Principles of Law: Function, Status and Impact in EU Tax Law

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Chapter 10: No Taxation without Representation in the European Union: Democracy, Patriotism and Taxes

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10.1. Introduction

It is herein assumed that the rule of law in respect of taxes both in the EU Member States and in the European Union requires the principle of people's sovereignty, separation of powers and legality (generality, promulgation, non-retroactivity, clarity, non-contradiction).[1] It can also be contended that by reason of the European Convention for the Protection of Human Rights and Fundamental Freedoms (ECHR), confiscatory taxation is forbidden, and the principle of *nemo tenetur se ipsum accusare* is applicable in the EU Member States.[2]

The rule of law in relation to taxes in the European Union has to take into account different and complementary perspectives: the competence of the Member States in respect of their national taxes which comprises allocation of taxing rights that are not yet harmonized and exercise of taxing rights in a manner that is compatible with secondary and primary EU law and the role of the Court of Justice of the European Union (ECJ); the competence of the European Union regarding harmonization; and the absence of taxes created by the European Union.

Some of the above-mentioned aspects of legality such as clarity and constancy through time are clearly not observed by EU Member States' tax systems and it has been suggested that simple laws and some legal vagueness are the best way to accomplish that purpose.[3] Moreover, horizontal pluralism in the interaction among EU Member States, and vertical pluralism deriving from EU harmonization (for example beneficial owner in the Savings Directive[4] or valid commercial reasons in the Merger Directive) and the ECJ case law (for example, artificial arrangements) contribute to legal vagueness (but not necessarily to uncertainty)[5] in the tax systems in force in the European Union.

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1. L.L. Fuller, *The Morality of Law*, 2nd edn (Yale University Press 1969); D. Dyzenhaus, *The Rule of Law as the Rule of the Liberal Principle*, in *Ronald Dworkin* p. 72 (A. Ripstein ed., Cambridge University Press 2007).
2. Regarding the prohibition of confiscatory taxation, *see*, e.g., Gáll v. Hungary 4.11.2013 ECHR and Art.1 (1) of the Protocol ECHR, §§ 63 and 64 of the decision. On the nemo tenetur principle and its (non) applicability to tax duties in the non-criminal procedure, *see* Chambaz c. Switzerland, ECHR 5.4. 2012. Inherent in the abovementioned concept of rule of law is the ability of law to guide behaviour and, in respect of EU Member States, the ECHR contains some constraining inner morality of law, for example by impeding tax surcharges when they are criminal charges or tax compliance duties that violate the *nemo tenetur se ipsum accusare* principle: *see*, respectively, R. Attard, *The Classification of Tax Disputes, Human Rights Implications*, in *Human Rights and Taxation in Europe and the World* pp. 401-410 (G. Kofler, M. Poiares Maduro & P. Pistone eds., IBFD 2011); A.P. Dourado and A. Silva Dias, *Information Duties, Aggressive Tax Planning and* nemo tenetur se ipsum accusare *in the light of Art. 6(1) of ECHR*, in Kofler, Poiares Maduro & Pistone eds., op. cit., at pp. 131-141; *see also* on competences in the European Union regarding human rights: S. Besson, *The Human Rights Competence in the EU. The State of the Question after Lisbon*, in Kofler, Poiares Maduro & Pistone eds., op. cit., at pp. 37-55; considering that human rights standards set by the ECHR still play a limited role in the constitutional scrutiny of national substantive taxation, *see* J. Englisch, *The Impact of Human Rights on Domestic Substantive Taxation – The German Experience*, in Kofler, Poiares Maduro & Pistone eds., op. cit., at pp. 285-302. Opposing any morality constraints in the concept of rule of law: J. Raz, *The Authority of Law: Essays on Law and Morality* pp. 210-229 (Clarendon Press 1979); H.L.A. Hart, *Essays in Jurisprudence and Philosophy* pp. 350-352 (Clarendon Press 1983); R. Dworkin, *Philosophy, Morality and Law: Observations Prompted by Professor Fuller's Novel Claim*, 113 University of Pennsylvania Law Review 5, p. 668 (1965). And I also analysed the rule of law in a perspective that deprived taxes of any morality in A.P. Dourado, *The Delicate Balance: Revenue Authority Discretions and the Rule of Law – Some Thoughts in a Legal Theory and Comparative Perspective*, in *The Delicate Balance – Tax, Discretion and the Rule of Law* p. 17 (C. Evans, J. Freedman & R. Krever eds., IBFD 2011).
3. *See*, e.g., A.P. Dourado, *General Report – In Search of Validity in Tax Law: The Boundaries between Creation and Application in a Rule-of-Law State*, in *Separation of Powers in Tax Law* secs. 1.2.4., 1.3. and 1.4.3., European Association of Tax Law Professors (EATLP) Congress, Santiago de Compostela, 2009 (A.P. Dourado ed., IBFD 2010); H.L.A. Hart, *The Concept of Law* p. 121 (Oxford University Press 1961); K. Günther, *The Sense of Appropriateness: Application Discourses in Morality and Law* pp. 270-271 (State University of New York Press 1993).
4. Council Directive 2003/48/EC of 3 June 2003, as amended on 14 April 2014.
5. Cf. A. Marmor, *The Rule of Law and Its Limits*, 23 Law and Philosophy 1, pp. 26-27 (and 12-15) (2004).

10.2. Legitimacy and validity of parliaments and delegated legislation

Tax law is legitimate and valid when socially accepted,[6] i.e. when it receives its legitimacy from democratic procedures, public discussion and argumentation, disagreement and compromise in parliament in a context of political plurality. In general, a legal system as a whole is valid as long as there is a "concordant practice by courts, officials and private persons" identifying the validity of law according to publicly known criteria and applying it[7] and as long as it expresses an authentic understanding of the juridical community, its shared values and interests and a rational choice of strategies and means.[8] Validity also requires that rules are the product of genuine argumentative interaction among the representatives of different legalities, which is particularly relevant in a political community like the European Union.[9]

The fact that governments and other public players draft the legislation and co-participate in policy decisions is not relevant in this respect, as long as there is public discussion and enactment by parliament. However, legislative competences being determined by national constitutions vary. In some European civil law countries, governments receive delegated legislative competence in tax matters but the main elements of taxes are still to be decided by parliaments, complying with the people's sovereignty and separation of powers principles. In contrast to Ronald Dworkin (an egalitarian liberal) and libertarians such as Dicey, Hewart and Hayek, according to whom policy is under parliament's monopoly and principles under judges' monopoly,[10] in rule-of-law states since the second half of the 20th century governments also play a relevant role (they have indirect democratic legitimacy) and the administration – not only the courts – interprets the law.[11]

Thus, legislation delegated to the executive is to be assessed differently from regulations and rulings by the minister of finance and the revenue authorities, even if these play a major role in complementing the technical aspects of the tax legislation. In Germany, however, regulations delegated to the (whole) government in tax matters seem to follow a similar constitutional procedure to the delegated legislation in Italy or Portugal and a similar relationship in respect of functions played by each act and its corresponding contents. In fact, the legal type of tax – the tax object, the taxpayer and the foreseeable amount of tax (taxable base, rates allowances, credits and exemptions) –, has to be determined by parliamentary law, according to the constitutions of the three aforementioned countries.[12] As a consequence, the tax aspects dealt with by both German delegated regulations and the Italian legislative decrees and the Portuguese delegated decree-laws are often comparable.[13]

The principles of people's sovereignty and separation of powers themselves require that the legal type of tax is discussed and approved by parliaments. It is widely recognized that parliaments cannot decide the technical details of taxes and moreover, creation and increase of taxes have been mainly driven by governments in the post world war II scenario,[14] in the era of the tax state (parliaments are keen to spend whereas governments are responsible to keep balanced budgets).

