Implementation of Regional Taxing Powers and EU Law: Recent Cases and Future Challenges[1]

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Executive Summary

This article aims at determining the conditions under which local and regional authorities may exercise their taxing powers while fulfilling their obligations under European Union law. Furthermore, it seeks to assess the possibility of combining new transfers of tax competences within Member States with the achievement of the Internal Market. It results from the analysis of the EU legislation and case-law, that, in many respects, EU law not only restricts the exercise by regional and local authorities the autonomous taxing powers that have been allocated to them in the internal legal order but also limits the autonomy of the Member States to organize the allocation of taxing powers between different levels of power.

1. Taxing Powers of Regional Authorities in an European Context: Constitutional Framework or Patchwork?

According to a traditional view, often expressed in the case-law of the Court of Justice[3], the obligation of the Member States to implement EU (tax) law does not have an impact on the internal constitutional framework regulating the attribution of (taxing) powers to and their exercise by local and regional authorities. This position is however to be nuanced, in the light of the numerous examples of interaction between EU law and regional competences.

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3 See for example, ECJ 25 May 1982, Case 96/81, *Commission v. the Netherlands*, *ECR.*, p. 1791, para. 12 and Case 97/81, *Commission v. the Netherlands*, *ECR*, p. 1819, para. 12; 2 February 1982, *Commission v. Belgium.*, joint Cases 68/81 à 73/81, *ECR*, p.153, para. 5.

In the EU, several Member States have already adopted a (quasi) federal structure and subnational authorities have been granted autonomous powers to regulate their own areas of competences without intervention of the central authority. Moreover, in other Member States, like Italy, institutional reforms towards more regional autonomy are seriously contemplated. This situation implies that the division of tax competences with the EU can now roughly be represented as a three-layer structure. However, in this structure, the taxing powers are unevenly divided according to two distinct logics. Indeed the legal principles and the political objectives underlying such division of taxing powers significantly vary according to whether the division concerns, on the one hand, the European Union and the Member States or, on the other hand, within the Member States, the central and the regional (and local) authorities.

The attribution of taxing powers to the European Union occurs according to *sui generis* principles, originally based on the law of international organizations[4]. It is characterized by a teleological and centripetal dimension. By founding or entering the EU, sovereign States have expressly or implicitly relinquished to a supranational body all the competences necessary to the achievement of the objectives for which this body was created, in particular the objective constituting in the gradual unification of national economies and their merger into one single market. In this institutional framework, the limits to the attribution of powers to the EU are more procedural than material, i.e. they mainly consist in general principles, such as proportionality and subsidiarity (EU Treaty, Art. 5), and rather stringent procedures, like the necessity to adopt European acts with qualified majorities, or even the unanimous consent of the Member States. In the EU structure, the attribution of taxing powers to the Union does not follow fundamentally different principles than those applicable to other EU competences. This can be explained by the fact that the EU powers on the area of taxation are intended as ancillary to the achievement of the internal market, without any budgetary purpose. The revenues of the taxes that are regulated at the EU level remain generally in the Member States, while the financial resources composing the EU budget are determined according different principles and rules[5].

The EU could therefore provide for the unanimity of the MS to agree to adopt directives (or regulations) for any type of taxes, both indirect (on the basis of Art. 113 TFEU) or direct (on the basis of Art. 115 TFEU), regulating any aspect of it (tax base, tax rate, tax reductions, assessment and collection rules, sanctions). Contrary to the constitutional traditions of most of the EU Member States, this could be done without the consent of an elected assembly, since the

4 J.H.H. WEILER, "In defence of the status quo: Europe's constitutional *Sonderweg*" in J.H.H. WEILER et M. WIND (éd.), *European Constitutionalism beyond the State*, Cambridge, Cambridge University Press, 2003, p. 2.

5 The rules governing the EU budget are to found in Art. 311 TFUE and in the Council implementing decision (see for example Council Decision 2007/436/EC of 7 June 2007 on the system of the European Communities' own resources, *OJ* L 163, 23 June 2007, p. 17-21).

EU Treaty reserves the legislative power in tax matters to the Council alone (the European Parliament being only granted a consultative role). Besides the power to enact legislation aiming at approximating national tax systems, other EU competences can implicitly have an influence on taxation, like the control of State aid and the application of EU treaty freedoms, not to mention soft law instrument like the Code of conduct in the area of business taxation[6].

Within the Member States, the constitutional arrangements allocating taxing powers between the central and the regional (and local) levels follow a very different logic. Although they greatly vary between Member States, depending on their historical, political, linguistic and social background, they generally do not aim at achieving a particular purpose, outside guaranteeing the autonomy of each level in the manner compatible with the preservation of the whole structure. This is rather understandable, since neither the central authority nor the regional authorities do exercise their taxing powers with the (exclusive) objective of implementing other non-fiscal competences. The division of powers in the area of taxation forms an integral part of the State's financial constitution (*Finanzverfassung*), i.e. the way financial resources are attributed to the different levels to enable them to exercise the powers attributed to them. The powers of each level are strictly defined, with regard to the type of taxes allocated, the extent of the competences for each tax, the allocation of revenues generated by each tax. Any breach of the constitutional rules on the division of taxing powers is sanctioned by the Constitutional Court. These rules are generally completed with purely financial agreements between State and regional authorities concerning the financial transfers, both vertical (from the federal State to the Regions, and sometimes inversely) and horizontal (between regions)[7].

Moreover, in several Member States, like Belgium, Italy or Spain, the allocation of taxing powers to regional authorities is the expression of a centrifugal dynamic, which weakens the central government and undermines the economic unity of the national territory. In this context, and unlike what can be observed in the European Union, the principles of federalism often collide with the principles of economic unity. Therefore, the allocation of taxing powers to regional authorities is often coupled with safeguarding rules and mechanisms, like individual economic freedoms, a limited right or intervention of the central authority, specific cooperation procedures between authorities or material limitations of the taxing powers attributed to subnational authorities[8].

6 Conclusions of the Ecofin Council of 1 December 1997, *JO* 6 January 1998, C 2, p. 1. For a comment, see W. Bratton et J. Mc Cahery, "Tax coordination and Tax competition in the European Union; Evaluating the code of conduct for business taxation", *CMLR* 2001, No. 38, p. 677-718.

7 See for example the Belgian Special law on 16 January 1989 on the financing of the Communities and Regions, amended several times (*MB* 17 January 1989, last modified in 2001) or the Austrian *Finanzverfassunsggesetz* of 1948 (*BGBl.* Nr. 45/1948, last modified in 2007).

8 For example, the power to fix tax rates can be limited by determining a minimum and a maximum rate, or elements of the tax basis of regional taxes can remain within the competences of the central level, in order to avoid harmful tax competition between subnational authorities, excessive compliance costs by taxpayers or simply to limit the collection costs by tax administrations.

There are thus no common principles between the systems of allocation of taxing powers between the EU and the Members States on the one hand, and within the Member States between the central authority and the subnational authorities on the other hand. Nevertheless, despite the absence of such common principles, the division of powers within the Member States has to take into consideration the peculiarities of the European Union's legal order, i.e. the primacy and the effectiveness of EU law. Under Article 4, para. 3 TUE (former Art. 10 EC), the Member States are indeed responsible for the implementation of the provisions of the EU Treaty and of the secondary legislation, even in the areas of competence which have been assigned to local and regional authorities. In particular, when a tax provision enacted by a Member State or by a local authority within that Member State is considered incompatible with EU law, the Member State or the local authority concerned is obliged not only to modify or abolish the unlawful tax provision but also to refund unduly paid taxes to the taxpayers and to recompense any other damage caused to them resulting from the infringement. The implementation of EU law by the Member States is subject to review by the European institutions, in particular by the Court of Justice. According to the ECJ, the Member States are free to determine the forms and the institutions by which EU law shall be implemented into the national legal system (principle of institutional and procedural autonomy). However, under the EU principles of effectiveness and equivalence, Member States are obliged to implement EU law in order to assure taxpayers the effectiveness of the rights they derive from the EU Treaties and EU secondary law. According to the Court of Justice, Member States have indeed "to settle procedural rules governing actions for safeguarding rights which individuals derive from Community law, provided that these rules are not less favorable than those governing similar domestic use and do not render virtually impossible or excessively difficult the exercise of rights conferred by Community law"[9]. These principles impose thus on the Member States an obligation of result: they are not allowed to justify their shortcomings by invoking provisions of internal law or peculiarities of their institutional structure[10]. When local authorities have, in the internal order, competences in the areas of administrative or judicial proceedings, they must also exercise them in accordance with these EU procedural principles[11].

