Evaluating the Code of Conduct on Business Taxation” 38 (2001) *Common Market Law Review* 685.

⁵³ Conduct of Conduct for Business Taxation, Annex to the ECOFIN Council meeting on 1 December 1997, OJ No. C 2, 6.1.1998, 3.

⁵⁴ *Ibid*, 3

⁵⁵ B J Kiekebeld, *Harmful Tax Competition in the European Union: Code of Conduct, Countermeasures and EU Law* (Deventer, Kluwer, 2004), 48.

having presented two interim reports, the Primarolo group submitted its final report to the ECOFIN Council on 29 November 1999.⁵⁶ This final Report singled identified 66 (existing) rules and practices as potentially harmful tax practices. The reactions of the Member States may be found in its footnotes. They concern not only views and reservations on their measures which were put on the “blacklist”, but also more general comments on the work of the Primarolo group and on the Report as a whole.

The Primarolo Report has not yet been formally approved by the Council, due to disagreement of several Member States on the blacklisting of their own measures. Another point of Member States’ criticism was the fact that the Report, as regards the criteria applied, in some instances seems to go beyond the scope of the Code of Conduct and the Group’s mandate. However, in an interim agreement on the package reached on 27 November 2000, the Member States decided not to formally reject the report (and its blacklist). The agreement provided for a conditional phasing-out of the designated measures.⁵⁷ This “interim agreement” entered into force on 3 June 2003, when an agreement was reached on the entire package to tackle harmful tax competition and on two directive proposals, on savings income and on cross-border interest and royalty payments between associated enterprises, respectively (Interest and Royalty Directive⁵⁸ and the Interest Savings Directive⁵⁹). Thus, Member States finally agreed on the (continued) Primarolo exercise.

The Code is a soft law instrument that does not legally bind the Member States. Nevertheless, its adoption marks an important step towards (further) tax coordination. “By proceeding softly where hard approaches have failed, the Code will [has] garnered agreement in principle to coordination, broadly phrased.”⁶⁰ The non-binding nature of the Code may be considered a strength rather than a weakness. On account of the peer pressure involved, Member States have taken

⁵⁶ Code of Conduct Group, European Council, *Report on the Code of Conduct (Business Taxation)*, SN 4901/99, 29.11.1999. In addition, at the request of the Code of Conduct Group, the Commission provided two studies to assist the Group in the review process; Kiekebeld, *Harmful Tax Competition in the European Union*, supra, n 55, 49.

⁵⁷ As part of the agreement, the Council adopted three sets of guidelines containing general criteria based on those set out in the Primarolo Report. See Pinto, *Tax Competition and EU Law*, supra, n 19, 209 ff.

⁵⁸ Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies in different Member States, OJ L 157, 26.6.2003, 49, adapted by Council Directive 2004/66/EC, OJ L 168, 1.5.2004, 35.

⁵⁹ Council Directive 2003/48/EC, 3.6.2003 on taxation of savings income in the form of interest payments, OJ L 157 of 26.6.2003, 38-48.

⁶⁰ Bratton and McCahery, “Tax Coordination and Tax Competition in The European Union”, supra, n 52, 685.

the Code seriously and amended most of their tax measures to comply with it.⁶¹ The Code of Conduct is generally regarded to be a quite effective political instrument.⁶² The Primarolo Report, stemming from the Code of Conduct, is a fundamental step in the fight against harmful tax competition. Not only does it contain a blacklist of harmful tax measures, but it also sets out the specific criteria used. Thus, important negative integration was achieved through the Member States suspending application of the tax measures under scrutiny, eg, the Dutch group finance company regime.⁶³ Ireland announced soon after the adoption of the Code that it was phasing out its preferential tax regimes and replacing them with a single lower rate of corporation tax applicable to all enterprises.⁶⁴

There is often a subtle interplay between soft law and hard law. This also goes for the Code of Conduct which was reinforced by a more strict application by the Commission of the Treaty rules on State aid. The State aid criteria and the Code of Conduct have a dominant influence on the national debates on corporate income tax.⁶⁵ Thus, the combination of hard law and soft law was used to convince the Member States to take their obligations with regard to tax coordination more seriously. Soft law itself may also have hard edges. Notable is the fact that the results of the Primarolo report were presented as *acquis communautaire* in the negotiations with new Member States. Here, a switch appears to have been made: soft law became a form of “extremely hard law.”⁶⁶ Of course, this treatment may lead to considerable pressure from new Member States on the old Member States to fully comply with the Code. Finally, soft law instruments from different institutional contexts may reinforce each other. In this respect it is interesting that the Code of Conduct explicitly refers to the OECD transfer pricing guidelines, on the one hand, and that the Code has had a

⁶¹ Pinto, *Tax Competition and EU Law*, supra, n 19, 205-206. Kiekebeld, *Harmful Tax Competition in the European Union*, supra, n 55, 51.

⁶² Cf Menéndez, “The Purse of the Polity”, supra, n 28, 201: “The Code of Conduct (also) had a limited but not irrelevant impact on the definition of national corporate income tax bases.”

⁶³ See, eg, Terra and Wattel, *European Tax Law*, supra, n 5, 117.

⁶⁴ R S Avi-Yonah, “Globalization, Tax Competition, and the Fiscal Crises of the Welfare State” (2000) 113 *Harvard Law Review* 1652.

⁶⁵ H Vording, “Naar 25 procent, en verder” (2005) 134 *Weekblad fiscaal recht* 737. The Commission studied all national measures already discussed within the Primarolo group; Terra and Wattel, *European Tax Law*, supra, n 5, 116.

⁶⁶ J M Mönsner, “Der Code of Conduct for Business Taxation vom 1.12.1997”, in M Lang, J Schuch and C. Staringer (eds), *Soft Law in der Praxis* (Vienna, Linde Verlag, 2005), 144. For Cyprus, which as part of its preparation for accession had to streamline its tax regime, see C HJI Panayi, “The Effect of Community Law on Pre-Accession Tax Treaties” (2007) 16 *EC Tax Review* 131: “Cyprus had to align its legislation with EU provisions on state aid and the EU Code of Conduct for Business Taxation.”

significant impact on the work of the OECD in the field of harmful tax competition, on the other.⁶⁷

Having set out the characteristics of the Code of Conduct and the process of assessment of potentially harmful tax measures it brought about, I will continue with some reflections on the notions of new governance and soft law, in order to put the Code of Conduct in a broader regulatory perspective. The emphasis is on horizontal interaction and involvement of civil society. Alternative means of regulation, soft law instruments among them, fit in well with this less hierarchical approach. The communicative quality of soft law is a key to its legitimacy. Communication by way of public consultation and participation may enhance the legitimacy and responsiveness of these soft instruments, as will be shown.

E. NEW GOVERNANCE AND SOFT LAW

1. New governance

The term new governance is a multi-faceted concept which is fluid and variable in content. In part 1 of this diptych on soft law I analysed the “essentially contested concept” of (new) governance in a national context, with regard to public administration and organisations in the private sector, especially multinational corporations (corporate governance).⁶⁸ Now I will focus on the term governance in the context of international and transnational organizations.

The term governance has several sets of meanings. In the literature, governance in the context of international and transnational organizations is often characterised as ‘horizontal networks and authority relationships defined by flexibility and voluntary rules.’⁶⁹ The emphasis is clearly on informal arrangements such as innovative practices of networks and new (horizontal) forms of interaction.⁷⁰ There is a shift of attention from the formal legal order strongly related to the sovereign state to informal relationships in which responsible citizens and organisations are engaged. This need not imply doing away with government; it conceptualizes the relationship between state(s) and

⁶⁷ Avi-Yonah, “Globalization, Tax Competition, and the Fiscal Crises of the Welfare State”, supra n 64, 1654.

⁶⁸ Gribnau, “Soft Law and Taxation”, supra n 2, 293-96 and 299-301, respectively.

⁶⁹ U Mörtz, “Introduction”, in U Mörtz (ed), *Soft Law in Governance and Regulation: An Interdisciplinary Analysis* (Cheltenham, Edward Elgar Publishing, 2004), 1.

⁷⁰ Cf E O Eriksen, “Reflexive Integration in the EU”, in Eriksen, *Making the European Polity*, supra, n 28, 11.

stakeholders in a less vertical way.⁷¹ I understand the well-known phrase “governing without Government” rather to mean that government is no longer supreme, because all the actors in particular policy areas need each other.⁷²

The traditional command and control approach based on hierarchical top down legislation and enforcement is becoming obsolete as the state needs citizens, interest groups, networks, and experts to furnish information. (This does not alter the fact that in many countries traditional modes of governance are still en vogue.) States and their agencies are partly dependent upon data, information, and documents provided by civil society. Furthermore, (new) governance is about meeting the needs of the people, which cannot but involve the people themselves in one way or another. Solving public problems which have become too complex for a government to handle on its own, and pursuing public purposes about which disagreements exist cannot but be a matter of collaboration between public agencies and the people. Consequently, at the heart of the governance approach is a shift away from hierarchy to networks with continuing interaction between interdependent actors in order to exchange resources and negotiate shared purposes, problems, and solutions.⁷³

However, informal processes will often become more formalised. Procedural rules are needed to regulate issues such as the choice of topics (agenda setting), and how opposing views should be treated. These legal procedures are aimed at providing fair structures of discussion between parties with “opposing interests and divergent understandings of what a regulatory problem is, and agents whose actions are not always rational.”⁷⁴ Consequently, new governance structures promote proceduralisation, engagement, and dialogue in order to enable

⁷¹ There are also many non-state (global) governance schemes which “by definition lack the traditional enforcement capacities associated with the sovereign state—the traditional site of authority in the international system where power, legitimacy, and political community appeared fused”; S Bernstein and B Cashore, “Non-State Global Governance: Is Forest Certification a Legitimate Alternative to a Global Forest Convention?”, in Kirton and Trebilcock (eds), *Hard Choices, Soft Law: Voluntary Standards in Global Trade, Environment and Social Governance* (Aldershot, Ashgate, 2004), 33.

⁷² Cf R A W Rhodes, *Understanding Governance: Policy Networks, Governance, Reflexivity and Accountability* (Buckingham, Open University Press, 2002), 450-51.

⁷³ Of course, this does not mean complete (legal) equality of the parties involved or the absence of any hierarchy or exclusive (legal) competence. However, interdependency often exists also within asymmetrical power relations characterized by opposing interests (see Gribnau, “Soft Law and Taxation”, *supra*, n 2, 293-96).

