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Economic Mobility and Fiscal Federalism: Taxation and European Responses in a Changing Constitutional Context

Jukka Snell and Jussi Jaakkola

Abstract

In this article we explore the claim that the four freedoms of the EU lead to the inevitable erosion of the capacity of Member States to collect tax, undermining national systems of welfare and solidarity. We argue that European tax integration has undergone a significant change during the last ten years or so, with a judicial, regulatory and legislative response by Union institutions. First, the Court of Justice has recalibrated some of the basic concepts it applies when reviewing the European constitutionality of national tax norms. Second, the Commission has utilised state aid rules to attack targeted tax competition. Third, important legislative initiatives have been adopted or proposed to safeguard Member State taxing capacities. The new phase is influenced by the changed constitutional context of the recent enlargements and the Eurozone crises, which may increase the supply of and demand for tax integration.

I Introduction

In this article we explore the claim that the four freedoms of the EU, in particular the free movement of capital but also the right of establishment, lead to an inevitable erosion of the capacity of Member States to collect taxes. It has been argued that corporations are able to rely on the four freedoms against national tax authorities and arrange their affairs so that profits are allocated to low tax jurisdictions and losses to high tax ones, or where they enjoy double deductions or double non-taxation.[1] Further, it is sometimes claimed that the single market necessarily results in a race to the bottom on tax, as Member States engage in a destructive spiral of competition to attract mobile capital through ever lower taxes. This would lead either to pressure to cut welfare benefits and public services, or shift the tax burden elsewhere—for example by means of raising consumption taxes or personal income

[1] These kinds of concerns were expressed by several Member States and accepted by the Court in Case C-446/03, *Marks & Spencer*, ECLI:EU:C:2005:763, paras 42–51. They have since been raised also on the international level; see OECD, *Addressing Base Erosion and Profit Shifting* (OECD Publishing, 2013).

tax—thus possibly resulting in unfair patterns of allocation of taxes.[2] In a nutshell, the charge is that the EU is undermining national systems of welfare and solidarity,[3] without replacing them with a European one.

The article proceeds as follows: we first outline the EU tax framework and the interdependence it creates among the Member States, as well as the effects of this framework on national taxation. We will suggest on the basis of empirical evidence that while the capacity to tax has not been eroded as a whole, some of the tax burden might have been shifted from mobile taxpayers to immobile ones. We then proceed to consider the actions that the EU institutions have taken, or are in the process of taking, to address these issues. We identify a judicial response, a regulatory response, and a legislative response. Our claim is that the legal situation is far more nuanced today than fifteen or even ten years ago, and that the various EU institutions are engaged in a set of actions that, taken together, may amount to a broad-based and reasonably coherent attempt to address the challenges. Further, we point out the changing constitutional context that is both increasing the 'supply' of and the 'demand' for EU action on tax. We conclude that the fundamental variable is not the law of the EU, but rather political will.

II European Integration and Constraints on National Taxation

A The European Union as a Legal Framework for Fiscal Interdependence

The creation of a single market among states with different national tax systems (and tax law traditions) was bound to result in enduring tensions between the European Union and its Member States. On the one hand, national tax norms have been regarded as obstacles to the effective establishment of a single market. On the other hand, market integration has been said to constrain the fiscal and redistributive capacities of national tax systems by fostering

[2] See eg the list of concerns outlined in Commission Staff Working Document, 'Corporate Income Taxation in the European Union' SWD(2015) 121 final, at 11–12.
[3] See also the article of M. Ferrera in this issue, which focuses on free movement of persons.

fiscal interdependence and, as a consequence, tax competition[4] between Member States. The Europeanisation of national tax systems has been marked by two dynamics.[5]

First is the establishment of the internal market. The 1957 Treaty establishing the European Economic Community set as objectives the realisation of free movement of goods, the right of establishment, free movement of workers, free provision of services, and—to a lesser extent—free movement of capital.[6] Realisation of economic freedoms required removing national norms and practices which hindered cross-border economic activities. The removal of restrictions was to take place through adoption of Community legislation.[7] From the 1970s onwards, the role of the freedoms in building the internal market became more salient.[8] A preliminary step in this process was their constitutionalisation.[9] Through decisions of the Court of Justice, the freedoms were granted two constitutional qualities: direct effect and primacy over national law.[10] The freedoms were transformed from principles that guided Community legislation to subjective rights that could be invoked directly by private economic actors.[11] Further, the substantive scope of these rights was expanded in the free movement

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[4] We emphasise the difference between tax competition and fiscal interdependence, of which the latter serves as a precondition for the former; see P. Dietsch, *Catching Capital. The Ethics of Tax Competition* (Oxford University Press, 2015), at 36, 77–80.
[5] For further reasons, see P. Genschel, A. Kemmerling and E. Seils, 'Accelerating Downhill: How the EU Shapes Corporate Tax Competition in the Single Market', (2011) 49 *Journal of Common Market Studies* 585–606, at 587–589.
[6] On the initially supplementary role of the free movement of capital, see eg J. Snell, 'Free Movement of Capital: Evolution as a Non-Linear Process', in P. Craig and G. de Búrca (eds), *The Evolution of EU Law* (Oxford University Press, 2nd edn, 2011), 547–574, at 548–551 and J. A. Usher, 'The Evolution of the Free Movement of Capital', (2007) 31 *Fordham International Law Journal* 1533–1570.
[7] P. Craig, 'The Evolution of the Single Market', in C. Barnard and J. Scott (eds), *The Law of the Single European Market* (Hart, 2002), 1–40, at 4.
[8] For an overview of the transformation of economic freedoms, see J. Snell 'The Internal Market and the Philosophies of Market Integration', in C. Barnard and S. Peers (eds), *European Union Law* (Oxford University Press, 2014), 300–324, at 307–315.
[9] See J. H. H. Weiler, 'The Transformation of Europe', in idem, *The constitution of Europe. 'Do the new clothes have an emperor?' and other essays on European integration* (Cambridge University Press, 1999), 10–101, at 16–39.
[10] Case 26/62 *Van Gend*, ECLI:EU:C:1963:1 and Case 6/64 *Costa v E.N.E.L.*, ECLI:EU:C:1964:66.
[11] D. Grimm, 'Europe's legitimacy problem and the courts', in D. Chalmers, M. Jachtenfuchs and C. Joerges (eds), *The End of the Eurocrats' Dream: Adjusting to European Diversity* (Cambridge University Press, 2016), 241–265, at 245.

case law of the Court from the 1970s onwards.[12] The constitutionalisation of the Treaties or—more precisely—the incorporation of the formal functions of national constitutions into European law eventually came to mean that the constitutionality of all kinds of national legal norms could be reviewed by the Court against internal market rules. The realisation of economic freedoms and removal of obstacles to cross-border economic activities through legislative and judicial integration gradually rendered capital and corporations factually mobile within the European market.