A consequence of these EU procedural constraints – and one first tangible sign of the impact of EU law on regional tax autonomy – is the existence in various Member States of substitution mechanisms derogating from the ordinary rules

9 See ECJ 16 December 1976, Case 33/76, *Rewe*, para. 5 and 16 December 1976, Case 45/76, Comet, paras. 13 and 16.

10 See for example ECJ 1 June 1999, Case C-302/97, *Klaus Konle v. Republik Österreich*, para. 63; 9 September 1999, Case C-374/97, *Anton Feyrer*, para. 34; 12 June 1990, Case 8/88, *Germany v. Commission*,; 10 November 1992, Case C-156/91, *Hansa Fleisch Ernst Mundt*, para. 23.

11 ECJ 2 October 2003, Case C-147/01, *Weber's Wine World*.

concerning the allocation of taxing powers to ensure the correct implementation of EU law by subnational authorities[12].

2. The Application of EU Treaty Freedoms to Regional Taxes: also to Purely Internal Situations?

Specific questions have arisen concerning the application of the Treaty freedoms to regional and local authorities of the Member States. As already said, the freedoms of movement of the EU Treaty play a fundamental role in the realization of the Community objective of the achievement of the Internal market. According to a well established case-law, the free movement of goods, persons, services and capital, as interpreted by the Court of Justice, affects the organization of the national tax systems and, inside the Member States, the exercise of fiscal competences by regional and local authorities. However, the present ECJ case-law on the matter lacks clarity on several aspects.

To clearly understand the peculiarity of the ECJ decisions involving regional and local taxes, it must be remembered that the Treaty freedoms can be seen as entailing a double prohibition for the Member States and their subdivisions. On the one hand, they prohibit discriminations, i.e. unjustified difference in treatment of comparable situations, based on nationality or on another criterion indirectly linkable with nationality, caused by a Member State and which negatively affect nationals of other Member States. On the other hand, the freedoms guarantee citizens of a Member State to move and to deploy their economic activity in other MS without unjustified restrictions[13]. All these provisions expressly refer to movements between Member States[14]. They are in

12 For example, for Belgium, see Art. 169 of the Constitution and A. ALEN et P. PEETERS, "Federal Belgium within the international legal order: theory and practice" in K. WELLENS (ed.), *International Law: Theory and Practice. Essays in Honour of Eric Suy*, The Hague, Martinus Nijhoff, 1998, p. 123-144. For Italy, see Art. 117, para. 5 and 120 para. 2 of the Constitution.

13 Concerning the free movement of goods, these two dimensions of the treaty freedoms are clearly identifiable in tax matters, since the prohibition of discrimination is contained in Art. 110 TFUE while the prohibition of tax restrictions between Member States is contained in Art. 30 TFUE (customs duties and taxes having equivalent effect). The wording of the other freedoms does not let appear this distinction (they do not even address specifically tax provisions), but this can nonetheless be inferred from the case-law of the Court of justice. On the distinction in the free movement of goods between the measures specifically targeting imported goods and the measure indistinctly applicable to domestic and imported goods, which have nonetheless a restrictive effect, see ECJ 20 February 1979, Case 120/78, *Rewe (Cassis de Dijon), Rec.*, p. 649. See also F. VANISTENDAEL, "The compatibility of the basic economic freedoms with the sovereign national tax systems of the Member States", *EC Tax Review* 2003, No. 3, p. 137; A. CORDEWENER, *Europäische Grundfreiheiten und nationales Steuerrecht – "Konvergenz" des Gemeinschaftsrechts und Kohärenz der direkten Steuern in der Rechtsprechung des EUGH'*, Köln, Otto Schmidt Verlag, 2002., p. 258seq.; A. MATTERA, "De l'arrêt Dassonville à l'arrêt Keck: l'obscure clarté d'une jurisprudence riche en principes novateurs et en contractions", *RMUE* n° 1, 1994, p. 117, esp. p. 138 seq.

14 As Art. 63-65 TFUE mention, the free movement of capital and payments also covers the relations with third countries. On the peculiarities of the application of this freedom to the relations with third countries, see K. STAHL, "Free Movement of capital between Member States and Third countries", *EC Tax Review* 2004, p. 48 ss.; C. PETERS et J. GOOIER, "The Freedom of Movement of Capital and Third countries: some observations", *European taxation* 2005, p. 477-478; P. PISTONE, "The impact of European law on the relations with third countries in the field of direct taxation", *Intertax* 2006, p. 234 seq.; R. LYAL, "Free Movement of Capital and Non-Member Countries – Consequences for Direct Taxation" in D. WEBER (ed.), *The influence of European Law on Direct taxation*, Kluwer Law International, 2007, p. 17 seq.

principle applicable to all national measures, whether adopted by the central authority or taken by regional or local bodies of the MS, independently of their degree of autonomy.

It results from the analysis of the Court's case-law that, in certain cases, the freedoms of movement may apply not only to cross-border, but also to internal tax obstacles. These cases concern mainly but not exclusively the free movement of goods. Their effect is primarily to strengthen the existing legal protection of taxpayers under national law. Nevertheless, it can be observed that the Court – at least in the cases decided so far – does not extend in all cases the application of the freedoms of movement to purely internal situations. Therefore, it may happen – under the current ECJ case law – that economic operators engaging in trade exclusively within a Member State are granted less protection than operators engaging in cross-border exchanges between Member States, when economic rights under domestic law are less developed than economic rights under EU law. To illustrate these inconsistencies in the Court's case-law, it is interesting to compare three decisions: the Carrara (or Carbonati Apuani) case, concerning a municipal tax on the transportation of marble[15], the Sardegna case, on a tax on stopovers for tourist purposes[16], the Gouvernement de la Communauté française case, a non tax case on a social assistance scheme for dependent persons[17].

The Carrara (or Carbonati Apuani) case has to be read as a natural evolution of three other precedent cases, i.e. the Legros, Lancry and Simitzi cases[18]. The Italian municipality of Carrara used to levy a tax on the transportation of marbles outside its territory, a levy which existed even before the independence of Italy. The consequences of this levy was that the marbles that were extracted and used or transformed within the territory of the municipality were exempt, that the marbles that were used or transformed in neighbouring municipalities were partially exempted, while all the other marbles extracted in the municipality were fully subject to it, whether transported to another part of the national territory or outside Italy. The Court of justice considers this tax as having an equivalent effect to a customs duty (on exports) and declares it incompatible with EU law as a whole, i.e. also insofar as it applies to marbles transported within the Italian territory. The Court bases its decision on former Article 25 EC Treaty (now, Art. 30 TFUE), as well as the Custom Union and the Internal market (former Art. 14 EC, now Art. 26 TFUE), by stating that "the very principle of a customs union, as provided for by Article 23 EC, requires the free movement of goods to be ensured within the union generally, not in trade between Member States alone, but more broadly throughout the territory of the