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6. J. Habermas, *Faktizität und Geltung, Beiträge zur Diskurstheorie des Rechts und des demokratischen Rechtsstaats* pp. 192-194 (Suhrkamp Verlag 1992); J. Waldron, *Law and Disagreement* ch. 2 (Oxford University Press 2004 [1999]).
7. Hart, *supra* n. 3, pp. 97-107 and 110 et seq.; J. Raz, *The Concept of a Legal System – An Introduction to the Theory of Legal System*, 2nd edn, pp. 197-200 (Clarendon Press 1980); J. Raz, *The Authority of Law: Essays on Law and Morality* chaps. 1-2 (Clarendon Press 1979).
8. Habermas, *supra* n. 6, at pp. 192 and 194; Waldron, *supra* n. 6, at ch. 2.
9. These concepts are therefore used here in the Habermasian sense: *see* J. Habermas, *supra* n. 6, at pp. 32-35; A.P. Dourado, *Is This a Pipe? Validity of a Tax Reform for a Developing Country*, in *Tax, Law and Development* pp. 134 et seq. (Y. Brauner and M. Stewart eds., Edward Elgar Publishing Ltd. 2013).
10. *See* D. Dyzenhaus, *The Rule of Law as the Rule of the Liberal Principle*, in *Ronald Dworkin*, pp. 69-72 (A. Ripstein ed., Cambridge University Press 2007); Dourado, *supra* n. 2.
11. In legal theory and in constitutional law 19th century, there is no place for governments and revenue authorities (Dourado, *supra* n. 2).
12. *See* Tipke et al., *Steuerrecht*, 21st edn, pp. 114-115, paras. 233-234 (Verlag Dr. Otto Schmidt 2012); L. del Federico with the collaboration of R. Castiglione and F. Miconi, *Relationship between the parliament and the tax authorities: The Influence of the Tax Authorities on Tax Legislation*, in Dourado ed., *supra* n. 3, at pp. 129-130; A.P. Dourado, *O Princípio da Legalidade Fiscal – Tipicidade, Conceitos Jurídicos Indeterminados e Margem de Livre Apreciação* pp. 103-125 (Almedina 2007); A. Carlos dos Santos & P. Nogueira da Costa, *Portugal*, in Dourado ed., *supra* n. 3, at pp. 181-182.
13. Dourado, *supra* n. 12, at pp. 273-279; *see also* Canada's blurring the three functions, as an example outside the European Union: K. Brooks, *A Reasonable Balance: Revenue Authority Discretions and the Rule of Law in Canada*, in Evans, Freedman & Krever eds., *supra* n. 2, at pp. 63-77.
14. *See* the several chapters in Evans, Freedman & Krever eds., *supra* n. 2; Dourado, *supra* n. 3.

Since governments emanate from parliamentary majorities, the delegated legislative competences of governments are widely accepted by all legal players and the society and therefore, legislation enacted by governments is valid.

Even if tax law can be valid both in the case of legislation enacted by parliaments and by governments through delegation, comparison of constitutional systems[15] has led us to the conclusion that in those systems where parliament plays an active role, the idea that creation of tax law belongs to them is reassured.[16] Checks and balances are also an important element in certifying separation of powers in tax matters.[17]

10.3. Tax state, tax sovereignty, tax patriotism and tax exile in the European Union

In EU Member States, especially up until the recent fiscal crisis, increase or decrease of taxes has furthermore been perceived as a tool of sovereignty and therefore linked to the principles of people's sovereignty and no taxation without representation. In contrast, any amendments resulting from the ECJ case law (where the case law does not imply a unique solution), EU directives or OECD standards are often not publicly discussed in parliaments, even if approved by them.

However, in the Economic and Monetary Union (EMU) Member States more or less hit by the euro, fiscal and bank crises, the traditional meaning of rule of law and the principle of people's sovereignty in taxes has changed since the crises. Taxes are now instruments for paying back states' and banks' debts during periods of emergency.[18] Governments have tried to link an increase in taxes such as value added tax (VAT) and personal income tax to national patriotism, and in some cases, have announced such measures as temporary, whereas the EMU as it stands has been presented as the unique available and non-negotiable option.

Tax patriotism has been debated in France, in respect of publicly known individual taxpayers announcing that they are either moving their residence to another Member State or switching their nationality for tax reasons (tax exile).[19] The phenomenon of tax exile is a manifestation of misrepresentation by parliaments of the people's sovereignty and will in taxes and it means that the aforementioned conversion of the tax state into a debt state is not accepted by the taxpayer. Moreover, when tax exile occurs within the European Union it reflects the exercise of a fundamental freedom by a EU citizen, and the awareness by those citizens of a mismatch between "no taxation without representation" entitling them to vote, and taxation of resident individuals, who are not necessarily citizens. In fact, residents are taxed according to the ability-to-pay principle and therefore on their progressive income and are entitled to tax allowances even if they are not citizens and therefore will not vote, which means that a citizen of a Member State can benefit from the EU fundamental freedoms and exit his or her state of citizenship mainly or exclusively for tax reasons, as long as the move is not artificial. It is a mismatch partially solved by voting with the feet: voters (citizens of a Member State) will move to another Member State, to be submitted to progressive taxation in the new residence state but will continue to vote in ballots in the state which they have exited.

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15. It is herein assumed and contended that, contrary to Jesch (D. Jesch, *Gesetz und Verwaltung*, 2nd edn, p. 4 (Mohr Siebeck 1968)) constitutional systems can be compared. *See also* on inclusion and the relationship between the nation state, rule of law and democracy J. Habermas, *Die Einbeziehung des Anderen: Studien zur politischen Theorie* pp. 154-185 (Suhrkamp Verlag 1996).
16. E.g. Belgium, Denmark, the United Kingdom: Dourado, *supra* n. 3, at p. 33.
17. *See* the case of the Netherlands, H. Gribnau, *Netherlands*, in Dourado ed., *supra* n. 3, at pp. 146-147.
18. On the transformation of tax states into debt states: W. Streeck, *Gekaufte Zeit – Die vertagte Krise des demokratischen Kapitalismus*, p. 119 (Suhrkamp Verlag 2013); J. Habermas, *Demokratie oder Kapitalismus? Vom Elend der nationalstaatlichen Frag-mentierung in einer kapitalistisch integrierten Weltgesellschaft*, in *Demokratie oder Kapitalismus? – Europa in der Krise*, Blätter für deutsche und internationale Politik (Hg.), pp. 76-77 (Blätter 2013).
19. L. Meneghin, *Que penser du patriotisme fiscal? (Première partie: dépasser les caricatures)*, Jeune Dirigeant. FR, le 30-01-2013, available at http://www.jeune-dirigeant.fr/011-805-Que-penser-du-patriotisme-fiscal-Premiere-partie-depasser-les-caricatures.html; Que penser du patriotisme fiscal? (Deuxième partie: la solidarité est-elle soluble dans la mo*ndialisation?)*, Jeune Dirigeant. FR, le 24-02-2013, available at http://www.jeune-dirigeant.fr/011-823-Que-penser-du-patriotisme-fiscal-Deuxieme-partie-la-solidarite-est-elle-soluble-dans-la-mondialisation.html 23.02.2013; M. Legros, *Le patriotisme fiscal a-t-il un sens?*, Philosophie magazine, 24.02.2013, available at http://www.philomag.com/lepoque/le-patriotisme-fiscal-a-t-il-un-sens-6271.

Even if a citizen of a Member State can rely on the EU fundamental freedoms, the mismatch between the principle of people's sovereignty and the EU fundamental freedoms is not fully resolved as long as an EU citizen does not return as resident, to the Member State of which he is a citizen.

