

EMERGENCE, GROWTH AND MOBILITY OF EUROPEAN COMPETENCE ON DIRECT TAX REGIME: AN ANALYTICAL AND EVOLUTIONARY REVIEW

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ABSTRACT

Since its founding days, the European Union (EU) constitution has not explicitly empowered the Union to formulate policy in the field of direct taxes; this area has been broadly left to the Member States. To date, limited EU-level intervention in direct taxes can, in part, be attributed to this power-allocation scheme in the European constitution. In fact, more than three decades since the inception of the EU, no substantive European legislation has existed in this area. Nevertheless, the EU was, and still is, implicitly empowered to enact tax laws if tax policies of Member States infringe the EU's single-market principles. This article analyses the EU's direct tax powers, reviews the EU (tax) competence 'submerged' in the constitutional freedoms and single-market idea and its sub-textual growth, and the way this progressively emerged. It also argues that as the single market grows, so do the possible meanings of EU competence in policy areas affecting that market, including (implicit) tax powers. By analysing growth and mobility in the (tax) legislative regime, the article concludes that the policy of limited EU intervention in the realm of direct taxes may not persist in the long run, but rather may shift to expansive legislation in times ahead.

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I INTRODUCTION

The European Union (EU) is a single market of 28 Member States.¹ To achieve its single-market objective, the EU adopted several legislative measures including single customs tariffs for the region, and intervened closely to harmonise national VAT regimes. To date, however, little progress has been made to integrate Members' income and corporate tax regimes. This article reviews this situation and offers a legal analysis of the lack of wider EU-level actions to integrate direct taxes of Member States. Based on the evolution of the division of powers between states and the supranational polity, the EU, this article argues that the current situation of limited intervention in the field of direct taxes may not persist in the long run, but might shift to wide-ranging EU-level actions in the times ahead.

Essentially, the EU direct tax law² foresees the institution of an internal European market.³ The governing treaties – the 'constitutional' document of the jurisdiction –⁴ proclaim direct taxes generally as Members' terrain,⁵ if they do not violate

¹ The EU comprises 28 Member States. The United Kingdom decided to leave the Union in a referendum held on 23 June 2016. However, until the UK formally departs, the Union membership remains 28.

² Direct taxation in this article refers to income taxes (personal and corporate taxes), notwithstanding any other forms of direct taxes in the national jurisdictions of Member States.

³ Creation of an internal market within the EU jurisdiction is a constitutional obligation under the EU law; see, eg, the Treaty on European Union (TEU) below n 4, art 3, [2010] OJ C 83/1, 17 and Treaty on the Functioning of the European Union (TFEU), below n 4, art 26, [2010] OJ C 83/1, 59. For the text of the internal market clause, see below n 18. References to single, common or Union market in this article will effectively mean internal market.

⁴ EU constitution or governing treaties in this article refers to respective treaty document in force in EU. The article refers to several EU treaties: (1) the existing constitution known as Lisbon Treaty became effective from 1 December 2009. It comprises: *The Consolidated Versions of the Treaty on European Union and the Treaty on the Functioning of the European Union*, [2010] OJ C 83/1 (respectively *TEU* and *TFEU*). The predecessors of the Lisbon Treaty were: (2) *The Consolidated Versions of the Treaty on European Union and the Treaty Establishing the European Community*, [2006] OJ C 321 E/1 (respectively *TEU pre-Lisbon* and *EC Treaty*); (3) *Treaty of Nice amending the Treaty on the European Union, the Treaty Establishing the European Communities and Certain Related Acts*, [2001] OJ C/80/1 (respectively, *TEU (Nice version)* and *EC Treaty (Nice version)*); (4) *Treaty of Amsterdam amending the Treaty on the European Union, the Treaties Establishing the European Communities and Certain Related Acts*, [1997] OJ C 340/1 (*Amsterdam Treaty*); (5) *Treaty on European Union Together with the Complete Text of Treaty Establishing the European Community* (until Maastricht), [1992] OJ C 224/1 [hereinafter *Maastricht EC Treaty*]; (6) *Single European Act*, [1987] OJ L 169/1 (*SEA*); (7) *Treaty Establishing the European Economic Community*, 25 March 1957, 298 UNTS 11 (*EEC Treaty*).

⁵ Broadly, the constitution assigns powers in the direct tax regime to Members. For example, in the existing constitution, areas of exclusive Union competences as well as areas of competences shared by both EU and Members (TFEU, above n 4, arts 3, 4(2), [2010] OJ C 83/1, 51–52) do not confer tax powers to EU in express form. Hence, pursuant to principle of conferral of residual powers (TEU, above n 4, art 4(1), [2010] OJ C 83/1, 18) that states powers not conferred upon the Union to stay (subject to TFEU, above n 4, art 4(1), [2010] OJ C 83/1, 51) with Members, direct taxation generally remains a Members' domain. Legal scholarship on EU tax law also holds similar views; see, eg, Charles E McLure, Jr, 'Legislative,

fundamental freedoms⁶ and prohibition principles⁷ (collectively called ‘freedom clauses’) enshrined in the constitution to institute a single market. The national governments of Member States are thus empowered to formulate their own domestic tax policies, as long as these policies do not infringe the EU law. On the other hand, it is obviously hard to achieve harmony in 28 sovereign and parallel tax systems operative in a single European market. Subject to specified principles,⁸ the EU nevertheless always had – and still has – the power to enact tax legislation⁹ that could intervene in those national tax policies which impede the functioning of a single economic market. These are unspoken powers in the EU constitution and, as this article canvasses, they remain buried in the legal subtext and are likely to expand further over time.

Judicial, Soft Law, and Cooperative Approaches to Harmonizing Corporate Income Taxes in the US and the EU’ (2008) 14 *Columbia Journal of European Law* 377, 382 (observing that ‘[M]ember States of the EC retain competence in the tax field, except insofar as exercise of the competence is restricted by regulations or directives’). McLure further says that it is well established in the case law that ‘Member States must none the less exercise that competence consistently with Community law’ (citing *Marks & Spencer v Halsey* (C-446/03) [2005] ECR I-10837, para 29, and citations to previous cases provided there).

⁶ Freedoms guaranteed (referred to as fundamental freedoms) in the internal market having nexus to direct taxation are: freedom of movement to work (TFEU, above n 4, art 45), freedom to right of establishment (TFEU, above n 4, art 49), freedom to provide services (TFEU, above n 4, art 56), freedom of movement of capital and payments (TFEU, above n 4, art 63).

⁷ Prohibitions declared in the internal market having nexus to direct taxation are: prohibition on discrimination on the basis of nationality (TFEU, above n 4, art 18) and prohibition on state aid (TFEU, above n 4, art 107).

⁸ For intervening national policies on direct taxes, the suprapower powers are exercised and governed by schematic legal orders set out in the EU law, in particular provisions meant for division of powers (below n 17) and principles of subsidiarity and proportionality (see below Part III(C)).

⁹ There are several ways to intervene in national tax policies. The most well known is through the adoption of directives, one of the forms of EU legislative acts. The current legislation on direct taxes (see below Part II(C)) takes the form of directives, which are binding under the EU law. However, directives have only vertical effect (enforcement of EU rights against state); they lack (horizontal) enforcement of EU rights against private persons. The doctrine of direct effect originates from the European Court of Justice ruling in the landmark case *Van Gend en Loos v Netherlandse Administratie der Belastingen* (26/62) [1963] ECR 1. This ruling stipulates that certain provisions (or instruments) of EU law inherit legal force that by virtue of direct effect are effective in Member States without being enacted into domestic laws. For more details on this principle, see, eg, Karen Davies, *Understand European Union Law* (5th ed, Ebooks Corporation, 2013) 69–84. On evolution and development of this principle, see Bruno de Witte, ‘Direct Effect, Primacy, and the Nature of Legal Order’ in Paul Craig and G de Burca (eds) *The Evolution of EU Law* (Oxford University Press, 2nd ed, 2011) 323.

Besides directive-based legislation, the EU is also empowered to intervene in those national tax policies which are selective in nature and can distort free competition in the single market. For these powers, see TFEU, above n 4, arts 107–109; on use of these powers by the European Commission in recent times, see, eg, <http://europa.eu/rapid/press-release_IP-16-2923_en.htm> (last accessed 30 August 2016), on Irish tax rulings issued to Apple Ireland.

Unlike VAT, which is subject to relatively strict central control by means of a VAT Directive¹⁰ based on explicit constitutional provisions,¹¹ the legislative measures adopted to date in the field of direct taxes are narrow in scope, dealing with discreet issues.¹² In fact, the EU-level legislation on direct taxes is constrained by two key factors: First, a constitutional framework that, in stark contrast with, for example, customs tariffs, contains no express provision directing the EU to intervene into the field of direct taxes. The Members, therefore, generally retain autonomy in this policy area.¹³ The second is the fact that the EU tax legislation requires unanimous consensus of all Members,¹⁴ a task difficult to achieve in the wake of fiscal sovereignty claims of national treasuries. With no change foreseeable in the unanimity rule to adopt direct tax legislation, any dramatic shift in politics of taxation in the near future is not expected. Nevertheless, the EU may be entering a new evolutionary phase of an ‘ever closer union’¹⁵ that could change the dynamics of the balance of powers between Member States and the EU, and this merits closer examination. This article examines the first of the two key restrictions posed to the tax legislation under EU law – that is, lack of express constitutional powers to enact measures in the field of direct taxes.

Investigation of the legislative regimes and balance of powers in the EU law is a challenging task. First, it involves scrutiny of a unique constitutional framework that is ‘a blend of international law, national constitutional law, and federalism’.¹⁶ Second, the analysis involves a legislative regime that is not otherwise articulated in the EU constitution – for that is the case with direct taxes. Thus, the complexity associated with defining four corners of a Union action in this area within a ‘sub-textual’ constitutional framework of division of powers¹⁷ is substantial. This article explores the gradual

¹⁰ *Council Directive 2006/112/EC on the Common System of Value Added Tax*, [2006] OJ L 347/1 (here referred to as the Existing VAT Directive). It replaced the earlier VAT legislation based on *Council Directive 77/388/EEC on Harmonization of the Laws of the Member States relating to Turnover Taxes – Common System of Value Added Tax: Uniform Basis of Assessment*, [1977] OJ L 145/1 (here referred to as the Old VAT Directive).

¹¹ See below Part III(B)(2).

¹² Each Directive adopted on direct taxes is fairly limited in scope and deals with specified issue; see, eg, below Part II(C).

¹³ See above n 5.

¹⁴ For direct taxation, existing legislative instruments (Directives) are based on TFEU, above n 4, art 115, which requires the unanimous consensus of all Members (each represented by respective minister in the Council of the EU). The unanimity criterion on tax legislation is popularly known as veto power of each Member; see, eg, Michael J Graetz and Alvin C Warren, Jr, ‘Income Tax Discrimination and the Political and Economic Integration of Europe’ (2006) 115 *Yale Law Journal* 1190–1191 (stating that the Council cannot act on income tax issues without unanimous consensus as any Member can veto any proposal).

¹⁵ A commitment of Member States ‘to create an ever closer union among the people of the Europe’ was inserted in the preamble under the Maastricht Treaty ([1992] OJ C 224/1, 3), and continues to exist there in the current EU law.

¹⁶ Graetz and Warren, above n 14, 1190 (citing James A Caporaso, ‘The European Union and Forms of State: Westphalian, Regulatory or Post-Modern?’ (1996) 34 *Journal of Common Market Studies* 29).

¹⁷ For the constitutional plan on division of powers between EU and Members, see principle of conferral of competences (TEU, above n 4, arts 4, 5(1) (2)), general scope of exercising competences (TFEU, above n 4, art 2), EU exclusive competences (TFEU, above n 4, art 3), EU-Members shared competences (TFEU, above n 4, art 4), ensuring coordination (TFEU, above n 4, art 5), EU supporting actions (TFEU, above n 4, art 6), Protocol No. 25 (on exercise of shared competences, [2010] OJ C 83/1, 307); Declaration No. 18 annexed to the Treaty of

emergence of European tax power, the way it developed over time, and its possible expansion in prospect.