15 ECJ 9 September 2004, Case C-72/03, *Carbonati Apuani*.
16 ECJ 17 November 2009, Case 169/08, *Presidente del Consiglio dei Ministri v. Regione autonoma della Sardegna*.
17 ECJ 1 April 2008, Case C-212/06, *Gouvernement de la Communauté française and Gouvernement wallon*.
18 ECJ 16 July 1992, Case C-163/90, *Administration des douanes et droits indirects v. Léopold Legros et alii*; 9 August 1994, Joint Cases C-363/93, C-407/93, C-408/93, C-409/93, C-410/93 and C-411/93, Lancry 14 September 1995, Case C-485/93 et C-486/93, *Simitzi*.

customs union. If Articles 23 EC and 25 EC make express reference only to trade between Member States, that is because the framers of the Treaty took it for granted that there were no charges exhibiting the features of a customs duty in existence within the Member States"[19]. The Court went on saying that "[…] it is to be borne in mind that in 1986 the Single European Act added to the EEC Treaty Article 8a (then Art. 7a of the EC Treaty, and now, after amendment, Art. 14 EC), which set as an aim the establishment of an internal market before 31 December 1992. Article 14(2) EC defines the internal market as "an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured", without drawing any distinction between inter-State frontiers and frontiers within a State"[20]. The Court then concluded that "since Article 23 EC et seq. must be read in conjunction with Article 14(2) EC, the absence of charges – whether between States or within a State – exhibiting the features of a customs duty is a precondition essential to the realisation of a customs union in which the free movement of goods is ensured"[21]. The reference to Article 14 is interesting since this provision does not make any distinction between borders between Member State and internal borders within the Member States. The Carrara case has been further confirmed in Jersey Produce Marketing Organization, where the Court made an extreme application of Article 25 EC to a levy that was only applied to transportation of goods within the United Kingdom, i.e. from the isle of Jersey to the British mainland[22].

This standing case-law constitutes a deviation in respect of the traditional position of the Court according to which European freedoms do not apply to purely internal situations, i.e. situations confined to the territory of one single Member States which do not entail any cross-border element which would trigger the application of European law[23].

However, the question remains whether – outside the particular case of taxes having equivalent effect to customs duties – a (regional) measure indistinctly applicable to cross-border and internal situations could be considered contrary to European freedoms as a whole and should be censored only in its external dimension, leaving to the national law the hypothetical discrimination between regions of the same Member States.

Two recent cases illustrate what could be seen as an inconsistency in the reasoning of the Court.

The *Communauté francaise* case concerned a care insurance scheme, adopted by the Flemish region (*rectius* Community), which gave the right to reimbursement of help and non-medical services to persons whose autonomy was "reduced by

19 ECJ, Case *Carbonati Apuani*, C-72/03, para. 22.
20 ECJ, Case *Carbonati Apuani*, C-72/03, para. 23.
21 ECJ, Case *Carbonati Apuani*, C-72/03, para. 23.
22 ECJ 8 November 2005, Case C-293/02, *Jersey Produce Marketing Organization Ltd v. States of Jersey et Jersey Potato Export Marketing Board*.
23 See ECJ 7 May 1997, Case C-321/94, *Pistre*, and 5 December 2000, Case C-448/98, *Guimont*.

serious and prolonged disability". The scope of this scheme was limited to the residents in the part of the Belgian territory for which that autonomous Community is competent, which excluded the residents from French speaking Wallonia from the benefits of this scheme.

The Court considered that this exclusion entailed an obstacle to freedom of movement for workers and to freedom of establishment. However, the Flemish scheme was considered as contrary to EU in so far as it limited the rights of movement of persons which could fall into the personal scope of application of EU law, i.e. those who had made use of their right to freedom of movement within the European Union. The Court referred to two kinds of EU citizens: nationals of other Member States than Belgium working in that entity's territory and Belgian nationals who had made use of their right to freedom of movement within the European Community. This meant that Belgian residents of Wallonia which had never made use of their EU freedoms, i.e. had never resided in another Member State or had no cross-border activities of any kind, could not benefit from European Treaty protection. Their only possibility to enjoy legal protection would have been to establish a breach of domestic law, whether the non-discrimination rules, the rules governing the division of powers between public authorities or the principle of the Economic and Monetary Union but the Belgian Constitutional Court, which had referred the question to this ECJ in this case, did not accept the arguments of the claimants[24]. This case is a typical example of reverse discrimination, i.e. a situation where, under the domestic law of a Member State, EU citizens are treated more favourably than some nationals of this Member State. Although the reasons that let the Belgian Constitutional Court to justify such a reverse discrimination may be understandable in the Belgian domestic context, by adopting a European prospective, one cannot but be skeptical about such situations, since their possible proliferation could at the end put in jeopardy some of the main objectives of the European integration.

However, this decision has to be nuanced at the light of the reasoning adopted by the Court in the *Sardinia* case, which is not only more recent, but moreover is a pure tax case. The levy at stake in this case was a regional tax imposed by the Italian Region of Sardinia in the event of stopovers for tourist purposes by aircraft used for the private transport of persons, or by recreational craft, and only on undertakings which had their tax domicile outside the territory of the region. The Court – quite obviously – saw in this tax on non-residents an unjustified restriction to the free provision of services. However, the Court did not make any distinction between residents of other Italian Regions and residents of others EU Member States; The court simply held that "Article 49 EC must be interpreted as precluding tax legislation, adopted by a regional authority, such as that provided for under [the Sardinian Regional law], which establishes a regional tax on stopovers for tourist purposes by aircraft used for the

[24] Belgian Constitutional Court, 21 January, Case No. 11/2009, available on www.const-court.be, in particular para. B.12.

private transport of persons, or by recreational craft, to be imposed only on undertakings whose tax domicile is outside the territory of the region". If the Court had followed its traditional case-law, it would have to carve out Italian – non Sardinian – residents which had never made use of their freedom of movement under EU law. The conclusion reached by the Court in the Sardinia case is similar to the one adopted in an another Italian case, on the preferential rates for the elderly granted by local or decentralised State authorities for the admission to public monuments to Italian nationals or to their own residents[25]. This case, although a non tax case, can be considered however relevant for the area of taxation, since a reduction of price for services carried out by a public authority can be compared for the application of EU Treaty freedoms to a partial exemption of a tax. The Court held that "by allowing discriminatory, advantageous rates for admission to museums, monuments, galleries, archaeological digs, parks and gardens classified as public monuments, granted by local or decentralised State authorities only in favour of Italian nationals and persons resident within the territory of those authorities running the cultural sites in question, who are aged over 60 or 65 years, and by excluding from such advantages tourists who are nationals of other Member States and non-residents who fulfil the same objective age requirements, the Italian Republic has failed to fulfil its obligations under Articles 12 EC and 49 EC". The Court seems to consider that the measures at stake are discriminatory as a whole, thus even if applied to Italian non-residents of these local bodies[26].

There is therefore in the present state of the ECJ case-law uncertainty on the question whether in the area of (direct) taxation an holistic, Single market, approach is to be followed, inspired by the case-law on former Article 14 and 25 CE or if the traditional case-law on internal situations in non tax cases should be applied. The author would favour the first, bolder, approach. However, this is not always necessary, since several Member States, like Belgium and to a lesser extent, Italy, have granted taxpayers in their domestic law economic rights similar to those enshrined in the European Treaties, which are applicable to internal situations[27].

25 ECJ 16 January 2003, Case C-388/01, *Commission v. Italy*.

26 At para. 14 of the *Commission v. Italy* Case, the Court held indeed that "(...) In that context, it is immaterial whether the contested measure affects, in some circumstances, nationals of the State in question resident in other parts of the national territory as well as nationals of other Member States. In order for a measure to be treated as being discriminatory, it is not necessary for it to have the effect of putting at an advantage all the nationals of the State in question or of putting at a disadvantage only nationals of other Member States, but not nationals of the State in question (see, to that effect, *inter alia*, Case C-281/98 *Angonese* [2000] ECR I-4139, paragraph 41)".

27 For Belgium, see the principle of Economic and Monetary Union in the case-law of the Constitutional Court. For Italy, see Art. 120 of the Italian Constitution.