Tax patriotism used by EMU parliaments or governments to justify the enormous increase of taxes relies on national patriotism and is linked to a pre-rational (or pre-enlightenment) thinking: patriotism as the readiness to die or be killed on behalf of one's country, as an abstraction of imaginary ingredients, independently of rational arguments.[20] National tax patriotism invoked as a fundament to raising taxes is not rational either because the need for raising taxes is being linked to austerity measures not necessarily improving the situation in the nation state in the logic of a social contract.[21]

Taxes are valid in a rule-of-law state if they finance public goods and services, and higher taxes mean more or at least better public goods and services. National patriotism as an argument for raising taxes is instead linked to the purpose of saving the EMU. However, since the principle of no taxation without representation is not applicable to the EMU in the current EU constitutional system, national tax patriotism is detached from the necessary underlying social contract.

The European Commission and the European Central Bank representing the EMU and the European Union are executive entities and not adequate to represent the principles of people's sovereignty, no taxation without representation and separation of powers. In the context of the bailouts, the aforementioned EU institutions are not necessarily differentiated from the International Monetary Fund (IMF) as an international organization playing its role as lender and therefore disconnected from taxation and representation.

The absence of a social contract that justifies an increase in national taxes, targeted at residents (personal income tax and VAT) and any other consumers (VAT), to save the EMU and not aimed at the nation state is a critical point. It undermines the basis for a democratic EMU and the European Union, and therefore, the rule of law, people's sovereignty and separation of powers. But there are other inconsistencies in the EU rule of law in tax matters which became visible with the crisis: the recent intergovernmental treaty[22] amending the Lisbon treaty and imposing the golden rule – balanced budgets in the European Union – is difficult to reconcile with the open and increasing competition among Member States in corporate income taxes, combined with an increase in VAT and personal income tax. From a global perspective, the fact that the fiscal policy is oriented to balanced budgets, also implies that EU Member States which were tax states are now being converted into debt states. Tax states are democratic states resulting from their citizens' choices whereas debt states depend on creditors.[23] Taxes are and will be raised in many EMU countries to keep the budget balanced and, as a consequence, to finance debt. The era of the modern state as a tax state is vanishing, not only because of the EMU's most recent budgetary policy, but also as a consequence of several constraints that globalization has brought to the Organisation for Economic Co-operation and Development (OECD) and the EU Member States: resident companies fear losing the ability to be competitive; international tax avoidance; cross-border taxable bases; tax competition among states.[24]

Tax exile is not the only demonstration of a mismatch between taxes raised on resident citizens to finance debt states and the principle of people's sovereignty. In general, and as noted above, tax law as any other law is valid if it is accepted by

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20. G. Kateb, *Patriotism and Other Mistakes* pp. 7-8 (also ch. 1) (Yale University Press 2006). Arguing for a rational patriotism, i.e. a constitutional patriotism centred on the norms and values of a liberal democratic constitution, rather than a national culture of the global human community, *see* J.-W. Müller *Constitutional Patriotism* pp. 119-139 (Princeton University Press 2009), e.g. on a European constitutional patriotism.
21. Taxes are justifiable on the basis of a social contract and not patriotism: *see* in this sense also R. Lavoie, *Patriotism and Taxation: The Tax Compliance Implications of the Tea Party Movement*, 45 Loy. L.A. L. Rev. 39, pp. 70-73 (2011), available at http://digitalcommons.lmu.edu/llr/vol45/iss1/2. The Tea Party movement in the United States is trying to establish a linkage between patriotism and the anti-tax sentiment and Lavoie criticizes this linkage.
22. The Intergovernmental Treaty on Stability, Coordination and Governance in the EMU was signed by all EU Member States, except the United Kingdom and the Czech Republic, by occasion of the Council of Europe meeting on 12 March 2012, and entered into force on 1 January 2013.
23. Habermas, *supra* n. 18, at pp. 76-77; Streeck, *supra* n. 18, at p. 119.
24. *See* P. Genschel & S. Uhl, *Der Steuerstaat und die Globalisierung*, in *Transformationen des Staates?* pp. 92-95 et seq. (S. Leibfried & M. Zürn eds., Suhrkamp 2006). Since the 19th century, taxes are the main source of state revenue, where the main taxes in OECD Member States were designed between the end of the 19th century and the seventies of the 20th century; id., at p. 92.

the agents applying it and the society in general (i.e. by the taxpayers).[25] In the context of the bailout of one Member State, the payment of 2/14 of salaries of civil servants and pensions of retired civil servants was suspended. This suspension was justified as being exceptional and linked to the economic emergency situation. Its constitutionality has been questioned on the basis of the ability-to-pay principle in taxes (the aforementioned suspension can be considered equivalent to a tax) and the national constitutional court declared it unconstitutional because it was not compliant with the principles of equality and proportionality, where it went beyond the period of 1 year.[26] In turn, reduction of pensions of civil servants (reduction of an expense and therefore not a tax) has been considered unconstitutional because it is violating protection of trust, which is in turn based on the rule-of-law principle.[27] Finally, additional taxes on personal income tax have not been declared unconstitutional in the same context, on the basis of their temporary character.[28] The aforementioned case law shows that fiscal crises and bailouts are not necessarily a condition of validity and they do not guarantee validity of tax measures adopted. Validity of law requires democratic argumentation in the process of enacting legislation in parliament and is then better achieved either in plenary sessions or in specialized commissions.[29]

10.4. Vagueness in law and legal determinacy

In the relationship between parliaments, governments with delegated legislative competence, administrations and courts, the major problem in respect of separation of powers in tax law relates to the requirement of determinacy and to the meaning and consequences of vagueness and indeterminacy of tax legislation.[30]

Determinacy is accomplished when the sufficiency of legal arguments is enough to justify the decisions of the administration and judges. If the legal arguments are insufficient, the result will be indeterminate and this will only occur in hard cases.[31]

The most difficult issue concerning separation of powers in tax law is finding the borderline between creation and interpretation: when the law is so vague that the institutions that are supposed to apply it are instead deciding the essential policy choices, regulations, rulings and courts are not applying the law, but creating it. Thus, the problem underlying indeterminacy is arbitrariness, since it will not be possible to predict the decisions by the tax administration and courts.[32]

Because tax law is subject to parliamentary competence, a higher level of determinacy is required. In this respect, it is not possible to claim that civil law countries are more demanding than common law countries (*see*, e.g., *UK Vestey v. IRC*[33]).

Determinacy in law is an ideal that is not fully achievable and in tax law it also conflicts with the principle of ability to pay and with a necessary reaction to abuse in the form of general anti-avoidance rules (GAARs). Legal certainty is normally linked to legal determinacy[34] whereas vagueness promotes uncertainty. Legal determinacy

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25. *See supra* n. 11 and the text before it.
26. Acórdão do Tribunal Constitucional no 353/2012, Processo no 40/12, 5 July 2012, Plenary Session, Judge Rapporteur: João Cura Mariano.
27. Acórdão do Tribunal Constitucional no 862/2013, Processo no 1260/13, 19 Dec. 2013, Plenary Session, Judge Rapporteur: Lino Rodrigues Ribeiro; *See* a comment on the Portuguese case, and the current conflict between capitalism and democracy in Habermas, *supra* n. 18, at p. 80 (pp. 79-81).
28. Acórdão do Tribunal Constitucional no 187/2013, processos no 2/2013, 5/2013, 8/2013 and 11/2013, plenary session, 5 Apr. 2013, Judge Rapporteur: Carlos Fernandes Cadilha. *Diário da República*, I série, no 78, 22 de abril 2012. In France, the rate of 75% applicable to individual taxpayers and not to the joint amount earned by married couples (or equivalent) was considered to violate the principle of equality and therefore unconstitutional. The French *Conseil d'Etat* did not reason on the basis of a confiscatory taxation or of emergency measures.
29. Dourado, *supra* n. 3, at pp. 31-33.
30. Dourado, *supra* n. 3, at pp. 39-55.
31. J.L. Coleman & B. Leiter, *Determinacy, Objectivity and Authority*, in *Law and Interpretation, Essays in Legal Philosophy* p. 215 (A. Marmor ed., Clarendon Press 1995).
32. Dourado, *supra* n. 3, at pp. 37 and 41; and, among others, Coleman & Leiter, *supra* n. 31, at pp. 229 and 235-237; Marmor, *supra* n. 5, at pp. 38-43; T. Endicott, *Vagueness in Law* pp. 185-188 (Oxford University Press 2000).
33. UK case of *Vestey v. Inland Revenue Commissioners* [1980] A.C. 1148 (H.L.). *See* J. Freedman & J. Vella, *HMRC's Management of the U.K. Tax System: The Boundaries of Legitimate Discretion*, in Evans, Freedman & Krever eds., *supra* n. 2, at pp. 108-119.
34. Endicott, *supra* n. 32, at pp. 186-187.

implies standardized thinking, adequate to stabilize rules and compatible with the massive tax acts enacted by the administration (e.g. under automatic exchange of information, or income tax assessment notifications).