The remainder of the article is structured as follows. Part II provides insights into the implied character of EU powers to legislate direct tax measures in accordance with the constitutional scheme. It also offers a concise appraisal of existing EU legislation in the field of direct taxes. Part III analyses factors embedded in the EU legal system that have potential to impact Union-level actions in this policy area. It explores the way the three factors – (a) the implied character, (b) the general legal basis, and (c) the subsidiarity rule – could possibly impact EU tax legislation. Part IV offers a historical discourse, tracks the tax journey and overviews the way EU tax powers have evolved since the founding days to attain constitutional force. By reviewing developments since inception of the EU, it also examines the so-called *inertia* of direct tax legislation during the initial three decades alongside the sub-textual legislative power in tax matters that existed *submerged* in the constitution under the single market principles. It then examines the gradual emergence and growth of European powers in the area of direct taxes. This part also argues that the persistent growth in interstate trade and transnational economic activity attained over time through freedoms induce corresponding changes in the integrational status of the single market. Accordingly, EU tax competence, now gestating in the undergrowth of freedom clauses, attains new meanings with the passage of time and gradually keeps expanding. The article also briefly touches upon the most recent EU developments on tax practices that are detrimental to the single market – those that resulted in the widely publicised taxation of Apple in Ireland. Finally, Part V draws a brief conclusion.

II SOURCES OF EU POWERS TO LEGISLATE MEASURES FOR DIRECT TAX INTEGRATION

The EU law is silent on legislative powers relating to income tax policymaking, as that realm has generally been left to the Members. The EU-level legislative powers are derived indirectly from other sources embedded in the constitution. To trace an implicit seamless story of direct tax law, three constitutional commitments together serve as threads (prerequisites) to interweave as the broad contours of EU tax powers: (1) a constitutional obligation to constitute a single market¹⁸ in accordance with the freedom clauses;¹⁹ (2) a constitutional authority or legal basis to enact measures to remove disparities in national tax rules and integrate them to make them compatible with the

Lisbon (principles of de-conferral of shared competence, [2010] OJ C 83/1, 344–45), etc. On constitutional principles setting out the plan to govern the use of non-exclusive EU competences, see principles of subsidiarity and proportionality (TEU, above n 4, art 5(3), (4), and below Part III(C)).

¹⁸ On specific obligations assigned to the Union, see TEU, above n 4, art 3(3): ‘The Union shall establish an internal market’, and corresponding powers vested in the Union, in particular, under TFEU, above n 4, art 26: ‘1. The Union shall adopt measures with the aim of establishing or ensuring the functioning of the internal market, in accordance with the relevant provisions of the Treaties. 2. The internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaties.’

¹⁹ See above nn 6–7. *Freedom clauses* serve as prime vehicles to achieve the core objective of creating single market.

single market notion;²⁰ and (3) while adopting such measures, a requirement that Union action remain consistent with power allocation scheme and the regulatory clauses set out in the constitution.²¹ The result is that a potential EU action in taxation is bound to adhere to these constitutional contemplations. Of these three ingredients, the first two are the main sources of power allocation that respectively inherit legal authority for supranational EU actions. The third component does not itself confer competence, but is rather an overseeing and regulatory provision, as explained in Part III(C).

A The Powers Inherent in Single Market Principles

Since its inception in 1957 through the foundational treaty establishing the European Economic Community (EEC Treaty), the EU law has not expressly mentioned direct taxes. The only explicit reference – concerning Members’ obligation to eliminate double taxation –²² also no longer exists, since the Treaty of Lisbon came into force. Despite lack of any directions and absence of its explicit mention in the body of the primary law,²³ EU tax competence remained – and still remains – integral to the *multilayered* EU constitution.²⁴ The obligation to institute a single European market together with freedom clauses²⁵ creates room for an EU role in the field of direct taxes.

As long as national jurisdictions of Member States do not infringe the EU law in terms of having tax rules reasonably compatible with the freedom clauses and the single market notion, hypothetically, there would arise hardly any need to legislate EU-wide income tax rules. In practice, however, it is conceivable that several situations triggered by parallel exercise of multiple sovereign tax policies might inevitably end up in derogation to the freedom clauses. Then, where national tax measures intersect with the freedom clauses and infringe upon them, Union-wide measures might be necessary. Owing largely to the dual constraints posed to supranational tax legislation pointed out in Part I, such efforts have not, to date, translated into substantive legislation. In past, several legislative

²⁰ These provisions embody those tools which are destined to provide a precise (legal) base, and serve as a launching pad for legislative acts. Consequently, to initiate legislation in different areas, there are several constitutional platforms (bases); see, eg, below n 27.

²¹ A legislative action of the Union in the area of direct taxes, while fulfilling its obligations to institute a single market, is akin to intervention in a policy area that otherwise is generally a Members’ domain. This makes the division of powers equilibrium between Members and Union convoluted. In any case, the equilibrium has to be in compliance with subsidiarity and proportionality rules (see below Part III(C)) that govern the legislative acts on all areas of non-exclusive EU competences including direct taxes.

²² See EC Treaty, above n 4, art 293, second indent, [2006] OJ C 321 E/1, 173; for legal text, see below n 121.

²³ Primary law, in EU parlance, refers to governing treaties or the constitution, whereas secondary law refers to legislation enacted thereunder, such as Regulations, Directives, Decisions, etc.

²⁴ The expression *multilayered* highlights specific design of EU law that comprises a unique mix of national and international laws; see, eg, Michael Longo *Constitutionalising Europe: Processes and Practices* (Ashgate, 2006) 11 (observing that ‘The EU has been described as a multi-level governance; a postmodern polity; a confederation; a quasi-federal system featuring pre-federal institutions; a sui generis legal order’ and so on); see also above n 16 and accompanying text.

²⁵ For constitutional authority on freedom clauses, see above nn 6–7.

proposals in this policy area either could not take the form of a binding law or remain awaiting approval due to lack of unanimous consensus of Member States.²⁶

B An Implicit Legal Basis to Remove Disparities

The initiation of an EU-level action requires a legal basis. That legal platform serves as a constitutional vehicle to translate the intents (legislative agenda) into actions (enactments). The clause that serves as a potential legal platform from which to initiate an EU-level (tax) measure is a general constitutional provision akin to the constitutional powers vested in freedom clauses to intervene into national (tax) rules in case the latter violate the single market notion. Article 115 (TFEU) authorises the EU to integrate those national laws (including direct taxes) that are incidental to the establishment or functioning of the single market.

The authority crafted in this legal basis inherits multiple characteristics that would support the initiation of a measure to integrate Member policy areas (including taxes). First, it is a constitutional prerequisite to initiating a legislative act.²⁷ Second, it determines voting criteria to enact legislation – that is, whether majority or unanimity of Members is required – that in turn has its own implications.²⁸ Third, among multiple legislative forms (such as regulation, directive, or decision), the legal basis in question sets out to adopt a directive form to enact direct tax legislation.²⁹ A directive is a form of binding legislation that allows Members liberty to choose their own modes of transposition into national rules to achieve its objectives. In this way, the legal platform has affinities with the state–suprastate power-sharing formula envisioned under the EU legal system. Furthermore, on a case-to-case basis, the chosen legal tools may also be

²⁶ Some of the legislative initiatives pursuant to eliminating specified disparities and bringing integration in direct taxes ended successfully in adoption of Directives (see below Part II(C)); while others are either pending, eg, European Commission Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), COM(2011) 121/4 – 2011/0058 (CNS) (March 2011) (*Commission Proposal on CCCTB Directive*), or withdrawn (eg European Commission Proposals, below n 97).

²⁷ ‘Legal acts shall state the reasons on which they are based’ (TFEU, above n 4, art 296, para 2). On various legal bases for legislative actions in different policy sectors, see, eg, TFEU, above n 4, arts 14, 16, 18–21, 22–25, 33, 43, 46, 48, 50–53, 56, 59, 64, 65, 75, 77–79, 81, 82–89, 91, 95, 103, 109, 113–116, 118, 352 and so forth. A few legal bases are general in character and may serve to initiate legislation in multiple sectors; eg, TFEU, above n 4, art 115 (see below Part III(B)(1)) and art 352.

²⁸ The unanimity criterion or veto power held by each Member is widely considered as one of the leading factors impeding legislation on direct taxes; see, eg, Tracy A Kaye, ‘Direct Taxation in the European Union: From Maastricht to Lisbon’ (2012) 35 *Fordham International Law Journal* 1232 (observing that unlike various other sectors having a requirement of qualified majority legislative procedure, direct tax harmonisation proceeded slowly due to the need for unanimous legislative process).

²⁹ Legislative acts in the form of Regulation, Directive, and Decision are binding, and those in the form of Recommendation and Opinion are non-binding. While both Regulation and Decision are binding in their entirety, and therefore of direct effect, the former is generally applicable to all Members, unlike the latter, which applies to whom it specifies. In comparison, directive is a type of legislation applicable to whom addressed but lacks the horizontal direct effect (rights enforceable only against state and not private parties). The Members are free to choose form and modalities to integrate it into their national laws with an obligation to the effect that the results desired by it must be achieved (see TFEU, above n 4, art 288; on principle of direct effect, see above n 9).

indicative of the schema of other broader guidelines – relevant but scattered elsewhere in the EU constitution – on exercise of powers in the multilayered European law.³⁰

C Exercise of Implicit Powers Until Now

The EU has exercised very limited legislative powers in the area of direct taxes. The legislation adopted to date is limited to a few narrow and discrete measures focusing predominantly on qualifying corporate taxpayers. The legislative instruments tend to limit double taxation by targeting the tax consequences of itemised cross-border transactions of specified taxpayers. In addition to assistance and recovery measures,³¹ a few such instruments (directives) have been issued to date by the legislator (the Council of EU, where each Member State is represented by its respective Minister) on the recommendations of the executive organ (the European Commission).³² The legislation in force generally aims to abolish specified forms of double tax burdens likely to arise pursuant to divergent national tax systems in the internal market. A brief description of each directive follows.

*The Parent–Subsidiary Directive*³³ is meant to bring interstate and intrastate companies to parity by removing tax disadvantages to the former. The legislation mitigates economic double taxation between parent and subsidiary by stipulating that the Member State of a parent company should either exempt the dividend distribution or extend an indirect credit of tax payments by the subsidiary. The Directive prohibits the Member State of a subsidiary company compulsorily imposing withholding tax on the dividend to avoid juridical double taxation. The scope of this directive is dividend-specific and limited to related companies, and is further subject to a qualifying ‘minimum holding’ requirement.

The Mergers Directive,³⁴ at the time of merger, division, partial division or transfer of assets, prohibits the state of the transferring company to tax any built-in capital gain. The taxation of capital gain is not removed altogether; rather, it is deferred. If taxation of the gain were not deferred, the transferring Member State would tax the difference between the book value and current value at the time of transfer, and the new state of residence

³⁰ See, eg, *Council Directive 2010/24/EU concerning Mutual Assistance on Recovery of Claims relating to Taxes, Duties and Other Claims*, [2010] OJ L 84/1 (*Recovery Directive*) and *Council Directive 2011/16/EU on Administrative Cooperation in the Field of Taxation*, [2011] OJ L 64/1 (hereinafter *Cooperation Directive*). Both Directives in their preambles, place reliance on multiple legal bases as ‘having regard to the Treaty on the Functioning of European Union, and in particular Articles 113 and 115 thereof’. Insertion of an additional legal base (TFEU, above n 4, art 113) is factually indicative of conferring competence in addition to what is required for direct taxes, and hence render both these directives equally applicable to indirect taxes.

³¹ *Recovery Directive* and *Cooperation Directive*, *ibid.* The *Cooperation Directive* has undergone some key amendments in view of the ongoing European campaign against Base Erosion and Profit Shifting (BEPS); see, eg, amendments noted in below n 37.

³² The Council of EU (represented by relevant minister of each Member) together with the EU Parliament constitute the legislature of the Union.

³³ *Council Directive 90/435/EEC on Common System of Taxation Applicable in the Case of Parent Companies and Subsidiaries of Different Member States*, [1990] OJ L 225/6–9 (as amended from time to time) (here referred to as *Parent–Subsidiary Directive*).