As a result, national income tax laws became subject to review of their European constitutionality.[13] Member State tax systems could be assessed against the economic freedoms like any other national law or regulatory practice, although the intensity of the review may differ, as explained in Section IIIA. The possibility of review was explicitly established by the Court in *Avoir Fiscal*.[14] In *Schumacker*, the Court set out its basic doctrine on review of personal income taxation, which has remained rather the same since. The Court stated that while Member States retained the power to shape income taxes, states must nevertheless exercise their power in a fashion consistent with Community law.[15] Thus, national tax legislation must to an extent be in line with economic freedoms as constructed by the CJEU. European constitutional review of national income tax laws has had a wide-reaching influence on national tax systems, among other reasons because review has proceeded on the basis of criteria unfamiliar to national constitutional law. Not many constitutions include principles such as free movement of capital against which the legality of tax laws would be assessed. From this perspective, the matter became potentially even more acute when the economic freedoms were pushed beyond non-discrimination and opened to a more substantive reading.[16] As a consequence, the Court has held many national tax norms to be in

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[12] See eg A. J. Menéndez, 'The Existential Crisis of the European Union', (2013) 14 *German Law Journal* 453–526, at 471–484.
[13] S. van Thiel, 'The Direct Income Tax Case Law of the European Court of Justice: Past Trends and Future Developments', (2008) 62 *Tax Law Review*, 143–192, at 148, 178 and R. Barents, 'The Single Market and National Tax Sovereignty', in S. J. J. M. Jansen (ed), *Fiscal Sovereignty of the Member States in an Internal Market* (Kluwer Law International, 2011), 51–71, at 59.
[14] Case 270/83, *Commission v France*, ECLI:EU:C:1986:37.
[15] Case 279/93, *Schumacker*, ECLI:EU:C:1995:31, para 21.
[16] Menéndez, n 12 above, at 480. Especially in the context of taxation, see A. J. Menéndez, 'The Unencumbered European Taxpayer as the Product of the Transformation of Personal Taxes by the Judicial Empowerment of "Market Forces"', in R. Letelier and A. J. Menéndez (eds),

breach of the free movement rules. This may well have eroded the integrity and coherence of national tax systems. At any rate, it has constrained the capacity of Member States to design their tax systems in a fully autonomous fashion; the effects of this limitation having been amplified by the very economic mobility fostered by economic integration.

The second dynamic that has determined the shape of the Europeanisation of national tax systems is the very limited harmonisation of national income taxation. This is largely the result of the allocation of tax competences between the EU and the Member States. The founding Treaties did not contain provisions conferring legislative powers upon the Communities in the field of income taxation. This remains the case. It is true that the Treaties foresee the approximation of Member States' laws in general, and that this could serve as a legal basis for the harmonisation of national income taxation. However, it is also true that Article 114 TFEU excludes 'fiscal provisions' from the scope of qualified majority voting. As a result, the eventual harmonisation of national income tax law would only be possible if the Council of Ministers unanimously approved the Commission's proposals.[17] The only exception to this rule would be European tax legislation aimed at eliminating distortions to the conditions of competition in the internal market.[18] However, the latter has not been made use of.[19] In consequence, the actual capacity of the Union to legislate on income taxation is rather weak in comparison with the power that Member States, at least formally, enjoy.

As a result, regulations and directives on income tax law are few and national income tax laws have not been harmonised.[20] As we will see, this has created the conditions under which Europeanisation of national income tax laws has been led by the CJEU, most especially so once the Court started favouring an expansive understanding of economic freedoms in the late

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Sinews of European Peace: Reconstituting the Democratic Legitimacy of the Socio-Economic Constitution of the European Union (2009) Arena Report 7, 157–268, at 207–230.

[17] Art 115 TFEU.

[18] Art 116 TFEU.

[19] In this context, the Spaak Report assumed that only specific distortions that affect certain sectors would be targeted. See 'Rapport des Chefs de Délégation', Bruxelles, 21 avril 1956, Mae 120 f/56 (corrigé), available at http://aei.pitt.edu/996/1/Spaak_report_french.pdf, at 61.

[20] The absence of secondary legislation on income taxation is often derived from the requirement of unanimity alone. Although the requirement of unanimity is a genuine procedural obstacle to tax integration, the existence of the requirement itself is an expression of the more fundamental reasons that render income taxation such an integration-resistant policy area. See P. Genschel, *Steuerwettbewerb und Steuerharmonisierung in der Europäischen Union* (Campus, 2002), at 18. See below Section IIB.

1970s. It could indeed be said that an inverse proportional relationship exists between the degree to which we can find European secondary legislation in each policy field and the 'demand' for judicial rulings determining the impact of economic freedoms in that field.[21] It should be further added that the few secondary income tax directives that have been adopted have failed to balance all the interests involved. Free movement has been furthered, but without taking fully into account the complexities of taxation of cross-border economic activity. A paramount example in that regard is the Interest and Royalty Directive.[22] The Directive provides that interest and royalty payments among associated companies resident in different Member States will not be taxed at source. This ensures that this income is not taxed *twice*. However, as was pointed by several national governments and indeed by scholars at the time, the serious risk arises of double non-taxation, or what is the same, of these payments not being subject to tax either at source or at destination.[23] Indeed, the Directive encourages companies to lobby states to procure national tax legislation that guarantees such a result. This may have exacerbated thin capitalisation of companies (that is, the disproportion between capital and debt of a company), given that debt is instrumental in the design of economic transactions so that they escape from taxation in all Member States. To put it differently, the very limited set of European secondary legislation on income taxation has fostered negative integration in the name of favouring capital mobility, and the few directives that have been adopted have also followed the logic of negative integration.[24]

To recapitulate, formally speaking Member States have retained the power to define income taxation. However, market integration has removed many obstacles, including tax obstacles,

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[21] T. Kingreen, 'Fundamental Freedoms', in A. von Bogdandy and J. Bast (eds), *Principles of European Constitutional Law* (Hart–Beck, 2nd revised edn, 2011), 515–549, at 526.
[22] Dir 2003/49/EC on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States, OJ L 157, of 26.6.2003, 49–154.
[23] It was against this background that the Commission proposed, soon after adoption of the original directive, that interest and royalty payments should be exempted from source country taxation only on the condition that they were subject to tax in the country of destination; see Commission 'Proposal for a Council Directive amending Directive 2003/49/EC on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States' COM(2003) 841 final. The amendment was, however, not endorsed by the Council.
[24] Negative integration refers to the de-regulatory integration designed to remove national market obstacles whereas positive integration refers to re-regulatory construction of market conditions at the European level. See F. W. Scharpf, *Governing in Europe: Effective and Democratic?* (Oxford University Press, 1999), at 45.

to cross-border economic activity in Europe. As a result, taxpayers (most especially individuals with high capital income and corporate taxpayers) can rearrange their economic activities (mainly financial activities) so as to pay taxes where the rates are lower (this is what is usually referred as tax base mobility). This results in a *bifurcated* system of income taxation. On the one hand, taxpayers that are less mobile are still fully subject to national tax laws. On the other hand, mobile taxpayers can exploit the *plurality of unharmonised national tax systems* to rearrange the financial structure of their economic activity or shift profits from one tax jurisdiction to another. The asymmetry between market integration and tax harmonisation *creates the conditions* of tax base mobility, while the sparse harmonisation of tax law generates incentives for taxpayers to exploit tax base mobility. This is the concrete shape of Europeanisation of income tax law at present.

B Fiscal Interdependence and National Taxation

The lack of European income tax harmonisation is not a coincidence. Retention of fiscal powers at the national level and failure to engage in tax harmonisation at the European level reflect Member States' endeavour to preserve national tax sovereignty, or what is the same, self-determination in income tax matters. The political preference has been to retain tax policy in the hands of the national political process. The normative justification for this could be the need to safeguard the democratic legitimacy of taxation, which we interpret as requiring that taxpayers have representation in the political process where taxes are instituted and designed.