Vagueness is common to every other legal field and the courts interpret the rules in these areas. Legal vagueness is quantitative and it can lead to shorter or broader indeterminacy and therefore to the use of a shorter or broader amount of extra-legal arguments.[35]

Vagueness allows a case-by-case assessment open to future developments of society and economy and also more equitable (as supposedly under transfer pricing advance pricing agreements (APAs) or even transfer pricing adjustments). Thus, vagueness in law foments long-lasting laws.[36]

Vagueness can lead to indeterminacy but determination is not necessarily equivalent to detailed legal rules.[37] A principles-based taxation can be more determined than an exhaustive list of examples, because it is open to new cases and situations that were not foreseeable under an exhaustive list (*see* the case of the annexes in the Parent-Subsidiary Directive in the version of 1990 and the *Gaz de France* case[38]).

Plural legal systems, such as EU law as well as the law of its Member States, go hand in hand with legal vagueness.[39] Determinacy is particularly required in respect of the "legal type of tax", as the amount of tax must be foreseeable by the taxpayer: tax object, tax subject, taxable base and any quantification elements (any rule that influences the final amount of tax must be approved by parliament and must be sufficiently determined). Even if the aforementioned statement may be true, it is a *quaestio diabolica* to define the limits of vagueness in tax law in a way that is still compatible with the constitutional requirement of legal determinacy in taxes (*see* the case of a GAAR); and the limits of administrative discretion (*see* the transfer pricing issues) and how far does judicial control go. Vagueness, and indeterminacy in hard cases, is not equivalent to tax administrative discretion: as a rule, courts control administrative application of tax law.[40]

If tax law is formulated around a typical situation and devalues the particularities of a case, it will likely be valid law, in the sense that it will be accepted by tax officials and courts.[41] Taking into account a typical situation when defining profits, dividends, royalties or derivatives will reduce vagueness, and vagueness will be higher if the law leaves it open to a variety of individual cases.[42]

Contrary to what happens in administrative law, in tax law, legal indeterminacy does not aim as a rule at an application according to the circumstances of the concrete case, but it is recommendable that the former is reduced by a general

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35. In this sense: M. Klatt, *Semantic Normativity and the Objectivity Claim of Legal Argumentation*, Associations Journal for Legal and Social Theory, pp. 121-122 (2003); Endicott, *supra* n. 32, at pp. 31 et seq. and 188 et seq., (p. 191); D. Jesch, *Unbestimmter Rechtsbegriff und Ermessen*, 82 Archiv des öffentlichen Rechts 2-3, pp. 167-168 and 177-178 (1957); H. Ehmke, *"Ermessen" und "unbestimmter Rechtsbegriff" im Verwaltungsrecht* p. 29. nos. 230-231 (Mohr (Paul Siebeck) 1960); H.-J. Koch, *Unbestimmte Rechtsbegriffe und Ermessensermächtigungen im Verwaltungsrecht – Eine logische und semantische Studie zur Gesetzesbindung der Verwaltung* pp. 34 et seq. (Frankfurter Habilitationsschrift 1979); H.-U. Erichsen, *Die sog. unbestimmten Rechtsbegriffe als Steuerungs- und Kontrollmaßgaben im Verhältnis von Gesetzesgebung, Verwaltung und Rechtsprechung*, DVBl., p. 22 (1985); N. Achterberg, *Allgemeines Verwaltungsrecht*, 2nd edn, p. 342 (C.F. Müller 1986).
36. *See* Günther, *supra* n. 3, at pp. 168-173. According to Günther, application of law is a free space of appropriateness argumentation based on the law itself, and political and moral principles accepted by a specific community, in a specific context: id., at pp. 169-170, 270-273 and 274-280.
37. Dourado, *supra* n. 12, at pp. 30-31; Endicott, *supra* n. 32, at pp. 189-190.
38. DE: ECJ, 1 Oct. 2009, Case C-247/08, *Gaz de France – Berliner Investissement SA v. Bundeszentralamt für Steuern*, paras. 25-44, ECJ Case Law IBFD.
39. Marmor, *supra* n. 5, at pp. 38-43.
40. On the equivocal identification between indeterminacy and administrative discretion (where courts do not control administrative application of the law), *see* H.H. Rupp, *"Ermessen", "unbestimmter Rechtsbegriff" und kein Ende*, in *Festschrift für Wolfgang Zeidler* Band 1, pp. 460-461 (W. Fürst, R. Herzog & D.C. Umbach eds., Walter de Gruyter 1987).
41. *See supra* n. 12, and the text before it.
42. Recommending that tax law takes into account the typical cases, *see* the classical work of H. Henkel, *Introducción a la Filosofia del Derecho* p. 588 (Taurus 1968); and also P. Kirchhof, *Der verfassungsrechtliche Auftrag zur Steuervereinfachung*, in *Steuervereinfachung, Festschrift für Dietrich Meyding zum 65. Geburtstag* pp. 9 and 13 (W. Bühler, P. Kirchhof & F. Klein eds., C.F. Müller 1994).

and abstract rule and by consistent case law.[43] Legality, practicability and *second best* equality recommend such concretization due to the fact that tax law implies mass administration. Revenue authorities are not allowed to create rules in a rule-of-law state, but their function allows them to apply extra-legal arguments linked to policy arguments. Thus, if the legal arguments are not enough to justify only one correct decision, and the tax administration adopts one correct decision, courts should accept it. However, as mentioned above, a high degree of vagueness will mean that the institutions that are supposed to apply the law are instead deciding the essential policy choices.

10.5. Hard cases in tax law: The example of a common GAAR in the EU Member States

Indeterminacy occurs in hard cases – where the legal arguments are not enough to grant only one solution to the case – and in tax law it can cover any element of the "legal type of tax", but in the case of tax object and subject it is an issue of yes or no.[44] If it is questioned whether trusts are beneficial owners or paying agents under the EU Savings Directive, or whether income from a derivative instrument is interest for the purposes of the same Directive, in both cases, the answer is either yes or no. Where there is doubt there is a legal gap, and in that case, the principles of people's sovereignty and separation of powers require that the answer is no.

In respect of the amount of deductible costs, the answer can be related to difficulties in quantification.[45] It can range from a minimum to a maximum value, even if some costs are either deductible or not and the same is applicable in respect of some losses. Tax administration discretion as a result of indeterminacy is only related to cases where the answer will be more or less[46] rather than yes or no.