³⁴ *Council Directive 90/434/EEC on Common System of Taxation Applicable to Mergers, Divisions, Transfers of Assets and Exchanges concerning Companies of Different Member States*, [1990] OJ L 225/1–5 (as amended from time to time) (here referred to as *Mergers Directive*).

would tax the difference between book value and sale value of assets. The deferral, to mitigate double taxation that might have happened pursuant to differences in timings of taxation, ensures that both Members tax at the same time when actual sale of assets takes place. The Directive also accommodates the possibility of transfers involving a third Member, providing that the state of transferring company either to forego its taxing right or while taxing the gain allow a credit for the taxes that the permanent establishment would have paid on these gains.

The *Interest and Royalty Directive*³⁵ makes it obligatory for the state of the paying company to refrain from charging withholding tax. The directive also resolves the problem of double taxation by prohibiting withholding tax on subsidiary companies and permanent establishments located in the source states. This is to eliminate issues of limitation of credit method that ordinarily stem from excessive tax deductions in source states relative to the actual tax bill of the given firms in residence states. The scope of the legislation is also limited in a manner similar to that of the Parent–Subsidiary Directive.

The Savings Directive:³⁶ This directive has recently been repealed.³⁷ As long as the legislation remained operative, it extended to taxation of interest income of individuals. Members, in their capacity of source country, would not, in general, impose withholding tax on interest income of individuals. Rather, the information would be passed on to the residence country for tax purposes. On transitional grounds, a few Member States were entitled to levy withholding tax on interest income; in those cases, the residence states were obliged to apply credit method to avoid double taxation. If the tax liability was less than the tax withheld at source, the residence states had to refund the excess to individual taxpayers. The legislation was limited to income from interest earnings.

The *Anti-Tax Avoidance Directive*³⁸ is the most recent addition to the EU tax legislation. It builds on some of the insights from the Base Erosion Profit Shifting (BEPS) project of the OECD and also serves as an interim measure towards a Common Consolidated Corporate Tax Base (CCCTB) system, since the directive also covers certain international aspects of anti-tax avoidance in the CCCTB draft.³⁹ The legislation limits the

³⁵ Council Directive 2003/49/EC on the Common System of Taxation Applicable to Interest and Royalty Payments Made between Associated Companies of Different Member States, [2003] OJ L 157/49–54 (as amended from time to time) (here referred to as *Interest-Royalty Directive*).

³⁶ Council Directive 2003/48, 2003 on Taxation of Savings Income in the Form of Interest Payments, [2003] OJ L 157/38–48 (*Savings Directive*). The Directive has been repealed; see below n 37.

³⁷ Savings Directive has been repealed on 10 November 2015 through a legislation adopted under Council Directive (EU) 2015/2060 [2015] OJ L 301/1–4. The repeal was consequential to another amendment brought in the Cooperation Directive, above n 29; for new addition to this directive, see amendment brought through Council Directive 2014/107/EU amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation; for this amendment, [2014] OJ L 359/1–29.

³⁸ Council Directive (EU) 2016/1164 laying down rules against avoidance practices that directly affect the functioning of the internal market, [2016] OJ L 193/1–14 (here referred to as *Anti-Tax Avoidance Directive*).

³⁹ The Commission has planned to re-launch the CCCTB proposal in phases. This phase-wise approach, *inter alia*, seeks to build in several ways on anti-tax avoidance measures foreseen under the BEPS guidelines; see, eg, *European Commission Communication: A Fair and Efficient Corporate Taxation in the European Union: 5 Key Areas for Action*, COM(2015) 301 Final (17 June 2015), available at <<https://ec.europa.eu/priorities/sites/beta-political/>

deductibility of interest for multinationals, provides a framework to tackle hybrid mismatches, sets out rules for exit taxation and controlled foreign companies, and lays down general anti-abuse rule to deny taxpayers the benefit of abusive tax arrangements.

III FACTORS AFFECTING LEGISLATIVE POWERS ON DIRECT TAXATION

Leaving aside the political dimension (the unanimity requirement), three constitutional factors could impact the EU powers to formulate income tax policy. The first is the primary source that provides legislative force to the Union actions in terms of a submerged mandate inherent in the single market principle and freedom clauses. The second is an authority vested in a non-tax-specific legal basis to intervene into those national (tax) provisions that impede the institution of single market. The third is a factor that otherwise does not confer the legislative competence in itself, but rather impacts legislation through its regulatory character. This last aspect oversees the justification and reasoning of an intended EU action, and restricts undue intervention in national (tax) systems through a constitutional framework under the principles of subsidiarity and proportionality, as explained in the final segment of this Part.

A Powers of Implicit Nature

The fact that it is buried in other powers (underneath the freedom clauses) only may limit the legislative competence on direct taxes. The powers to legislate are derived indirectly from the constitutional obligations to institute internal market. The implicit character might have at least two major implications for the policy area in question. First, an EU-level action in this area has to enter into the territory of the doctrine of derived powers. The restrictive designs generally adhering to the doctrine in extending powers from the principal framework to the derivative one are explicable.⁴⁰

Second, and more evident, is the fact that the idea of an internal market and its related principles, on which the income taxation powers mainly rely, are dynamic concepts – that is, ever-evolving since the founding days. For instance, the fundamental freedoms, the core elements constituting common market, had yet to unfold in the transitional period (12–15 years) envisioned by the EEC system when founded.⁴¹ Unless the transitional episode were over and, in theory, the objectives successfully attained, the derived powers conditional upon them (for example direct taxation) would have little meanings. Once the specified transitional period is over, the concept of the single market would attain real meaning, to the extent of realisation of the initial tasks, and so would the corresponding powers originating from it. Likewise, whenever new spheres of influence or policy areas were gradually added for EU-level actions, or the existing ones increasingly expanded

files/com_2015_302_en.pdf> (last accessed 18 June 2015); see also the accompanying document European Commission Staff Working Document: Corporate Income Taxation in the European Union, SWD(2015) 121 Final (17 June 2015).

⁴⁰ See, eg, Antonio Tizzano, 'The Powers of Community' in Antonio Tizzano (ed) *Thirty Years of Community Law* (Commission of the European Communities, 1981) 47 (referring to the complexities of application of the doctrine from judicial perspective).

⁴¹ See EEC Treaty, above n 4, art 8; the clause envisioned a period of 12–15 years for gradually establishing the common market in accordance with the scheme of (the then) given policy areas when founded in 1957.

through various treaty amendments,⁴² the status of the single market over time would reach an advanced stage. With the assigned objectives of integration gradually accomplished in the expanded policy sectors, the market unification would take a new turn, and so, too, the scope of the implicit derivative powers dependent on market integration.

Thus the changing dynamics of conferral of implicit power in the area of direct taxes – a key lawmaking area – is not compartmentalised in the text of the EU constitution. Instead, it remains implicit and has evolved without textual changes in the EU constitution. This implied power becomes comprehensible when traced as a common evolutionary thread running from past to present to future, as discussed in Part IV.

B Non-Specialised Legal Basis

As a vital tool of legislative apparatus, a general legal basis (as opposed to a specialised basis) may at first glance appear to be equipped with powers of a restrictive character that might limit a wide-ranging supranational action in this area. This section explains how a non-specialist general legal basis applied to an (implicit) income tax regime could substantially differ in outcomes, compared with a specialised one, such as an area-specific (explicit) legal basis meant for legislation in the VAT regime – a sister policy area.

(a) Legal Basis to Legislate in the Area of Direct Taxes

In the absence of express mention of direct taxes, how could one locate a legal basis for legislation in direct taxes? This aspect of the discussion – the evolution of EU tax powers – is discussed in Part IV of this article. This segment considers the legacy that might devolve from such a legal basis, if established – what the regime could possibly inherit, in terms of a mandate of prescriptions and proscriptions for tax legislation. The constitutional provision (Article 115 TFEU)⁴³ invoked to date as legal basis to legislate direct tax rules, set out in EU law reads as (emphasis added):

The Council shall, acting *unanimously* in accordance with a special legislative procedure and after consulting the European Parliament and Economic and Social Committee, issue *directives* for the *approximation* of such laws, regulations or administrative provisions of the Member States as *directly affect* the establishment or functioning of the internal market.

A legal analysis of the text reveals that the expression ‘unanimously’ refers to the requirement to have a unanimous consensus of all Members. The expression indeed manifests the political sensitivity of tax legislation in indicating that no Member wants a tax legislation to be adopted without its will. Undoubtedly, this is a serious impediment to European-level tax legislation. This study, however, does not focus on the politics of

⁴² On addition/expansion of areas of EU influence, see below nn 85–8.

⁴³ Since actual legislative measures taken in the field of direct taxes were mostly adopted before TFEU came into force under Lisbon Treaty, the legal bases of these legislative instruments have equivalents of TFEU, above n 4, art 115; that is, the (then) legal bases were: EEC Treaty, above n 4, art 100 for Parent–Subsidiary and Mergers Directives, above nn 33–34 and EC Treaty, above n 4, art 94 for Interest–Royalty and Savings Directives, above nn 35–36.

European taxation; rather, its key concern remains the legal and constitutional dimension of EU tax powers, as pointed out in the introductory part.

Besides that expression, at least three other expressions in the text, instrumental to an EU-level tax mandate, merit greater attention: ‘directives’, ‘approximation’, and ‘directly affect’. Of all the legislative forms that are binding in character, the ‘directives’ format may take precedence over others, given the sensitivity of national treasuries to EU tax measures. That is because directives require transposition into national statutes. Thus, directives can not only intervene in the national laws but, at the same time, also provide Members with a welcome breathing space in an area of heightened politics and sovereignty concerns. Other forms of legislation, such as Regulation or similar instruments, having a stronger impact (deeper national intervention), could better correspond to an area of extensive and explicit EU competence, but that is clearly not the case with the policy area in question.

‘Approximation’ (relative to the term ‘harmonisation’ used for indirect taxes), likewise inherits softer connotations of intervention in national (tax) powers.⁴⁴ The expression ‘directly affect’, in the same vein, underpins a restraint on intrusion into national (tax) rules and subjects an EU action to it if – and only if – Members’ (tax) rules ‘directly affect’ the internal market. This is unlike the case with legal bases to adopt legislation on indirect tax laws and other national laws of non-fiscal nature.⁴⁵ In both the latter situations, legal bases empowered to initiate integrative measures are not necessarily pre-conditioned as to whether a given (national) law ‘directly affects’ the internal market or otherwise.

To sum up, in exercising European supranational legislative powers, the in-built legal plan of (general) legal base is not sufficiently self-contained to impart greater or deeper force to EU-level actions on its own. It has empathy to house multiple traits for different policy areas, but it could be manifested only when the areas are spoken of in the EU law, which is not the case with direct taxes. No doubt the nature of a general legal platform may also not extend beyond the traditional dynamism, yet an action based on (implicit) platform relying, in turn, on implicit powers, seemingly adds to the convolution of the EU mandate to take actions in the area of direct taxes.

How a general legal basis (of direct tax legislation) inherits a different scope for potential Union actions relative to an explicit and specialised one as is in the case of VAT is illustrated in the following part.

(b) Comparison with Legal Basis Meant for Integration of VAT Law

Unlike direct taxes, right from the inception of European Community, indirect taxes were allocated an explicit segment in the European law, titled ‘Tax provisions’.⁴⁶ To harmonise indirect taxes, a specialised legal basis also existed from the beginning stating that ‘The Commission shall consider in what way the laws of the various Member States

⁴⁴ From the founding days (under the EEC Treaty) to date (under the Lisbon Treaty), the words ‘harmonisation’ and ‘approximation’ have been employed for, respectively, integration of indirect taxes and direct taxes; the former embedded a specialised legal basis while the latter imported a general legal basis. See further below n 53.

⁴⁵ For indirect taxes, see below Part III(B)(2); for other laws of non-fiscal nature, see TFEU, above n 4, art 114 (equivalent to EC Treaty, above n 4, art 95 and Maastricht EC Treaty, above n 4, art 100a).

⁴⁶ EEC Treaty, above n 4, arts 95–99.

concerning turnover taxes, excise duties and other indirect taxes... can be harmonised in the interests of the common market. The Commission shall submit proposals to the Council, which should decide by unanimous vote'.⁴⁷ A distinct chapter titled 'Tax provisions' was also devoted to indirect taxes under the subsequent versions of the European (then Community) law⁴⁸ and so it remains under the current EU law.⁴⁹

With this brief preface on the constitutional agenda of indirect taxes, the EU-level power to intrude deeper into national VAT codes and to take wider EU-level actions in the VAT regime is fairly comprehensible. The existing clause (Article 113 TFEU)⁵⁰ meant to serve as a legal basis to adopt VAT legislation, reads as (emphasis added):

The Council shall acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and Economic and Social Committee, adopt *provisions* for the *harmonisation* of legislation concerning *turnover taxes, excise duties and other forms of indirect taxation* to the extent that such *harmonisation* is necessary to ensure the establishment and functioning of internal market and to *avoid distortion of competition*.