However, the credibility and desirability of national tax autonomy can be questioned, precisely on account of the interdependence between tax systems that unavoidably results from market integration. The repertoire of tax policy alternatives factually available for one Member State is dependent on and conditioned by the tax policies of other Member States, as the influence of national tax policies beyond national boundaries unavoidably follows from economic freedoms. Decision-making is national but its effects are European. Therefore, while formal or legal tax autonomy may still be proclaimed, economic freedoms drastically constrain *actual* tax autonomy. Further, it could be argued that the interplay between market integration and markedly weak tax harmonisation results in democratic under-inclusiveness. When national decision-making in one Member State affects other Member States but the

citizens of the latter cannot participate in the decision-making process of the former, democratic decision-making becomes under-inclusive.[25] This pathology could be reduced through the joint exercise of powers at the European level since decision-making would include representation from all Member States.[26] As a result, efforts to safeguard the democratic legitimacy of national tax law by abstaining from tax harmonisation may be *bound* to be counterproductive.[27]

From that perspective, it could be argued that economic freedoms also promote democratic inclusiveness. Tax laws are enacted by national parliaments, while the right to vote in parliamentary elections is based on citizenship. However, tax liability is not based on citizenship but residence or source country of income. This generates incongruence between the right to participate and the obligation to pay. Taking seriously the nexus between representation and taxation, one is bound to ask to what extent it is legitimate to impose a tax on a foreigner, who has undoubtedly benefited from the infrastructure and public services paid for by taxation, but who had no representation when the tax was designed, especially if the tax has particularly harsh consequences for them. It has been claimed that the four freedoms enhance democracy—they ensure judicial protection for those who have not been heard in a national political process.[28]

Acknowledging that the economic freedoms also enhance representation, the question remains: who benefits from the freedoms? The immediate beneficiaries are capital holders and corporations because of their high mobility. Due to the comparatively immobile nature of

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[25] For this line of argumentation, see A. J. Menéndez, 'Another View of the Democratic Deficit: No Taxation without Representation', in C. Joerges, Y. Mény and J. H. H. Weiler (eds), *What Kind of Constitution for What Kind of Polity? Responses to Joschka Fischer* (European University Institute, 2000), 125–138, at 131–135.
[26] Alternatively, integration could be scaled back dramatically, although this would not remedy the problem completely without further action to limit the effects of globalisation.
[27] For this counterintuitive tendency, see P. Genschel and M. Jachtenfuchs, 'How the European Union Constrains the State: Multilevel Governance of Taxation', (2011) 50 *European Journal of Political Research* 293–314, at 294, 306–309.
[28] See for the seminal text from the US perspective J. H. Ely, *Democracy and Distrust: A Theory of Judicial Review* (Harvard, 1980), at 73–104. See also M. Poiares Maduro, *We The Court: The European Court of Justice and the European Economic Constitution* (Hart, 1998), eg at 173 and C. Joerges, 'What Is Left of the European Economic Constitution? A Melancholic Eulogy', (2005) 30 *European Law Review* 461–489, at 488, and for critical remarks A. Somek, 'The Darling Dogma of Bourgeois Europeanists', (2014) 20 *European Law Journal* 688–712.

labour, the benefits may be divided in an unbalanced manner between capital holders and workers.[29] Some of the empirical research on tax competition suggests that this imbalance can also be seen as regards taxation. Competition may have exerted a downward pressure on the level of corporate and capital income taxation. In order to cope with the threat of diminishing tax revenues, states may have shifted the tax burden from mobile to immobile tax bases—that is, from capital and corporate income to labour.[30] If true, the shift might represent an unfair allocation of the tax burden between taxpayers and change the redistributive logic of national tax systems. Because redistribution has, by tradition, been one of the primary methods of reinforcing the social and democratic credentials of a modern state,[31] any alteration of the redistributive balance touches a raw nerve, as it has a major influence on the way in which one of the fundamental functions of taxation is carried out. Consequently, fiscal interdependence presents a challenge to one of the key functions of tax law in a democratic polity, as it seems to undermine the capacity to create factual conditions for equal participation *through* taxation. This is connected to the wider challenge of reconciling the normative ethos of supranational and national constitutional law. Interpreting the economic freedoms as individual liberty rights has been claimed to contribute to the empowerment of a liberal state ideal over a republican one, something which would have altered the balance between different conceptions of the state as reflected in national constitutional traditions.[32] In fact, Hayek even saw a move to 'an essentially liberal economic regime [as] a necessary condition for the success of any interstate federation.'[33]

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[29] F. W. Scharpf, 'Globalisierung als Beschränkung der Handlungsmöglichkeiten nationalstaatlicher Politik', *MPIfG Discussion Paper* 97/1, available at http://www.mpifg.de/pu/mpifg_dp/dp97-1.pdf, at 11.
[30] P. Genschel and P. Schwarz, 'Tax Competition and Fiscal Democracy', in A. Schäfer and W. Streeck (eds), *Politics in the Age of Austerity* (Polity, 2015), 59–83, at 63–72, 75–76. For an overview of the discussion, see P. Genschel and P. Schwarz, 'Tax competition: a literature review', (2011) 9 *Socio-Economic Review* 339–370, at 342–351.
[31] See also the article by M. Ferrera in this issue.
[32] See F. W. Scharpf, 'Legitimacy in the Multi-level European Polity', in P. Dobner and M. Loughlin (eds), *The Twilight of Constitutionalism* (Oxford University Press, 2010), 89–119, at 111–117.
[33] F.A. Hayek, 'The Economic Conditions of Interstate Federalism', in idem, *Individualism and Economic Order* (University of Chicago Press, 1948), at 269.

It seems to us, however, that it is important to keep arguments within proportion. First, there is no aggregate reduction of tax yields.[34] For corporate income tax, the aggregate level of revenue contribution has not changed significantly in recent years—this is known as the 'corporate income rate-revenue paradox'—although this may mask a reduction in real terms, given that the share of capital in income has increased.[35] For labour, the figures for implicit tax rates 1995-2012 and tax wedges for low wage workers 2002-2012 fail to reveal any clear patterns.[36] Secondly, tax competition is not inherently bad, but may also produce beneficial results. For example, EU fiscal interdependence may have resulted in lower but broader corporate tax rates[37]—a result that brings fewer distortions and less complexity. Thirdly, and more controversially, public choice argues that competition among jurisdictions is beneficial in taming the Leviathan.[38] The fear is that the state and self-interested public officials in control of its offices have a tendency to engage in excessive taxation and in squandering the proceeds. Democracy may only provide an imperfect constraint on such a tendency. Politicians may decide on taxes and spending to bribe key constituencies in the hopes of re-election rather than to improve the public weal. It can be argued that competition from other jurisdictions may serve a useful function in constraining public power. *Exit* is added to the *voice* that democracy supplies.[39] What these arguments suggest is that rather than condemning all tax competition outright, the need is to identify and take action against those forms of tax competition that are harmful. For example, it might be argued that 'beggar-thy-neighbour' targeted tax competition designed to attract particular companies with specific tax incentives is unlikely to have redeeming virtues, while lowering of tax rates as a result of the

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[34] Genschel and Schwarz, 'Tax Competition and Fiscal Democracy', n 30 above, at 72. For data, see http://ec.europa.eu/eurostat/statistics-explained/images/8/85/Total_revenue_from_taxes_and_social_contributions%2C_EU-28_and_EA-19%2C%25_of_GDP%2C_1995-2014.png.

[35] 'Corporate Income Taxation in the European Union', n 2 above, at 19–20.

[36] Eurostat, 'Taxation Trends in the European Union 2014', at 28 and 30, available at http://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/gen_info/economic_analysis/tax_structures/2014/report.pdf. See also Commission, 'Tax Reforms in EU Member States 2015' available at http://ec.europa.eu/economy_finance/publications/eeip/pdf/ip008_en.pdf, at 108–109.

[37] 'Corporate Income Taxation in the European Union', n 2 above, Annex I.

[38] G. Brennan and J.M. Buchanan, *The Power to Tax: Analytical Foundations of a Fiscal Constitution* (Cambridge University Press, 1980), in particular Ch 9.

[39] The argument is not that tax havens or tax avoidance are just or efficient. Rather, the ability of taxpayers to locate their activities in a jurisdiction where a certain level of infrastructure and public services are provided at the lowest cost in terms of the tax burden serves to spur countries to greater efficiency and innovation.

broadening of the tax base or to reflect more efficient delivery of public services is beneficial, even if it puts pressure on other countries.[40] Finally, it could well be argued that the same pattern can be observed in non-EU countries, so the transformation of national tax systems is to be considered within the context of globalisation. This entails that Member States would find themselves in much the same situation even if they had not joined the EU (or were to leave it).