3. Do European Tax Directives Allow the Transfer and Exercise of Regional Taxing Powers in the Area of Harmonized Taxes?

The core question concerning the – difficult – relation between regional tax autonomy and European tax harmonization is whether the same tax may be object of an harmonizing directive at European level, while being at the same time transferred to subnational authorities within a Member State, which would be inside the national territory alone responsible for their implementation and would autonomously determine the other – non harmonized – elements of the tax. To avoid any misunderstanding, it must be recalled that in various European countries, the words "fiscal federalism" with which some regions invoke constitutional reform refer both to revenues and legislatives competences. European harmonisation acts could only affect regulatory powers, but do not limit the freedom of Members States to adopt sharing mechanisms between central and subnational authorities to allocate tax revenues to each level according to determined criteria.

At first sight, we cannot but emphasize the incompatibility of the objectives of, on the one hand, the approximation or the harmonization of the tax legislation of the Member States at a EU level and, on the other hand, the transfer of taxing powers to local and regional authorities within the Member States. However, that incompatibility does not mean *ipso facto* that any exercise by a local or regional authority of a tax competence granted under national law would be incompatible with EU law.

The harmonization Directives in the area of taxation concern indeed only a few taxes, which relate primarily to indirect taxation. Moreover, incompatibilities can only either result from specific provisions of the harmonization Directives (adopted unanimously by the Council) or be based on a teleological interpretation of the directives creating a common system for specific taxes, like VAT and excise duties.

EU tax harmonization finds its roots in various reports[28] and as always be seen as the optimal (from an economical prospective) instrument to create a common market between Member States without distortions of competition of fiscal

[28] Among the various reports published for or on behalf of the European Commission, see the 1962 Neumark report (European Commission, Rapport du Comité Fiscal et Financier, Annex A, 95, Office for Official Publications of the European Communities, Brussels, 1962), the 1970 van den Tempel report (European Commission, Corporation tax and individual income tax in the European Communities, Competition – Approximation of legislation series 15, Luxembourg, 1970), the Werner report ("Report to the Council and the Commission on the Realization by Stages of Economic and Monetary Union in the Community" [Werner Report], October 1970, *Bull. EEC*, supplement No. 11, 1970), the 1980 Burke report (European Commission, Report from the Commission to the Council on the Scope for Convergence of Tax Systems in the Community, adopted 26 March 1980, COM(80) 139, *Bulletin EEC*, Supplement No. 1, 1980), the 1992 Ruding Report (European Commission, Report of the Committee of Independent Experts on Company Taxation, 18 March 1992, Office for Official Publications of the European Communities, 1992), and the Commission's working Paper "Company Taxation in the Internal Market" (COM (2001) 582 final). On these reports, see C. PINTO, *Tax Competition and EU Law* (Deventer: Kluwer, 2003), 20-35.

nature. The idea behind tax harmonization is that diversity of tax legislation between Member States constitute an obstacle to cross-border economic activity, partly because it requires compliance with as many tax systems as States, which generates additional costs, besides the other costs inherent to cross-borders activities and not related to legal factors, like differences in language and culture, or peculiarities of the employment market.

Political obstacles have since the beginning of the European Union slowed down the tax harmonization process and only few directives have been enacted. Moreover, these directives usually harmonize particular elements of a tax, or even only the tax treatment of a particular operation. There is therefore a need to distinguish between taxes that have reached a sufficient level of harmonization to exclude their transfer to regional authorities within Member States and taxes that are concerned by European directives but whose level of European "harmonization" is still not significant enough to really constitute an obstacle to regionalization.

VAT, excise duties and indirect taxes on the raising of capital belong to the first category, while income taxes and vehicle taxes are in the second.

Value added tax is – until now – the paradigm of the European tax. The VAT directives (and regulations) harmonize the tax territorial and personal scope, the taxable event, the taxable base, the exemptions (although partially), some administrative obligations of the taxpayers and provide also for cooperation between administrative authorities of the Member States in order to ensure efficient collection of VAT and to reduce the risk of fraud, in particular for cross-border operations. Minimal ordinary tax rates, as well as the categories of goods and services to which reduced rates may apply, are also fixed by European legislation[29]. Specific derogations to the harmonized regime contained in the 2006/112/EC Directive only apply to a portion of the territory of some Member States, and sometimes to regions with autonomous taxing powers. For example, according to Article 105 of the 2006/112/EC Directive, the autonomous regions of the Azores and Madeira can apply rates lower than those applying on the Portuguese mainland[30]. Besides those explicitly mentioned in the directive, other derogations may be granted under strict material and procedural conditions, under review of the European Court of justice[31].

The extent of the harmonization in the field of value-added tax makes it almost impossible for Member States to grant taxing powers to regional authorities. Even in semi-harmonized areas like rates, the VAT Directive imposes one standard rate and maximum two reduced rates, which have to be applied to all supply of goods and services of the same nature, in line with the principle of

[29] Council directive 2006/112//CE of 28 November 2006 on the common system of value added tax, *OJ* L 349, 11 December 2006, Title VIII.
[30] See also Directive 2006/112/CE, Art. 142.
[31] Directive 2006/112/CE, Art. 395. For an example of review by the ECJ, see ECJ 14 September 2006, C-Case C-228/05, *Stradasfalti*.

neutrality. Regional rates would not only inevitably multiply the number of rates in a single Member State, but would only lead to the application of different rates to the same type of supply of goods and services, depending on the Region where they are located. It would thus go far beyond what it is allowed by the VAT Directive. As for the exemptions, they are generally compulsory and even in the case where a room for manoeuvre is left for Members States, like for example in the adoption of exclusions to the scope of the exemption of the letting of immovable property which are not already contained in the Directive (Directive 2006/112/CE, Art. 136), such exclusions would have to be applied on the whole national territory. Regional differentiation would be thus conflict with the principle of neutrality and thus be contrary to EU law. The only possibility would be to introduce in the VAT directive itself the possibility of transferring the power to regulate some elements of the tax at a regional level, but it would be highly unlikely that unanimous agreement could be reached in the Council, provided that – which is even more unlikely – the Commission would accept to put the proposal on the Council's agenda. Moreover, the VAT directive contains a prohibition to adopt general turnover taxes other than VAT[32]. Regions would therefore not be allowed under EU law to adopt such taxes, even if they were granted this power by their national constitution.

Excise duties are also object of various directives concerning manufactured tobaccos, alcohol and alcoholic beverages as well as energy products (formerly limited to mineral oils, extended since 2003 to coal and coke, gas and electricity)[33]. Harmonized elements are the taxable event, the definition of the products subject to the harmonized duties, minimal tax rates and exemptions, although various derogations are provided in favour of several Members States, including regional derogations. For example, reduced rates can be applied on the rum produced in French overseas departments, or on the locally produced beer in the Portuguese autonomous region of Madeira[34]. In a very questionable decision in 2005, the Council even allowed France for three years to grant taxing powers in the area of fuel taxation to French Regions[35]. However, most derogations in the area of excise duties are supposed to be granted temporarily to Member States, and are periodically reviewed by the European Commission.

32 Directive 2006/112/EC, Art. 401. On the application of this prohibition by the ECJ, see ECJ 3 October 2006, Case C-475/03, *Banca popolare di Cremona*.

33 The list of the Directives on harmonized excise duties can be found in the EUR-LEX Directory of European Union legislation in force, under the reference 09.30.20.

34 Council Decision 2008/417/EC of 3 June 2008 authorizing Portugal to apply a reduced rate of excise duty on locally produced beer in the autonomous region of Madeira, *OJ* L 147, 6 June 2008, p. 61-62; Council Decision 2007/659/EC of 9 October 2007 authorizing France to apply a reduced rate of excise duty on traditional rum produced in its overseas departments and repealing Decision 2002/166/EC, *OJ* L 270, 13 October 2007, 12-14.