The requirement of unanimous consensus of Members, similar to one for direct taxes, is a prerequisite to adopting legislative acts in the field of indirect taxes. Why unanimity hinders the adoption of European VAT law much less than it does for direct taxes, is not the issue at hand. However, it can fairly be attributed, in varying degree, to the political willingness of the Members and the competence and explicit character of powers laid down in the EU constitutional scheme right from the foundational times.⁵¹

In order to compare and analyse the legal bases on which to legislate two forms of taxation, at least four expressions emphasised in the above legal text are worth attention. First, the format of VAT legislation, contrary to direct taxes, is not confined to directives. The word 'provisions'⁵² gives the law-maker liberty to adopt legislation beyond a

⁴⁷ EEC Treaty, above n 4, art 99.

⁴⁸ Maastricht EC Treaty, above n 4, arts 95–99; EC Treaty, above n 4, arts 90–93.

⁴⁹ TFEU, above n 4, arts 110–113.

⁵⁰ TFEU, above n 4, art 113 replaced EC Treaty, above n 4, art 93; the latter in turn was preceded by EEC Treaty, above n 4, art 99. All these three provisions are substantially almost similar. The legal basis of main legislative measure taken for VAT (Old VAT Directive, above n 10) refers to dual legal basis by placing reliance on double legal provisions, ie, EEC Treaty, above n 4, arts 99–100. The instrument was subsequently replaced by the existing VAT law (Existing VAT Directive, above n 9) having a single legal basis, ie, EC Treaty, above n 4, art 93.

⁵¹ See, eg, above nn 45–48 and the accompanying text.

⁵² By virtue of the expression 'provisions' used in the legal foundation, TFEU, above n 4, art 296, para 1 (see above n 29) becomes applicable to it. Thus the scope of choice to use legal tools, unlike direct taxes, can no longer be restricted exclusively to Directives. Based on the content and depth required at the Union level (proportionality), an action can also be enforced in the form of a Regulation or Decision to intervene national VAT regimes. Notwithstanding that the current instrument of VAT law in force is a Directive (see, Existing VAT Directive, above n 10), the scope of its application and the level of integration of national (VAT) regimes achieved by it is unrivalled to similar tool(s) adopted for direct taxation; for brief discussion so far as relatively enhanced scope of EU actions in VAT is concerned, see also below nn 54–55; for direct tax Directives, see above Part II(C) At the same time, irrespective of the fact that current core legislation on Union VAT law in force is in the form

directive, using other forms such as Regulation or Decision. Second, the legal basis at hand considers ‘harmonisation’ of indirect taxes instead of ‘approximation’. The former seems to signify a relatively deeper penetration into national laws (enhanced integration) when viewed in the context of European constitutional scheme.⁵³ Third, it intensifies the integrative scope by assigning ‘harmonisation’ (over and above the single market objective to) an additional but explicit objective to ‘avoid distortion of competition’.⁵⁴ Likewise, when contemplating harmonisation initiatives as such, there is no legal obligation to pre-establish whether the national (VAT) laws ‘affect’ the internal market ‘directly’ (as is the pre-condition under Article 115 TFEU) or otherwise.

All these features, in aggregate, craft powers in such a way that supranational actions could permeate deeper into national VAT codes to institute a wider and deeper level of harmonisation at EU-level. As a result, contrary to direct taxation, the specialised and explicit legal basis for indirect tax laws ends up in (considerably) enhanced scope for Union-level VAT policymaking. This argument is also evidenced by the scale of the VAT legislation adopted to date.⁵⁵ The European Commission’s recent and prospective VAT

of a Directive, the authority conferred upon the legal basis for VAT to select and adopt other forms of legislative tools (Regulations, Decisions, etc) remains equally intact.

⁵³ According to McLure, above n 5, 379–80, ‘the term “harmonization” means different in the EU and the US (“Coordination” is the more common word used in the US)’. Citing Linda Senden *Soft Law in European Community Law* (Hart Publishing, 2004) 45–6, McLure identifies three related concepts used in the EU discussions of tax policy: harmonisation, approximation, and unification, and says that ‘harmonization – and thus by implication approximation – refers to integration processes that do not lead to the creation of uniform law, but rather to the creation of common frameworks or legal rules establishing a common goal, which leave room for divergent national specifications’.

My analysis differs slightly from this interpretation by making a fine distinction between ‘approximation’ and ‘harmonization’ on grounds set out in the peculiarity of two legal bases (EEC Treaty, above n 4, arts 99–100). Whereas EEC art 99 was applicable exclusively to turnover taxes, excise duties and other indirect taxes, EEC art 100 was not intended to be direct tax-specific. By scope, the latter, as a general legal basis, was extendable to all laws (and hence all powers) of Members directly affecting the common market. Both expressions essentially involve integration (intervention) of national laws (powers). The use of one expression covered a single, too explicit area (indirect taxes), while the second expression covered several implicit (as well as explicit) areas. Against this backdrop, ‘approximation’ relative to ‘harmonisation’ plausibly hints at a degree of *reluctance* in accessing national laws.

McLure’s observation about harmonisation meaning different things in the EC and the US seems justified when viewed in the wider US context where, unlike the EU, harmonisation and approximation are taken as one and the same. For instance, the US version in English translates the title of section 3 of the EEC Treaty as ‘Harmonisation of Laws’ (see, eg, *Treaty Establishing the European Economic Community* (October 1957) 51 *American Journal of International Law* 900), whereas the European English version translates the same title of the EEC Treaty as ‘Approximation of Laws’. Nevertheless, the use of word harmonization in a general sense to represent allied concepts may also not be misleading unless an EU legal context otherwise so requires.

⁵⁴ The additional objective codified in the legal foundation proportionally delegates enhanced scope to harmonise national VAT laws. To ‘avoid distortion of competition’ (in addition to the core single market objective), the clause also takes into account constitutional provisions laid down in chapter (titled) ‘Rules on competition’ (TFEU, above n 4, arts 101–109). This entrusts additional sanction to this base and assigns wider capacity to enact expansive legislative acts.

⁵⁵ Existing VAT Directive, above n 10; legislation to harmonize national VAT regimes under this Directive is an incomparably sweeping enactment compared to those on direct taxation

agenda is also indicative of this rationale. For instance, based on studies and consultations,⁵⁶ a draft legislation to adopt a common VAT return across the single market was on cards in the recent past.⁵⁷

C Subsidiarity and Proportionality

1 In General

The subsidiarity rule, a constitutional provision superimposed on the balance of powers, governs the exercise of legislative actions in all areas of non-exclusive EU competences. Since its introduction in the EU law under the Maastricht Treaty,⁵⁸ the provision has been the subject of considerable academic discourse, and a plethora of literature is available on it.⁵⁹ The distinctive clause, when added to the EU (the then Community) law, read as:

(above Part II(C)). The former sets out an EU-wide detailed VAT regime and also encompasses legal acts of second generation; eg, *Council Implementing Regulation 282/2011/EU laying down Implementation Measures for Directive 2006/112/EC on the Common System of Value Added Tax*, [2011] OJ L 77/1. Factually, the Implementing Regulation is 'second generation' tool (and a non-legislative delegated act in terms of TFEU, above n 4, art 291) of the legal basis meant for VAT law. EC Treaty, above n 4, art 93 (now TFEU, above n 4, art 113) created the (Existing VAT) Directive, above n 10 and then the (art 397 of the existing VAT) Directive created Implementing Regulation. The same is the case with a number of VAT Implementing Decisions addressed to various Members in pursuance to mandate derived from art 395 of Existing VAT Directive (eg *Council Implementing Decision 2013/54/EU to the Republic of Slovenia on Certain Measures concerning Existing VAT Directive*, [2013] OJ L 22/15).

⁵⁶ See, eg, *European Commission Specific Contract No. 9: Study on the Feasibility and Impact of Common EU Standard VAT Return*, TAXAUD/2011/DE/329 Final Report (February 2013), <http://ec.europa.eu/taxation_customs/common/publications/studies/index_en.htm> (last accessed 26 August 2015).

⁵⁷ *European Commission Proposal for a Council Directive to Amend Directive 2004/112/EC on the Common System of VAT as regards Standard VAT Return*, COM(2013) 721 Final (October 2013).

⁵⁸ Maastricht EC Treaty, above n 4, art 3b.

⁵⁹ On diverse views and interpretations on application of principles of subsidiarity and proportionality, see, eg, Ib Martin Jarvad, 'Subsidiarity and Autonomy' (1994) 19 *History of European Ideas* 797-803; Deborah Z Cass, 'The Word that Saves Maastricht? The Principle of Subsidiarity and the Division of Power within the European Community' (1992) 29 *Common Market Law Review* 1107; Koen Lenaerts, 'The Principle of Subsidiarity and the Environment in the European Union: Keeping the balance of Federalism' (1994) 17 *Fordham International Law Journal* 846; Grainne de Bruca *Reappearing Subsidiarity's Significance after Amsterdam* (Harvard Jean Monnet Working Paper No. 7 1999), available at <www.jeanmonnetprogram.org/archive/papers/99/990701.html> (last accessed 12 December 2016); Thomas Horsley, 'Subsidiarity and the European Court of Justice: Missing pieces in the Subsidiarity Jigsaw?' (2012) 50 *Journal of Common Market Studies* 267; Andrea Biondi, 'Subsidiarity in the Courtroom' in Andrea Biondi et al (eds) *EU Law after Lisbon* (Oxford University Press, 2012) 213; P J Devine (ed) *Competitiveness, Subsidiarity and Industrial Policy* (Routledge, 1996); G M M Gelauff et al (eds) *Subsidiarity and Economic Reform in Europe* (Springer, 2008); Aurelien Portuese, 'The Principle of Subsidiarity as a Principle of Economic Efficiency' (2011) 17 *Columbia Journal of European Law* 231; Paul Craig, 'Subsidiarity: A Political and Legal Analysis' (2012) 50 *Journal of Common Market Studies* 72; Gareth Davies, 'Subsidiarity: The wrong idea, in the wrong place, at the wrong time' (2006) 43 *Common Market Law Review* 63.

In areas which do not fall within its exclusive competence, the Community shall take action, in accordance with the principle of subsidiarity, only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community.

Any action by the Community shall not go beyond what is necessary to achieve the objectives of this Treaty.

Later, a protocol, and a declaration were added to the EU law to explain the procedure on application of the subsidiarity principle.⁶⁰ These provisions in substance, together with an amended protocol on their application, remain part of the current version of EU law adopted under the Treaty of Lisbon.⁶¹ As an exceptional constitutional tool, it governs the exercise of EU powers in areas of non-exclusive Union competences. The scope of the subsidiarity principle does not extend to the conferral of powers, but rather performs a regulatory function. The subsidiarity principle does not confer powers to the EU. It may, however, expand or confine supranational actions while the Union exercises its shared-powers – the powers that are inscribed elsewhere in the EU law.⁶² Every legislative act in related areas, including taxation, must therefore undergo the test set forth in this principle. A Union action must pass that test; the EU cannot take legislative action unless (1) the Members' action cannot sufficiently realise the objectives; (2) the Union can perform better in doing the same (3) by reason of scale or effects of the action; and (4) any intervention by the EU should strictly not exceed the limit of attaining objectives (proportionality principle).

2 In Taxation

The subsidiarity yardstick in the tax policy area may largely be applicable at the interface of law and economics rather than law and politics. The addition under the Amsterdam Treaty on how to apply subsidiarity sees it to be 'a dynamic concept'⁶³ applicable to the legislative process to achieve objectives laid down in the EU constitution. The principle encapsulates diverse notions: the economic dimension, in terms of a cost–benefit analysis is apparent from the text of the clause, since it invites an EU action when a similar action at the level of national governments is inefficient. Besides the economic dimension, subsidiarity has been termed 'first and foremost a political principle'.⁶⁴ Further, the

⁶⁰ Protocol and Declaration on subsidiarity was added through the Amsterdam Treaty, above n 4, [1997] OJ C 340/1, 105–107, 140.