III The Response of the EU Institutions

In this section, we focus on the way EU institutions have reacted in recent years to the challenge of reconciling European integration with effective taxation. We distinguish a judicial, a regulatory, and a legislative response. It is important to highlight that all three responses go in the same direction, namely, the protection of Member State ability to collect taxes, either through a (re-)calibrated understanding of economic freedoms, a targeted use of the power to monitor state aid, or by proposing legislative initiatives. In addition, it should be observed that the institutional pattern is more complex (and thus richer) than in the past. A fair balance between the conflicting demands of market integration and national tax autonomy is not being aimed at exclusively by the judiciary, but this time around political institutions are also involved.[41]

A The Judicial Response: The Change of Approach by the Court of Justice

The extent to which market integration compromises the ability of Member States to collect income tax depends to a large degree on the concrete way in which economic freedoms are defined and implemented. Paramount here is the influence of the jurisprudence of the Court. The European judges interpret the abstract rules of the Treaty and set out their meaning in practice. What is important to realise is that in the last ten years or so the case law of the CJEU

[40] It may in practice be difficult to decide whether a particular instance of competition is harmful. The EU has adopted a code of conduct and established a monitoring group for these purposes; see 'Resolution of the Council and the Representatives of the Governments of the Member States on a Code of Conduct for Business Taxation', OJ C 2, of 6.1.1998, 2–5.

[41] It is notorious that the EU legislature has stayed away from the field of direct taxes in the past, producing only a handful of substantive directives with limited scope, while the Court has handed down well over 200 rulings on these matters. The Commission's energetic use of state aid powers against national tax measures is also a relatively recent development.

affecting the interplay between economic freedoms and tax law has changed. The Court has recognised that its earlier jurisprudence may have gone too far; consequently, its rulings have become more accommodating towards Member State concerns.[42] The case law has evolved in respect of the two main elements of free movement law—both the notion of restriction on economic freedoms and the definition of justifications of limitations to economic freedoms have undergone substantial changes.[43] In the following we consider them in turn.

As regards the notion of restriction, some of the earlier case law took the view that there was no reason to differentiate between fiscal and regulatory rules. Instead, the same broad notion of restriction was employed in both contexts. The ruling in *Manninen* on the Finnish dividend imputation system (i.e. arrangements that mitigate or eliminate economic double taxation of dividends)[44] represents the high-water mark of the said earlier tax case law. It suffices to quote from Advocate General Kokott's Opinion, which was followed by the Grand Chamber of the Court:

> Any measure that makes the cross-border transfer of capital more difficult or less attractive and is thus liable to deter the investor constitutes a restriction on the free movement of capital. In this respect the concept of a restriction of capital movements corresponds to the concept of a restriction that the Court has developed with regard to the other fundamental freedoms, especially the freedom of movement of goods.[45]

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[42] The Opinions of AG Geelhoed were an important precursor; see in particular Case C-374/04, *Test Claimants in Class IV of the ACT Group Litigation*, ECLI:EU:C:2006:139 where he sought to set out 'the fundamental framework for analysis of the application of the free movement rules in the direct taxation sphere' and pointed out the poor fit of some of the previous case law with it.
[43] See also eg A. Cordewener, G. Kofler and S. Van Thiel, 'The Clash between European Freedoms and National Direct Tax Law: Public Interest Defences Available to the Member States', (2009) 46 *Common Market Law Review* 1951–2000, at 1996–1997, who deplore the 'new caution'.
[44] Case C-319/02, *Manninen*, ECLI:EU:C:2004:484.
[45] Case C-319/02, *Manninen*, Opinion of AG Kokott, ECLI:EU:C:2004:164, para 28 (footnotes omitted).

However, only two years later the Court underwent a change of heart. The first case where this was clearly at work was the Grand Chamber ruling in *Kerckhaert*.[46] The case concerned straightforward double taxation. The dividends that the plaintiffs had received on account of their investment were first taxed in the source country, France. The dividends were then also taxed in Belgium, the country of residence of the taxpayers. The Belgian authorities did not take into account the tax that the plaintiffs had already paid. Double taxation is quite clearly a disincentive to engage in cross-border investment (the most obvious one, we would say). This breed of national rules had been the main target of the Court's case law ever since the seminal judgment in *Cassis de Dijon* in the late 1970s.[47] Yet in *Kerckhaert* the Court concluded that the overlap of French and Belgian law did not create a restriction on free movement of capital. The Court stated that the situation in which the plaintiffs found themselves was the result of the parallel exercise of fiscal sovereignty by two Member States. European law as it stood did not provide the plaintiffs with a remedy. This approach has prevailed since.[48] The notion of restriction has consequently come to be construed more narrowly in the fiscal than in the regulatory context. In the absence of discrimination, the CJEU is unlikely to find that national income tax laws restrict economic freedoms.[49]

A similar adjustment has taken place for justifications. In *Bachmann* in the early 1990s the Court had established that Member States could justify tax rules restricting economic freedoms by relying on the need to ensure the coherence of the tax system.[50] Yet *Bachmann* did not become a leading case, but rather remained an exception. Step by step, the CJEU raised the bar for pleading coherence. For several years, no Member State managed to win a case on this ground. In 1992, Member States, acting as masters of the Treaties, amended what is now Article 65.1(a) TFEU so as to shelter the differentiated tax treatment of residents and non-residents from being contested as a restriction on the movement of capital. Yet in 2000, the CJEU in *Verkooijen* construed the provision as merely confirming its previous strict case law

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[46] Case C-513/04, *Kerckhaert*, ECLI:EU:C:2006:713. See Case C-376/03, *D*, ECLI:EU:C:2005:424 for an earlier indication.
[47] Case C-120/78, *Rewe-Zentral v Bundesmonopolverwaltung für Branntwein*, ECLI:EU:C:1979:42.
[48] See eg Case C-67/08, *Block*, ECLI:EU:C:2009:92.
[49] See J. Snell, 'Non-discriminatory tax obstacles in Community law', (2007) 56 *International and Comparative Law Quarterly* 339–370 for a full version of this argument. See also S. Kingston, 'A Light in the Darkness: Recent Developments in the ECJ's Direct Tax Jurisprudence', (2007) 44 *Common Market Law Review* 1321–1359.
[50] Case C-204/90, *Bachmann*, ECLI:EU:C:1992:35.

rather than as a genuinely new rule.[51] At the same time, the CJEU interpreted the justification of prevention of tax avoidance in a rather narrow fashion, by means of applying it exclusively to 'wholly artificial arrangements' in cases such as *ICI* and *Lankhorst-Hohorst*.[52]

By contrast, since the 2005 *Marks & Spencer* case[53] the Court has become more accommodating towards Member State efforts to justify their restrictive rules. In particular, the CJEU has ruled in several cases that the exercise of economic freedoms cannot be protected if the result is to undermine the allocation of the power to tax among Member States.[54] This rationale is difficult to distinguish from the fiscal coherence justification[55] (which has also been pleaded again with success, after many years in which, as was pointed out, it had become a losing strategy to do so).[56] In addition, balanced allocation is connected to and serves to broaden the ground of preventing tax avoidance beyond the notion of wholly artificial arrangements—in *SGI* the Court said that even if the restrictive Belgian arm's length legislation in issue was not specifically designed to combat purely artificial arrangements, it could nevertheless be justified by a combination of the need to prevent tax avoidance and to preserve the balanced allocation of the power to impose taxes if there was a risk of base erosion.[57] Although some of the distinctions drawn in the case law are rather hard to understand,[58] for our purposes the key point is clear: the Court today is aware of the need to respect the integrity of the tax bases of the Member States, and its rulings have evolved accordingly.