⁷⁴ K Sideri, *Law’s Practical Wisdom: The Theory and Practice of Law Making in New Governance Structures in the European Union* (Aldershot, Ashgate, 2007), 119; S Smismans, “Civil Society and Legitimate European Governance: From Concepts to Research Agenda”, in S Smismans (ed), *Civil Society and Legitimate European Governance* (Cheltenham, Edward Elgar Publishers, 2006), 9, also points out that, while the involvement of civil society in governance is often informal, it “may also be institutionalised and codified—for instance, through consultation procedures—and publicly enforced.”

agreement, compromise, and consensus.⁷⁵ However, there also risks involved, such as the risk of fragmentation of policy and political decision-making, which may be at odds with the need for continuity. This fragmentation also makes it more difficult to see who exactly can be held accountable for deciding what. This kind of shared responsibility leads to “the problem of many hands”: if no one can be held accountable, then no one needs to behave responsibly.⁷⁶

The success of the term “governance” may thus come from the fact that it “allows all the potential players to contribute to the debates in the domain of institutions and rules. In this vein, Slaughter seeks to develop a new model for international law that goes beyond the traditional focus on states as the basic actors and creators of law. There is a change in the relevant actors doing the social construction of international legal rules. New actors form networks capable of producing “transnational consensus” on specific rules and approaches. The goal is a new consensus that produces new and better norms. This consensus moves “soft law” into firm principles of international law that focus on various levels of rule-initiation, rule-making and rule-enforcement processes.⁷⁷ The notion of governance makes visible and may help to understand the very important transformations in the state and state institutions that are now taking place. In line with these transformations the law and the way it changes should be examined. More specifically, a new focus on the production and legitimation of law itself is needed, ie, “the social construction of rules at the national and transnational level, taking into account competitive processes and hierarchies of authority.”⁷⁸

In general, the governance approach shifts the focus to the processes and actors that are part of policy-making or offer alternative sources of governing, stressing the importance of different stages of policy-making and modes of governing. These processes and actors are ignored by the “traditional focus on the core institutions of ‘government’, namely parliament, executive, administration

⁷⁵ Sideri, *Law's Practical Wisdom*, supra, n 74, 5. She argues that compromise “provides the theoretical tools to move away from the notions of consensus—reaching agreement on universal principles—and strategic bargaining in order to maximise egoistic interests.”

⁷⁶ M Bovens, *The Quest for Responsibility: Accountability and Citizenship in Complex Organisations* (Cambridge University Press, 1998), 45 ff.

⁷⁷ A M Slaughter, “Breaking Out: The Proliferation of Actors in the International Systems”, in Y Dezalay and B Garth (eds), *Global Prescriptions: The Production, Exportation, and Importation of a New Legal Orthodoxy* (Ann Arbor, The University of Michigan Press, 2002), 12-36.

⁷⁸ Y Dezalay and B Garth, “Legitimizing the New Legal Orthodoxy”, in id, *Global Prescriptions*, supra, n 77, 312. They point to the fact that, in this way different disciplines may study the social construction of institutions and rules, because “governance” can, for example, “include formal procedures and rules as well as the more informal spaces typically studied by anthropologists” (311). All disciplines may meet and fight.

and party politics.”⁷⁹ In a way, traditional formal and hierarchical governance is complemented by modes of informal governance. In my view, the shift away from state centrist thinking and acting is a basic rethinking of the state and its functions, rather than completely abandoning the concept of the state. Even so, soft and hard law are often intertwined, as will be shown. According to this “governance” concept, legitimate regulation presupposes the involvement of civil society; this concept recognizes the importance of the multiple interactions between public structures and civil society. The Commission White Paper on European Governance uses a (normative) definition of its own: “rules, processes and behaviour that affect the way in which powers are exercised at European level, particularly as regards openness, participation, accountability, effectiveness and coherence.” This rather limited number of principles underpin “good governance.”⁸⁰ A few years later, in 2004, the Commission became more specific as to the content of the concept “governance”: “The way public functions are carried out, public resources are managed and public regulatory powers are exercised is the major issue to be addressed in that context.”⁸¹ Note that the reference to certain principles marks the difference between “governance” and “good governance.” According to the OECD, good governance principles transform not only the relationship between governments, citizens, and parliaments, but the effective functioning of government itself.⁸²

Van Gerven links good governance explicitly to a government’s capacity to achieve citizens’ goals. The idea of good governance, therefore, refers to “the exercise of public power to pursue objectives and attain results in the interest of the people through a variety of regulative and executive processes.”⁸³ Here, the

⁷⁹ S Smismans, *Law, Legitimacy, and European Governance* (Oxford University Press, 2004), 25-26. Cf id, “Civil Society and Legitimate European Governance: From Concepts to Research Agenda”, in id, *Civil Society and Legitimate European Governance*, supra, n 74, 3-19.

⁸⁰ *White Paper on European Governance*, COM(2001) 428 final, 8. D Curtin and I Dekker, “Good Governance: The Concept and its Application by the European Union”, in D M Curtin and R A Wessel (eds), *Good Governance and the European Union: Reflections on Concepts, Institutions and Substance* (Antwerp, Intersentia Uitgevers, 2005), 4. They take a critical stance to this peculiar definition whereby the Commission effectively incorporates its own agenda into the definition without any reference to the other definitions “in existing literature nor with the practice of other international organisations.” They discuss two of the five principles, viz, the EU principle of openness and of participation.

⁸¹ *Communication on Governance and Development Policy*, COM(2003) 615 final, 3.

⁸² “These principles are: respect for the rule of law; openness, transparency and accountability to democratic institutions; fairness and equity in dealings with citizens, including mechanisms for consultation and participation; efficient, effective services; clear, transparent and applicable laws and regulations; consistency and coherence in policy formation; and high standards of ethical behaviour”; http://www.oecd.org/about/0,3347,en_2649_37405_1923009_1_1_1_37405,00.html (last accessed 18 December 2007).

⁸³ W van Gerven, *The European Union. A Polity of States and Peoples* (Oxford, Hart Publishing, 2005), 158.

descriptive and the normative notions of “governance” are relevant, as Westerman points out. Therefore, “governance” and “good governance” are not clearly separated. “Actual regulatory practices, ‘best practices’ as well as the principles that should be met in order to count as such a ‘best practice’, all seem to be captured by the same notion of governance.”⁸⁴

According to the Commission good governance requires the Union to renew the Community method of governance by following “a less top-down approach and complementing its policy tools more effectively with non-legislative instruments.” To achieve improvement, it must be recognized that “legislation is often only part of a broader solution combining formal rules with other non-binding tools such as recommendations, guidelines, or even self-regulation within a commonly agreed framework.”⁸⁵ Such soft law instruments as Codes of Conduct fit in well with this idea of more diversified governance schemes in the European Community.

2. The new European legislative culture⁸⁶

(a) *A shift in European legislative policy*

Governance emerged in the European Union as a result of a shift in the European legislative policy. This new policy had two aims; firstly, less and better legislation and, secondly, more diversified European governance mechanisms. The latter aim comprises the use of soft law. What are the reasons for this new European legislative policy? During the second half of the 1980s, a new way of thinking on European legislation developed. The stagnation of the internal market and the citizens’ doubts about the necessity and advantages of the common market contributed to Euro-scepticism, a growing anti-integrationist mood and demands for subsidiarity. The existing national deregulatory tendencies, and the criticism of both the quantity and the quality of the body of European legislation and the burden it imposed on national authorities and companies “constituted an effective catalyst for the EC to reconsider its legislative task.”⁸⁷ The aims of better regulation and ensuring good governance invoked a debate on the extent to which

⁸⁴ P Westerman, “Governing by Goals: Governance as a Legal Style” (2007) 1 *Legisprudence*, 52. She further points out that the term “governance” is often used as a manifesto and an agenda for reform, the White Paper on European Governance being a case in point.

⁸⁵ COM(2001) 428 final, 4 and 20.

⁸⁶ For a previous version of this section, see H Gribnau, “Improving the Legitimacy of Soft Law in EU Tax Law” (2007) 35 *Intertax* 31-33.

⁸⁷ L Senden, “Soft Law, Self-regulation and Co-Regulation in European Law: Where Do They Meet?” (2005) 9 *Electronic Journal of Comparative Law*, <<http://www.ejcl.org/>> (last accessed 13 December 2007); cf L Senden, *Soft Law in European Community Law: Its Relationship to Legislation* (Oxford, Hart Publishing, 2004).

the traditional Community command and control method (whereby the Council and the European Parliament decide upon a proposal from the Commission) was still the right way to proceed, and what new modes of European governance should be explored and promoted. An interest was developed in modalities of “new governance” to overcome the prevalent style of governance which “was paternalistic rather than participatory, providing for example, for the uses of EcoSoc and the social partners as machinery for consultation in rule-making procedures.”⁸⁸

This debate on alternative modes of governance brought about, in the wording of the European Commission, a “new legislative culture.”⁸⁹ As a result, the aims of European legislative policy were changed. The general idea was that legislation should be pitched on a more general or abstract level, stating a framework for implementation, rather than becoming deeply involved in the detail.⁹⁰ On the one hand, there was the aim to make less use of the instrument of legislation and to reduce the existing body of European legislation. Improving the quality of European legislation is also an important point here. On the other hand, the White Paper proposed to make more use of other modes of governance or regulation, which are of a less compelling or of a non-governmental nature. Thus, the use of soft law was encouraged as a means of differentiating the legislative instruments of the European Community.

(b) Less and better European legislation

The subject of this article being soft law, I will only make a few remarks on the first aim of the new Union's legislative policy, ie, less and better legislation. Here, simplification and deregulation are the key words for putting the motto “do less in order to do better” into practice.⁹¹

⁸⁸ C Harlow, “Civil Society Organisations and Participatory Administration: A Challenge to EU Administrative Law?”, in Smismans, *Civil Society and Legitimate European Governance*, supra, n 74, 124. She argues that, far from representing civil society, all kinds of comitology procedures represent the interests of the Member States, committee members being chiefly public servants (unelected and nominated by their employers). Comitology—a structure of advisory committees and expert groups—includes consultation with interest representatives, national government employees, and experts for both drafting its regulations and monitoring compliance with them. There seems to be a shift from a closed-circuit rulemaking system to more inclusive participatory and transparent procedures.

⁸⁹ See the Report on Implementation of the Commission's work programme for 1996, European Commission, Brussels, 16.10.1996, 10.

⁹⁰ COM(2001) 428 final, 20.

⁹¹ See the Commission opinion “Reinforcing Political Union and Preparing for Enlargement”, Office for Official Publications of the European Communities, 1996, 13. See also the Council Resolution of 8 July 1996 on legislative and administrative simplification in the field of the internal market, OJ 1996, C 224/5.

According to the Molitor Report, simplification implies “that it is essential to ensure that regulation imposes the least constraint on competitiveness and employment whilst maximizing the benefits of direct government intervention.”

⁹² Deregulation is linked to simplification because “in some instances, an unavoidable extension of simplification will be the reduction or removal of government regulations, where such regulations are no longer necessary, or where their objectives can be achieved more effectively through alternative mechanisms.”⁹³

Consequently, deregulation explicitly aims at limiting legislative activity to what is necessary, reducing the complexity of the European body of legislation, and enhancing its accessibility. This may entail not only the consolidation and codification of legislation but also the removal of obsolete legislation. A fine example of codification is the realisation of the Community Customs Code.⁹⁴ Codification means the adoption of a formal legal act⁹⁵ through which all earlier texts are repealed and replaced by one new text. Codification, in principle at least, does not alter the original contents.⁹⁶

(c) Alternative means of regulation

Diminishing the amount of European regulation is not always possible. Often regulations are deemed to be inevitable. However, legislation may be avoided when other forms of governance or regulation are available. Several non-legislative instruments or modes of governance are a possible alternative at the European level. In its Action plan “Simplifying and Improving the Regulatory Environment”, the Commission distinguished a broad range of modes of governance, particularly the use of soft law (recommendations), co-regulation, voluntary sectoral agreements, benchmarking, peer pressure, networks, and the open method of co-ordination.⁹⁷

In passing it may be noted that the OECD soft law governance approach seems to have been a source of inspiration for the EU. The OECD is a framework for convening networks of national ministers of thirty countries who share

⁹² *Molitor Report* COM(95) 288, 21.6.1995.