⁶¹ See, TEU post-Lisbon, above n 4, art 5(3) (on principles of subsidiarity and proportionality), Protocol No. 2 (on the application of these principles) annexed to the Lisbon Treaty, [2010] OJ C 83/1, 206.

⁶² According to Portuese, above n 59, 233, 'this principle does not convey whether or not the EU has the power to act with regard to a specific policy'; on impacts of subsidiarity principle in relation to legislation, see also, European Commission Report: The Adaptation of Community Legislation to the Subsidiarity Principle, COM(93) 545 Final, 1 (September 1993) (*Commission Report*) (explaining that 'Its function is not to distribute powers ... The aim of the subsidiarity is, rather, to regulate the exercise of powers and justify their use').

⁶³ Protocol, above n 60, para 3; the provision also states: 'It allows Community action within the limits of its powers to be expanded where circumstances so require, and conversely, to be restricted or discontinued where it is no longer justified'.

⁶⁴ Commission Report, above n 62.

principle is denoted ‘a state of mind’⁶⁵ (political dimension) and ‘a sort of rule of reason’⁶⁶ (legal, political, economic dimensions).

The existence of a relatively scarce case law on subsidiarity is another remarkable feature; the provision has yet not undergone the process of extensive judicial review.⁶⁷ As a multidimensional concept, it is ‘one of the most debated, analysed, criticized, despised and, in few cases, loved concepts of EU law’ in the academic world.⁶⁸ The several aspects of the subsidiarity including its comprehensive discourse in relation to taxation are beyond the scope of this article. I do, however, briefly explore its regulatory interplay with the EU legislative powers in relation to direct taxes.

The argument that the subsidiarity rule takes lego-economic dimension to oversee a Union action in taxation takes its backing from the birth place of this rule within the EU law. When the policy area of environment was being added to the actionable spheres of the EU (then the Community) under the Single European Act (SEA),⁶⁹ subsidiarity (without being named) was embodied in the EU law for the first time, and was applicable exclusively to Union actions in the field of environment.⁷⁰ As within the newly assigned EU power (on environment) it was possible that certain supranational actions could encroach upon some Member States without their consent, by virtue of majoritarian voting,⁷¹ a subsidiarity check could, therefore, mitigate their concerns to a certain extent. The subsequent introduction of a subsidiarity calculus extendable to all non-exclusive EU powers under the Maastricht Treaty could also be a manifestation of similar national concerns about losing sovereignty by virtue of introducing majoritarian voting to various policy regimes in those times.⁷² If the subsidiarity check is there to cater for sovereignty fears raised by the ease of voting, the political dimensions of the rule are obvious.

Nevertheless, in the realm of taxation, the requirement of unanimous voting remains intact. That being the case, the lego-political role of the provision cannot be argued forcefully, since in the presence of unanimity rule for an EU legislation on direct taxes, national governments still retain the power to veto any supranational action deemed to be *unwarranted intrusion*. Against that backdrop, subsidiarity might rather seem to be a superfluous notion for taxation, if explained strictly in political terms. This is where the lego-economic character of this dynamic principle comes into picture. A legal rationale of subsidiarity that takes into account economic parameters better explains the application of this principle in matters concerning EU-level tax legislation. Further, application of

⁶⁵ Ibid, 2.

⁶⁶ Ibid.

⁶⁷ Craig, above n 59, 80 (observing that since the subsidiarity principle put in place under the Maastricht Treaty (see above n 58), there had been hardly ten substantial cases challenging the provision before the ECJ in almost 20 years).

⁶⁸ See Biondi, above n 59, 213.

⁶⁹ See amendments to the EEC Treaty through SEA, above n 4, arts 130r, 130s.

⁷⁰ SEA, above n 4, art 130r(5).

⁷¹ Some of the Community actions on environment could be contemplated by qualified majority voting; see SEA, above n 4, art 130s, para 2. This could leave room for an act that some (opposing minority) Members might be concerned of. The subsidiarity insertion, to an extent, could potentially address it.

⁷² Amendments under the SEA introduced the principle of qualified majority voting (in contrast to the unanimity principle) to several legal bases for EU actions in an array of policy areas; eg, SEA, above n 4, arts 28, 57(2), 70(1), 84(2), 100a, 100b, 118a, 130q(2) (in conj. with arts 130k, 130l, 130m, 130n, 130p), 130s, para 2.

subsidiarity rule in tax matters takes precedence at the intersection of law and economics over law and politics notion. The criteria set out under the subsidiarity clause would thus predominantly take into account arguments of economic efficiency and a cost–benefit analysis to assess measures such as those meant to reduce transnational spillover effects of tax policy or tax-induced distortions in the internal market.⁷³ To sum up, the overseeing effect of subsidiarity as to ‘expansion or restriction’ of an EU action in the area of direct taxes would be largely determined by economic efficiency rather than politics.

IV EVOLUTION OF IMPLIED COMPETENCE TO LEGISLATE IN THE FIELD OF DIRECT TAXES

Nothing in the legislative regimes of the EU constitution makes sense as clearly as in the light of evolutionary developments of power equilibrium. Supranational governance has evolved in the European jurisdiction, making it difficult to answer the question, who – whether Members or the Union – governs a particular policy area, because this changes over time.⁷⁴ In relation to direct taxation, it was argued in Part III(A) that the powers implicit in single-market principles are dynamic and mobile in nature. In fact, all the three factors that were considered as relevant to legislation are not in the least compartmentalised. Considering each factor in isolation as to its potential impact on legislative outcomes might convey some broader outlines, but not the fuller picture of their interaction in the legislative tale.

Tracing the evolutionary path of the growth and allocation of powers in general, and the interplay of factors affecting legislative framework for direct taxes in particular, appears the best way to frame the right perspective here. Further, the atypical role of the three EU organs – the executive (Commission), the judiciary (European Court of Justice), and the legislator (Council) – is also hardly comprehensible in the legislative processes except in the light of peculiar institutional interactions. Thus, to facilitate such an analysis, in what follows, I take an excursion of contextual developments behind the shifting balance of powers in the European legal system in the area of direct taxes.

A *The Foundational Phase*

The EEC Treaty, founded generally along the lines of an international organisation, ostensibly kept direct taxes away from the purview of supranational meddling, in particular, relative to tariffs and turnover tax regimes.⁷⁵ With no conscious policy agenda on its integration in the founding periods, the Treaty, *prima facie*, paid little attention to direct taxation in express terms. The one and only explicit mention of direct taxes found

⁷³ See, eg, Stephen Smith, ‘Subsidiarity’ and the Co-ordination of Indirect Taxes in the European Community’ (1993) 9 *Oxford Review of Economic Policy* 70, 92.

⁷⁴ Alec Stone Sweet and Wayne Sandholtz, ‘European integration and supranational governance’ (1997) 4 *Journal of European Public Policy* 297, 299 (observing, in the context of Community’s seats of policy making and competences to govern, that ‘within the same policy sector, the answer to the question, ‘who governs?’, has changed over time’); see also Shafi U Khan Niazi and Richard Krever, ‘Is integration of taxation possible in the EU?’ (2015) 30 *Australian Tax Forum* 457, note 11.

⁷⁵ Unlike direct taxes, abolition of customs duties between Members (EEC Treaty, above n 4, arts 12–17), and establishment of common customs tariff (EEC Treaty, above n 4, arts 18–29) were amongst the most explicit supranational competences. On similar powers to harmonize VAT and indirect taxes, see above Part III(B)(2).

its place in the last chapter (General and Final Provisions) of the Treaty.⁷⁶ Intuitively, this reference too, commensurate with the (then) status of the polity akin to an international organisation, was nothing more than a recommendation to the Members to explore channels under public international law to avoid double taxation.

During the 1960s when, based on the land mark ECJ rulings, the EEC Treaty was transforming into a constitution covering areas such as shaping its supremacy over national laws,⁷⁷ the indirect taxes, based on the explicit Treaty powers, also witnessed some pioneering legislation on harmonisation of national turnover taxes.⁷⁸ No analogous EU actions in the area of direct taxes were observed in those times, however. The difference between the two tax regimes could fairly be attributed (besides the political willingness of Members) to the absence of any specialised legal basis or any expressed supranational powers on direct taxes in the Treaty.

The only supranational legal clout that existed in the foundational periods could be traced to ‘buried objectives’ deep down in the EEC Treaty. The objectives, *inter alia*, stated that ‘the activities of the Community shall include ... the approximation of ... [Members’] laws to the extent necessary for the functioning of the Common Market’.⁷⁹ No doubt the objective did not exclusively target direct taxes; rather it encompassed a cohesion of all (national) laws in general, to the extent of their potential damaging effects to the common market. Direct taxation could, therefore, be considered as one of those (sub-textual) laws which the common market objectives (inherently) might intend to approximate in due course. Yet, several factors could substantially impede *deciphering* of tax power that otherwise existed submerged under the single market notion.

B Direct Taxation in the ‘Back Seat’?

At the time of the first major revision under the SEA, some of the amendments to the EEC Treaty also signify key underlying intents of the drafters towards potential EU powers (or lack thereof) in fiscal matters, particularly on direct taxes. The legal basis meant to enact directives in the policy area of direct taxes, which otherwise had general features to accommodate several sectors, was constrained to narrow down so as to become applicable to fewer areas including direct taxes.⁸⁰ This constraint was created

⁷⁶ EEC Treaty, above n 4, art 220, at 87 that was retained as EC Treaty, above n 22, art 293 (before being repealed under the Treaty of Lisbon).

⁷⁷ For example, *Costa v ENEL* (6/64) [1964] ECR 585 (assigning supremacy to the EU law over national laws). On the principle of direct effect that also lies at the core of the constitutionalisation process, see *Van Gend en Loos*, [1963] ECR 1, above n 9. On more details of principle of direct effect and some major doctrines of the initial phase, see De Witte above n 9. On judicial developments regarding ‘constitutionlaization’ of EU law, see, eg, J H H Weiler, ‘The Transformation of Europe’ (1991) 100 *Yale Law Journal* 2413.

⁷⁸ On explicit provisions concerning indirect taxes, see above n 46; on pioneering legislative acts on turnover taxes, see *First Council Directive 67/227/EEC on the Harmonization of Legislation of Member States concerning Turnover Taxes*, [1967] OJ 71/1301, and *Second Council Directive 67/228/EEC on the Harmonization of Legislation of Member States concerning Turnover Taxes*, [1967] OJ 71/1303.

⁷⁹ EEC Treaty, above n 4, art 3(h).

⁸⁰ Textually, the powers vested in existing general legal base (EEC Treaty, above n 4, art 100) and its application to all laws affecting common market remained intact. However, since insertion of a new legal basis (SEA, above n 4, art 100a), a number of areas would automatically prefer legislation through the new basis over the existing one. The preferential value of the new legal basis would rest in its voting ease as well as flexibility to

without bringing any textual change to the legal basis in question; but rather within the same part of the constitution (titled as approximation of laws), another legal basis was crafted and, in chronological order, placed immediately next to the (general legal) basis considered for direct taxes.⁸¹ The new legal base, also designed to be somewhat general in character to legislate the EU-level acts in multiple policy areas, operated differently from the pre-existing (general) legal base meant for approximation of (national) laws on direct taxes. Unlike the older clause that served as a potential legal basis for EU actions in an array of areas including direct taxes, the new legal basis was equipped with a 'legislative ease' (no unanimity requirement), and could also adopt multiple legislative forms (not confined to directives).⁸² Further, the new legal basis also did not lay down a pre-condition that an EU action could be taken only if a national policy 'directly affect[s] the internal market'. Thus, in the post-SEA era, intended EU actions in various policy areas would positively prefer to invoke the new legal basis, with its 'convenience plan', over the existing one. This indeed would render the old legal basis applicable only to those limited areas not covered by the new basis. For instance, the fiscal matters including taxation were debarred from the purview of the new basis,⁸³ and an EU-level action on direct taxes required (and still require) the use of already existing general legal bases. The new legal basis also excluded indirect taxes from its purview; however, (besides unanimity), it had little impact on indirect tax legislation, since this policy area already had a specialised legal basis of its own (Part III(B)(2)).