35 Council Decision 2005/767/EC of 24 October 2005 authorising France to apply differentiated levels of taxation to motor fuels in accordance with Art. 19 of Directive 2003/96/EC, *OJ* L 290, 4 November 2005, p. 25-26. For a comment of this decision, see E. TRAVERSA, *L'autonomie fiscale des collectivités territoriales face au droit communautaire*, Brussels, Larcier, 2010, n°467-473. A renewal of this derogation has been granted in December 2010.

Moreover, according to the 2008/118/EC Directive, Member States are allowed to impose other – non harmonized – taxes on these products, "for specific purposes", and "provided that those taxes comply with the Community tax rules applicable for excise duty or value added tax as far as determination of the tax base, calculation of the tax, chargeability and monitoring of the tax are concerned, but not including the provisions on exemptions"[36]. Member States remain free to impose excise duties on other products, as well as on services related to products subject to harmonized duties, on the condition that the levying of these duties does not "in trade between Member States, give rise to formalities connected with the crossing of frontiers"[37]. It is worth noticing that the Court has applied these provisions to regional and local taxes in two important cases: the *Evangelischer Krankenhausverein Wien (EKW)* case, concerning an Austrian municipal beverage duty[38] and the *Hermann* case, on a German local tax on the supply of alcoholic beverages[39]. If in the *Hermann* case, the Court considered the local tax compatible with EU law, in the *EKW* case, it considered the Austrian tax partially contrary to EU law. In particular, the Court rejected the argument put forward by the Austrian government that the tax was meant to reinforce municipal tax autonomy. The Court held that "the reinforcement of municipal autonomy through the grant of a power to generate tax income constitutes a purely budgetary objective which, as has just been indicated, cannot, taken alone, constitute a specific purpose in the sense contemplated by Article 3(2) of the excise duty directive". The Court nevertheless accepted to limit the temporal effects of its judgment, on the ground that retroactivity would "cast into confusion the system whereby Austrian municipalities are financed" (para. 59).

Indirect taxes on the raising of capital are also harmonized at the European level, but this harmonization mainly takes the form of a prohibition of capital duties on the constitution and restructuring of companies and of duties on the issue of securities[40]. This means that Member States have simply lost the power to tax such operations, whether at national or at a subnational level. Two consequences arise from this situation. First, the prohibition applies in the same way to all levels of government[41]. Second, an hypothetical competence in relation to those taxes cannot be transferred; the transfer of competence itself would constitute a violation of the European commitments for the Member States, even if this power is not put in practice by the subnational authorities[42].

[36] Council Directive 2008/118/EC of 16 December 2008 concerning the general arrangements for excise duty and repealing Directive 92/12/EEC, *OJ* L 009, 14 January 2009, p. 12-30, Art. 1., 2.
[37] Directive 2008/118/EC, Art. 1, 3.
[38] ECJ 9 March 2000, Case C-437/97, *Evangelischer Krankenhausverein Wien*.
[39] ECJ 10 March 2005, Case C-491/03, *Hermann*.
[40] Council Directive 2008/7/EC of 12 February 2008 concerning indirect taxes on the raising of capital, OJ L 46, 21 January 2008, p. 11-22, which has replaced the former Directive 69/335/EC.
[41] For an example of the application of the prohibition contained in the former 69/335/EC directive to a regional tax, see ECJ 11 December 1997, Case C-8/96, *Locamion SA et Directeur des services fiscaux d'Indre-et-Loire* (French regional tax on the registration of vehicles). For a comment, see E. Traversa (2010), Nos. 414-415.
[42] Such a transfer could be indeed compared to, in criminal law, an instigation to commit an offence, which is usually punished as such even if the primary offence is not committed.

The 2008/7/EC directive however excludes from the scope of the prohibition several taxes, among which registration duties on the transfer of immovable property as well as duties on the constitution of mortgages, which interestingly are an area of regional or local competence in some Member States, like for instance Belgium.

Concerning direct taxes, harmonization directives are unlikely to constitute obstacles to the exercise of regional tax autonomy. This is partly due to the fact that their scope of application is quite limited, and partly because they apply to corporate income taxes, which are usually regulated at national level in the Members States. Moreover, in the area of corporate taxation, the EU rules on the prohibition of State aid remain the most significant EU tool to restrict the tax sovereignty of the Member States and their subdivisions, at least until the – unlikely – adoption of a common consolidated tax base in the area of company taxation.

4. Are Regional Tax Incentives Compatible with the EU Prohibition of State Aid and with the Code of Conduct?

EU control on State aid granted to undertakings severely limits the exercise of autonomous taxing powers by the Member States and their subdivisions. The control on state aid exercised by the Commission, based on Article 107 to 109 TFUE (former Art. 87 to 89 EC), covers all measures, financed by public resources and attributable to a public authority, which grants a selective advantage to certain undertakings and whose effect is to affect trade in the internal market and to distort competition. Such measures are generally prohibited, unless if they can benefit from one of exemption listed in the Treaty. This control of the compatibility of an aid is the sole responsibility of the Commission and is subject to strict procedural rules. The overall regime also applies to tax measures[43], including measures adopted by regional authorities[44], provided they meet the four cumulative criteria of the concept of aid as interpreted by the Court of justice[45]. Among these criteria, the decisive criterion is undoubtedly the selectivity, as opposed to measures of general application, which are not prohibited by EU law, even when they are very favorable to the taxpayers. The aid can be

43 ECJ 2 July 1974, *Italy v. Commission*, Case 173/73.
44 ECJ 14 October 1987, *Germany v. Commission*, Case C-248/84, *ECR*, p. 4013, point 17.
45 On the concept of (fiscal) State aid, see M. DONY, "La notion d'aide d'Etat", *Cahiers de Droit européen* 1993, vol. 29, Nos. 3-4, p. 399-344; M. SLOTBOOM, "State Aid in Community Law: A Broad or Narrow Definition?", *European Law Review* 1995, vol. 20, p. 289-301; J. WOUTERS et B. VAN HEES, "Les règles communautaires en matière d'aides d'Etat et la fiscalité directe: quelques observations critiques", *CDE* 2001, n^{os} 5-6, p. 652 et s.; A. MARTÍN JIMÉNEZ, "El concepto de ayuda de Estado las normas tributarias: problemas de delimitación del ámbito de aplicacion del Article 87.1 TCE", *Noticias de la UE*, n° 196/2001, p. 81 et s.; C. PINTO, *Tax competition and Eu law*, La Haye, Kluwer, 2003, p. 107 et s.; J. WINTER, "Redefining the notion of state aid in Article 87(1) of EC Treaty", *CMLR* 2004, No. 41, p. 47-504; F.P. SUTTER, *Das EG-Beihilfenverbot und sein Durchführungsverbot in Steuersachen*, Wien, Linde Verlag, 2005, p. 39-72; D. TRIANTAFYLLOU, "La fiscalité façonnée par la discipline des aides d'Etat", *EC State Aid Law/Le droit des aides d'Etat dans la CE – Liber Amicorum Francisco Santaolalla Gadea*, Alphen/Rijn, Kluwer Law International, 2008, p. 409-424.

territorially selective, when the measure applies only to a part of the territory taken as a framework of reference, usually the territory of a Member State, but also materially selective, in the case where the measure provides benefits only to a particular economic sector or to specific undertakings. As the Commission's practice shows, the reductions of the general tax burden which can be seen as prohibited aid may take extremely various forms[46].

EU control over state aid is strengthened, with respect to direct business taxation, by the development of soft law instruments to fight against harmful tax competition between Member States, in particular the Code of Conduct on business taxation. The Code of Conduct on business taxation, despite – or perhaps thanks to – its soft law nature, proves to be a rather effective instrument in combating certain special tax regimes established by the Member States in order to attract investors from other Member States or even from third States, and considered harmful to the entire EU. These non-binding rules may concern tax measures adopted by all authorities of Member States, including regional and local authorities[47]. Indeed, some of the special tax regimes rolled back thanks to the Code of Conduct had been adopted not by central government but by local authorities with extensive fiscal autonomy. This feature has not prevented the Primarolo Group, responsible for the implementation of the Code of Conduct, to declare these regimes harmful.