⁹³ *Molitor Report* COM(95) 288. See also the Communication *Implementing the Community Lisbon Programme: A Strategy for the Simplification of the Regulatory Environment*, COM(2005) 535 final, in which the Commission (following a broad consultation of Member States and stakeholders) proposes to repeal, codify, recast or modify 222 basic legislations and over 1,400 related legal acts in the next three years.

⁹⁴ Established in Council Regulation 2913/92, OJ 1992, L 302/1.

⁹⁵ Codification occurs when a formal legal act is adopted, such as a regulation or a directive, on the basis of the prescribed procedures.

⁹⁶ See, in this sense the Conclusions of the Edinburgh European Council, Bull. EC 12-1992, 15.

⁹⁷ Communication from the Commission, COM(2002) 278 final, 5.6.2002, 7.

information, conduct studies and produce model codes.⁹⁸ It is the archetypical example of an intergovernmental organisation that “governs through deliberation, persuasion, surveillance and self regulation.”⁹⁹ An important part of the OECD governance is “legal governance”, the adoption of binding as well as non-binding legal texts through formal decision-making procedures.¹⁰⁰ To an increasing extent, non-binding recommendations and guidelines are becoming typical instruments applied in formal decision-making forums. Of the acts in force, only about 20% can be classified as binding. All others can be categorized as non-binding. In the context of fiscal affairs, fifteen Recommendations and one Convention belonged to this type of soft law in 2004, according to Marcussen.¹⁰¹ The OECD has developed and refined various soft law governance mechanisms. Recommendations adopted by the OECD Council, such as to follow the OECD transfer pricing Guidelines of 1995, though not legally binding on the Member Countries, have great authority and are often complied with.¹⁰² According to Engelen, the OECD Model Tax Convention and its Commentaries also have authority in Non-Member Countries, due to the possibility of inviting the governments of these countries to participate in the activities of the OECD and because the ongoing process of revising this Convention and its Commentaries has “been opened up to benefit from the input of non-member States, other international organisations and other interested parties.”¹⁰³ Thus, consultation is instrumental to the goal of achieving transnational consensus. Other international organisations, such as the United Nations, the International Monetary Fund, and the European Union, have increasingly adopted the OECD soft law model.

⁹⁸ See “OECD: About”, on the Organisation for Economic Cooperation and Development, <www.oecd.org> (last accessed 17 December 2007).

⁹⁹ M Marcussen, “OECD Governance through Soft Law”, in Mörth (ed), *Soft Law in Governance and Regulation*, supra, n 69, 103.

¹⁰⁰ Ibid, 104. He also distinguishes two other categories of OECD governance; normative governance, “the development and diffusion of informal rules of appropriateness in a multitude of committees” (good governance measures, for instance), and cognitive governance, “the construction of a sense of community, solidarity and common myths among the OECD Member States.”

¹⁰¹ Ibid, 109. A nice example is the Final Seoul Declaration, 15 September 2006, expanding “the OECD 2004 Governance Guidelines to give greater attention to the linkage between tax and good governance”; see Gribnau, “Soft Law and Taxation”, supra, n 2, 313, fn 68.

¹⁰² For a number of factors contributing to the great authority of the OECD Model Tax Convention and its Commentaries, see F Engelen, *Interpretation of Tax Treaties under International Law* (IBFD, Amsterdam 2004), 455-458.

¹⁰³ Ibid, 457. In order to become more inclusive, the OECD tries to develop networks of ministers from less-developed countries to offer reactions and advice on the various codes it is developing; A-M Slaughter, *A New World Order?* (Princeton, Princeton University Press, 2004), 143.

In the following, I will focus on some aspects of the Conduct of Conduct for Business Taxation, which is but one of the EU soft law instruments, which are in their turn part of the non-legislative instruments or modes of governance. However, it should be borne in mind that this use of soft law instead of legislation is not an end in itself; already in the above-mentioned White Paper on European Governance, it is seen as a means to contribute to enhance values such as effectiveness, legitimacy, and transparency. Clearly, the use of soft law in direct taxation, notably the Code of Conduct for Business Taxation, is often not just a matter of less (and better) European tax legislation. In 1994, Snyder argued that the European Commission resorted to soft law, in part as a response to institutional inertia, and in part as an “attempt to circumvent or avoid the implications to reach political agreement.”¹⁰⁴ Similarly, the use of soft law in direct taxation seems to be rather a pragmatic second best choice, traditional command and control legislation being hard to achieve in view of the difficulty of reaching unanimous agreement. This lack of political consensus blocks the road to traditional legislation. The choice of the voluntary Code of Conduct for Business Taxation, for example, was the result of political expediency. “Most governments felt that a directive would erode political sovereignty and would be difficult to manage.”¹⁰⁵

Furthermore, the European Commission often resorts to soft law in direct taxation, but it is not the only European institution which can implement soft law. The Code of Conduct for Business Taxation, for instance, was agreed on by the Finance Ministers of the Member States. The soft law approach in policy and rule making, therefore, is a matter of institutional interplay, a cooperative effort by several European institutions.

In spite of the apparent effect of soft law in the European context, a clearly defined concept of soft law is lacking. Therefore, the concept of soft law needs to be clarified, in particular the different ways in which it presents itself and the different functions it can be said to fulfil. I will address these important topics in the next section.

¹⁰⁴ F Snyder, “Soft Law and Institutional Practice in the European Community”, in S Martin (ed), *The Construction of Europe: Essays in Honour of Emile Noël* (Dordrecht, Kluwer Academic Publishers, 1994), 199-200. Cf Cini, “The Soft Law Approach”, supra, n 23, 199: after the Commission failed to persuade the Council to regulate the politicized State aid area, it began to rely more and more on its own informal rule-making (guidelines).

¹⁰⁵ Radaelli, “The Code of Conduct against Harmful Tax Competition, supra, n 30, 521.

F. SOFT LAW

1. Soft law: a global phenomenon

The term “soft law” is used in many EU contexts and for a wide array of instruments. Communications, codes of conduct, and recommendations were already mentioned. The notion of “soft law” should therefore be clarified. The concept of soft law is a subject of great debate among legal scholars. In the field of international law, soft law is often seen as a device that can be deliberately used by non-state actors, to influence state behaviour when there is little prospect of successfully concluding a treaty. Nongovernmental organisations (NGOs) and individual experts may produce declaratory and programmatic texts at international conferences. Despite high governmental participation in these conferences and preparatory meetings, these final conference documents are mostly not binding. However, once “a prospective norm has been formulated in soft form it can become a catalyst for the development of customary international law.”¹⁰⁶ Consequently, soft law refers to principles, norms, rules, and decision-making procedures that “rely primarily on the participation and resources of nongovernmental actors in the construction, operation, and implementation of a governance arrangement.”¹⁰⁷

Snyder’s definition of soft law may serve as a starting point: “[r]ules of conduct which, in principle, have no legally binding force but which nevertheless may have practical effects.”¹⁰⁸ Kirton and Trebilcock identify four characteristics which distinguish soft law from hard law. Soft law does not rely upon the formal legal, regulatory authority and power of the state, and there is voluntary participation, and a strong reliance on consensus-based decision-making for action—and as a source for legitimacy. Finally, the authoritative sanctioning power of the state to induce consent and compliance is absent.¹⁰⁹ Notwithstanding these four distinguishing characteristics, the hard law-soft law

¹⁰⁶ C Chinkin, “Normative Development in the International Legal System”, in D Shelton (ed), *Commitment and Compliance: The Role of Non-binding Norms in the International Legal System* (Oxford University Press, 2003), 21-42. She points out that to many commentators, this hardening of soft law is “the *raison d’être* of soft law and its entry point into the traditional sources of law.”

¹⁰⁷ J J Kirton and M J Trebilcock, “Introduction: Hard Choices and Soft Law in Sustainable”, in Kirton and Trebilcock, *Hard Choices, Soft Law*, supra, n 71, 3-29, 9. For an analysis of substantive and procedural criteria to assess the legitimacy of NGOs, see A Vedder (ed), *NGO Involvement in International Governance and Policy: Sources and Legitimacy* (Leiden/Boston, Martinus Nijhoff, 2006).

¹⁰⁸ Snyder, “Soft Law and Institutional Practice in the European Community”, supra, n 104, 198; he does not stress the aim of it having legal/practical effects.

¹⁰⁹ Kirton and Trebilcock, “Introduction”, supra, n 107, 9.

duality may be conceived as a continuum rather than a dichotomy. This is partly due to the fact that the category of international law itself is nuanced, which accounts for the variable weight of norms.¹¹⁰ Soft law instruments themselves may have a variable weight, because hardening of soft law is possible.¹¹¹ The inclusion of soft law in hard law suggests, according to Shelton, that both form and content are relevant to the sense of legal obligation. Some forms of soft law may even have a “specific content that is ‘harder’ than the soft commitments treaties.”¹¹² Furthermore, international soft law comes in many forms used by different institutions. Informal institutions may use voluntary standards, but soft law also includes formal intergovernmental organisations using voluntary codes.

The precise significance and effect of EU legal instruments, such as soft law, can of course only be assessed against the specific background and peculiarities of the European Community legal order. Assessing and improving the legitimacy of European soft law, therefore, is not a matter of merely transplanting international practices, for example, with regard to public participation and consultation of such non-state actors as NGOs, individual experts and enterprises in formulating soft law documents. Although many similarities may exist between international soft law and EU soft law instruments, these instruments must be assessed in the light of the proper legal system, as the Community constitutes a legal order in its own right. Unlike many international settings, there is a legislator in the Community, and therefore, hard law. The Council and the European Parliament, deciding upon a proposal from the Commission, produce legislation. Furthermore, in contrast with the European Union, international institutions and regimes are to a great extent hardly capable of becoming politically autonomous, established as they are by nation-states existing independently of the institutions and regimes themselves.¹¹³ Therefore, EU soft law differs from international soft law, in that it is often formulated in relation to existing hard law. This fact accounts for some characteristics of EU soft law and the use made of it.

Nonetheless, the notion of “soft law” as used in the EU bears many similarities to conceptions of soft law in an international (as well as national) context. In the context of the EC, legal doctrine points to three core elements of soft law. Firstly, the concept refers to “rules of conduct” or “commitments”. The second element is that these rules or commitments are laid down in instruments

¹¹⁰ Chinkin, “Normative Development in the International Legal System”, supra, n 106, 24. Compliance and non-compliance with law cannot be separated from extra-legal factors.

¹¹¹ For the hardening of soft law in the context of international law, see Chinkin, “Normative Development in the International Legal System”, supra, n 106, 31-34.

¹¹² D Shelton, “Introduction: Law, Non-Law and the Problem of ‘Soft Law’”, in id, *Commitment and Compliance*, supra, n 106, 4.