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[51] Case C-35/98, *Verkooijen*, ECLI:EU:C:2000:294, para 43.
[52] Case C-264/96, *ICI*, ECLI:EU:C:1998:370, para 26 and Case C-324/00, *Lankhorst-Hohorst*, ECLI:EU:C:2002:749, para 37.
[53] See n 1 above. P. Farmer, 'Direct Taxation and Fundamental Freedoms', in D. Chalmers and A. Arnull (eds), *The Oxford Handbook of European Union Law* (Oxford University Press, 2015) 809–833, writes at 824: 'the *Marks & Spencer* decision can be seen as something of a watershed in the Court's case law. Before then Member States' attempts to justify their rules were nearly always rejected, often rather summarily. Since then the Court's case law has generally been more nuanced, often turning on an inquiry into proportionality left in varying degrees to the national court.'
[54] See eg Case C-231/05, *Oy AA*, ECLI:EU:C:2007:439 and Case C-337/08, *X-Holding*, ECLI:EU:C:2010:89.
[55] In Case C-371/10, *National Grid Indus*, ECLI:EU:C:2011:785, para 80 the Court said that the grounds 'coincide'.
[56] See eg Case C-157/07, *Krankenheim Ruhesitz*, ECLI:EU:C:2008:588.
[57] Case C-311/08, *SGI*, ECLI:EU:C:2010:26, paras 65–67.
[58] See B.J.M. Terra and P.J. Wattel, *European Tax Law* (Kluwer, 6th edn, 2012), especially at 913–939, for a magisterial exposition.

A good example of this development is *Lidl Belgium*.[59] A German company operated a lossmaking permanent establishment in Luxembourg. The company's attempt to deduct losses when determining its tax liabilities in Germany was rejected, although the deduction would have been available had the permanent establishment been situated in Germany. The Fourth Chamber of the Court found that the German decision restricted freedom of establishment, but the restriction was nonetheless justified. The Court noted that income generated by the permanent establishment was taxed in Luxembourg. In view of the need to preserve allocation of taxing powers between Member States, this meant that losses also had to be taken into account in Luxembourg to safeguard the symmetry between taxation of profits and deduction of losses, and to avoid the danger of their being taken into account twice. While *Marks & Spencer* had also referred to the aim of preventing tax avoidance, the Court did not consider this necessary for justification to be available. The Court established, contrary to the views of the Commission and of Advocate General Sharpston,[60] that the German rules involved were also proportionate. The judges added that Member States were allowed to prevent conduct liable to undermine the right to exercise the power of taxation.[61] *Lidl Belgium* stands in marked contrast to the ruling in *Bosal* five years earlier,[62] where the Fifth Chamber of the Court had held that the Netherlands had to allow a Dutch parent company to deduct costs relating to subsidiaries established in other Member States despite the fact that the Netherlands had no power to tax profits generated by them or their distribution, in order to guarantee treatment similar to domestic subsidiaries. In *Bosal*, the Court's primary concern was to ensure that a company investing abroad was subject to exactly the same treatment as a company investing in the home market. Deductions had to be allowed even in the absence of taxation of profits. In *Lidl Belgium* the main concern was to ensure that a Member State could exercise its taxing powers. Deductions did not need to be granted, since there was no taxation of profits.

In 2014 the Court introduced a further public interest justification, namely combating tax havens. In the ruling in *Felixstowe Dock and Railway Company*, the Grand Chamber remarked that this rationale could in principle have justified the relevant British rules on consortium

[59] Case C-414/06, *Lidl Belgium*, ECLI:EU:C:2008:278.
[60] Case C-414/06, *Lidl Belgium*, Opinion of AG Sharpston, ECLI:EU:C:2008:88.
[61] At para 52.
[62] Case C-168/01, *Bosal Holding*, ECLI:EU:C:2003:479.

group relief, although on the facts the national law was not drawn sufficiently narrowly.[63] In *X and TBG* the Third Chamber established that a discriminatory Dutch tax on dividends paid to holding companies in the Netherlands Antilles did not violate the free movement of capital rules of the EU Overseas Association Decision, as it was designed to counter the allure of the Netherlands Antilles as a tax haven.[64] It is clear that this public interest rationale is full of possibilities from the perspective of national treasuries. It may indeed serve to assuage some of the anxieties that afflict Member States over the effects of free movement of capital, which extends to third countries, on their effective capacity to tax. Remarkably, the Court seems to have established this new justification of its own motion without being prompted by the litigants, as the UK Government had not sought to justify its legislation in *Felixstowe*.[65] To quote Peter Wattel: 'The Court of Justice seems to have the right antenna for the fiscal spirit of the times'.[66]

In sum, the kind of criticism directed against the case law of the CJEU on income taxation in the early 2000s would be partially misplaced if reiterated today. The European judges are no longer riding roughshod over the tax autonomy of Member States but instead have recalibrated some of the basic concepts of free movement law to fit the fiscal context. The case law is messy and undoubtedly individual decisions are to be criticised—yet the big picture is worth noting. The judicial organ of the EU has responded. Only discriminatory rules count as restrictions and even they may prove lawful, especially if they are necessary to protect the integrity of the tax base.[67]

B The Regulatory Response: State Aid Investigations

In the 1990s, a common understanding was that the guidelines on applying the state aid rules should be clarified and that the Commission should examine Member State tax laws on the basis of those rules.[68] This initiative came hand in hand with adoption of the code of conduct[69]

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[63] Case C-80/12, *Felixstowe Dock and Railway Company*, ECLI:EU:C:2014:200, para 32.
[64] Joined Cases C-24 and 27/12, *X and TBG*, ECLI:EU:C:2014:1385.
[65] See para 27.
[66] P. Wattel, 'Taxation in the Internal Market', in P. Koutrakos and J. Snell (eds), *Research Handbook on the Law of the EU's Internal Market* (Edward Elgar, 2017), at 320.
[67] See also Farmer, n 53 above, at 813-814 and 817.
[68] For the earliest line of this thought, see 'Taxation in the European Union. Discussion paper for the Informal Meeting of ECOFIN Ministers' SEC(96) 487 final, available at

for business taxation and plans to determine which forms of tax competition were to be considered harmful.[70] Consequently, state aid investigations became a part of the Commission's toolbox to curb tax competition.

Since 2013, the Commission has engaged in a more systematic examination of national tax practices in the light of state aid rules. The Commission has asked for information from particular Member States on their tax rulings (or, what amounts to the same, written interpretations of tax law provided ex ante, in general to multinational corporations).[71] However, after Luxembourg tax rulings 'granted' to hundreds of corporations became public,[72] the Commission extended its requests (and investigation) to all Member States. On that basis, the Commission has established that specific Luxembourg, Dutch, Belgian and Irish tax rulings were in breach of EU law.[73] Other cases are still pending.[74] In this way, the Commission works against harmful targeted tax competition that provides tax benefits in a selective and discriminatory fashion, thus (among other things) distorting competition between Member States.

Three remarks seem to us pertinent. First, the Commission is prepared to make active use of its power to check the European constitutionality of state aid as a part of a more comprehensive tax policy. Secondly, the removal of illegal state aid practices leads to a form of negative integration but one that eliminates harmful national tax measures (measures that actually undermine national capacity to tax: in some cases of all states, or in most states bar the one issuing the tax ruling). This proves that negative integration not only facilitates tax

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http://www.verginet.net/UserFiles/File/Avrupa_Birligi/Taxation/General_Information/taxation_sec(1996)487_en%204%20Ek%203.pdf, at 13.

[69] See n 40 above.

[70] For the background, see F. de Cecco, *State Aid and the European Economic Constitution* (Hart, 2013), at 128–133.

[71] See A. Christians, 'Lux Leaks: Revealing the Law, One Plain Brown Envelope at a Time', available at https://papers.ssrn.com/sol3/Papers.cfm?abstract_id=2546923.

[72] 'Leak reveals scale of corporate tax deals with Luxembourg', *Financial Times*, 6 November 2014.

[73] Commission Decision 2016/1699/EU on the excess profit exemption State Aid scheme SA.37667 (2015/C) (ex 2015/NN) implemented by Belgium, OJ L 260, of 27.9.2016, 61–103, and SA.38375 (Luxembourg), SA38374 (The Netherlands) and SA.38373 (Ireland) where the decisions have been made but are not publicly available.