Like in other areas of EU law, such as the freedoms of movement or the tax harmonization directives, State aid rules, as well as the regime of the Code of Conduct, are thus in principle applicable to tax measures adopted by local authorities of the Member States. Nevertheless, in both regimes, regional tax autonomy raises additional and specific issues.

Concerning State aid control, regional tax autonomy can have an impact on the qualification of the measure, and therefore on the compatibility of a regional tax measure. Both the Commission and the Court of Justice acknowledge that the mere exercise by Member States' regional and local authorities of autonomous taxing powers they have been granted under constitutional arrangements does not in itself constitute a measure territorially selective[48]. A measure adopted under such autonomy cannot a priori be classified as state aid and is not contrary to EU law. Such an assertion could not however be construed as giving

[46] Report of 9 February 2004 on the implementation of the Commission notice on the application of the state aid rules to measures relating to direct business taxation, COM (2004) 434. See also P. ROSSI-MACCANICO, "State aid review of business tax measures", *European state aid law quarterly* 2007, vol. 6, No. 2, p. 215-230; P. ROSSI-MACCANICO, "The specificity criterion in fiscal aid review: proposals for state aid control of direct business tax measures", *EC Tax Review* 2007, v. 16, No. 2, p. 90-103; P. WERNER, "Fiscal state aid: on tax exemptions and reimbursement of taxes", *Cambridge yearbook of European legal studies 2006/2007*, 2007, v. 9, p. 481-505.

[47] In the Primarolo Report, implementing the Code of Conduct, some regional tax regimes were found to be harmful, like for example some tax measures sopted by the Basque Country. See Primarolo Report of 29 November 1999, available on the European Commission (DG TAXUD) website, p. 24, measure A005.

[48] See for example Commission Decision 2005/261/CE of 30 March 2004 on the aid scheme which the United Kingdom is planning to implement as regards the Government of Gibraltar Corporation Tax Reform, *OJ* L 085, 2 April 2005, p. 1-26, para 115, and ECJ 6 September 2006, Case C-88/03, *Portugal v. Commission*, para. 64.

carte blanche to Member States' regional and local authorities for circumventing the EU state aid prohibition applicable to the central authorities.

Several hypotheses need to be examined. One hypothesis is the exercise of taxing powers regarding purely regional or local, i.e. taxes autonomously created by the subnational authorities or levies formerly regulated by the central authority whose entire competence has been transferred. In such a case, the differences in the tax rate or the tax base cannot be analyzed as State aid, even from the prospective of the authority, which would give the most favorable tax treatment to its taxpayers. For example, lower overall rates of registration fees by one of the three Belgian regions may not have the effect of transforming into a state aid the simple difference between the tax rate applicable in this region and the tax rates applicable in the other two regions.

Concerning the exercise of a marginal competence of modification of the level of taxation of a tax whose competence is shared between the central and the regional level, two distinctions can be made. First, subnational authorities could have either a power to increase or a power to reduce the national or federal tax rate (or both of them). Second, this competence may be attributed to all local authorities (from the same level) of the Member State or only to some or even to one of them. The exercise of an increase in the tax rate, whether by one or by various subnational entities, could hardly be constitutive of a state aid because the criterion of advantage is lacking. Even if all regions of a Member States except one decide to increase the rate of a federal tax, the only regions which would not have done it could not be considered as having granted a state aid to its taxpayers just because of the behavior of other entities.

When all regional authorities in a Member States are granted the competence to reduce the level of taxation, one could be tempted to adopt the same line of reasoning. However, if it seems likely that there would be no State aid if all regions decide to lower the federal level of taxation to the same extent, an asymmetrical use of this power (by one region only, or by some of them) would necessarily need to be examined under the triple test that the European Court of Justice adopted for the first in the *Azores* case, and subsequently confirmed in the *UGT La Rioja* case[49].

These cases concerned the – peculiar but not unique in the European Union – situation of a region which has been granted more taxing powers under the Constitution than most of the other regions of the same Member States. The Court considered that in such an hypothesis it must be ascertained, in order toe exclude the qualification of state aid, whether the region adopting the tax

49 ECJ 11 September 2008, Joint Cases C-428/06 to C-434/06, *Unión General de Trabajadores de La Rioja (UGT-Rioja) e.a.* For a comment, see D. ARNESTO, "The ECJ's Judgment regarding the Tax Autonomy of the Basque Country", *European Taxation* 2009, No. 1, p. 11-20. See also CFI 18 December 2008, Joint Cases 211/04 and T-215/04, *Gibraltar and United Kingdom v. Commission*. For a comment, P. ROSSI-MACCANICO, "Gibraltar and the Unsettled Limits of Selectivity in Fiscal Aids", *European State aid Law Quarterly* 2009/1, p. 63-72.

measure has "a fundamental role in defining the political and economic environment in which corporate works"[50], which implies a political and tax autonomy in the domestic system of the Member State concerned, which has to be assessed from a constitutional, a procedural and a financial perspective. According to the Court, "[...] in order that a decision taken in such circumstances can be regarded as having been adopted in the exercise of sufficiently autonomous powers, that decision must, first of all, have been taken by a regional or local authority which has, from a constitutional point of view, a political and administrative status separate from that of the central government. Next, it must have been adopted without the central government being able to directly intervene as regards its content. Finally, the financial consequences of a reduction of the national tax rate for undertakings in the region must not be offset by aid or subsidies from other regions or central government"[51]. In this case, the measure cannot be considered as territorially selective State aid because the territorial frame of reference to determine the selectivity of the measure is the territory of the region concerned and not the whole Member State. However, the measure could be considered selective from a material point of view, as it already happened in several Commission decision involving the Basque Country[52].

The fact that a measure is considered as state aid does not imply that this measures in incompatible with EU law. The EU regime on state aid is indeed also a tool of EU policy for the regional development. The compatibility of aids is assessed by the Commission, on the basis of the criteria laid down by the EU Treaty. Among these criteria, the Treaty provides some derogations for Member States' "regions" which are considered socio-economically behind the EU average, according to objective criteria established by the Commission (see TFUE, Art. 107, para. 3, a. and c.)[53]. Although these "regions" are defined according to purely geographical criteria, in some Member States, including Italy, they cover the territory of autonomous political authorities.

Concerning the application to the Code of conduct, one could also wonder whether the fact that an harmful tax measure is adopted by regional authorities of a Member States could have an impact of its qualification. The answer is clearly negative. It is true that the Code of Conduct is meant to apply to tax schemes that derogate from the (national) common tax regime. This concept refers in principle to the tax system of the Member State, understood as a single

50 ECJ 6 September 2006, *Republic of Portugal v. Commission*, Case C-88/03, paras 58 and 66.

51 ECJ 6 September 2006, *Republic of Portugal v. Commission*, Case C-88/03, para 67. As the Court stated in *the UGT-Rioja Case,* "[...], where an infra-State body is sufficiently autonomous, in other words, when it has autonomy from the institutional, procedural and economic points of view, it plays a fundamental role in the definition of the political and economic environment in which the undertakings operate. That fundamental role is the consequence of the autonomy and not a precondition for that autonomy" (para. 55).

52 See for example the Commission Decision 2000/795/CE of 22 December 1999, *OJ* 16 December 2000, L 318, p. 36, or the Commission 2003/192/CE of 20 December 2001, *OJ* 24 March 2003, L 77, p. 1.

53 On the compatibility of regional aids, see Commission Regulation (EC) No. 800/2008 of 6 August 2008 declaring certain categories of aid compatible with the common market in application of Articles 87 and 88 of the Treaty (General block exemption Regulation), *OJ* L 214, 9 August 2008, p. 3-47, Art. 13 and 14 and Guidelines on National Regional aid for 2007-2013, *OJ* C 54, 4 March 2006, p. 13.

entity. However, concerning certain tax regimes adopted by local authorities, the Primarolo group, in the cases where it was not possible to compare the regional regime with a national benchmark, took as a benchmark the tax system of the regional authority[54].