Vague laws can also be interpreted according to the typical case and this has been done by the ECJ. The risk of jeopardizing allocation of taxing rights, the risk of double deduction of losses, expenses incurred that are not compatible with the arm's length principle, a loan granted that does not respect the arm's length, are examples of interpretation of a principle (vague rule), such as the right of establishment, according to a typical case. In a typical case, financial transfers such as those described in *OY AA*,[47] could jeopardize allocation of taxing rights in the source and the residence states involved. In a typical case of cross-border losses, there is a risk of them being deducted twice, if two states allow that deduction.[48] And in a typical case of cross-border losses[49] or cross-border gratuitous loans (*SGI*),[50] there is a risk of tax avoidance or evasion. In order to avoid disproportionate restrictions on the fundamental freedoms, the Court has linked the risk of tax avoidance to the risk of jeopardizing allocation of taxing rights, even if it has later stated that the two arguments that act as justifications to a restriction are autonomous.[51] Ultimately, the ECJ justifies restrictive measures where avoidance is promoted by disparities or mismatches. However, if interpretation according to the typical case restricts the scope of the law, it is not compatible with it. Moreover, the difficulty of courts assessing the individual case is not accepted in the EU legal system, as the *Foggia* case demonstrates,[52] and as it should be in a rule-of-law order.

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43. Application according to the typical case will reduce vagueness, indeterminacy and uncertainty: F. Bydlinski, *Juristische Methodenlehre und Rechtsbegriff* 2nd edn, pp. 548-549 et seq. (Springer-Verlag 1991).
44. On the difference between legal indeterminacy and the option between yes or no, *see* Dourado, *supra* n. 12, at title III, ch. 6, sec. 1.
45. *See* BE: ECJ, 21 Jan. 2010, Case C-311/08, *Société de Gestion Industrielle SA (SGI) v. Belgian State*, paras. 9-17, ECJ Case Law IBFD.
46. "Any other capital income" (example of hard cases: capital income vs. capital gains); "expenses related to income"; "transactions at arm's length"; cross referral to accounting standards; core (typical) cases have to be foreseen by the legislator. *See supra* n. 43.
47. FI: ECJ, 18 July 2007, Case C-231/05, *Oy AA*, paras. 11-15, ECJ Case Law IBFD.
48. E.g., UK: ECJ, 13 Dec. 2005, Case C-446/03, *Marks & Spencer plc v. Halsey (Her Majesty's Inspector of Taxes)*, paras. 46-48, ECJ Case Law IBFD.
49. Id., para. 49.
50. *See SGI* (C-311/08).
51. DE: ECJ, 15 May 2008, Case C-414/06, *Lidl Belgium GmbH & Co. KG v. Finanzamt Heilbronn*, paras. 40-42, ECJ Case Law IBFD.
52. PT: ECJ, 10 Nov. 2011, Case C-126/10, *Foggia – Sociedade Gestora de Participações Sociais SA v. Secretário de Estado dos Assuntos Fiscais*, paras. 37-51, ECJ Case Law IBFD.

One of the most striking examples of legal indeterminacy in tax legislation are GAARs. They are recommended by the European Commission.[53]

> 4.1. To counteract aggressive tax planning practices which fall outside the scope of their specific anti-avoidance rules, Member States should adopt a general anti-abuse rule, adapted to domestic and cross-border situations confined to the Union and situations involving third countries.
>
> 4.2. To give effect to point 4.1, Member States are encouraged to introduce the following clause in their national legislation:
>
> "An artificial arrangement or an artificial series of arrangements which has been put into place for the essential purpose of avoiding taxation and leads to a tax benefit shall be ignored. National authorities shall treat these arrangements for tax purposes by reference to their economic substance".

If the ECJ will consider itself competent to interpret national GAARs that follow the recommendation lines,[54] indeterminacy will be progressively reduced by consistent case law. GAARs are not incompatible with determinacy requirements, considering that they are a tool to overcome interpretation of tax law closely connected to the literal element in domestic law. Furthermore, taking into account the EU fundamental principles and non-discrimination, a GAAR will allow a proportionate reaction to abuse, since it requires a case-by-case assessment of abuse, for example based on a wholly artificial arrangement test, and does not operate as an irrebuttable presumption.[55] Interpretation according to the typical case, allows reduction of vagueness.

In contrast, the ECJ does not accept irrebuttable anti-abuse rules based on the typical case (controlled foreign company (CFC) clauses, thin capitalization clauses): except for the cases on cross-border losses and expenses,[56] irrebuttable presumptions are declared to be incompatible with the fundamental freedoms, because they are considered to be disproportionate. The ECJ case law illustrates that vague rules in tax legislation, such as "valid commercial reasons",[57] are not incompatible with a determinacy requirement. Settled case law assessing tax abuse provisions also demonstrates that vague concepts such as the arm's length principle (or the arm's length test)[58] are considered to be compatible with EU constitutional law.

A case-by-case analysis of abuse leads to a more equitable result, but it is burdensome and brings uncertainty in the short or even medium term, since it relies on vague clauses. Ideally, if the ECJ were competent to judge all cross-border and domestic tax cases with implications in the internal market, vagueness in law would be reduced and certainty would increase over time. However, the ECJ itself has been contributing to vagueness and indeterminacy by introducing or accepting principles in the European Union such as the aforementioned "wholly artificial arrangements" or "arm's length test" and asking the national courts to apply them. If this methodology persuades national courts to assume their

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53. Brussels, 6.12.2012, C(2012) 8806 final, Commission Recommendation of 6.12.2012 on aggressive tax planning; on the artificiality test, *see* F. Vanistendael, Cadbury Schweppes *and Abuse from an EU Tax Law Perspective*, in *A General Principle of Abuse in European Law* pp. 411-413 (R. de la Feria & S. Vogenauer eds., Hart Publishing 2011); M. Lang, Cadbury Schweppes' *Line of Case Law from the Member States' Perspective*, in De la Feria & Vogenauer eds., op. cit., at pp. 435-441.
54. The ECJ has recently extended the artificiality test to a VAT case: *see* UK: ECJ, 20 June 2013, Case C-653/11, *Her Majesty's Commissioners of Revenue and Customs v. Paul Newey t/a Ocean Finance*, ECJ Case Law IBFD. *See* the commentary on the case by R. de la Feria & M. Silva Costa, *O Impacto de Ocean Finance no Conceito de Abuso do Direito para Efeitos de IVA*, 6 Revista de Finanças Públicas e Direito Fiscal 3, pp. 321-347 (2013).
55. Irrebuttable presumptions are considered to be restrictive and disproportionate: UK: ECJ, 12 Sept. 2006, Case C-196/04, *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*, paras. 63-65, ECJ Case Law IBFD; DE: ECJ, 12 Dec. 2002, Case C-324/00, *Lankhorst-Hohorst GmbH v. Finanzamt Steinfurt*, para. 37, ECJ Case Law IBFD.
56. *See* A.P. Dourado, *Tax Mobility in the European Union: Present and Future Trends*, in *Movement of Persons and Tax Mobility in the EU: Changing Winds* sec. 1.5.1. (A.P. Dourado ed., IBFD 2014), Online Books IBFD.
57. *See Foggia* (C-126/10).
58. UK: ECJ, 13 Mar. 2007, Case C-524/04, *Test Claimants in the Thin Cap Group Litigation v. Commissioners of Inland Revenue*, paras. 81-87, ECJ Case Law IBFD; *SGI* (C-311/08).

role as EU courts, in cooperation with the ECJ, promoting legal pluralism and therefore overcoming the hierarchy that results from the principle of primacy and contributing to more EU integration,[59] it increases legal uncertainty, at least in the short or even medium term.

In order to bring legal certainty and equality to the EU taxpayers, the ECJ would need to be reformed, to include more sections, and specialized sections that would be able not only to interpret/apply the fundamental freedoms but also to interpret the facts in light of the tax principles that are common to the EU and the OECD Member States. Separation of powers and the rule of law cannot be achieved by the ECJ if main principles of taxation such as ability to pay (*see* the *Margarete Block* case[60]) and practicability, and second tier principles (such as wholly artificial arrangements) are not included in its assessments.

Legal certainty is also an EU principle;[61] however, the ECJ case law very often contributes to the opposite result.