¹¹³ M Zürn, “Democratic Governance beyond the Nation-State”, in M Th Greven and L W Pauly, *Democracy beyond the State?* (Lanham, Rowman and Littlefield, 2000), 95.

which have no legally binding force (they are not directly enforceable) as such. Although soft law lacks the possibility for legal sanctions, it may nevertheless produce indirect legal effects. Thirdly, rules of soft law aim at, and may lead to, some practical effect or impact on behaviour. In this way, hard and soft law seem to be conceptually well distinguished. However, in practice, it is not all that clear. Some even argue it is not “the legal form, but substantive provisions that are relevant” in a given relevant policy field.¹¹⁴ Consequently, there may be little difference between, eg, guidelines that take the form of legislation and those of a softer kind. This shows that the normative force of norms is not by definition of an all or nothing fashion, for “also within the category of so-called ‘binding’ decisions—like Regulations of Framework Decisions of the EU Council—one may discover norm-types with a variable normative force.”¹¹⁵

On the basis of these elements, Senden proposes the following definition of soft law: “Rules of conduct that are laid down in instruments which have not been attributed legally binding force as such, but nevertheless may have certain—indirect—legal effects, and that are aimed at and may produce practical effects.”¹¹⁶ Note that this definition explicitly acknowledges the tension between the intention (aim) and the result. Furthermore, it is clear that soft law blurs the distinction between law and politics. As for its non-binding character, in a way soft law compensates for the lack of enforceability; its softness makes “this law more flexible and adaptive to changing circumstances.”¹¹⁷ Finally, soft law facilitates innovation and experiment. It can provide the essential preparatory phase before people are ready for hard law commitments.¹¹⁸ However, in its form

¹¹⁴ Cini, “The Soft Law Approach”, supra, n 23, 200, referring to Rawlinson, a former Principal Administrator in the Commission State aid directorate. This argument will not appeal to most lawyers, because the uncertain legal effects have long puzzled them, as Cini tells us. Most lawyers and legal scholars do not have a taste for soft law and other forms of new informal governance. Unfortunately so, because, while “traditionally public lawyers tend to think of law mainly in terms of straightforward power—of issuing commands and imposing sovereign will—much of government power is less about the state and law and more related to engaging with many networks and alliances that make up the chains or networks in society which translate power from one locale to another” according to J Morison, “Modernising Government and the E-Government Revolution”, in K-N Bamforth and P Leyland (eds), *Law in a Multi-layered Constitution* (Oxford, Hart Publishing, 2003), 157-188, 167. See also Westerman, “Governing by Goals”, supra, n 84, 53.

¹¹⁵ I F Dekker and A Wessel, “Governance by International Organizations: Rethinking the Normative Force of International Decisions”, in I F Dekker and W Werner (eds), *Governance and International Legal Theory* (Leiden/Boston, Martinus Nijhoff Publishers, 2004), 227.

¹¹⁶ Senden, “Soft Law, Self-regulation and Co-Regulation in European Law”, supra, n 87, 17.

¹¹⁷ G Teubner (ed), “Global Bukowina: Legal Pluralism in the World Society”, in G Teubner, *Global Law Without a State* (Aldershot, Dartmouth, 1997), 21.

¹¹⁸ Kirton and Trebilcock, “Introduction”, supra, n 107, 12: “[M]uch of the value of soft law might come from its role as a pioneer or a stimulus of hard law.” The trend towards soft law is also valued because soft law instrument are being to some national systems and expressing more

as voluntary standards, soft law can also be used as an “excuse for avoiding firm commitments and it can come apart under pressure.”¹¹⁹ Soft law, therefore, may well deliver standards less stringent than those required to meet current and future demands.¹²⁰ Of course, the effectiveness of soft law instruments depends on different factors, eg, the (hard law) context in which it used, and the actors involved. To be sure, there are many forms of soft law, all with their own characteristics. One form may be an effective means to solve a problem, whereas another may be ineffective. Soft law may also have time-saving potential: guidelines may be quickly established, and thus speed up decision-taking and reduce backlogs.¹²¹ However, establishing a Code of Conduct may be very time-consuming.

2. The complex relationship between soft law and hard law

EU soft law is always related to hard legislation. Soft law only exists in a broader setting of – primary and secondary – European legislation. Soft law is often used as a supplement to a hard law instrument, or as a precursor to hard law. New modes of governance are often backed up by the threat that “traditional legislation will ensue if implementation should be unsatisfactory.”¹²² A case in point is the interplay between the Code of Conduct in the field of tax policy and State aid which may encompass special tax regimes in disguise. The Code of Conduct is a

consensus and legitimacy. However, sometimes doubts are voiced with regard to soft law’s ability to contribute to a more coherent, transparent, democratic and simplified system of Community legal instruments (L A J Senden, “General Report. The Quality of European Legislation and Its Implementation and Application in the National Legal Order”, in E M H Hirsch Ballin and L A J Senden, *Co-actorship in the Development of European Law-making. The Quality of European Legislation and its Implementation and Application in the National Legal Order* (The Hague, TMC Asser Press, 2005), 48-49.

¹¹⁹ N Bayne, “Hard and Soft Law in International Institutions: Complements, Not Alternatives”, in Kirton and Trebilcock, *Hard Choices, Soft Law*, supra, n 71, 351.

¹²⁰ In the field of global trade, environmental and social issues, businesses and civil society actors have long arrived at arrangements to guide their shared concerns. Soft law institutions have the flexibility to go beyond the narrow, codified bureaucratically entrenched rules and to mobilise the resources required to put new principles and norms into effect, particularly in open democratic societies. Kirton and Trebilcock, “Introduction”, supra, n 107, 11, point out that, however, “the lack of authority associated with soft law can lead to a proliferation of competing standards that generates duplication, confusion and uncertainty about which will prevail and which governments themselves might ultimately adopt.”

¹²¹ Cini, “The Soft Law Approach”, supra, n 23, 199, referring to Rawlinson. Therefore, on a case-by-case basis, the significance of these instruments from a legal and a political point of view will have to be considered, Senden, “General Report”, supra, n 118, 49.

¹²² A Heritier, “New Modes of Governance in Europe: Policy-Making without Legislation?”, in A Heritier (ed), *Common Goods: Reinventing European and International Governance* (Lanham, Rowman and Littlefield, 2002), 202.

non-binding instrument; in the domain of State aid, however, the Commission has considerable power. Mr Mario Monti, the former EC Commissioner for the internal market, who in 1997 initiated the Code of Conduct, later became EC Commissioner for Competition, and then switched to hard law. On 11 July 2001, he started formal investigation procedures under article 88(2) of the EC Treaty (State aid) in respect of 11 national tax measures. Thus, the Commission supplemented the carrot with a stick.¹²³ Some pressure from the Commission based on State aid was necessary to achieve the Code of Conduct.¹²⁴ Soft law, therefore, will not automatically make hard law superfluous.

In passing it should be noted that in the field of State aid itself, soft law instruments are used to reinforce hard law. As shown above, the State aid regime, which regulates the granting of subsidies by (sub)national authorities in order to prevent distortion of free market competition between the EU's Member States, is based on EC Treaty provisions (arts 87-89; see, supra B.3). The State aid rules, therefore, at first sight seem to be hard law par excellence because of the powers accorded to the Commission. However, the State aid regime is a mixture of hard and soft law, for the soft law approach is also used within the Commission's State aid regime. According to Cini, in substantive State aid law, there is a trend to use soft law to ensure compliance with hard law.¹²⁵

A recent example of this interplay between hard law and soft law is the in-depth State aid investigation by the Commission into one part of the proposed Dutch groepsrentebox (group interest box) tax break scheme. The opening of this investigation also enables interested third parties to submit their comments on the proposed measures.¹²⁶ According to a communication of the Dutch State Secretary of Finance to the Dutch parliament, the Primarolo group will decide upon investigating the group interest box scheme after the State aid procedure is

¹²³ Terra and Wattel, *European Tax Law*, supra, n 5, 114 ff.

¹²⁴ Kiekebeld, *Harmful Tax Competition in the European Union*, supra, n 55, 85. Interestingly, the EU uses the threat of the public aid prohibition of art 23 of the 1972 bilateral Free Trade Agreement between the EU and the Swiss Confederation to gain leverage in the negotiations on Swiss participation in the Code of Conduct for Business Taxation in order to tackle Swiss harmful tax measures, cf R H C Lujala, "Should Fiscal State Aid Go Global?" (2007) 16 EC Tax Review 233.

¹²⁵ The situation differs substantially with regard to procedural matters, in which context the Regulations suggest "a trend away from soft to harder forms of regulation", Cini, "The Soft Law Approach: Commission Rule-Making in the EU's State Aid Regime", supra, n 23, 204. However, this is still about nuances of softness and hardness of ways of regulating, for "the state aid policy area seems to be shifting towards harder, albeit not legally binding rules", M Aldestam, "Soft Law in the State Aid Policy Area", in Mörth, *Soft Law in Governance and Regulation*, supra, n 69, 33-34.

¹²⁶ IP/07/154, 07.02.2007; another part of the group interest box scheme was approved by the Commission.

finished.¹²⁷ Another example is soft law as part of a policy package of (mostly direct-tax) measures.¹²⁸ A case in point is the Commission's 1997 package to tackle harmful tax competition by means of the Code of Conduct, measures to eliminate distortions in effective taxation of savings income, and measures to eliminate withholding taxes on cross-border payments of interest and royalties between companies; the final outcome being the Interest and Royalty Directive¹²⁹ and the Interest Savings Directive¹³⁰, both adopted in 2003. This tax package meant an emphasis on so-called tax coordination, which "comes hand in hand with the abandonment of legislative proposals of a more systematic character."¹³¹ Not only the Commission "implements" soft law into hard law. The EC Court of Justice also uses components of soft law in its rulings, eg, on the Commission's Recommendation on the tax treatment of non-residents of 1993.¹³² The ECJ not only adopted the ideas of the Commission in its case law, but even surpassed them in the cases of *Schumacker*, *Wielockx*, *Geschwind*, *Gilly*, and *De Groot*, thereby bringing forward the integration within the EU.¹³³ However, it is doubtful whether the ECJ will attach much legal significance to the Code of Conduct, not being a general rule adopted by the Community legislator. Legal form really seems to matter to the ECJ.¹³⁴

¹²⁷ Letter State Secretary of Finance, 1.10.2007, no AFP2007-703, *Vakstudie-Nieuws* 2007/48.9.

¹²⁸ Paper *Towards Tax Co-ordination in the European Union*, COM(97) 495, 22.10.1996; a commitment to publish guidelines on the application of State aid was included.

¹²⁹ Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies in different Member States, OJ L 157, 26.6.2003, 49, adapted by Council Directive 2004/66/EC, OJ L 168, 1.5.2004, 35.

¹³⁰ Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments, OJ L 157 26.6.2003, 38-48.

¹³¹ Menéndez, "The Purse of the Polity, supra, n 28, 206.

¹³² Recommendation 94/79/EC of 21 December 1993 on the taxation of certain items of income received by non-residents in a Member State other than that in which they are resident, OJ L 39, 22-28.

¹³³ Case C-279/93, *Schumacker*, [1995] ECR I-225; Case C-80/94 *Wielockx*, [1999]; Case C-336/96, *Gilly* [1998] ECR I-2793; Case C-391/97, *Geschwind* [1999] ECR-I-5451; and Case C-385/00 *De Groot*, [2002] ECR I-11819. See Terra and Wattel, *European Tax Law*, supra, n 5, 391.