Another feature of the SEA-induced amendments in the EEC Treaty was that they prioritised certain policy areas including indirect taxes and set out a project for their time-bound integration so as to gradually establish a single market.⁸⁴ Direct taxes, covered under the general objective of approximation of laws, was certainly missing from this preferential time-bound sectoral integration plan. The changes inserted through the SEA were indicative of the progressive extensions of EU powers, indicating a *go-ahead scheme* for integration of various areas excluding direct taxes.

Does this imply that EU powers in the area of direct taxes from the EEC Treaty (1957) to the SEA (1986) were subject to inertia? With the foregoing analysis of the Treaty revision, and given the fact that the first ever substantive legislation on direct taxes had yet to materialise even after three decades, the response to this question could possibly be resoundingly in the affirmative. Nevertheless, a closer examination of the overall growth and expansion in EU powers in different policy sectors during the first three decades may shape a rather different response to this question. The picture becomes clearer if one takes into account the derivative nature of powers on direct taxes being

adapt any legal form that might not necessarily be a directive. Hence, after the SEA amendment, the practical use of the existing base would narrow down only to the fiscal matters which were excluded from the purview of the new base (SEA, above n 4, art 100a(2)).

⁸¹ The new legal base (SEA, above n 4, art 100a) was placed next to the pre-existing general legal base (EEC Treaty, art 100).

⁸² SEA, above n 4, art 100a(1).

⁸³ Ibid art 100a(2).

⁸⁴ Ibid art 8a (in conj. With ibid arts 8b, 8c, 100b) authorized the Community to take integrative measures to gradually establish internal market until 31 December 1992 in various sectors (covered under EEC Treaty, above n 4, arts 28, 57(2), 59, 70(1), 84, 99, and under SEA, above n 4, art 100a) including indirect taxes. Notably, direct taxation, covered under the existing general legal base, was missing from the list and therefore excluded from the time-bound integration plan.

‘nurtured’ within its principal framework, that is, in the undergrowth of freedom clauses and the common market – the market that certainly had grown and widely integrated much beyond its foundational status. By correlating the activities on direct taxation taking place at the Commission-level, the European executive organ responsible for initiating of legislative proposals, during the so-called period of inertia in direct taxes may capture a fuller and bigger picture of developments taking place in the European tax landscape.

C Sub-Textual Growth and Emergence of Tax Powers

An incontrovertible assumption about several EU powers is that, to varying degrees, they originate from or, are impacted by, the schema of the common market crafted as a core objective in the constitution. As the market agenda can hardly be precluded from a wide range of policy sectors, several market essentials (powers) could be added to the menu of the market agenda.⁸⁵ It is also plausible that when EU was founded as an international polity in 1957, neither all such ‘menu items’ in the garb of market-based European powers were explicit, nor were they designed to be readily enforceable in one go. At one point in time (EEC Treaty 1957), a few items of the ‘menu’ were active,⁸⁶ while others (were semi-active or dormant and) gradually ‘queuing’ in the undergrowth of imperatives to establish a common market. At another point (SEA 1986), some of those powers ‘due-in-queue’ were added to the ‘activation list’,⁸⁷ leaving behind another ‘updated list-in-waiting’ to be activated later at a certain optimal stage (Maastricht Treaty 1992),⁸⁸ and so forth. Against that backdrop, EU powers to legislate measures in almost all policy areas, in theory, had inevitably to remain ‘mobile’ in the quest of achieving a common market.

⁸⁵ This is what practically transpired if one takes an overview from the EEC to the pre-Lisbon times; Davies, above n 59, 1 (noting that ‘the scope of the Community activity is now so broad that few if any areas of national policy are immune from its effects’).

⁸⁶ See, eg, free movement of goods (EEC Treaty, above n 4, arts 9–11), elimination of customs duties between Members (EEC Treaty, above n 4, arts 12–17), setting up of common customs tariffs (EEC Treaty, above n 4, arts 18–29), elimination of quantitative restrictions between Members (EEC Treaty, above n 4, arts 30–37).

⁸⁷ See, eg, extension in supranational influence to new policy areas in EEC Treaty through amendments under the SEA, above n 4, arts 102a(2) (in conj. with 236), 118a, 130a–130e, 130r, 130s (respectively, on economic and monetary policy, laying down criteria for national laws on health and safety of workers, on roles in regional development and economic and social cohesion, on research and technological development, and on environment). Likewise, harmonisation of turnover taxes, excise duties and other indirect taxes still required unanimity (no change in EEC Treaty, above n 4, art 99). A newly added general legal basis (SEA, above n 4, art 100a) covering a number of policy sectors inserted through these amendments did not require unanimity to integrate national laws; however, fiscal matters (including direct taxation) were excluded from its purview (SEA, above n 4, art 100a(2)). Some of the newly added legal bases however, required unanimity; eg, ESA, above n 4, arts 130q(1) (in conj. with 130i, 130o), 130s, para1.

⁸⁸ See, eg, Maastricht EC Treaty, above n 4, arts 2, 3, 3a. Some of the explicitly added/amended new tasks included common commercial policy, common policies in the spheres of agriculture, fisheries, transport, environment, energy and tourism; measures on movement of persons, avoidance of distortive competition, and strengthening of economic and social cohesion in the internal market (Maastricht EC Treaty, above n 4, art 3); measures leading to the introduction of single currency (Maastricht EC Treaty, above n 4, art 3a), etc. See also Commission Report, above n 62 (reporting that pursuant to the amendments under the Maastricht Treaty, as many as twenty or so activities became open to the supranational actions).

Indeed, this was precisely also the case with EU constitutional powers on direct taxes that factually never suffered from inertia. It was – and to an extent still is – a matter of academic and legal argument to pinpoint where direct taxation could most likely be located in the ‘active, semi-active or awaiting’ items (powers) on the agenda menu (common market).⁸⁹ What follows below is a brief narrative of some of the developments (at the Commission-level)⁹⁰ during the first three decades when, *prima facie*, there had been a widespread vacuum (of EU powers) in terms of non-adoption of legislation on direct taxes.⁹¹

1 *The Initial Period*

Shortly after the EEC Treaty came into force, the Commission appointed a committee to study issues concerning tax harmonisation in the common market.⁹² The report of this committee identified several problems in the field of direct taxes, such as disparities in company tax base and tax rates, withholding tax on dividends, and double taxation.⁹³ The next study conducted by the Commission appeared in 1970; it largely focused on the

⁸⁹ Certainly, the market-led power mobility alone may not necessarily be the ultimate factor in determining sequence of the so called *due-in-queue* or *list-in-waiting* considerations. One cannot ignore political factors (and also whether a given legislation needs majoritarian or unanimous voting) that essentially – to varying degrees in various sectors – have their say in surrendering or retention of national powers. For instance, on question as regards Union powers to legislate in tax policy area, Members’ concerns over potential loss of (taxing) powers and (fiscal) autonomy can fairly be considered as one of the major factors impacting it. The evolution of competence dynamics in the Community law and the political dimension of Members, however, may not be mutually exclusive; in their interplay, both factors inevitably might also, to varying degrees in different sectors, push and impact each other. Since this article, as mentioned in the start, seeks to investigate only competence constraint on EU-level tax policymaking, the political dimension (veto) has thus largely been ignored while analyzing the so called list-in-waiting notion and alike.

The foregoing argument and the analysis to follow in next segment (Part IV(D)) draws upon on and builds on the neo-functionalist theory of European integration developed by Ernst B Hass, *The Uniting of Europe: Political, Economic and Social Forces, 1950–1957* (Stanford University Press, 1958), and then updated, in particular, by Wayne Sandholtz and Alec Stone Sweet *Neofunctionalism and Supranational Governance* (unabridged version) SelectedWorks of Alec Stone Sweet (Yale University, 2012), available at <http://works.bepress.com/alec_stone_sweet/38/> (last accessed 26 August 2015). The major difference is that instead of covering general processes of European integration as theorised by neo-functional model, this article briefly touches upon the policy spillover confined largely to direct tax domain within the framework of European constitutional construct.

⁹⁰ The European Commission, the executive organ of the EU, is responsible for moving draft legislative proposals To the Council for adoption. The role of the Commission is thus extremely important in the legislative history of the EU.

⁹¹ *Council Directive 77/799/EEC concerning Mutual Assistance by the Competent Authorities of the Member States in the Field of Direct Taxation*, [1977] OJ L 336/15–20, which features procedural aspects of administrative and assistance matters is not being considered here as a substantive legislative tool of tax integration.

⁹² Report of the Fiscal and Financial Committee (Neumark Report) *The EEC Reports on Tax Harmonization* (an unofficial translation into English language, by Hugh Thurston, International Bureau of Fiscal Documentation, 1963).

⁹³ *Ibid* 134–38, 141–45.

possibility to mitigate economic double taxation in the single market.⁹⁴ The studies undertaken by the Commission contributed to the initial legislative proposals in the field of direct taxes. In fact, the 1970s witnessed the highest-ever legislative proposals on direct taxes submitted by the European Commission to seek consent of the legislator (the Council of EU).⁹⁵

Most of these legislative proposals were aborted in due course.⁹⁶ The failure to adopt tax legislation at that stage could be fairly attributed to the dual constraints noted in Part I, that is, a lack of political will together with controversies surrounding EU powers on tax legislation. In 1975, for example, the Commission submitted a proposal to adopt a directive on harmonisation of corporate tax systems and withholding taxes.⁹⁷ The draft proposed an EU-wide single corporate tax rate (45–55 per cent), a partial imputation credit system with a single rate of tax credit on distributed dividends, and 25 per cent withholding tax rate on dividends (except for parent–subsidiary) in the common market. The proposal met strong opposition from Members in the Council (a political dimension).⁹⁸ For the Council, a complete tax harmonisation could not be attained in absence of an integrated tax base⁹⁹ (a connotation that the proposal was disproportionate to tax powers). The proposed legislation thus could not seek approval of the legislator and was finally withdrawn by the Commission in 1990.¹⁰⁰

Another piece of draft legislation, proposed by the Commission in 1976¹⁰¹ to adopt a directive on arbitration convention for elimination of double taxation between associated enterprises, met a similar fate and failed. This proposal remained pending with the

⁹⁴ A J Van den Tempel *Studies: Corporation Tax and Individual Income Tax in the European Communities*, Competition: Approximation of Legislation Series No. 15 (Commission of the European Communities, 1970).

⁹⁵ During the 1970s, at least six legislative proposals from the Commission seeking adoption as Directives on direct taxation remained pending with the Council; on four of them, see below n 97.

⁹⁶ See, eg, European Commission Proposals for Council Directives: (1) concerning the Harmonization of Systems of Company Taxation and Withholding Taxes on Dividends, COM(75) 392 Final (July 1975); (2) on the Elimination of Double Taxation in Connection with the Adjustment of Transfers of Profits between Associated Enterprises, COM(76) 611 Final (November 1976); (3) on the Application to Collective Investment Institutions of the Council Directive concerning the Harmonization of Systems of Company Taxation and of Withholding Taxes of Dividends, COM(78) 340 Final (July 1978); (4) concerning the Harmonization of Income Taxation Provisions with Respect to Freedom of Movement for Workers within the Community, COM(79) 737 Final (December 1979); (5) on the Harmonization of the Laws of the Member States relating to Tax Arrangements for the Carry-Over of Losses of Undertakings, COM(84) 404 Final (as amended through COM(85) 319 Final) (September 1984); (6) concerning Arrangements for the Taking into Account by Enterprises of the Losses of their Permanent Establishments and Subsidiaries Situated in Other Member States, COM(90) 595 Final (January 1991) (respectively *Commission Proposal (1), (2), (3), (4), (5), (6)*).

⁹⁷ Commission Proposal (1).

⁹⁸ J E Brinkman and A O Riecker, 'European Community Taxation: The Ruding Committee Report Gives Harmonization Efforts a New Impetus' (1993) *The International Lawyer* 1061, 1065.

⁹⁹ George Kopits, 'Overview' in George Kopits (ed) *IMF Occasional Paper No. 94: Tax Harmonization in the European Community: Policy Issues and Analysis* (IMF, 1992) 11.

¹⁰⁰ European Commission Communication: Guidelines on Company Taxation, at 10, SEC (90) 601 Final (April 1990).