[74] See generally eg 'Multinationals seek cover as EU begins tax avoidance battle', *Financial Times*, 21 October 2015.

competition but can also be a practical means of tackling it. Thirdly, in terms of the legality or illegality of tax regimes, the decision on whether they constitute a form of illegal state aid requires confronting them with a general pattern of taxation. In the absence of any European tax system that could serve as a yardstick, the deviation is to be determined by reference to the national system in question,[75] which in turn might limit the effectiveness of this tool in tackling inter-state tax competition.

C The Legislative Response: Safeguarding the Power to Tax through Positive Integration

Recent years have witnessed a variety of legislative initiatives to safeguard Member State power to tax. In contrast to negative integration, efforts are under way to reconstitute taxing powers within the internal market. This includes endeavours to harmonise corporate tax systems, to establish a tax on financial transactions, and to impose obligations on taxpayers to document tax-related information and on tax administrations to exchange information. We will examine these in turn.

For corporate taxation, in July 2016 the Council adopted a Directive to harmonise Member States' anti-tax avoidance measures.[76] This in turn was in response to recent initiatives within the Organisation for Economic Co-operation and Development (OECD) to tackle tax base erosion and artificial profit-shifting from one tax jurisdiction to another.[77] More ambitiously, the Commission has relaunched proposals for a common and consolidated corporate tax base (CCCTB).[78] The measures aim not at negative integration but, to the contrary, their purpose is to ensure that market integration does not undermine effective capacity to tax. The present CCCTB proposal sets a different course from the one proposed in 2011.[79] In particular, the

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[75] W. Schön, 'Taxation and State Aid Law in the European Union', (1999) 36 *Common Market Law Review* 911–936, at 923. See C. Micheau, 'Tax Selectivity in European Law of State Aid: Legal Assessment and Alternative Approaches', (2015) 40 *European Law Review* 323–348 for an assessment of the selectivity criterion.
[76] Directive 2016/1164/EU laying down rules against tax avoidance practices that directly affect the functioning of the internal market, OJ L 193, of 19.7.2016, 1–13.
[77] On OECD cooperation, see the website at http://www.oecd.org/ctp/beps/.
[78] Commission 'Proposal for a Council Directive on a Common Corporate Tax Base' COM(2016) 685 final and Commission 'Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB)' COM(2016) 683 final.
[79] Commission 'Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB)' COM(2011) 121/4.

proposed rules will be compulsory (and not facultative) for multinational groups with revenues over 750 million euros. This reflects a clear anti-avoidance purpose. Having said that, the mechanics are still largely in line with the previous proposal. First, there would be a single scheme for calculating the tax base for multinational groups. This would drastically curb tax competition on the basis of tax base disparities. Secondly, groups would be treated as one single taxpayer whose profits would be pooled into one consolidated tax base. This single base would then be apportioned between the Member States. The criterion used to allocate the fractions of the tax base would be the place where the economic activity takes place.[80] This would entail that corporate taxes become payable where the profits have been generated (the principle of tax territoriality). Opportunities for aggressive tax planning through profit-shifting among states would be drastically reduced, given that all profits would be aggregated in one consolidated tax base, and the allocation would be proof against formal manipulation of financial flows. The functionality of the system would clearly depend on the choice of the precise allocation rules. An appropriate weighing of different factors is needed.[81] For the sake of providing the reader with a full record, it should be said that there has been considerable resistance to this allocation element of the proposal, which explains why the Commission has separated it from the proposal pertaining to the rules on calculating the common tax base.[82] The pre-Brexit British government seemed to be leading opposition to the measure, but had declared that 'it will not… stand in the way if other Member States want to push forward with the proposal'.[83] Brexit renders that of no practical relevance, but other states, previously perhaps silent behind British opposition, may come forward to express their (negative) position more openly.

The financial crisis that began in 2007/8 brought the idea of imposing a tax on financial transactions—the financial transaction tax (FTT) sometimes referred to somewhat

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[80] Art 28 of Commission Proposal COM(2016) 683 final, n 78 above.
[81] See G. Zucman, *The Hidden Wealth of Nations: The Scourge of Tax Havens* (The University of Chicago Press, 2015), at 110–111.
[82] Commission Proposal COM(2016) 685 final, n 78 above, states at 3: 'The discussions in Council since 2011 have shown that the CCCTB proposal, being a very ambitious project, would be unlikely to get adopted, in its entirety, without a staged approach. Thus, various elements (especially, tax consolidation) have given rise to a difficult debate and could be holding back progress on other fundamental features of the system.'
[83] House of Commons European Scrutiny Committee, 18 March 2015,16.8 available at http://www.publications.parliament.uk/pa/cm201415/cmselect/cmeuleg/219-xxxvi/21919.htm.

imprecisely as the Tobin tax—back on the European agenda. Proposals have been on the table to introduce it within the framework of enhanced cooperation: that is, by agreement between many but not all Member States, and only applicable to those that agree.[84] The purpose of the tax is said to be dual: not only to harmonise existing laws but also to make the under-taxed financial sector—financial transactions are not subject to value added tax—pay its tax share and, in the process, curb short-term financial transactions that do not increase the efficiency of the markets and are not welfare enhancing.[85] In its most ambitious form, the FTT would introduce a new European tax that could serve as a revenue source for the Eurozone (and thus fund a Eurozone Treasury). But not only does it still remain to be seen whether and how FTT will be implemented, but if it is effectively approved by a limited number of Member States, its tax yielding capacity is likely to be rather modest.[86] This does not undermine the fact that the tax will subject the source of income (and wealth) that benefits the most from the single market liable to tax, thus contributing to a fairer balance between economic benefits and tax obligations.[87] The FTT is thus a paradigmatic example of how taxes could be designed so as to achieve that objective.

Finally, administrative cooperation in tax matters is in the process of being transformed. The decisive step has been adoption of mandatory automatic exchange of information between tax administrations,[88] including financial assets[89] and tax rulings.[90] Cooperation aspires to cover the epistemic deficit of tax administrations caused by the compartmentalisation of the tax

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[84] See generally A. Cédelle and J. Vella, 'Differentiated Integration in the EU: Lessons from the Financial Transaction Tax' in Koutrakos and Snell (eds), n 66 above.
[85] Commission 'Proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax' COM(2013) 71 final, at 4.
[86] See F. Fabbrini, 'Taxing and Spending in the Euro Zone: Legal and Political Challenges Related to the Adoption of the Financial Transaction Tax', (2014) 39 *European Law Review* 155–175.
[87] See M. Poiares Maduro, 'A New Governance for the European Union and the Euro: Democracy and Justice', *RSCAS Policy Paper* 2012/11, available at http://cadmus.eui.eu/handle/1814/24295, at 13.
[88] Dir 2011/16/EU on administrative cooperation in the field of taxation and repealing Dir 77/799/EEC, OJ L 64, of 11.3.2011, 1–12.
[89] Dir 2014/107/EU amending Dir 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, OJ L 359, of 16.12.2014, 1–29.
[90] Dir 2015/2376/EU amending Dir 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, OJ L 332, of 18.12.2015, 1–10.

base into separate jurisdictions. Moreover, the Council has adopted a Directive[91] on country by country (CBC) reporting obligations for large multinational companies, while the Commission has pushed forward public availability of the said information.[92] Public country by country reporting would not only provide tax administrations with more information and help to curb tax avoidance but is also likely to enhance the perception of tax transparency in the eyes of citizens.

The three sets of legislative responses represent very different forms of tax integration. However, they all point in the same direction: one in which taxes are not necessarily identified as market obstacles that should be removed by negative integration but as fundamental institutions on the effectiveness of which societal cooperation depends, and whose collection is thus to be guaranteed through positive harmonisation. In this sense, the current legislative responses might mark a return to an earlier phase of integration when positive tax harmonisation was regarded as part and parcel of the process of European integration.[93]

IV The Changing Constitutional Context: The Rise of Differentiated Integration and the Eurocrisis

As already hinted at, proposals for a common corporate tax base and for a financial transactions tax should be placed in the changed (and changing) constitutional context brought about by two of the arguably greatest shocks that have ever hit the European integration project: the 2004 and 2007 enlargements and the financial, economic and fiscal crises. The former has led to greater reliance on enhanced cooperation, while the latter has ignited a broader debate about the need to harmonise and possibly transfer fiscal competences to the Union. Both supply of and demand for further Europeanisation of income tax law are likely to go up.