5. Towards the Explicit Recognition in EU Law of the Tax Autonomy of Member's States Subnational Entities?

After this area by area analysis of the issues raised by the application of EU law to regional taxing powers, the question may asked whether EU regions and local bodies with autonomous taxing powers enjoy a specific status in EU law or not. To be given an adequate answer, this question should be divided in three subquestions: a) Do EU limitations to the tax sovereignty of the Members States specifically apply to regional bodies? b) Does EU law in some cases takes into account the fact that some subnational bodies in European have autonomous taxing powers? c) does EU law have an impact on the transfer of autonomous taxing power to subnational entities?

Firstly, one could wonder whether EU law contains specific restrictions to regional tax autonomy, i.e. restrictions other than those which are applicable to the taxing powers exercises by the central government. It is indeed known that EU law restricts the tax sovereignty of Member States. As the Court of Justice repeatedly stated, "by empowering the European institutions, Member States have submitted a corresponding limitation of their sovereign rights. It adheres to the treaty system that the tax field is no an exception, of course, of these limitations"[55]. There are however in EU law limits that apply specifically to local authorities of the Member States, which have, under the internal law, autonomous taxing powers.

On the one hand, the extension by the ECJ of the scope of some freedoms of movement to internal trade within a Member State, in particular but not only the prohibition of customs duties and charges with equivalent effect between Member States specifically restricts the power of regional governments to adopt tax measures that constitute internal obstacles to intrastate trade. In countries like Belgium and Italy, regional measures constituting intrastate hindrances to economic freedoms are prohibited by national law. However, this is not the case in all Members States. Moreover, it may happen that, even in Members States like Belgium and Italy, domestic Courts do not necessarily follow the case-law of the Court of justice while applying domestic economic freedoms. Therefore, this could be an argument to justify an evolution of the case-law of the ECJ towards a wider application of all EU freedoms, i.e. also to internal situations.

54 See in the Primarolo Report, the analyses of the tax regimes of the Basque Country (Spain), Gibraltar (United Kingdom) and the Aland islands (Denmark), in particular the mesures A005 and B012.

55 See for example ECJ 13 December 1967, Case 17/67, *Neumann Hauptzollamt Hof v. Saale*.

On the other hand, the application of EU rules on State aid specifically seem to limit the exercise of taxing powers by Member States' regional and local authorities which do not enjoy substantial institutional, procedural and financial autonomy. In such cases, any use of their autonomous taxing powers that would reduce the tax burden of their taxpayers, even if applicable to all their taxpayers, in comparison to taxpayers located in other regions of the same State, would be prohibited under the state aid regime, except if caught by a derogation under the regional aid schemes (under the control of the EU Commission).

Secondly, there are also hypothesis where EU law explicitly of implicitly recognizes, and even strengthens, the fiscal (and financial) autonomy of local governments.

Explicit guarantees of financial and fiscal autonomy of regional and local authorities in the Member States are primarily found in the field of state aid. The regional and local authorities of Member States may indeed find in the EU system to control aid to companies, an effective tool to preserve their tax autonomy. First, the system of state aid is usually neutral with respect to national systems of allocation of powers where all regions are given the same taxing powers. In addition, misuse of asymmetrical taxing powers by one region may be considered as a state aid, which constitutes protection for the "ordinary" regions in the Member States[56]. Another example of how State aid law favors regional autonomy is the derogatory regime to certain (poorer) regions of Member States (see above). This can be seen as legitimizing the exercise, by the political authorities whose territory coincides with the favored economic regions, of autonomous taxing powers.

Similarly, the development of the Court of Justice case law with regard to freedoms of movement, and the regime of the Code of Conduct established to fight against harmful tax competition, provide for local authorities of the Member States not only protection against protectionist measures adopted by other Member States but also against those committed by other regions or local bodies within the same Member State, which could have in impact on intraregional trade.

Moreover, the Treaty specifically protects certain regions. Indeed, some EU regions characterized by a "structural social and economic situation [...], which is compounded by their remoteness, insularity, small size, difficult topography and climate, economic dependence on a few products, the permanence and combination of which severely restrain their development" enjoy a special status under Article 349 TFUE (former Art. 299 EC). These outermost areas are the French overseas departments, the Azores, Madeira and the Canary Islands, which are all regions that enjoy a certain level of tax autonomy. By a decision of the Council, these regions may enjoy special regimes with regard to freedoms of

56 See for example, the Commission Decision 2000/795/EC of 22 December 1999, *OJ* 16 December 2000, which was adopted after a formal complaint of a neighbouring region of the Basque Country.

movement that for instance allow them to collect taxes normally contrary to EC Treaty provisions on free movement of goods[57]. They are also generally excluded from the scope of tax harmonization directives or benefit from specific exemptions. Finally, regarding State aid received by the outermost regions, more flexible criteria for compatibility of regional aid are applied, in particular for the admission of operating aid (normally excluded) or the calculation of the maximum ceiling of aid level[58]. And even in the Code of conduct on business taxation, their specificity is taken into account. Paragraph G of the Code of Conduct states indeed that "*insofar as the tax measures are used to support the economic development of particular regions, an assessment will be made of whether the measures are in proportion to, and targeted at, the aims sought. In assessing this, particular attention will be paid to special features and constraints in the case of the outermost regions and small islands, without undermining the integrity and coherence of the Community legal order, including the internal market and common policies*".

Besides these clear examples of explicit recognition by the EU of the tax and financial autonomy of regional and local authorities, there are situations where European institutions, and in particular the ECJ, seem to implicitly acknowledge the specificities of these authorities. In several cases, it seems that the Court was influenced by the potential consequences of its rulings on the fiscal and financial autonomy of regional or local governments. For example, in the case of taxes which revenues are allocated to regional and local authorities, the retroactive repayment obligation linked to a declaration of EU incompatibility by the ECJ can be especially burdensome and jeopardize the financial stability of those communities. In two cases, one concerning the free movement of goods (*Legros*), the other on the harmonization of excises duties (*EKW*), the Court took into account the necessity to preserve the financial autonomy of local authorities to give the benefit of non-retroactivity of its decision[59]. Although financial autonomy and tax autonomy are two distinct concepts, it appears that the Court, by safeguarding the first, indirectly protects the second. Indeed, a non-retroactive decision of the Court of Justice by maintaining the effects for the past of tax provisions of the local authorities of the Member State preserves the effects of the past exercise of autonomous taxing powers by regional or local authorities.

57 See Council Decision 2004/162/ECof 10 February 2004 concerning the dock dues in the French overseas departments and extending the period of validity of Decision 89/688/EEC, L 52, 21 February 2004, p. 64; Council Decision 2002/546/CE of 20 June 2002 on the AIEM tax applicable in the Canary Islands, *OJ* L 179, 9 July 2002, p. 22.

58 On the status of outermost regions, see European Parliament resolution of 20 May 2008 on the strategy for the outermost regions: achievements and future prospects (2008/2010(INI)), *OJ* C 279 E, 19 November 2009, p. 2; Commission Communication from the of 12 September 2007, "Strategy for the outermost regions: achievements and future prospects", COM(2007)050, Commission communications of 12 May 2004 (COM(2004)0343) and 23 August 2004 (COM(2004)0543) on a stronger partnership for the outermost regions.

59 ECJ 16 July 1992, Case C-163/90, *Administration des douanes et droits indirects v. Léopold Legros e.a.*, para 34; 9 March 2000, Case C-437/97, *Evangelischer Krankenhausverein Wien (EKW)*.