¹⁰¹ Commission Proposal (2), above n 97 ([1976] OJ C 301/4).

legislator for several years. The Members, sensitive to potential loss of taxing powers and fiscal sovereignty, were reluctant to adopt that legislation. Alongside fiscal concerns, absence of spoken EU tax powers would further add to the controversies in the minds of legislators. To replace this proposed legislation, the Members agreed to institute an arbitration convention to resolve double tax disputes under public international law, outside the EU constitution. While concluding the arbitration convention, the Members took shelter under an advisory provision (now repealed) of the EU constitution.¹⁰² The Commission in the end had to withdraw its proposed legislation in 1996 – twenty years after its pendency before the Council.¹⁰³

The synopsis of legislative endeavours presented above indicates the evolutionary developments of a direct tax regime with the hindsight of three decades of prolonged stagnation. It also suggests that the EU tax power was indeed seeking its locus in the progressively growing European agenda (common market). Instead of passing through legislative inertia, this tale is indicative of the propensity of direct tax measures to ‘search a legal space’ within the ever-evolving and mobile EU powers. It was finally in 1990, when, without any textual amendment in the constitution, European power on direct taxes secured a limited but substantive legal space. That is, a couple of long-awaited legislative proposals sought the approval of the law-maker, resulting in adoption of a narrow but substantive legislation in the field of direct taxes.¹⁰⁴

2 *The Second Period*

In 1992, alongside a shift in constitutional paradigms under the Maastricht Treaty, in the form of new EU powers and the subsidiarity notion,¹⁰⁵ the Commission, a few months from adoption of the pioneering legislation on direct taxes, appointed a high-profile committee to look into the tax-induced distortions in the internal market.¹⁰⁶ The recommendations of the committee (the Ruding Report) appeared in 1992. They included: elimination of double taxation in several forms; a uniform withholding tax rate of 30 percent on dividends, subject to waiver on appropriate tax identification; concerted action by the Commission and Members defining common policy on double tax agreements; a uniform tax base; and a minimum corporate tax rate of 30 percent to plug the harmful effects of the ‘race to the bottom’ approach.¹⁰⁷

¹⁰² The Members, pursuant to EEC Treaty, above n 4, art 220 (predecessor to EC Treaty, above n 22, art 293 before being repealed under the Lisbon Treaty) entered into an Arbitration Convention (90/436/EEC), [1990] OJ L 225/10–24) under the international diplomatic law. The act was also indicative of Members to proceed autonomously (potentially) in disregard to the pending supranational legislation for want of the latter’s authority in the given policy area.

¹⁰³ See [1997] OJ C 2/6.

¹⁰⁴ Parent–Subsidiary and Mergers Directives, above nn 33–34. The Commission proposals on these directives were transmitted to the Council on 16 January 1969 ([1969] OJ C 39/1–2).

¹⁰⁵ Deliberations by the Heads of Member States (Edinburgh Summit, 11–12 December 1992) on the new constitutional plan, and inauguration of subsidiarity rule in the early 1990s; see above n 58 and accompanying text. On additional information regarding extension of competences, see above n 89.

¹⁰⁶ The Committee with Onno Ruding, the Dutch Finance Minister, in chair was appointed by the European Commission as of 25 October 1990 to examine company taxation; Ruding, below n 107, 7.

¹⁰⁷ Onno Ruding *Conclusions and Recommendations of the Committee of Independent Experts on Company Taxation* (European Commission’s Working Document, 1992) 27–40. For views on

While most of these recommendations were widely seen as over-ambitious in political terms,¹⁰⁸ a new impetus to the activities of the Commission in tax policy was nevertheless noticeable in the 1990s. For instance, in an attempt to cleanse the legislative agenda, some of the archaic pending proposals that in due course had lost relevance were withdrawn by the Commission.¹⁰⁹ There was also a visible intensity in the European Commission as it issued recommendations and communications.¹¹⁰ These measures – generally known as a ‘soft law’ approach in EU parlance – are meant to ‘sensitise and orientate’ the Member States towards adopting a harmonious approach before adopting a ‘hard law’ approach that is binding in character. These European approaches resulted into adoption of soft law against harmful tax competition at an informal meeting of the ministers of the Economic and Financial Affairs Council (ECOFIN).¹¹¹ This pioneering soft law in the field of direct taxes, known as Code of Conduct for Business Taxation, exists to this day and is widely considered an influential tool against several harmful tax practices in the common market.¹¹² The momentum generated by the ECOFIN interactions also led the European Commission to revisit the two pending legislative proposals which were later adopted in 2003 as binding law in the form of directives.¹¹³ These were times when fresh plans found

this report, see, eg, Franz Vanistendael, ‘The Ruding Committee Report: A Personal View’ (1992) 13 *Fiscal Studies* 85.

¹⁰⁸ See, eg, KPMG *The KPMG Guide to CCCTB* (KPMG, 2011) 8, available at <www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Documents/ccctb-part1.pdf> (last accessed 24 February 2015).

¹⁰⁹ The proposed Arbitration Convention was withdrawn as it had lost much of the relevance (see above n 103 and accompanying text); the pending legislation such as Commission Proposal (5), above n 97 was withdrawn ([1997] OJ C 2/6). Other withdrawals of 1990s (respectively on 13 April 1993 and 9 September 1992) included Commission Proposals (3), (4), above n 97.

¹¹⁰ See, eg, European Commission Recommendations: (1) 94/79/EC on the Taxation of Certain Items of Income Received by Non-Resident in a Member State Other Than That in which They Are Resident, [1994] OJ L 39/22–28; and (2) 94/390/EC on Taxation of Small and Medium Sized Enterprises, [1994] OJ L 177/1–19; European Commission Communication: The Improvement of the Fiscal Environment of Small and Medium Sized Enterprises, COM(94) 206 Final (May 1994).

¹¹¹ See European Commission Report: Taxation in the European Union – The Development of Tax Systems, COM(96) 546 Final (October 1996). This report presented to the ECOFIN reveals that the Commission initiated an informal discussion with the ECOFIN Ministers in meeting at Verona on 13 April 1996 regarding challenges such as stability of fiscal system and realisation of the single market. The ECOFIN appointed a Group to consider the issues. The Group met four times to examine some of the core issues of tax policy and obtained views of the stakeholders and experts. The Committee on Economic and Monetary Affairs & Industrial Policy of the EU Parliament was also taken into confidence on the developments. See also European Commission Communication: A Package to Tackle Harmful Tax Competition in the European Union, COM(97) 564 Final (November 1997). This document was submitted pursuant to meeting with the ECOFIN in Mandorf-les-Bains on 13 September 1997.

¹¹² Consequent to developments at the meeting and the European Commission Communication, *ibid*, the ECOFIN met again on 1 December 1997 and adopted a Code of Conduct for Business Taxation to tackle the harmful tax competition among Member States, [1998] OJ C 2/2.

¹¹³ The ECOFIN meeting, *ibid* (of 1 December 1997) also approved text of draft Savings Directive and led the Commission to resubmit its draft proposal on Interest-Royalty Directive, above n 35. Accordingly, a proposal for the latter was submitted to the Council (European Commission Proposal for a Council Directive on a Common System of Taxation Applicable to Interest and Royalty Payments Made between Associated Companies of different Member States, COM(98) 67 Final (March 1998)). The other proposal on Savings

a place in the European tax agenda. These included an introduction of the CCCTB and a vigorous pursuit of removal of double taxation in the single market.¹¹⁴

3 *The Recent Period*

As noted above, the EU, owing to the ‘slow but consistent emergence’ of constitutional powers in the area of direct taxes, entered the twenty-first century with an updated tax agenda – an agenda that hinted towards some of the ‘proto-federal’ character of tax powers. For instance, the Commission’s policy initiative to have a CCCTB for internal market was launched in 2001.¹¹⁵ A decade down the road in 2011, the Commission submitted a formal draft legislation to the Council for adoption of CCCTB rules.¹¹⁶ The proposal includes an EU-wide single set of tax rules for computing, consolidating and sharing the tax bases under the CCCTB for the group of companies opting for it. No doubt the CCCTB proposal has since moved at a glacial pace for want of unanimous consensus. However, the draft CCCTB legislation remains at the top tax agenda and the Commission has recently announced to relaunch a more pragmatic version of the draft towards the end of 2016.¹¹⁷ The anti-tax avoidance drive that has taken an unprecedented momentum in 2016 indeed serves as phase one of the EU plan towards CCCTB legislation.¹¹⁸

In 2011, the European Commission also focused on the bilateral tax treaties network existing between the Member States, highlighting the inadequacy of classical tax treaty regime in abolishing challenges posed by double tax burdens to the free flow of labour and capital in the single market. The Commission held an extensive EU-wide consultation with individuals, professional bodies and businesses on factual cases of double

Directive, after deliberation by the Parliament and then again by the ECOFIN in its meeting of 26–27 November 2000, was resubmitted to the Council (European Commission Proposal for a Council Directive to Ensure Effective Taxation of Savings Income in the Form of Interest Payments within the Community, COM(2001) 400 Final–2001/0164 (CNS) (July 2001). Finally, both legislation were adopted through Interest-Royalty and Savings Directives, above nn 35–36.

¹¹⁴ See, eg, European Commission Communication: Tax Policy for the European Union – Priorities for the Years Ahead, COM(2001) 260 Final (May 2001); European Commission Communication: Towards an Internal Market without Tax Obstacles – A Strategy for Providing Companies with a Consolidated Corporate Tax Base for Their EU-Wide Activities, COM(2001) 582 Final (October 2001); on related work, see also European Commission Staff Working Paper: Company Taxation in the Internal Market, SEC(2001) 1681 Final (October 2001). Having regard to the Commission’s initiatives, the EU Parliament also adopted a resolution (Mar. 14, 2002) affirming the priority agenda ahead on tax policy (European Parliament Resolution on the European Commission Communication on Tax Policy in the European Union COM(2001)260, [2003] OJ C 47/E/591–594).

¹¹⁵ European Commission Communication: An Internal Market without Company Tax Obstacles: Achievements, /Ongoing Initiatives and Remaining Challenges, COM(2003) 726 Final (November 2003). On the CCCTB initiative, meetings and documents of its Working Group, see <http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/index_en.htm> (last accessed 26 August 2015).

¹¹⁶ Commission Proposal on CCCTB Directive, above n 26.

¹¹⁷ European Commission press release IP/15/5188: Commission presents Action Plan for Fair and Efficient Corporate Taxation in the EU (17 June 2015), available <http://europa.eu/rapid/press-release_IP-15-5188_en.htm> (last accessed 18 June 2015); see also Commission documents cited in above n 39.

¹¹⁸ On anti-tax avoidance measures, see, eg, above n 38, and accompanying text; see also below n124.

taxation.¹¹⁹ The EU model tax convention or some other multilateral tax treaty apparatus in the single market has long been an area of interest for several European tax law experts.¹²⁰ This is because the supranational governance in the EU has attained a structure akin to a ‘federal-like’ polity. On the contrary, however, the classical bilateral treaty network between the Members, based largely on the OECD Model Tax Convention, does not go beyond traditional *bilateral-market-solutions*, and that too, in limited spheres between two sovereign nations concluded under the public international law. Thus the Commission’s focus on ridding the single market of double tax burdens through some kind of European apparatus beyond the traditional bilateral treaty regime seems consistent with the mobility of EU powers. Furthermore, pursuant to the demise of article 293 of EC Treaty, which urged Members to search for fixes to double taxation problems outside the EU law, one cannot rule out prospects of ‘new European tax powers’ against excessive taxation in the single market.¹²¹ Since the Lisbon Treaty came into effect in 2009, there has been an ongoing debate on a shift in EU tax powers because article 293 of EC Treaty – meant for bilateral negotiation to abolish double taxation – has been repealed.¹²² The Commission’s consultation on how to abolish double taxation in recent years is a fair indication as to a starting point towards prospective EU policy initiatives against double tax burdens in accordance with the expanding legal room in the European constitution.

A more recent focus of the EU on measures concerning anti-Base Erosion and Profit Shifting in the single market has witnessed unprecedented activity surrounding tax legislation. A series of legislative measures, including the adoption of an anti-tax avoidance directive¹²³ together with several other measures amending pre-existing tax directives,¹²⁴ indeed underpin that growth in unspoken European legislative powers, which have gained remarkable momentum in their journey along the evolutionary path.