10.6. Legal gaps and GAARs

It was previously mentioned that legal vagueness can lead to more than one answer compatible with the law, because legal arguments are not sufficient to justify one and only one answer in hard cases. This is not the only relevant meaning of indeterminacy in order to assess separation of powers and the rule of law in taxes. I am referring to the case where legal arguments are not adequate to guarantee any result, and this is where legal gaps occur.[62] Analogy is not admitted in tax matters in most domestic legal systems where separation of powers is applicable.

In turn, vagueness is only associated with the first-mentioned meaning of indeterminacy. A GAAR may be vague and lead itself to some indeterminacy in the first-mentioned sense, but it has the function of reducing legal gaps.

10.7. The rule of law and validity in the European Union

Tax harmonization has EU constitutional grounds (articles 113 and 115 of the Treaty on the Functioning of the European Union (TFEU)). Directives have to be transposed in domestic legal systems according to domestic constitutional rules, but it is *acte clair* that they have primacy and direct effect over national law, granting rights on national taxpayers.[63] In tax matters this means that national parliaments will either approve a law with the contents of the directive or delegate their competence to the government to approve a decree-law with the aforementioned contents, in those systems where governments have delegated legislative competence.

In practice, separation of powers operates upside-down: the Economic and Financial Affairs Council (ECOFIN) starts the process, the Commission proposes the directive, the Council approves it and national parliaments have to transpose the directive.[64] This is neither a novelty nor less compliant with the principle of separation of powers, in comparison to most of, if not all, national legislative processes, since the second half of the 20th century.[65] Commissions of experts elaborate tax law drafts which are first submitted to the ministry of finance, then to the government and the government submits a proposal to parliament. And amendments to existing tax laws are initially submitted by tax administrations. We may assume that each and all of the aforementioned drafters are skilled and rational legislative drafters as envisaged by Hobbes, John Stuart Mill and the Enlightenment thinking (the larger the legislative assembly the lower the level of wisdom and knowledge among the lawmakers): a rational legislative drafter is not in himself an obstacle to the principle of separation of powers.[66] But since the latter principle requires legislation to emerge from communication

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59. Discussing sovereignty, supremacy, constitutional pluralism: G. de Búrca, *Sovereignty and the Supremacy Doctrine of the European Court of Justice*, in *Sovereignty in Transition* pp. 449-460 (N. Walker ed., Hart Publishing 2003); M. Maduro, *Contrapunctual Law: Europe's Constitutional Pluralism in Action*, in De Búrca, op. cit., at pp. 501-538.
60. DE: ECJ, 12 Feb. 2009, Case C-67/08, *Margarete Block v. Finanzamt Kaufbeuren*, ECJ Case Law IBFD.
61. A. Dashwood et al., *Wyatt & Dashwood's European Union Law*, 6th edn, pp. 328-332 (Sweet & Maxwell 2011).
62. Coleman & Leiter, *supra* n. 31, at p. 213.
63. Dashwood et al., *supra* n. 61, at pp. 244-278.
64. *See* the example of the Savings Directive (2003/48/EC).
65. *See* Dourado, *supra* n. 3, at pp. 29-33; and Dourado, *supra* n. 2.
66. Waldron, *supra* n. 6, chaps. I.2 and I.3, pp. 49 et seq. and 69 et seq.; Dourado, *supra* n. 3; and Dourado, *supra* n. 2.

and disagreement in democratic assemblies internalizing dissenting opinions[67] the EU principles of direct effect and primacy require that national parliaments are only competent to discuss and internalize dissenting opinions before a directive has been enacted, and it is dubious if all or even the majority of the Member States do so.

Moreover, contrary to the fundamental freedoms, where qualifying beneficiaries of non-discriminatory measures are citizens of a Member State, beneficiaries of EU tax harmonization are not necessarily EU citizens: in the case of direct taxes (income taxes), beneficiaries are residents and non-residents with income with source in a Member State, and, in the case of VAT, beneficiaries are taxable persons who carry out activities in other Member States.

Both in case of domestic tax systems where EU law has had no impact until now and of EU harmonization, taxes are voted by nationals but their formal and/or material obligations fall mostly on residents and non-residents with income with source in a Member State, or with property located in a Member State, and on consumers within the EU territory and other taxable persons, even if they are not citizens of a Member State and therefore they cannot vote on their taxes.

In turn, the fact that commissions of experts prepare laws is not contrary to the rule of law and separation of powers, as long as parliaments discuss them prior to approval. It has to be seen if there is enough public discussion, argumentation and political plurality. Moreover, it is not obvious that participation of national representatives at the Council implies previous national validity and legitimacy.

10.8. Harmonization and separation of powers

Harmonization of national taxes implies not only allocation of taxing rights (e.g.the VAT consolidated directive and the Parent-Subsidiary Directive), but also rules on the legal type of tax. That is clear in the case of VAT that harmonizes the legal type of tax (tax object, taxable person, taxable base, rates, exemptions) but it also occurs in respect of partial harmonization of direct taxes: elimination of economic double taxation under the Parent-Subsidiary Directive is not only an issue of allocation of taxing rights, it implies setting up a regime where dividends cannot be submitted to economic double taxation, both in the source and the residence Member States.

In direct taxes, most of the directives do not imply taxation (creation of taxes) but prohibition of taxation together with the aforementioned allocation of taxing rights. However in the EU Savings Directive systematic and historical interpretation leads us to conclude that prohibition of a withholding tax by the paying agent implies taxation in the residence state (also because the transitional regime obliges the Member State of the paying agent to withhold and deliver 75% of the tax to the residence state).[68] The switch-over rules of the Proposal for a Council Directive amending the Parent-Subsidiary Directive[69] will also imply taxation in the Member State of the parent company where the Member State of the subsidiary does not tax.

According to article 4, paragraph 1, point (a) of the Proposal it is specified that the Member State of the receiving company (parent company or its permanent establishment) shall refrain from taxing the received profit distribution only to the extent that those profit distributions are not deductible in the source Member State (i.e. in the Member State of the distributing subsidiary). The Member State of the receiving company shall therefore tax the portion of profits that is deductible in the source Member State.

VAT, excise duties and also the Common Consolidated Corporate Tax Base (CCCTB) if it comes into force, means creation of taxes (VAT, excises and corporate income tax) for the purposes of the principles of people's sovereignty and separation of powers. Creation of taxes as well as allocation of taxing rights (implying elimination of taxable income), exemptions or any other tax benefits are submitted to the principle of people's sovereignty and separation of powers.

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67. Waldron, *supra* n. 6, at pp. 21-24, 27, 39-41, 66 and 69 et seq.
68. A.P. Dourado, *The EC Draft Directive on Interest from Savings from a Perspective of International Tax Law*, EC Tax Review 3, pp. 144-152 (2000).
69. Brussels, 25.11.2013, COM(2013) 814 final, Proposal for a Council Directive Amending Directive 2011/96/EU on the Common System of Taxation Applicable in the Case of Parent Companies and Subsidiaries of Different Member States, EU Law IBFD.

According to the principle of separation of powers, the competence of national parliaments covers not only creation of taxes, but also amendment of the elements belonging to the legal type of taxes, increase, decrease and elimination of taxes.[70]

Thus, elimination of tax on dividends is also submitted to approval by national parliaments or delegated to governments in those legal systems where they have legislative competence. Harmonization of corporate income tax concerning deferral of taxes in the case of restructuring of companies also contains rules on the allocation of taxing rights. More than that, it is *acte clair* that deferral of taxation and the anti-abuse provision (the absence of valid commercial reasons to deny application of the regime) are both applicable to cross-border and domestic situations and influence the final tax to be paid.[71] The Merger Directive provides for the setting up of the same tax regime concerning deferred taxation of capital gains in case of company restructuring, for cross-border and domestic situations.

The Interest and Royalties Directive also implies allocation of taxing rights and elimination of withholding taxes in the source state. For the purposes of separation of powers, it is to be analysed in the same terms as the Parent-Subsidiary Directive.