Another example of "region friendly" case-law concern the interpretation of the limitations contained in the tax harmonization directives. In the decisions in the *Hermann* case on municipal duties on alcoholic beverages[60] and in the *Banca popolare di Cremona* case about the Italian IRAP (regional tax on productive activities)[61], the Court of justice adopted innovative interpretations of EU secondary law, respectively of Article 3 of Directive 92/12/EEC and Article 33 of the Sixth VAT Directive, which particularly favored subnational authorities, in this cases the German municipalities and the Italian regions[62].

Finally, also the third sub question, on whether EU law has an influence on the transfer of taxation powers to regional and local authorities must be answered positively.. It is true that according to the Court of Justice, "when the Treaty provisions or regulations confer powers to Member States or impose obligations for the implementation of EU law, the question of how the exercise of these powers and the implementation of these obligations may be assigned by states to specific national bodies, is solely depending on the constitutional system of each State."[63] This statement should however be nuanced concerning the allocation of taxing powers between central and local authorities within Member States.

EU law can indeed be an obstacle to federalization and decentralization processes within Member States. This is the case for harmonized taxes, especially the value added tax, and to a lesser extent, excise duties. However, Member States remain free to allocate the entirety or a part of the revenue generated by harmonized taxes to regional and local authorities. One could even wonder if there is a standstill obligation for Member States to avoid transferring a tax to subnational authorities whenever there would be Commission's initiatives towards further harmonization, like for example concerning the common consolidated corporate tax base (CCCTB).

This is also the cases for non harmonized taxes, when these transfers would lead to obstacles to the economic freedoms or would constitute prohibited State aid or harmful tax competition within the meaning of the Code of conduct. In particular, the economic freedoms as interpreted by the ECJ make it very difficult to allocate for the same tax the power to regulate the tax obligation of residents and of non residents to different authorities without strict coordination. Such a situation would indeed almost inevitably cause violations of the freedoms of movement[64]. The only solution to keep this disjunction of taxing powers for residents and non-residents in line with European standards would

60 ECJ 10 March 2005, Case C-491/03, *Hermann*.
61 ECJ 3 October 2006, Case C-475/03, *Banca popolare di Cremona*.
62 It is worth comparing the IRAP decision with the *Dansk Denkavit* decision (ECJ 31 March 1992, C-200/90, *Dansk Denkavit et Poulsen Trading*, and the *Hermann* decision with the EKW ruling (Case C-437/97).
63 ECJ 15 December 1971, joint Cases 51/71 to 54/71, *International Fruit Company NV et autres v. Produktschap voor groenten en fruit*; ECJ 1 June 1999, Case C-302/97, *Klaus Konle v. Republik Österreich*, para 63.
64 On this problem, see the opinion of Adv-Gen. Saggio of 1 July 1999 in the joint Cases C-400 to C-402/97, as well as Traversa, E. Traversa, *L'autonomie fiscale des collectivités territoriales face au droit communautaire, Brussels*, Larcier, 2010, para. 269 to 275.

be to monitor both federal and regional legislation (in every region) and ensuring that each modification of one or the other authorities would not cause of breach of the European freedoms. This would undermine the very reason why their own taxing powers have been transferred to regions, that is, to enable them to differentiate between taxpayers according to regional preferences. Therefore, it seems more reasonable to conclude that European law requires that the competence for residents and non residents must be granted in the domestic tax system to the same authority. As recent examples have shown in Belgian regions, like the *Eckelkamp* case[65], this is the best way to ensure a timely implementation of European law into regional tax legislation.

6. Conclusions and Proposals

Several general conclusions can be drawn as to the impact of Community law on the exercise of tax competences by regional and local authorities. Those conclusions are not without ambiguities. They can even, to a certain extent, appear contradictory. In general, the application of EU law to taxing powers of regional or local authorities restricts the actual or potential exercise of those competences. However, in some cases, the attribution of tax competences to regional or local authorities itself is jeopardized by the application of EU law. Conversely, in very few cases, it can be observed that the application of EU law has as a direct or indirect consequence the favoring of autonomous powers of regional and local authorities in tax matters, granted by internal provisions. This is the case in specific phenomena of tax competition or certain protectionist tax obstacles between political sub-national bodies within one Member State.

Various proposals can be formulated to enhance the current EU institutional framework[66]. First, a more systemic coordination between the EU institutions and the regional and authorities would be helpful for both sides. Such coordination necessitates acknowledging the role displayed by the Members States' local and regional authorities in the implementation of EU law. When according to national law, the local or regional authorities have to implement EU law, EU institutions should take the internal division of responsibilities duly into consideration, for example by establishing an institutional dialogue directly with the competent local or regional bodies.

In order to assure the effectiveness of EU law as well as the efficient control of its implementation, it is however necessary that such consideration of the regional and local authorities' responsibility does not consequently diminish the responsibility of the Member State as a whole (the central government). A compromise could be that both the Member State and the local and regional

65 ECJ 11 September 2008, Case C-11/07, *Eckelkamp*.

66 Better coordination would furthermore improve the overall efficiency of EC regional policy. See C. ANSELL, C. PARSONS and K. DARDEN, "Dual networks in European, regional development policy", *Journal of Common Market Studies* No. 3, 1997, p. 347-375.

authorities within that Member State would be considered co-responsible as to the fulfillment of the obligations arising from the membership of the State to the EU, notably the implementation of the tax harmonization Directives into national law.

However, the acknowledgment of the regional and local authorities should not lead to a differentiated application of the EU provisions, according to the level of the government within the respective Member State competent for the implementation of Community law. For example, tax measures taken by local or regional bodies should not be excluded as a rule of the scope of application of the prohibition of State aid. Such differentiation would harm the effectiveness and the uniformity of EU law, in particular with regard to the guarantees conferred directly upon EU citizens.

The difficulties encountered in exploring the EU limits to the exercise of local and regional authorities' competences in the field of taxation seem to find their source mainly in the indeterminate extent of the EU competences in the area of tax law. This indetermination derives from the mode of attribution of the tax competences to the Community, which is based on a functional criterion, with regard to a non-fiscal objective, namely the achievement of the Internal market, and is not linked with any financial responsibility. An institutional reform at a European level should therefore take into particular account the harmonious integration of a system where competences are shared with the Members States' national systems according to a model that combines multi-level and non-hierarchical governance together with effectiveness of EU law.

At a time when several Member States, like Belgium and Italy consider conferring new taxing competences on local and regional authorities, it is of particular importance to take those obligations emanating from EU law into consideration. In Belgium, the prospect of a new constitutional reform after the elections of 13 June 2010 provides for an increase of the tax competences of the Regions. It is fundamental that the progresses of European tax integration are duly taken into consideration in the forthcoming national institutional negotiations. Also in Italy, the recent implementation in 2009 of the constitutional principles adopted in 2001 of "fiscal federalism", i.e. the division of taxing powers between the State, the regions and the local authorities will have to be achieved according to EU requirements. Even if the IRAP, the tax which yields the most significant part of the Italian regions' revenues, has been declared compatible with the VAT Directive by the ECJ (case C-475/03), the development of an autonomous tax policy by the Regions will nevertheless raise new issues, like the protection of internal economic freedoms in interregional trade and the increase of tax competition between regions[67].

In conclusion, the study of EU law has a lot to bring to Member States' internal debate on the division of taxing powers between State, regional and local

[67] On these issues, F. GALLO, "Il federalismo fiscale cooperativo", *Rass. Trib*. 1995, No. 2, p. 275-284, p. 282.

authorities, especially by re-focusing the institutional questions on the importance of protecting the individual rights of citizens-taxpayers. Conversely, the actual reforms in the Member States concerning the division of taxing powers, based on the financial responsibility of the local and regional bodies, bring to light an essential condition to be fulfilled in order to transform the European Union into a supranational political body. These internal reforms recall that the exercise of autonomous powers, i.e. the right to freely adopt binding rules, cannot be dissociated from the responsibility, i.e. the obligation to bear the consequences, whether legal, political or budgetary, of the application of these rules vis-à-vis their addressees.