¹¹⁹ European Commission Communication: Double Taxation in the Single Market, COM(2011) 712 Final (November 2011); see also Directorate-General for Taxation and Customs Union, ‘Commission’s Consultation on Double Taxation Conventions and the Internal Market: Factual Examples of Double Taxation Cases’ (January 2011), available at <http://ec.europa.eu/taxation_customs/common/consultations/tax/2010_04_doubletax_en.htm> (last accessed 26 August 2015).

¹²⁰ See, eg, Pasquale Pistone, *The Impact of Community Law on Tax Treaties – Issues and Solutions* (Kluwer Publishers, 2002); Eric Kemmeren, *Principle of Origin in Tax Conventions: A Rethinking of Models* (Tilburg University PhD Dissertation, 2001).

¹²¹ Above n 22 (EC Treaty above n 4, art 293, second indent: ‘Member States shall, so far as is necessary, enter into negotiations with each other with a view to securing for the benefit of their nationals: ... the abolition of double taxation within the Community’).

¹²² See, eg, Shafi U Khan Niazi and Richard Krever, ‘*Romance and Divorce* between International Law and EU law: Implications for European Competence on Direct Taxes’ (forthcoming) 53 *Stanford Journal of International Law* (arguing that the international law paradigm gradually *alienates* from the EU law and that, in turn, boosts constitutional powers to enact EU-level tax policy); Eric Kemmeren, ‘After repeal of Article 293 EC Treaty under the Lisbon Treaty: the EU objective of eliminating double taxation can be applied more widely’ (2008) 17 *EC Tax Review* 156; Khan Niazi and Krever, above n 74, 462–70.

¹²³ For Anti-Tax Avoidance Directive, see above n 38 and accompanying text.

¹²⁴ On some of the amendments/draft amendments in the pre-existing tax directives that have nexus with anti-BEPS measures, see, eg, (1): *Council Directive 2014/86/EU, amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States*, [2014] OJ L 219/40–41; (2) *Council Directive (EU) 2015/2376 amending Directive 2011/16/EU as regards mandatory automatic*

To that end, besides tax legislation at the Council-level, some of the measures initiated by the Commission against abusive tax practices and national tax subsidies are also unparalleled in EU tax history. There is, for example, no earlier precedent in the EU of recent actions against national tax rulings that in view of the Commission amount to illegal tax subsidies extended by Members to certain multinationals. The application of the EU state aid regime to national tax measures, which has resulted in rulings on recovery of huge tax amounts from Apple, Starbucks, and Fiat Finance and Trade,¹²⁵ is already making headlines in the international tax arena. Also, the Commission's scrutiny in other cases of similar character including McDonalds, Amazon and others is ongoing.¹²⁶ While the executive rulings in this 'new-found-land' have yet to undergo judicial review,¹²⁷ this activity nevertheless points to an opening of new doors to ever-evolving EU tax powers.

D Enhanced Referrals to the ECJ

The landscape of EU tax powers remains incomplete without looking into the judicial version on the competence allocation in this policy area. One significant aspect of the judicial context is a remarkable rise in the frequency of ECJ rulings caused by increased tax litigation in recent decades. The Court rulings in direct tax regime have been increasing since the late 1980s and became intensive in the subsequent periods.¹²⁸

exchange of information in the field of taxation, [2015] OJ L 332/1–10; (3) European Commission Proposal for a Directive of the Parliament and the Council amending Directive 2013/34/EU as regards disclosure of income tax information by certain undertakings and branches, COM(2016) 198/2, 2016/0107 (COD) (2016), <http://ec.europa.eu/finance/company-reporting/docs/country-by-country-reporting/160412-proposal_en.pdf> (last accessed 12 April 2016).

¹²⁵ European Commission press release IP/16/2923: State aid: Ireland gave illegal benefits to Apple worth € 13 billion (30 August 2016), available at <http://europa.eu/rapid/press-release_IP-16-2923_en.htm> (last accessed 30 August 2016); European Commission press release IP/15/5880: Commission decides selective advantages for Fiat in Luxembourg and Starbucks in the Netherlands are illegal under EU State aid rules (21 October 2015), available at <http://europa.eu/rapid/press-release_IP-15-5880_en.htm> (last accessed 30 August 2016).

¹²⁶ See, eg, European Commission press release IP/15/6221: State aid: Commission opens formal investigation into Luxembourg's tax treatment of McDonalds (3 December 2015), available at <http://europa.eu/rapid/press-release_IP-15-6221_en.htm> (last accessed 30 August 2016); European Commission press release IP/14/1105: State aid: Commission investigates transfer pricing arrangements on corporate taxation of Amazon in Luxembourg (7 October 2014), available at <http://europa.eu/rapid/press-release_IP-14-1105_en.htm> (last accessed 30 August 2016); European Commission press release IP/16/3085: State aid: Commission opens in-depth investigations into Luxembourg's tax treatment of GDF Suez (now Engie) (19 September 2016), available at <http://europa.eu/rapid/press-release_IP-16-3085_en.htm> (last accessed 19 September 2016).

¹²⁷ The Commission's tax rulings in the cases of Starbucks, and Fiat Trade and Finance are under appeal; see *Fiat Chrysler Finance Europe v Commission*, T-759/15, appealed on 29 December 2015; *Netherlands v Commission*, T-760/15, appealed on 23 December 2015. Likewise, Ireland has also decided to contest the Apple decision before the court; see <www.finance.gov.ie/news-centre/press-releases/minister-noonan-disagrees-profoundly-commission-apple> (last accessed 1 September 2016).

¹²⁸ About 290 cases of all kinds of direct taxes came before the ECJ until 2014. Just a few of these cases relate to the pre-1990 period, followed by around 40 cases in 1991–2000, while the remaining cases came up before the Court in 2001–2014; see Marcel Schaper, '30 years of Direct tax Litigation before the Court of Justice of the European Union: An Empirical Survey'

Notwithstanding the disputation of ECJ tax case law by a segment of legal scholarship,¹²⁹ the increased litigation in itself explains an ever-expanding space of European tax powers. The rise in number of tax disputes before the ECJ is also suggestive of a progressive shift in the locus of tax competence in the so-called flexible list of items on the menu (Part IV(C)). The following illustrates how a growing array of tax litigation also correlates with a changing notion for EU tax powers.

In its response to the evolutionary phase the single European market passes through and the level of integration it attains, the mobility of accompanying economic and fiscal essentials (ie powers in these areas) become inevitable. In these circumstances, either the Member States have to pre-empt or respond on their own to the integrational imperatives of the increasingly integrated market or, if their inaction (or insufficient action) does not meet the gaps created by inter-Member trade and economic activity, market forces call for an optimal EU intervention. If both national and EU actions are non-existent, or are deficient, the injured parties would tend to enforce their constitutional rights such as free movement of labour and capital by seeking remedies through national courts. The wider the gap, the larger would be the number of cases contested before the courts. With increased lawsuits in the national courts, the probability of referrals to the ECJ would equally increase. The result is obvious – that is, enhanced referrals from national courts seeking preliminary rulings of the ECJ – and this has been precisely the case in recent years.¹³⁰

In addition to moving national courts, demands generated through transnational taxpayers, firms and other non-state, pro-integration lobbyists may also push the European Commission to activate its efforts to settle cross-border tax disputes of firms and individuals.¹³¹ This may again end up in increased litigation in tax matters before the ECJ, since one of the Commission's key activities involves initiation of infringement

(2014) 68 *Bulletin for International Taxation* 236–237 (data of ECJ cases during 1983–2013); see also Directorate-General of Taxation & Customs & Union, *CJEU Cases in the Area of, or of Particular Interest for, Direct Taxation* (2015), <http://ec.europa.eu/taxation_customs/resources/documents/common/infringements/case_law/court_cases_direct_taxation_en.pdf> (last accessed 4 January 2016).

¹²⁹ A segment of legal scholarship is critical of decisions of the ECJ on direct taxation, in particular the Court's robust approach towards achieving non-discriminatory taxation in absence of harmonized tax base and rate, dismantling of long established imputation system on dividend taxation in Europe; see, eg Graetz and Warren, above n 14, 1208–1212; Michael J Graetz and Alvin C Warren, 'Dividend taxation in Europe: When the ECJ makes tax policy' (2007) 44 *Common Market Law Review* 1577–1623; Wolfgang Schön, 'Neutrality and Territoriality – Competing or Converging Concepts in European Tax Law?' (2015) 69 *Bulletin for International Taxation* 271–293. However, without going into a discussion on merits of ECJ rulings, the point in question is to emphasize a significant increase in transnational tax litigation in recent decades; see, eg, data in above n 128.

¹³⁰ Unlike the known litigation process worldwide, where aggrieved parties (taxpayers or tax authorities, as the case may be) bring their cases to federal constitutional courts, it is different with the ECJ. The aggrieved parties cannot bring their cases before the ECJ. Rather, there could be two main possibilities behind institution of cases before the ECJ: (1) National courts may refer certain questions arising from interpretation of primary or secondary EU law to seek preliminary ruling of the ECJ (TFEU, above n 4, art 267); (2) The Commission may refer any matter to the ECJ if a Member is considered to have failed to fulfil its obligation under the EU law (TFEU, above n 4, art 258).

¹³¹ In theorising growth in transnationalism causing increased activity at the ECJ and Commission-level, see discussion and literature cited in above n 89.

proceedings against those national tax policies that impede free movement of labour and capital in the single market.¹³² Eventually, the infringement-based activity of the Commission also in several cases ends up in litigation at the level of the ECJ.¹³³

The tax-related litigation, whether initiated through referrals of national courts or triggered by Commission infringement proceedings, is indeed supportive of the reasoning noted above. That is, the internal market, in consequence of growth in transnational economic activity caused by the freedom clauses, increasingly attained a new integrational phase over time. At each phase, the locus of the derivative EU (tax) power that otherwise is submerged in the freedom clauses and the single market notion migrates to a new position.

To that effect, if this argument – even in part – qualifies to explain the increased frequency of litigation before the ECJ in the field of direct taxes, it may then reasonably uphold the thesis of growing implicit EU legislative powers in the tax realm over time. Thus the EU power to formulate Union-wide policy for integration of direct taxes could be argued to have inevitably gained width and breadth relative to the founding times – and, on the same rationale, is likely to grow and expand further in times ahead.

V CONCLUSION

The EU law does not explicitly empower the Union to formulate policy in the area of direct taxes – an area left generally to Member States. Nevertheless, if national (tax) laws infringe the single market principles, the EU could intervene. This study dissected the constitutional notion of the internal market to explore the emergence of implied European powers on direct taxes developing in the undergrowth of freedom clauses. A unique feature of multilevel governance is that the Union-Members power equilibrium is of dynamic character and changes over time in accordance with the level of integration attained by the single market at a given point in time. The freedom clauses cultivate the seeds of transnational economic activity through free movement of labour, capital, goods, and services in the single market. Alongside the growth of these freedoms, economic activity across the European market also grows and, consequently, so do the meanings of EU powers in those policy areas which are incidental to that market including the (implicit) tax powers. This article suggests that pursuant to freedom clauses, the transnational economic activity has grown – and may grow further – to attain level(s) where adequate EU-level actions become increasingly inevitable in the tax policy sector. The result is an ever-mobile (implicit) supranational EU competence to address double tax burdens, tax-induced distortions and tax avoidance issues that impede the functioning of single European market. The analysis offered here, therefore, concludes that the policy

¹³² TFEU, above n 4, art 258.

¹³³ In fact, about 56 direct tax cases decided by the ECJ until 2001 originated from the Commission; out of these, more than 90 percent (around 52) cases have been initiated by the Commission against Members for breach of EU (direct tax) law just since 2002; see Shaper, above n 128. Besides, a large number of infringement cases do not undergo litigation since Members mostly comply with the infringement notices of the Commission and remove inconsistencies in their national tax measures. For example, during the period 2000–13, almost 700 cases of infringement proceedings initiated by the Commission against income tax measures of Members were settled out of court. (Commission's letter of 29 January 2015 (personal communication; letter on file with author.)

of limited intervention to formulate EU-level rules in the field of direct taxes may not persist in the long run, but rather may shift to wider and deeper European tax measures in times ahead.

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