¹³⁴ Although the example of the Code of Conduct on public access to Commission and Council documents demonstrates that the ECJ is prepared to interpret quite broadly and boldly instruments in which the legal nature is not self-evident, I Österdahl, "The ECJ and Soft Law: Who's Afraid of the EU Fundamental Rights Charter?", in Mörrth, *Soft Law in Governance and Regulation*, supra, n 69, 58. This Code of Conduct on public access to Commission and Council documents (93/730/EC; OJ 1993, L 340/41) soon developed into semi-hard law in the form of a Council decision on public access to Council documents, Decision 93/731/EC of 20 December 1993, OJ 1993, L 340/43, and a Commission decision on public access to Commission documents, Decision 94/90ECSC, EC, Euratom, 8.2.1994, OJ 1994, L 46/58 respectively. Österdahl concludes (58): "One may wonder whether it is the legal form as such or the legal form merely as evidence of the presence or absence of a uniform political will that matters to the

As mentioned above, the EC Court of Justice has struck down many national regulations which it qualified as a violation of the free movement rule (see *supra*, section B 3). The Court has removed many tax obstacles to cross-border activities. However, there are inherent limitations to the jurisdiction of the Court. Unlike other European institutions, it cannot give positive guidance. The Court can merely tell Member States what not to do, but it cannot tell them what to do. Here, the Commission might give positive guidance with soft law in the form of interpretative instruments. In order to enable the Member States to overcome these difficulties, the Commission has offered to provide guidance on the implications of the Court's case law for the Member States' tax systems,¹³⁵ as well as "to provide a forum for a co-ordinated response to individual court rulings."¹³⁶ Thus, the Commission has adopted a Communication announcing a series of initiatives to promote better co-ordination of national direct tax systems in the EU. The aim is to ensure that national tax systems comply with Community law and interact coherently with each other. These initiatives seek "to remove discrimination and double taxation for the benefit of individuals and business while preventing tax abuse and erosion of the tax base."¹³⁷

In passing, it may be noted that the hard impact of EU soft law is by no means an exception. It was already pointed out that the arm's length principle received extra normative force because of its inclusion in article 9, para 1 of the OECD Model Tax Convention and further elaboration in the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (*supra* section C2). Thus, the OECD Recommendation on transfer pricing is implemented at the domestic level. Some countries have even codified the arm's length principle accordingly in their corporate tax law, eg, the Netherlands (art 8b, para 1 Corporation Income Tax Act 1969). The so-called "Commentaries on the Model Tax Convention" should also be mentioned. These Commentaries constitute recommendations issued by the OECD Council with the aim of stimulating Member Countries to follow the principles enshrined in the Guidelines referred

ECJ.... [T]he ECJ will be careful not to apply a soft law instrument if it senses political controversy surrounding the instrument."

¹³⁵ The Commission Company Tax Communication, *Towards an Internal Market without Tax Obstacles*, COM(2001) 582 final; see *infra*, section E 4.2

¹³⁶ M Aujean, "The Future of Non-Discrimination—Direct Taxation in Community Law", in Avi-Jonah, Hines Jr, and Lang (eds), *Comparative Fiscal Federalism*, *supra*, n 17, 321-30, 329. He points to the difficulty that the ECJ cannot test the Community law compatibility of these soft law initiatives in advance of implementation. The ensuing uncertainties could perhaps be removed if the Commission (or the other institutions) were allowed to refer requests for preliminary rulings on the Community law compatibility of such initiatives to the Court."

¹³⁷ *Co-ordinating Member States Direct Tax Systems in the Internal Market*, COM 2006(823), One of these initiatives regards exit taxation; *Exit taxation and the Need for Co-ordination of Member States' Tax Policies*, COM(2006) 825 final.

to. These non-binding instruments do not lack legal value. Engelen holds that Commentaries on the Model tax Convention constitute a form of “elaborative soft law” that can be described as “principles that provide guidance to the interpretation, elaboration, or application of hard law”.¹³⁸ Such soft law reflects the consensus of the member countries as to the proper interpretation and application of the provisions of existing tax treaties that are based on the OECD Model Tax Convention (or other OECD soft law instruments), and in this way, it can be said, that hard and soft law are interdependent and the latter derives authority from, and extends the meaning of the former.¹³⁹

More generally, soft law providing international guidance and such non-legal instruments as codes of best practices, model legislation, and a set of governing principles, have appeared to be powerful instruments. States seeking to create new legal rules and policies often borrow from other states or internationally renowned experts. In environmental regulation, for example, the World Bank issued an internal operation manual in 1984 containing all kinds of instructions issued by the Office of Environmental Affairs, including a set of general policy principles, which gradually found its way into the legislation of many countries, sometimes after having been adopted in international conventions.¹⁴⁰

In conclusion, it can be stated that the relationship between soft law and hard law is a complicated affair and probably has an effect on relations between the EU institutions. Now I will proceed with a classification of EU soft law instruments.

G. VARIETIES OF EU SOFT LAW

A starting point for a classification should be the assessment of the possible use of the soft law instrument as an alternative to, or complement of, legislation. Therefore, a classification is best made on the basis of the function and objective of the various soft-law instruments. Notwithstanding the limitations of such a

¹³⁸ He quotes Chinkin, “Normative Development in the International Legal System”, supra, n 106, 21-42, 30.

¹³⁹ Engelen, *Interpretation of Tax Treaties under International Law*, supra, n 102, 457-458. K Vogel, “Soft Law und Doppelbesteuerungsabkommen”, in Lang, Schuch and Staringer, *Soft Law in der Praxis*, supra, n 66, 146. He observes: “Although the recommendations in most constitutions do not have direct (legal) effect, an exception to this rule is Norway, they are followed worldwide, not only by tax administrations and tax payers and their advisors, but also by courts.” (My translation).

¹⁴⁰ Slaughter, *A New World Order?*, supra, n 103, 179.

classification (as with every classification), it enables us to identify the different roles that soft-law instruments play in the Community's legal order.¹⁴¹

1. Preparatory and informative instruments

A first category of instruments which are usually considered soft law are the preparatory and informative instruments. This includes in particular Green Papers, White Papers, action programmes, and informative communications. These instruments do not communicate any (clear) guideline for behaviour. Their goal is to prepare further Community law and policy and/or provide information on Community action. Senden rightly questions whether these instruments actually constitute soft law at all. Not establishing any rules of conduct themselves, they only pave the way for adoption of future rules of conduct (legislation) "in the sense that they are an element in the assessment of their desirability or necessity and possible contents."¹⁴² As such, they can also be regarded as fulfilling a pre-law function, in the sense that they may facilitate the subsequent adoption of legislation by providing or increasing the basis of support for the rules contained therein.¹⁴³

The already mentioned Ruding Committee Report is a famous example of a preparatory and informative instrument.¹⁴⁴ The policy recommendations of this report did not have much impact. One possible reason for this failure was that the Ruding Committee's proposals paid too much attention to the interests of the business community and did not sufficiently reflect the problems faced by the finance ministers.¹⁴⁵

The Monti paper should also be mentioned here. In 1996, Mr. Mario Monti introduced a new approach based on intensive consultation with the Council and the Member States. As said above, with this Memorandum, the Commission for the first time put the distorting effects of tax competition high on the political

¹⁴¹ For a categorisation of international soft law forms, see Chinkin, "Normative Development in the International Legal System", *supra*, n 106, 30-31.

¹⁴² Senden, "Soft Law, Self-Regulation and Co-Regulation in European Law", *supra*, n 87, 17.

¹⁴³ Ch E McLure, "Legislative, Judicial, and Soft Law Approaches to Harmonizing Corporate Income Taxes in the US and the EU" (2008) 14 *Columbia Journal of European Law*, section 1B and IVE. According to Mc Lure, soft law, as that term is understood in the EC, does not exist in the US. "If law is not hard, it is not law." Similarly, enhanced cooperation is a uniquely European concept that reflects constitutional and political realities in the EC. However, cooperative approaches have long been employed in the effort to produce uniformity in state corporate taxation of income in the United States. These "initiatives are, for the most part, reasonably characterized as fulfilling a pre-law function."

¹⁴⁴ *Report of the Committee of Independent Experts on Company Taxation*, Commission of the European Communities, *supra*, n 32.

¹⁴⁵ Cf Radaelli, "The Code of Conduct against Harmful Tax Competition", *supra*, n 30, 518.

agenda.¹⁴⁶ A few years later, the Commission set out its view in another informative instrument, the Communication entitled “Tax Policy in the European Union - Priorities for the Years Ahead.”¹⁴⁷ This Communication not only meant to stress the continuing importance of the fight against harmful tax competition, but also to ensure that tax policy is in line with the Lisbon goals, and thereby supports the continued success and development of the internal market and contributes to a durable reduction in the overall tax burden.¹⁴⁸ In view of these goals, the Commission recommends certain general objectives for a future tax policy at Community level and identifies a number of specific priorities in the domains of direct and indirect taxation. Where the instruments for achieving these objectives are concerned, since unanimity remains the legal basis for decisions on taxation for the time being, the Commission also looks into the possibility of non-legislative approaches or “soft legislation” in addition to legislation.¹⁴⁹ Thus, the notion that ‘the use of non-legislative approaches or “soft legislation” could be seen as an additional means of making progress in the tax field’ became more widely accepted.¹⁵⁰ It must be noted, however, that the Communication warns that the Commission will be strict in the application of the Treaty rules on State aid. Thus, hard law was used to convince the Member States to abide by the soft law agreed upon.

Another example of this first category of instruments is the Company Taxation Study, a Commission staff working paper.¹⁵¹ This study was accompanied by a Communication in which the Commission proposed to develop guidance on important ECJ rulings and to coordinate their implementation via appropriate Communications from the Commission.¹⁵² The Communication specifically mentioned the *Verkooijen* ruling¹⁵³ on dividend taxation as important

¹⁴⁶ Discussion paper for the international meeting of Ecofin Ministers, SEC(96) 487 final, 20.3.1996.

¹⁴⁷ COM(2001) 260 final.

¹⁴⁸ It must also strengthen the economic, employment, health, and consumer protection and energy policies of the European Union. Furthermore, globalisation and vastly expanded trade and capital flows require Community policies which enhance rather than put at risk the EU's global competitiveness.

¹⁴⁹ Cf G Meussen, “The EU-Fight against Harmful Tax Competition; Future Developments” (2002) 11 EC Tax Review 159, on the suggestion of a European Union with a different speed of tax reform for leader Member States and Member States lagging behind.

¹⁵⁰ COM(2001) 260 final, 10 and 22-24.

¹⁵¹ SEC(2001) 1681, “Company Taxation in the Internal Market”, a Commission staff working paper released on 23 October 2001, available on the Commission's website at http://europa.eu.int/comm/taxation_customs/publications/official_doc/sec/sec.htm (last accessed on 7 December 2007).

¹⁵² The Commission Company Tax Communication, *Towards an Internal Market without Tax Obstacles*, COM(2001) 582 final.

¹⁵³ Case C-35/98 *Verkooijen* [2000] ECR I-4071.

for the design of Member States' tax systems. All these instruments, a discussion paper, a study and a communication, do not establish any rules of conduct themselves; they are merely exploring and preparing the ground for future rules of conduct.

2. Interpretative and decisional instruments

A second category of soft-law instruments communicates standards of behaviour by way of interpretative and decisional instruments. These rules aim at providing guidance as to the interpretation and application of existing Community law, thus enhancing legal certainty, legal equality, and transparency. They are not intended to be legally binding. The line between interpretative and decisional instruments may appear blurred, as they are closely related. The interpretative instruments elucidate the existing body of rules, including the case law of the ECJ. As such, they restate or recapitulate the interpretation that should be given to Community law provisions. The decisional instruments, on the other hand, go further than mere interpretation. They indicate in what way a Community institution—usually the Commission—will apply Community law provisions in a particular case where it has implementing and discretionary powers. Thus, these implementing and discretionary powers are a precondition for these indications as to the way in which the institution will decide individual cases. As such, these instruments clearly communicate rules of conduct.