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[91] Dir 2016/881/EU amending Dir 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, OJ L 146, of 3.6.2016, 8–21.
[92] Commission 'Proposal for a Council Directive of the European Parliament and of the Council amending Directive 2013/34/EU as regards disclosure of income tax information by certain undertakings and branches' COM(2016) 198 final.
[93] A.J. Menéndez, 'Neumark Vindicated: The Europeanisation of National Tax Systems and the Future of the Social and Democratic Rechtsstaat', (2015) *Arena Working Paper* 4, at 35.

Treaty provisions enabling enhanced cooperation were inserted in the Treaties in 1997.[94] It took more than ten years for them to actually be made use of. Regulations adopted on the basis of enhanced cooperation are already in force on divorce[95] and patents.[96]
The financial transaction tax proposal is part of the same dynamic. From the present perspective, it is noteworthy that the patent legislation deals with issues subject to unanimous decision-making as foreseen in Article 118(2) TFEU, and that it was approved despite *active resistance* by some Member States. Enhanced cooperation broke the deadlock in a field where progress had been blocked for decades. Further, this has subsequently been approved by the Court. Legal action to stop the proposed legislation failed as the Court held that the rule of unanimity only requires unanimity among the participating Member States—non-participating ones cannot block the venture. [97] So far, none of the legal challenges to enhanced cooperation has succeeded.[98]

This 'permissive' approach to what enhanced cooperation requires entails that the hurdle of unanimous voting in the Council that for long was thought to prevent positive harmonisation in the tax context no longer stands as high as was thought.[99] If Member States wish to proceed, they may be able to do so despite objections. The real question is not the legal

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[94] The Treaty of Amsterdam originally introduced closer cooperation for areas covered by the EC Treaty and for police and judicial cooperation in criminal matters, under conditions set out in Arts 43-45 TEU.
[95] Council Regulation (EU) No 1259/2010 implementing enhanced cooperation in the area of the law applicable to divorce and legal separation, OJ L 343, of 29.12.2010, 10–16.
[96] Regulation (EU) No 1257/2012 of the European Parliament and of the Council implementing enhanced cooperation in the area of the creation of unitary patent protection OJ L 361, of 31 December 2012, 1–8; Council Regulation (EU) No 1260/2012 implementing enhanced cooperation in the area of the creation of unitary patent protection with regard to the applicable translation arrangements, OJ L 361, of 31.12.2012, 89–92; and Agreement on a Unified Patent Court, OJ C 175, of 20.6.2013, 1–40.
[97] Joined Cases C-274 and 295/11, *Spain and Italy v Council*, ECLI:EU:C:2013:240. For background and critical commentary, see eg F. Fabbrini, 'Enhanced Cooperation under Scrutiny: Revisiting the Law and Practice of Multi-Speed Integration in Light of the First Involvement of the EU Judiciary', (2013) 40 *Legal Issues of Economic Integration* 197–224.
[98] See Case C-209/13, *United Kingdom v European Parliament and Council*, ECLI:EU:C:2014:283 for the FTT.
[99] Even before these developments, enhanced cooperation had been called the 'best hope for those who favour further direct tax integration' in M. O'Brien, 'Company Taxation, State Aid and Fundamental Freedoms: Is the Next Step Enhanced Cooperation?', (2005) 30 *European Law Review* 209–233, at 233.

feasibility of harmonisation but the political will to make it effective.[100] Having said that, not all legal issues have been settled, and this may affect political calculations.[101] In particular in the context of the FTT proposal, discussion has focused on its allegedly extraterritorial effects. The wide reach of the proposal may be helpful in ensuring that the objectives of enhanced cooperation are not frustrated by the strategic behaviour of economic actors, but its compatibility with both public international law and EU law has been questioned.[102] In general, the more leeway the participating Member States enjoy in managing the strategic responses of taxpayers, the more likely they are to agree to enhanced cooperation.[103]

At the same time, the Eurocrisis has increased calls for further EU action in tax matters, especially within the Eurozone. This comprises at least four aspects. First, Member States are not only still reeling from the impact of the financial crisis but also struggling to meet new and tighter fiscal rules that set ceilings to debt and deficit levels, and now also establish compulsory trajectories of reduction and automatic mechanisms reducing expenditure if fiscal targets are not met. As a result, states have become much less tolerant of so-called 'tax planning strategies', indeed so much so that referring to some of them as 'aggressive' has become standard jargon. As explained in previous sections, the EU is already providing Member States with assistance, in particular through its state aid investigations and by means of fostering greater tax transparency. Additionally, a drive is under way to make the EU more active in the global struggle of the OECD against practices that erode the capacity of states to effectively tax (the so-called 'base erosion'), including the formal shifting of profits among jurisdictions.[104] Even if views have differed somewhat about the specific role that the EU

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[100] For comparison, the U.S. Multistate Tax Compact has been enacted by 16 States into state law, while Nevada and Virginia do not participate at all in the work of the Multistate Tax Commission. See http://www.mtc.gov/Home.
[101] See Genschel and Schwarz, n 30 above, at 355 on the calculus.
[102] See the conflicting views of the Council Legal Services in Council doc 13412/13 limité and the response of the Commission Services in a 'non-paper' available eg at http://linklaters.de/fileadmin/redaktion/Steuerrecht/Gesetzesmaterialien/Finanztransaktionssteuer/20131218_FTT_European_Commission_response_to_the_Council_legal_service.pdf. For academic analysis, see J. Englisch, J. Vella and A. Yevgenyeva, 'The Financial Transaction Tax Proposal under the Enhanced Cooperation Procedure: Legal and Practical Considerations', (2013) *British Tax Review* 223–259.
[103] In subsequent actions concerning the precise content of the unitary patent regime the ECJ again found no violations: see Case C-146/13, *Spain v European Parliament and Council*, ECLI:EU:C:2015:298 and Case C-147/13, *Spain v Council*, ECLI:EU:C:2015:299.
[104] See Annex IV to 'Corporate Income Taxation in the European Union', n 2 above.

should play, a consensus seems to have emerged that the Union should not undermine OECD efforts,[105] and the EU has very recently managed to adopt legislation in the area, coordinating Member State approaches through minimum harmonisation.[106]

Secondly, calls for 'completion' of the economic union (clearly the less developed and less robust part of economic and monetary union) have increased dramatically. This is said to require the setting of EU standards on 'certain aspects of tax policy (for example the corporate tax base).'[107] The proclaimed aim is to ensure that all Member States make their economic structures *resilient* so that they can absorb shocks internally. Clearly, the economies of the Eurozone states are closely related, so the 'bad' policies of any state are likely to affect all states. Consequently, every state has a clear interest in all others applying sound economic policies.

Thirdly, initiatives have been taken so as to create 'deeper and more integrated' capital markets in Europe (the so-called 'capital markets union') and, in particular, to encourage the private sector to participate in cross-border risk sharing.[108] Tax issues are bound to be at the core of this specific project. More integrated capital markets require 'neutral treatment for different but comparable activities and investments across jurisdictions'.[109] On a more practical level, the Commission is, for example, investigating whether national tax systems create barriers to cross-border distribution of investment funds and preparing a code of conduct on the principles to be applied to ensure relief in respect of withholding taxes (that is, of amounts retained by the source state).[110]

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105 The special issue (2015) 3 *British Tax Review* is dedicated to this theme.
106 Directive 2016/1164/EU laying down rules against tax avoidance practices, n 76 above.
107 Commission, 'Completing Europe's Economic and Monetary Union: Report by Jean-Claude Juncker in close cooperation with Donald Tusk, Jeroen Dijsselbloem, Mario Draghi and Martin Schulz' (2015), available at http://ec.europa.eu/priorities/economic-monetary-union/docs/5-presidents-report_en.pdf, at 9.
108 Ibid at 12. The idea is that if economic problems exist in a country, domestic investors are to an extent sheltered by returns from cross-border investments, and if local sources of capital dry up, residents can still access cross-border flows.
109 Ibid.
110 Commission Communication, 'Action Plan on Building a Capital Markets Union' COM(2015) 468 final.