The Savings Directive not only allocates taxing rights, it also leads to the elimination of a tax in the paying agent Member State concerning interest paid by a paying agent to the beneficial owner – except for the transitional rule, where withholding taxes were exceptionally accepted. Article 16 of the EU Savings Directive still allows taxation on source (and withholding taxes) according to bilateral tax treaties, as long as the debtor of the interest is not the paying agent;[72] for example, the entity issuing public debt can apply a withholding tax in the source country, but the entity paying the interest cannot withhold the tax, except in the case of Austria and Luxembourg, for the transitional period and as long as the beneficial owner does not opt for the information to be exchanged (a bank that subscribed public debt and sells it to a beneficial owner). Moreover, the Savings Directive may interact with taxpayers' guarantees by implying automatic exchange of information (confidentiality rights, the right to be heard, for example) – by definition without prior notification to the taxpayer.[73]

Both the Directives on Mutual Assistance in Administrative Matters and on the Assistance for Collection deal with administrative matters and overcome the limits of territoriality, and to the extent that they may interfere with the taxpayers' rights and guarantees[74] they have to be approved by parliamentary law or delegated legislation.

If the rule of law is observed by the tax harmonization process, it is not so clear that harmonized tax legislation fulfils the criteria of validity. The question is whether there is enough public discussion, argumentation and political plurality in respect of EU tax harmonization. The European Union (i.e. the Commission) has improved its efforts to increase transparency and discussion in discussion groups, such as the Platform for Tax Good Governance.[75] The EU democratic deficit is mainly attributed to the insufficient role played by the European Parliament and to the insufficient public discussion of EU secondary legislation.

In contrast, the unanimity rule in tax matters could be regarded as contributing to ensure the principle of no taxation without representation, since each and every Member State can reject a directive if it does not agree with the regime proposed. However, unanimity very often contributes to postponing national public discussion of the proposals of

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70. Dourado, *supra* n. 12, at pp. 139-140.
71. *Foggia* (C-126/10).
72. *See* A. Rust, *How European Law Could Solve Double Taxation*, in *Double Taxation within the European Union* pp. 147-148 (A. Rust ed., Kluwer Law International 2011).
73. On the taxpayers' fundamental rights, *see*, e.g, A. Rust, *Data Protection as a Fundamental Right*, in *Exchange of Information and Bank Secrecy* pp. 177-195 (A. Rust & E. Fort eds., Kluwer Law International 2010). *See* the *Sabou* case: the rights of defence, including the right to be heard, are among the fundamental rights that form an integral part of the EU legal order (CZ: ECJ, 22 Oct. 2013, Case C-276/12, *Ji#í Sabou v. Finan#ní #editelství pro hlavní m#sto Prahu*, paras. 28 and 38, ECJ Case Law IBFD).
74. *See again Sabou* (C-276/12).
75. For example, the work of the EU Platform for Tax Good Governance is available at http://ec.europa.eu/taxation_customs/taxation/gen_info/good_governance_matters/platform/index_en.htm#section_5. However article 14(1) of the draft rules of procedure provides for the confidentiality of the deliberations, but article 14(2) foresees that "in agreement with the Chair, the group may, by a simple majority of its members, decide to open its deliberations to the public" (Brussels, June 2013, Taxud/D1/ DOC: Platform/001/2013/EN).

directives, as many Member States rely on the inertia of the procedure, do not believe that harmonization will proceed in the short term or even at all (e.g. the CCCTB) and therefore do not debate the proposals at national level.

Very often too, Member States (national governments) hide their own accountability in the outcome of a directive by switching the unanimity rule into a consensus rule – if everyone else agreed one or two Member States will also agree, so that they will not be the only ones to veto the directive.[76] And at last but not least, although the procedures regarding presentation and discussion of a proposal for a directive are more and more accessible to tax experts, they do not normally have enough impact in the media, since there is a belief that the citizens do not feel affected by their result.[77]

If the aforementioned scenario is a frequent one, it is also true that governments have domestically discussed some proposals of directives in direct taxes and their effects. The Proposal of the Savings Directive in 1998,[78] suggesting a coexistence model of withholding taxes and exchange of information raised severe obstacles from the UK financial sector, because withholding taxes on interest income from savings would presumably damage the UK Eurobonds market, set up in the beginning of the seventies as a result of withholding taxes introduced in the United States at the end of the sixties.[79] The Financial Transactions Proposal for a Directive has also led to hot public discussions ("the Robin Hood tax", "the Tobin tax") at least in France, Germany and the United Kingdom.[80]

So far, the CCCTB proposal has been refused by many Member States whereas business is mainly sceptical about it.[81] It is interesting to note that both the Commission and national governments often discuss an initiative for harmonization even prior to the presentation of a proposal for a directive with agents who will act as tax substitutes (withholding the tax and not with the taxpayers themselves) or who will have to assume relevant compliance costs (such as in the EU Savings Directive). In any case, the fact that at least in some Member States the proposal for the Savings Directive and the introduction of cross-border automatic exchange of information in respect of interest was not debated at the level of the national parliaments, suggests the introduction of a regime that could be met with unpopular reaction by abolishing the bank which existed at that time in those states. This can only be justified as a prevention of delocalization of savings from the EU territory to third countries that were not covered by the Directive, since free movement of capital has worldwide personal and territorial scope (it covers the European Union and third countries, EU nationals and nationals of third countries) and the Directive could be easily circumvented: on the one hand, for the purposes of the Directive, beneficial owners were only individuals resident in a Member State and the interposition of an entity in a third country, that would act as the beneficial owner would lead to non-application of the Directive. On the other hand, the paying agent concept could also be easily circumvented since, for the purposes of the Directive, the paying agent obliged to grant the information on interest paid to a beneficial owner to its own tax authorities, also had to be established in a Member State.[82]

In the absence of public discussion, argumentation and political plurality as they occur in parliaments, mitigation of the principle of separation of powers in this case (first tier principle) can perhaps be justified for the purpose of preventing tax planning by EU taxpayers, in an EU territory where the free movement of capital includes third countries and third

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76. *See* the origin of the "tax package" involving the Code of Conduct, the Savings Directive and the Interest and Royalties Directive, where Member States agreed that each of the instruments would only be approved if there was agreement on all of them: P. Cattoir, *A History of the "Tax Package –The Principles and Issues Underlying the Community Approach*, Taxation Papers, Working Paper no. 10, Dec. 2006 (European Commission –Taxation and Customs Duties, Luxembourg, EU 2007).
77. Criticizing the fact that governments do not share EU problems and issues with their citizens: J. Habermas, *Ach Europa – Kleine politische Schriften XI*, pp. 96-108 (Suhrkamp Verlag 2008).
78. *See* COM(1998) 295. This proposal for a directive followed up and replaced a proposal first tabled by the Commission in 1989, fixing a 15% withholding tax on income from interest payments (COM(1989) 60).
79. Cattoir, *supra* n. 76, at p. 9. The scope of the Proposal of Directive included interest payments of debt claims, including income from domestic or international bonds.
80. *See* the news in the Financial Times, e.g., at: http://www.ft.com/in-depth/financial-transaction-tax.
81. *See*, e.g.: http://agenda.ibec.ie/gpyd8fhookn; http://www.pwc.lu/en/press-articles/2011/businesses-and-the-ccctb-proposal-how-to-react.jhtml. *See* a critical legal view in J. Englisch, J. Vella & A. Yevgenyeva, *The Financial Transaction Tax Proposal under the Enhanced Cooperation Procedure: Legal and Practical Considerations*, British Tax Review 2, pp. 223-259 (2013).
82. *See* articles 4 and 8 of the original version of the Directive (EU Savings Directive (2003): Council Directive 2003/48/EC of 3 June 2003 on Taxation of Savings Income in the Form of Interest Payments, EU Law IBFD.

countries' nationals – the purpose of preserving the observance of the principle of ability to pay as an expression of equality could justify a mitigation of the separation of powers.