On the basis of the principle of legitimate expectations, for example, these instruments might even be legally binding on the Commission itself. Whether a soft law device has generated an expectation will depend upon its nature and wording.¹⁵⁴ Thus, the hardening of these EU soft law instruments is possible (see also *supra*, section F 1).

Within this category fall the Commission's communications and notices and also certain guidelines, codes, and frameworks frequently adopted in the areas of competition law and State aid.¹⁵⁵ These instruments bear resemblance to the administrative rules or policy rules that exist in quite a few national legal systems. They are usually not intended to substitute legislation, but rather to complement it. Hard and fast rules such as guidelines discipline the Commission itself (self-

¹⁵⁴ Cf Senden, *Soft Law in European Community Law*, *supra*, n 87, 440-442; S Schönberg, *Legitimate Expectations in Administrative Law* (Oxford University Press, 2000), 121; J Raitio, *The Principle of Legal Certainty in EC Law* (Dordrecht, Kluwer Academic Publishers, 2003), 217; Aldestam, "Soft Law in the State Aid Policy Area", *supra*, n 124, 11-36.

¹⁵⁵ A Evans, *European Community Law of State Aid* (Oxford, Clarendon Press, 1997), 407. He argues that, after early legislative proposals in the area of State aid did not meet the Council's approval, the Commission preferred to maintain a clear separation between its power and that of the Council and to rely on dialogue and consultation with Member States. Cf Cini, "The Soft Law Approach", *supra*, n 23, 199.

binding). The resulting consistency in the application of the regulatory regime is of special importance in heavily politicized regulatory fields, like State aid.¹⁵⁶ Although issued by the Commission alone, Member States are consulted prior to the issuing of such soft law instruments (such as communications, notices and guidelines); they have the opportunity to comment on a draft of the relevant instrument at multilateral meetings held approximately four times a year.¹⁵⁷

An early example is the Commission's Communication¹⁵⁸ on the consequences of the judgment of the ECJ in *Cassis de Dijon*.¹⁵⁹ Other examples are the Communication from the Commission to the Council, the European Parliament, and the European Economic and Social Committee on 'Dividend taxation of individuals in the Internal Market'.¹⁶⁰ This communication might be considered a follow-up of the above-mentioned Communication¹⁶¹ in which the Commission proposed to develop guidance on important ECJ rulings and to coordinate their implementation. As stated in this Communication, "it provides guidance on the implications of Community law for Member States' dividend taxation systems, to help Member States to ensure that their systems are compatible with the requirements of the Internal Market." This Communication, thus, provides guidance as to the interpretation and application of existing Community law. The same goes for the Commission's Notice on the application of the State aid rules to measures relating to direct business taxation.¹⁶² This Notice provides guidelines on the application of article 87 (former article 92) of the EC Treaty (State aid) in corporate tax matters.

3. Steering instruments

The third category contains what could be called—formal and non-formal—steering instruments. The aim of these instruments is establishing or giving further effect to Community objectives and policy or related policy areas. Sometimes this is done in a rather political and declaratory way—in declarations and conclusions—but "often also with a view to establishing closer cooperation or even harmonisation between the Member States in a non-binding way, as

¹⁵⁶ Cini, "The Soft Law Approach", supra, n 23, 198-199, referring to Rawlinson.

¹⁵⁷ Cf Aldestam, "Soft Law in the State Aid Policy Area", supra, n 124, 14.

¹⁵⁸ Commission of the European Communities, Communication from the Commission concerning the consequences of the judgment given by the Court of Justice on 20 February 1979, in Case 120/78 (*Cassis de Dijon*), OJ 1980, C 256/2.

¹⁵⁹ Case 120/78 *Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein (Cassis de Dijon)*, [1979] ECR 649.

¹⁶⁰ COM(2003) 810 final.

¹⁶¹ COM(2001) 582 final.

¹⁶² Commission Notice of 11 November 1998, press release No. IP/98/983.

occurs in particular in recommendations, resolutions and codes of conduct.”¹⁶³ The recommendation constitutes a formal steering instrument; it is presented as a Community legal instrument in article 249 EC. The other instruments are non-formal instruments. To a certain extent at least, they are used as alternatives to legislation.

The Code of Conduct for Business Taxation is a case in point. Besides being well known, the Code is a successful example of soft law in EU tax matters. The Code relies on peer pressure, which is political quite effective. It has also had a significant impact “on the related work of the OECD.” Thus, important negative integration was achieved through the Member States suspending application of the potentially harmful tax measures under scrutiny.

Another example is the Code of Conduct¹⁶⁴ for the effective implementation of the Arbitration Convention.¹⁶⁵ The aim of the Convention is the elimination of double taxation in connection with the adjustment of profits of associated enterprises and certain related issues of the mutual agreement procedure under double tax treaties between Member States. The Code of Conduct applies in cases where an EU Member State’s tax administration increases the taxable profits of a company from its cross-border intra-group transactions, for example, by making a transfer pricing adjustment. It should ensure a more effective and uniform application by all EU Member States of the 1990 Arbitration Convention (90/436/EEC) by establishing certain common procedures. The legally non-binding character of the Code is nicely stated in the preamble: “Emphasising that the Code of Conduct is a political commitment and does not affect the Member States’ rights and obligations or the respective spheres of competence of the Member States and the Community resulting from the Treaty.” The same phrase was used in the preamble to the Code of Conduct for Business Taxation.

Having clarified the concept of soft law and the variety of soft law instruments, we may now turn to the legitimacy enhancing features of soft law. These features are closely connected to the more communicative style of regulation embodied by soft law, as will be shown in the next section.

¹⁶³ Senden, “Soft Law, Self-regulation and Co-Regulation in European Law”, *supra*, n 87, 18.

¹⁶⁴ 12695/2/04 REV 2, Brussels, 31.3.2005, FISC 173.

¹⁶⁵ Convention 90/436/EEC of 23.7.1990, OJ L 225 of 20.8.1990, 10.

H. SOFT LAW AND THE COMMUNICATIVE STYLE OF REGULATION

1. The communicative style of regulation

What is the conception of law which the use of soft law is founded on? Law is a means to communicate standards of behaviour.¹⁶⁶ Legislation, and more generally, regulation, is often a statement, an announcement, about how people should behave. Thus, legal rules communicate normative standards, which lead to expectations of appropriate behaviour. Recently, this communicative function of law has become more predominant.¹⁶⁷ Soft law fits particularly well into the concept of communicative law. This does not mean that the communicative dimension is the exclusive function of law. It is just one important aspect of law and law making, that is not to be ignored.

Consequently, a government can try to direct people's actions either by means of clear and distinct directives, backed up with sanctions (fines or imprisonment), or by appealing in a less mandatory way (legally at least) to their need or wish to cooperate, their conscience, or their sense of decency. The first style of regulation (or broader: governance), the imperative one, is based on a hierarchical and one-way model of communication: a superior (the state) gives a clear-cut command (the law) to its subordinates (the people), who are expected to obey and who are punished if they do not. This is the traditional command and control method of regulation. This system of command and control is characterized by "the domination of hierarchy and monopoly for rule setters."¹⁶⁸

The second one, the communicative style of regulation, on the contrary, relies on persuasion rather than punishment. It takes regulation more as an invitation to a dialogue between more or less equal parties: state officials (including the executive, public prosecutors, judges, etc), intermediary organisations, and citizens.¹⁶⁹ Therefore, the legislator does not intervene directly in social reality, but lays down "in the law a fundamental value (for example, equality) in order to promote a gradual change in attitude and behaviour within the legal community."¹⁷⁰ Such a precondition of a common value is not always met. More

¹⁶⁶ As M Van Hoecke, *Law as Communication* (Oxford, Hart Publishing, 2002), 10, reminds us: "Law is communication, and not only about differing forms of interhuman communications." (Emphasis in original).

¹⁶⁷ See W Witteveen and B van Klink, "Why Is Soft Law Really Law? A Communicative Approach to Legislation" 14 (1999) *RegelMaat* 3 126-140. Cf W Witteveen, "Turning to Communication in the Study of Legislation", in N Zeegers, W Witteveen and B van Klink (eds), *Social and Symbolic Effects of Legislation under the Rule of Law* (Lewiston, The Edwin Mellen Press, 2005), 17-44.

¹⁶⁸ Mörth "Introduction", supra, n 69, 1.

¹⁶⁹ Witteveen and Van Klink, "Why Is Soft Law Really Law?", supra, n 167, 126.

¹⁷⁰ Ibid, 127.

or less agreement on a fundamental value may be present. However, it may also be diffuse or even non-existent as a resource for joint problem-solving. “The coordinative force of problem-solving—its ability to harmonize action—should therefore be sought for in the process itself, in the process of finding efficient or right solutions.”¹⁷¹ Even so, a rule may contain a norm which has to be fleshed out by a regulatory agency and the citizens addressed by this norm.¹⁷² As said above, government and its agencies are partly dependent upon data, information, and documents provided by civil society. To make the best regulations possible, regulatory agencies are dependent upon the expertise of stakeholders. Meeting the needs of the people cannot but involve the people themselves in order to exchange resources and negotiated shared purposes, problems, and solutions. Formulating and solving public problems which have become too complex for a government to handle on its own cannot but be a matter of collaboration between public agencies and civil society.

Communicative regulation, therefore, depends on reciprocal interaction rather than on unilateral commands, the former being better capable of responding to the expectations, interests, and preferences of a community. As such, it enables the establishment of a community of discourse, which might be labelled as an indicator of convergence in “talk.”¹⁷³

The participants in the dialogue form an interpretative community, with a subsequent discursive practice which allows for the shaping and reshaping of attitudes, the establishment of a common vocabulary, and the coordination of action.¹⁷⁴ A common vocabulary and mutual trust are the basis for productive communication. This does not occur automatically; on the contrary, it often results from cautious communicative steps. Moreover, the discursive practice is often a matter of trial and error. Success and progress are not guaranteed. An effective dialogue between the participants in a discursive practice may lead to compromise or even consensus which enables joint decision-making and acting.

Of course, these two styles of regulation are not mutually exclusive. Depending on the context, a government may, in one case, opt for a more imperative regulation and for the more communicative style of soft law in another.

¹⁷¹ Eriksen, “Reflexive Integration in the EU”, *supra*, n 70, 15.

¹⁷² Gribnau, “Soft Law and Taxation”, *supra*, n 2, 308-312 with regard to administrative rule-making. The consultation and participation of taxpayers often improves user-friendliness and reduces the administrative burden of administrative rules.

¹⁷³ For a plea to make a stronger distinction than hitherto between convergence talk, convergence decision, and convergence action, recognizing the fact that divergences frequently develop between talk (debate), decisions and actions (which should not be regarded in a purely negative way), see C Pollitt, “Convergence: The Useful Myth?” (2001) 79 *Public Administration* 938.

¹⁷⁴ Witteveen and Van Klink, “Why Is Soft Law Really Law?”, *supra*, n 167, 128-129.