Finally, it has been argued that the Eurozone needs to put in place a proper common macroeconomic policy, so as to ensure centralised macroeconomic stabilisation of the Eurozone economy. This would provide the Eurozone with the means to deal with shocks that Member States are incapable of handling through unilateral action. The obvious question is how stabilisation policies (to the extent that they involve public expenditure) will be funded. More recent proposals have avoided this issue, but earlier proposals, such as the Commission's blueprint for a deep and genuine EMU, referred (again) to the need to equip the Union with a genuine autonomous power to tax.[111]

What emerges from this changing constitutional context is that both the supply of and the demand for EU action on tax have increased. On the supply side, the availability of enhanced cooperation and the Court's permissive attitude towards it makes it easier to engage in harmonisation. On the demand side, the consequences and lessons of the Eurocrisis point towards the need for more European action. Arguably, both the renewed push for the CCCTB and the launch of the FTT proposal are reflections of this changed constitutional context.

V Conclusion

In this article we have argued that the simple narrative according which market integration necessarily leads to erosion of the ability of Member States to tax income is not persuasive, despite its being logically consistent. No evidence suggests a decline of aggregate tax revenue. What we find is a possible shift of the tax burden (and increasingly of the tax design) from mobile to immobile tax bases (and taxpayers). Nevertheless, the dangers implicit in the present division of powers between the Union and Member States as to income taxation should not be ignored, in particular as these powers stand at the core of the broader problematique of the distributional consequences of internationalisation of economic activity; or what is the same, of the correlation between globalisation (in the shape of Europeanisation) and the growth of inequalities.[112] We argue that European institutions have reacted or are in the process of reacting. The case law of the Court of Justice has been recalibrated. The Commission is actively using its powers in the field of state aid to tackle

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[111] Commission Communication, 'A Blueprint for a Deep and Genuine Economic and Monetary Union: Launching a European Debate' COM(2012) 777 final/2, eg at 33. See Menéndez, n 93 above, at 37 for a highly critical view.

[112] See also the article by M. Ferrera in this issue.

targeted tax competition. Important secondary legislation has been adopted or is in the pipeline. Taken together, these responses represent a broad-based and reasonably coherent attempt to address the challenges. Further, the changed wider constitutional context has provided the EU both with more tools and with more reasons to engage actively in this field.

The ball is now in the court of the Member States. Do they have the political will—or, better, the incentives—to engage constructively in the field of taxation? Or do they remain stubbornly committed to the dogma of tax sovereignty and all that it entails? As proposals for a deep and genuine economic and monetary union have argued, much of the success of the integration project may hinge on this.

As a historically evolving institution, taxation is sensitive to changes in its social and legal context. Since the emergence of the tax state in Europe, taxation has been harnessed to serve the most fundamental government functions, which has guided the design of tax systems in nation states. Yet while national tax policy making is still premised on these purposes, it now takes place in a changed economic context and under a transformed economic constitution. Internationally integrated capital markets have transnationalised financial relations and rendered financial assets reactive to differentials in non-integrated national policy fields. The liberalisation of transnational capital movements entails the mobility of a large proportion of national tax bases. In other words, international economic mobility, fostered further in Europe by the economic freedoms, sets a new framework for national taxation. The national functions of taxation have remained, but the conditions for their realisation have changed.[113] The design of tax laws has become more dependent on decisions of economic actors, and in some cases the differentiation between public and private spheres has even been blurred.[114]

In particular since the 1980s, tax policies have taken into account the responsiveness of both out-bound and in-bound capital flows. In this sense, the transnational integration of capital markets has extended its effects on tax policies, just as on other areas of regulation. Some

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[113] See S. Steinmo, *Taxation and Democracy: Swedish, British and American Approaches to Financing the Modern State* (Yale University Press, 1993), at 191–192 and S. Steinmo, 'The End of Redistribution? International Pressures and Domestic Tax Policy Choices', (1994) 37 *Challenge* 6/November–December 9–17, at 15.

[114] eg when multinational corporations and national tax administrations have engaged in negotiations on tax treatment before investment decisions are taken.

have argued that this has contributed to a crisis in the tax state (a state that extracts the revenues for public expenditure predominantly through taxation), which may be displaced by the debt or consolidation state.[115] Moreover, concerns exist that European welfare regimes have become entangled, challenging domestic redistributive policies that have implemented national commitments to solidarity. From this perspective, the present shape of the European microeconomic constitution and global financial integration has put into doubt the tradition of a socially embedded market economy.[116] The challenge is to reconcile post-war social traditions and extant transnational economies.

While the transnationalisation of capital movements in Europe has presented a challenge for redistributive policies, the EU may also provide Member States with an array of tools to respond and to reconstitute commitments to solidarity. The financial and subsequent sovereign debt crisis brought into discourse the principles of the European macroeconomic constitution—European rules on fiscal and monetary policies. Sovereign debt arrangements between Member States have provoked questions on European solidarity: whether fiscal self-responsibility should be sustained to the full or joint liability for obligations be introduced. Although taxation has to some extent been absent from debates, it is inevitably implicated.

European tax solidarity does not necessarily entail radical moves such as the pooling of tax revenues between Member States. It may also take a more modest form. Rather than replacing states, integration may be harnessed to strengthen them. This may take place through active use in the field of taxation of legislative powers that are already pooled. This would remedy the previous over-reliance on the judicial branch for reconciliation of the internal market and national tax systems. If Member States are prepared to put limits on their formally unfettered national autonomy,[117] they can better manage the risks inherent in the internationalisation of capital movements. Transnationalisation of tax solidarity would provide an alternative to the plurality of interdependent fiscal regimes that are left to engage in tax competition and to bear individually the risks that competition engenders. Solidarity

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[115] See W. Streeck, *Buying Time: The Delayed Crisis of Democratic Capitalism* (Verso, 2014), at 47–96.

[116] See the introductory article by S. Frerichs in this issue.

[117] Renouncing unrestrained sovereign powers has been considered one of the cornerstones of inter-state solidarity; see R. Bieber, 'Solidarität als Verfassungsprinzip der Europäischen Union' in A. von Bogdandy and S. Kadelbach (Hrsg.), *Solidarität und Europäische Integration: Kolloquium zum 65. Geburtstag von Manfred Zuleeg* (Nomos, 2002), 41–52, at 46.

through European tax legislation would present a counterpart to economic interdependence.[118] Whether transnationalised legal solidarity corresponds to the social reality of Europe, whether the societal preconditions exist for European solidarity on the level of civil society, is a question not to be neglected. However, an equally crucial question is whether commitments to national solidarity can persist without being complemented by European legislative solidarity between Member States. Solidary exercise of legislative powers on taxation, balancing competition-inducing non-integration, might promote the concrete realisation of national solidarity, in particular if coupled with an EU judiciary that is sensitive to the integrity of national tax bases and EU regulators that police harmful targeted tax competition. In recent tax trends within the EU, a push in this direction can be observed.

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[118] In abstract terms, as integration proceeds in certain policy fields in order to amplify the problem-solving capacities of Member States, it provokes challenges in dependent policy terrains, where capacities may become more constrained. Solidarity between Member States can be seen to have a corrective function of mitigating the risks that arise on the basis of prior steps of integration. For such a line of argument, see A. Sangiovanni, 'Solidarity in the European Union', (2013) 33 *Oxford Journal of Legal Studies* 213–241, especially at 218 and 230.