The first, imperative—command and control—style of regulation is well-known in European tax law. Frequently used legislative instruments such as regulations and directives have legally binding force. These forms of Community secondary legislation both have a general scope. Regulations and directives are often used in tax matters to establish positive integration, especially harmonization of indirect taxes. Well-known examples are the adoption of (Council) Regulation 2913/92, introducing the Community Customs Code, and the Sixth VAT Directive (77/388/EC).

However, this traditional command and control mode of regulation is based on binding and uniform legislation, and is not always useful or appropriate, for example, in those areas where the interests and preferences of the Member States are less convergent. This is the case with the harmonization of direct taxes, which is generally regarded as a politically highly sensitive area. This is not surprising, since taxation is a fundamental sign of national sovereignty. Apart from that, in the regulatory welfare state, taxation has become a very important instrument of national governments for wide-scale social, economic, cultural, and even environmental policies. Therefore, national tax preferences have sufficiently high political salience to prevent agreement on strictly uniform European tax policies.

Consequently, the European Commission has filled the gap with soft law: non-binding norms are used to supplement or substitute legally binding obligations with increasing frequency. Of course, soft law instruments may also be used to facilitate and stimulate the gradual evolution of the consensus required for the establishment of new (hard) legislation.¹⁷⁵

Soft law clearly is an example of this communicative style of regulation. It may lay down a fundamental value, but not necessarily so. In economic matters, for example, it may define general terms or a list of criteria or concepts to promote further debate and change in behaviour. The Code of Conduct for Business Taxation is a case in point. It defines harmful tax competition in general terms and provides a list of criteria to define the harmful characteristics of tax competition. The common definition, vocabulary, and concepts provided enabled a community of discourse to emerge; shared tax policy beliefs and norms about “good” and “bad” tax competition were established.¹⁷⁶ Thus, a dialogue came about between the Member States, resulting in some commitment and a degree of consensus within the interpretative community with a shared vocabulary. To be

¹⁷⁵ Shelton, “Introduction”, *supra*, n 111, 32. For a critical review of the assumptions underlying the idea of consensus, which is a hallmark of governance, see P Westerman, “Governing by Goals”, 59-61.

¹⁷⁶ Radaelli, “The Code of Conduct against Harmful Tax Competition”, *supra*, n 30, 522-523. Other soft-law instruments, such as interpretative and decisional instruments, providing guidance as to the interpretation and application of existing Community law, and thus enhancing legal certainty and equality, may also be based on a collaboration with the relevant stakeholders.

sure, an interpretative community does not “mean total agreement, but instead commitment to share a ‘communicative framework’.”¹⁷⁷ There is room for different deep substantive convictions as long as the participants agree on how to cope with differences in these convictions. To be sure, the dialogue will not always be conducted rationally and fairly, antagonism being inherent to the conflicting power to tax of the Member States, for after all it is about the allocation of tax revenue.

Put in slightly other words, “socialisation” emerged as a consequence of this mode of governance, socialisation developing “patterns of trust, and multilateral understandings that provide the essential mechanisms” through which the Code of Conduct operates.¹⁷⁸ The shared beliefs in this highly technical network of corporate tax specialists was another important factor in the process of socialisation. These factors enabled peer review in the Primarolo group, a specific new governance solution. Thus, socialisation brought about a form of tax coordination in EU bodies dedicated to direct taxation. Although, historically there has been more socialisation in the OECD, “the situation has changed since 1997”.¹⁷⁹

This socialisation existed mainly in convergence of talk. An important element of this convergence in “talk” is the peer review of potentially harmful characteristics of tax measures in which arguments, mutual adjustment, and persuasion play an important role (see *supra*, section D).

Communicative instruments are used in order to promote a gradual change in attitude and behaviour within the legal community by way of cooperative processes, for example, when there is little prospect of reaching unanimity. However, real success, ie, convergence in actual practice and in results, is not guaranteed. As for the Code of Conduct for Business Taxation, convergence remains limited (cf the changes in the Netherlands’ intermediate royalty and interest entities advance pricing agreement and advance ruling practices).¹⁸⁰

¹⁷⁷ M Minow, *Making All the Difference. Inclusion, Exclusion and American Law* (Ithaca, Cornell University Press, 1990), 294. Burke, *Reflections on the Revolution in France*, *supra*, n 1, 280: In “a slow but well-sustained progress, the effect of each step is watched” and in this process “we compensate, we reconcile, we balance.”

¹⁷⁸ C M Radaelli and U S Kraemer, *Final Project Report*, ref no 22D/10, New Modes of Government Project, Priority 7—Citizens and Governance in the Knowledge-based Society, June 2007, <http://www.eu-newgov.org/database/DELIV/D22D10_Final_Project_Report.pdf>, 5 (last accessed on 7 December 2007).

¹⁷⁹ Radaelli en Kraemer, *Final Project Report*, *supra*, n 178, 6.

¹⁸⁰ The use of soft law may have an impact, but compliance with soft law is not an unqualified success story. This also goes for other EU policy fields. G Falkner, *Complying with Europe; EU Harmonisation and Soft Law in the Member States* (Cambridge University Press, 2005), 199, conclude, on the basis of ninety-one implementation studies in the field of working conditions, which are addressed by the EU’s social policy measures, that the view that only binding law has the potential to harmonise the different domestic working conditions does not hold for the large

Member States continue to compete with each other in order to attract economic activity, and try to innovate their corporate tax systems in order to attract business with “unique selling points”. The “plasticity of taxes” is an important factor here.¹⁸¹ Tax incentives and privileges may take very refined and not easy to detect forms.

Therefore, it is still mainly convergence in concepts, beliefs, and norms. Consequently, there “is more convergence in ‘talk’ and (to some extent) EU-level decisions than in domestic implementation and policy results.”¹⁸² Still, there seems to be a difference between compliance with rules of conduct voluntarily agreed upon and rules of conduct laid down in the case law of the ECJ. Member States’ compliance with voluntary agreements such the Code of Conduct, may be limited but this form of self-binding nonetheless generates a more positive attitude. Member States are more inclined to comply with standards of conduct agreed upon than with judgments imposed upon them by the ECJ.¹⁸³ “EU Member States typically limit ECJ interference with the content of European rights and obligations by containing their compliance: national administrations obey individual ECJ judgments and simultaneously ignore the implications that unwelcome judicial interpretation has for the universe of parallel situations.”¹⁸⁴ In the case of self-regulation based on codes of conduct, Member States are more committed to the standards of conduct bargained about, than to Court rulings, based on one single case and merely telling Member States what not to do. The Code of Conduct shows that Member States “take their obligations with regard to the Common market more seriously.”¹⁸⁵

majority of cases. Neither does soft law come close to hard law in its effects: the carrots of “learning processes” and the sticks of “naming and shaming” (a “soft form of harmonisation”) do not drive Member States to go with the recommended practices, ie, to follow the EU’s recommendations systematically and transform them into hard domestic provisions, or even go beyond these recommendations and uphold standards beyond the required minimum.

¹⁸¹ G Casado Ollero, “The Community Legal System and the Internal Tax System”, in A Amatucci (ed), *International Tax Law* (Alphen aan den Rijn, Kluwer Law International, 2006), 376.

¹⁸² Radaelli, “The Code of Conduct against Harmful Tax Competition”, supra, n 30, 528.

¹⁸³ Here, the theory of “rational institutionalism” might be of interest. It points out that it most cases the participants’ interests and motives for co-operation are mixed. Besides the interest in the short-term maximization of individual gains, future considerations might also make actors cautious in a way that does not endanger co-operative outcomes, see M Zürn, “Introduction: Law and Compliance at Different Levels”, in M Zürn and Ch Joerges (eds), *Law and Governance in Postnational Europe: Compliance Beyond the Nation-State* (Cambridge University Press, 2005), 20.

¹⁸⁴ L Conant, *Justice Contained: Law and Politics in the European Union* (Ithaca, Cornell University Press, 2002), 3.

¹⁸⁵ Kieckebeld, *Harmful Tax Competition in the European Union*, supra, n 55, 137.

However, as already mentioned that dialogue between members of an interpretative community is not a linear process of progress without backlash. Stagnation and even decline may occur, as the fate of the Code of Conduct shows. It has been quite an effective political instrument but its future effects are uncertain. On the basis of an in-depth study with consultation of different stakeholders and experts, Radaelli and Kraemer conclude that the “code is already considered an experience of the past.”¹⁸⁶ However, some experts argue that the future of the Code may lie in the technical analysis of standstill, thereby making sure that Member States notify potential harmful regimes and accept subjecting these to peer review. There is not much political momentum here, for the “level of participants in the group chaired by Dawn Primarolo has gone down, from high level tax authorities, often the same people who would accompany their ministers at ECOFIN, to less important figures.”¹⁸⁷ Nonetheless, the Code of Conduct had an impact, in any case in terms of the socialization processes within the Primarolo group.

The Code of Conduct can, therefore, be seen as typical of a communicative approach: European soft law has “a persuasive and constructive role in the formulation and execution of the policies of the Union.”¹⁸⁸ Such a step by step soft law approach will be more effective in securing support among the Member States and citizens for EU tax policies than top-down legislation, enhancing the legitimacy of the Community actions. At the same time, this rulemaking and communication of standards of behaviour, by reciprocal commitment, will improve voluntary compliance. The policy will have more actual impact, and will be more successful. More effectiveness in achieving the policy goals will in its turn enhance legitimacy, because it is “necessary not only for the sake of efficiency of the internal market but also to strengthen the credibility of the Union and its Institutions.”¹⁸⁹ Obviously, this credibility is linked with the improvement of the Community’s legitimacy.

In conclusion, it can be stated that the use of soft law may be suitable as a supplement or even an alternative to legislation, thus improving the legitimacy and effectiveness of policies and regulative processes. But in what ways could the communicative quality of soft law be enhanced? Here, public participation and consultation spring to mind. The EU already acknowledges their importance as a

¹⁸⁶ Radaelli and Kraemer, *Final Project Report*, supra, n 178, 9.

¹⁸⁷ *Ibid.*, 19. They point to the direct involvement of EU commissioner Monti in the fight against harmful tax competition. Bolkestein his successor, showed far less involvement: “It was a fact that taxation was not one of his priorities.” Nonetheless, it should be pointed out that Bolkestein initiated the so-called Common Consolidated Tax Base project, a form of positive integration (supra, section B3).

¹⁸⁸ R Baldwin, *Rules and Government* (Oxford University Press, 1995), 226.

¹⁸⁹ COM(2001) 428 final, 5.

means to promote the legitimacy of community action, as will be shown in the next section.

2. Public consultation and participation and EU soft law

Soft law instruments may concretise, specify, and clarify formal EU legislation. Soft law may also prepare the ground for, supplement, or reinforce hard law. This fits in well with the new Community method of policy and rule-making, part of which is guided by the aim to set legislation on “a more general or abstract level, providing a framework for implementation, rather than becoming embroiled in the detail.”¹⁹⁰ Policies and rules may subsequently be (further) elaborated via communicative practices.

In order to formulate policies which meet the needs of the people, citizens, interest groups, networks, and experts are needed to furnish information. Thus, the EU institutions are enabled to respond efficiently and effectively to the expectations, interests, and needs of the people. Better policies and rules enhance the output legitimacy of the EU and its institutions. However, in the decision-making process, the quality of procedures is also of importance. Public participation may serve to enhance this input legitimacy.¹⁹¹ Participation should be “inclusive”, ie, the people affected by the policy or rule to be established should be enabled to participate.¹⁹² That is to say, the degree to which those affected (the stakeholders) have been included in the decision-making processes and have had the opportunity to influence the outcome (“inclusiveness”) contributes to the input legitimacy.¹⁹³ It was shown in section E2 that the Commission explicitly acknowledges this mode of governance. “The Union ... will no longer be judged solely by its ability to remove barriers to trade or to complete an internal market; its legitimacy today depends on involvement and participation.”¹⁹⁴ This fits in well with the idea that government cannot do without the engagement of the citizens. Good government, viz, accountable,

¹⁹⁰ D Wincott, “The Governance White Paper, the Commission and the Search for Legitimacy”, in A Arnall and D Wincott (eds), *Accountability and Legitimacy in the European Union* (Oxford University Press, 2002), 389. See COM(2001) 428 final, 20.

¹⁹¹ See J Habermas, *Between Facts and Norms: Contributions to a Discourse Theory of Law and Democracy*, W Rehg (tr) (Cambridge, Mass, MIT Press, 1996), 228-229. For an in-depth discussion of participation mechanisms in another field of European law, see J M Verschuuren, “Public Participation Regarding the Elaboration and Approval of Projects in the EU after the Aarhus Convention”, in T F M Etty et al (eds), *Yearbook of European Environmental Law*, Volume 4 (Oxford University Press, 2005), 29-48.

¹⁹² I M Young, *Inclusion and Democracy* (Oxford University Press, 2000), 5.

¹⁹³ This input legitimacy depends on communicative interaction with the citizens in the pre-decision-making stage and at the stage of the decision-making itself. See Gribnau, “Improving the Legitimacy of Soft Law in EU Tax Law”, supra, n 186, 38.

¹⁹⁴ COM(2001) 428 final, 11.

effective, and legitimate government, requires substantial civic and political engagement “by the people themselves.”¹⁹⁵ What is more, public participation contributes to self-government, instead of bureaucratic rule from a remote centre—a kind of “government by strangers”—and improves responsiveness and legitimacy.¹⁹⁶ In my opinion, public participation should not only concern the decision- or rule-making process (“agenda setting” included¹⁹⁷), but also the evaluative assessment of a decision or a rule once adopted. Public participation is a useful instrument for improvement, taking into account the pros and cons experienced by citizens and enterprises in daily practice.

The EU has put communication of stakeholders by way of consultation high on the political agenda. The White Paper on European Governance states that the “Commission already consults interested parties through different instruments, such as Green and White Papers, Communications, advisory committees, business test panels and ad hoc consultations.”¹⁹⁸ Furthermore, on-line consultation through the interactive policy-making initiative has been developed.¹⁹⁹ Evidently, such consultation of stakeholders helps the Commission and the other EU institutions to arbitrate between competing claims and priorities. Here, guarantees should be built in order to enable the equal expression of all perspectives and to neutralize “the ability of powerful interests to distort discussion.”²⁰⁰ Because of the often enormous lobbying capacity of multinational enterprises, countervailing access to deliberations of EU institutions on the part of other groups and interests may be helpful.²⁰¹ Consultation may thus not only be a matter of finding solutions for urgent problems and developing short-term policies, but also of developing a longer term policy perspective. Therefore, “participation is about more effective policy shaping based on early consultation and past experience.”²⁰²

¹⁹⁵ S Macedo ea, *Democracy at Risk* (Washington, Brookings Institution Press, 2005), 13.

¹⁹⁶ L Siedentop, *Democracy in Europe* (London, The Penguin Press, 2001), 4, referring to Montesquieu.

¹⁹⁷ On the importance of agenda setting, B Barber, *Strong Democracy* (Berkeley, University of California Press, 1984), 181: “What counts as an ‘issue’ or a ‘problem’ and how such issues and problems are formulated may to a large extent predetermine what decisions are reached.”

¹⁹⁸ See < http://ec.europa.eu/internal_market/strategy/docs/consultation_en.pdf > (last accessed 25 January 2008).

¹⁹⁹ See < <http://ec.europa.eu/idabc/en/document/6541> > (last accessed 25 January 2008).

²⁰⁰ I Young, “Difference as a Resource”, in D Estlund (ed), *Democracy* (Oxford, Blackwell Publishing, 2002), 228.

²⁰¹ P T Muchlinsky, “‘Global Bukowina’ Examined: Viewing the Multinational enterprise as a Transnational Law-Making Community”, in G Teubner (ed), *Global Law without State* (Dartmouth, Aldershot, 1997), 98-99. He elaborates on the lobbying attempts of multinational enterprises.

²⁰² COM(2001) 428 final, 15.

ICT is thus recognised as an important instrument in the field of consultation which may enhance the communicative quality of EU policy-making processes. The Commission hopes that businesses, consumers, and citizens will use Interactive Policy Making (IPM) and similar Internet-based tools as an additional means of evaluating existing EU policies and of conducting consultations on new initiatives, and wherever possible, to help the Commission to respond faster and more accurately to their needs.²⁰³ Consultations are already being conducted in tax matters, eg, the Consultation on Home State Taxation for SMEs (closed on 31 December 2004), the Consultation on proposals for passenger car taxation (closed on 11 September 2004), and the Consultation on Modernising the Value Added Tax.²⁰⁴

Of course public consultation and participation will seldom produce unequivocal conclusions and solutions, because of the conflicting needs and interests of the participants (and non-participants). Consultation, therefore, does not reduce the role of Community institutions to merely monitoring the process. They should do their best to protect general interests “in a world which seems to be disintegrating into sub-interests.”²⁰⁵ They should use their right to decide and intervene. The primacy of politics, therefore, should not be ignored. In the end, the representation of certain interests cannot replace political representation.²⁰⁶ This does not mean that Community institutions should claim the exclusive right to establish the general interest by themselves. They should do this in collaboration with civil society, adopting a communicative and learning attitude.

This kind of public participation by stakeholders and interested parties may improve the feasibility and practicability of soft rules. Thus civil society plays an important role in shaping policies. This form “inclusive governance” accounts for civil society as a potential participant in democratic experimentalism, civil society not remaining outside governance, as an abstract idealisation, but, on the contrary, being brought “directly into governance as a concrete political and legal

²⁰³ To take the example of the CCCTB project (supra, section B3), much work is being done by the Common Consolidated Corporate Tax Base Working Group, in which experts from all 27 Member States and the Commission Services participate. The group has approximately four meetings a year. Working documents for discussion in meetings of the working group are published on a website shortly after each meeting. In many cases, the documents include a series of questions and comments and contributions from interested parties. Written contributions received from several organisations are available on the website, in their original language.

²⁰⁴ For an overview, see <http://ec.europa.eu.int/taxation_customs/consultations/tax/index_en.htm> (last accessed 25 January 2008). The overview also indicates target groups, eg, trader, business, “public”.

²⁰⁵ B M J van Klink and J E J Prins (eds), *Law and Regulation: Scenarios for the Information Age* (Amsterdam, IOS Press, 2002), 96.

²⁰⁶ Cf A Verhoeven, “Democratic Life in the European Union, According to its Constitution”, in Curtin and Wessel, *Good Governance and the European Union*, supra, n 80, 170.

actor.”²⁰⁷ To be sure, it is not just about a communication of discourse in which governments are participating. Turning back to the Code of Conduct for Business Taxation, it must be pointed out that civil society is hardly involved. The Code of Conduct therefore, is not a good example of participatory governance, since only governments are participating.²⁰⁸ The managing of the Code by high-level tax-policy makers (the Primarolo group) is a matter of informal governance, but not inclusive governance. Business representatives and other non-governmental actors such as employers’ confederations and think tanks “have so far remained outsiders in the deliberation concerning the code.”²⁰⁹ Here, the principle of publicity should also be mentioned. Publicity lies at the heart of communicative policy-making and regulation. It “encourages citizens to deliberate about public policy and enables officials to learn about and from public opinion.”²¹⁰ With regard to the Code of Conduct, stakeholders have hardly gained any insight into the considerations and arguments underlying the decisions of the Primarolo group, its meetings taking place away from public scrutiny. Therefore, a public and informed debate, depending on publicity, was hardly possible. Consequently, the Code, managed in secret, does not score well in terms of transparency and input legitimacy and perhaps even output legitimacy may be affected. To conclude this section, the involvement of civil society in policy and rule-making by way of communicative practices and such public participation and consultation of stakeholders may improve the quality of soft law. Even so, consultation of social actors, such as individuals and companies, creates a social basis of the implementation and application of tax laws and attributes to the effectiveness and responsiveness of EU tax regulations. Thus, output legitimacy will be enhanced. At the same time, public participation promotes input legitimacy, contributing to a more communicative style of rule making, depending on reciprocal interaction instead of unilaterally established rules.²¹¹

²⁰⁷ K A Armstrong, “Inclusive Governance? Civil Society and the Open Method of Co-ordination”, in Smismans, *Civil Society and Legitimate European Governance*, supra, n 74, 61.

²⁰⁸ Governmental authorities, rather than firms, are the targets of the Code of Conduct meant to curb harmful tax competition, for states compete with their tax system with other (Member) States. Nonetheless, governments are not the only interested parties; if only because they do not pay the taxes themselves.

²⁰⁹ Cf Radaelli, “The Code of Conduct against Harmful Tax Competition”, supra, n 30, 515. For business interest representation, see P Bouwen, “Business Interest Representation and Legitimate European Governance”, in Smismans, *Civil Society and Legitimate European Governance*, supra, n 74, 277-296.

²¹⁰ A Gutmann and D Thompson, *Democracy and Disagreement* (Cambridge, Mass, Belknap Press of Harvard University Press, 1996), 97, with reference to Bentham.

²¹¹ For a more elaborated discussion of some aspects of accountability, transparency, and publicity in relation to consultation in this field, see Gribnau, “Soft Law and Taxation”, supra, n 2, 309-312.

I. CONCLUSION

The EU increasingly uses diversified (new) governance mechanisms in order to improve its performance and legitimacy. In tax matters, various kinds of soft law are used, in indirect taxation as well as in direct taxation. One such instrument, the Code of Conduct for Business Taxation, is deployed to tackle harmful tax competition with respect to direct taxation. In this field of direct taxes, the unanimity requirement has been a serious impediment to harmonisation, because Member States treasure their tax sovereignty. Nevertheless, the Code's adoption marked an important step towards (further) tax coordination. The political commitment to tax coordination was translated into peer review, which stimulated the Member States to take the Code seriously; they subsequently amended most of their harmful tax measures. There is a subtle interplay between the Code of Conduct and existing hard law in the EU, the State aid provisions playing an important role. Furthermore, the Code and the OECD's soft law instruments reinforce each other. Though the Code's effectiveness is limited, producing negative integration only, it still is significant in facilitating an ongoing dialogue on harmful tax competition between the Member States.

The new governance approach fosters a dialogue between EU agencies and stakeholders, non-hierarchical communication being an essential condition for taking Europe's citizens seriously. The communicative quality of soft policy-making and regulation may be enhanced by involving stakeholders by way of consultation and participation. The Code of Conduct, however, does not score well in terms of this kind of communication with stakeholders, and therefore in terms of legitimacy and transparency: the Member States are involved, not civil society. More inclusive and transparent participation and consultation should be at the heart of EU policy-shaping. This will enhance the responsiveness and legitimacy of EU policies, regulations, and institutions.