But the fact that the first version of the Directive was so easily circumvented, and that it took about 10 years to amend it[83] so that it became a serious instrument of exchange of information, allowing savings to be taxed in the EU country of residence of the beneficial owner, is closely linked to the lack of democratic governance in the European Union and therefore to the lack of "taxation with representation": these factors cannot justify non-compliance with the national constitutional principles of separation of powers. In fact, the outcome of the EU Savings Directive shows how contradictory the interests of different Member States are (at the time 15 Member States) and how strong lobbies of paying agents in some Member States managed to bring about the use of the unanimity rule to block a rational outcome.

If the European Parliament had the same competence as the Council to discuss proposals for directives, being represented by specialized parliamentary committees, the EU interest would be more compliant with democratic procedures, with the principle of separation of powers and the principle of no taxation without representation. The unanimity rule should either be substituted by a qualified majority rule or at least the enhanced cooperation mechanism should be used in tax matters. Public discussion in national parliaments would most likely increase if unanimity was abandoned (reactions would be both more passionate and more rational in defence of the state interest) and if the European Parliament had to approve the tax directives together with the Council.

Under the current rules, harmonization mainly receives its validity from national democratic procedures by means of transposition, and into a very insignificant extent from the EU Parliament. It is the Council's competence acting unanimously in accordance with a special legislative procedure after consulting the Parliament and the Economic and Social Committee, "to adopt provisions for the harmonization of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonization is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition" (article 113 of the TFEU). And it is also within the Council's competence to "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, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee" (article 115 of the TFEU).

All in all, the procedure under articles 113 and 115 would be more adequate from the viewpoint of validity of EU law, if both the European Parliament and the Council were competent to issue directives on tax matters.

10.9. How detailed should tax directives be: National parliaments as executive powers when transposing a directive

EU directives incorporate a mix of methodologies of the different EU legal systems.

EU tax directives combine a principles-based method with illustrative typifying standards that may lead to greater uncertainty (*see* the indicative lists in the Annexes of the new Savings Directive), and increase complexity.

As mentioned above, any tax legislator should, as a rule, aim at the typical case when drafting the tax object, taxable subject, taxable base, tax rates and other quantification elements: a principles-based taxation is designed around large groups and typical cases, and has a higher level of success in achieving equality and predictability.[84] Directives partially harmonizing direct taxes have not given rise to too many problems in the interpretation of their concepts except for the anti-abuse clause in the Merger Directive.[85] In contrast, full harmonization of the legal type of tax, as in VAT, raises many questions similar to what happens in domestic tax legislation.[86]

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83. The EU Council of Ministers adopted changes to the Savings Directive on 24 March 2014.
84. *See supra* n. 34.
85. J. Englisch, *National Measures To Counter Tax Avoidance under the Merger Directive*, in Dourado ed., *supra* n. 56, at pp. 213-283.
86. Criticizing the fact that national VAT legislation is not being sufficiently scrutinized by the ECJ in light of the Treaty provisions (but only in light of the Directives): R. de la Feria, *VAT and the EU Internal Market, the Paradoxes of Harmonization*, in *Traditional and Alternative Routes to European Tax Integration*, secs. 12.3.2.-12.3.3. (D. Weber ed., IBFD 2010), Online Books IBFD.

Vague concepts in EU tax directives do not imply granting discretion to the tax administration as their application is to be controlled by national courts and the ECJ (*see* the example of the Merger Directive and the *Leur-Bloem*, *Kofoed*, *Modehuis* and especially the *Foggia* case).[87] The discussion on vagueness and determinacy concerning EU tax directives is more important in the relationship between the EU Council and the Member States' parliaments, because that is mostly where the principle of people's sovereignty and separation of powers may be at stake. Considering that, according to the TFEU national parliaments have to transpose directives into national legislation, and the fact herein assumed that there is insufficient communication and disagreement in national parliaments in respect of proposals for directives, the principle of people's sovereignty would require that approved directives be vaguer than they are. If they were vaguer in respect of the legal type of tax, both the Council and the national parliaments would debate them.

This may be true from a formal viewpoint, but if national parliaments were able to debate directives after their approval and had discretion in transposing them in respect of the harmonized tax elements – either on allocation of taxing rights or in respect of the legal type of tax (what, who and how much to tax) –, the purposes of harmonization would not be reached. Taking into account that harmonization of taxes is intended to set up a level playing field for taxpayers with activity in the European Union – eliminating obstacles to the internal market and to competition – after a directive is approved, national parliaments can only share competences with the Council in respect of tax rates (ideally within limits) and other aspects that do not endanger the internal market. Deductibility of losses by the beneficiary of a restructuring operation is not binding, because its denial has anti-abuse purposes and the Member State is authorized by the Merger Directive to refuse such deduction, as long as such refusal is not discriminatory.[88] Otherwise, the Directive would not achieve its harmonizing purpose. Vague rules in the Directive do not imply policy options in national parliaments, as the principle of people's sovereignty considered alone would require, but some discretion in their application, and this means that after a directive is approved, national parliaments act as an executive power, and not as a legislative one sharing responsibility with the EU Council.[89]

All in all, taking into account that there is not enough public discussion and argumentation in national parliaments, capable of influencing the Member State's position in the Council when a proposal for a directive is negotiated and considering that national parliaments cannot engage in public discussion and argumentation after the directive has been approved, the legislative process of tax harmonization does not meet the requirements of people's sovereignty and separation of powers. In respect of EU tax directives national parliaments have converted themselves into executive powers, probably due to inertia and in order to avoid work overload, endangering democracy in the European Union.

10.10. The rule of law in the European Union and a tax union: Concluding remarks

Taxation and representation are the best solution for the European Union not only because the current situation is unsatisfactory from the viewpoint of people's sovereignty, separation of powers and ultimately the rule of law, but also because the European Union, and especially the EMU, will hardly resist another crisis in the absence of integrated budgetary policies and democratic decision-making.[90] Democratic decision-making can be implemented by requiring co-decision-making by the European Parliament, national parliaments and the Council. The EMU cannot be fully accomplished, in a democratic manner, with a mere banking union that enhances the current executive federalism.

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87. NL: ECJ, 17 July 1997, Case C-28/95, *A. Leur-Bloem v. Inspecteur der Belastingdienst/Ondernemingen Amsterdam 2*, paras. 35 et seq., ECJ Case Law IBFD; DK: ECJ, 5 July 2007, Case C-321/05, *Hans Markus Kofoed v. Skatteministeriet*, paras. 37 et seq., ECJ Case Law IBFD; DE: ECJ, 11 Dec. 2008, Case C-285/07, *A.T. v. Finanzamt Stuttgart-Körperschaften*, paras. 30 et seq., ECJ Case Law IBFD; NL: ECJ, 20 May 2010, Case C-352/08, *Modehuis A. Zwijnenburg BV v. Staatssecretaris van Financiën*, paras. 42 et seq., ECJ Case Law IBFD; *Foggia* (C-126/10).
88. A.P. Dourado & J. Almeida Fernandes, *Portugal: Pending Cases and Other Infringement Procedures*, in *ECJ – Recent Developments in Direct Taxation 2010* pp. 206-208 (M. Lang et al eds., Linde Verlag 2011).
89. On the European Union itself as an "executive federalism": S. Oeter, *Föderalismus und Demokratie*, in *Europäisches Verfassungsrecht, Theoretische und dogmatische Grundzuge* p. 103 (pp. 73-120) (A. von Bogdandy & J. Bast eds., Springer 2010).
90. *See* the criticism to the current situation: Habermas, *supra* n. 77, at pp. 96-108; Habermas, *supra* n. 18, at pp. 75 et seq.; very critical and nostalgic: W. Streeck, *Auf der Ruinen der alten Welt. Von der Demokratie zur Marktgesellschaft*, in *Demokratie oder Kapitalismus…*, *supra* n. 18, at pp. 63 et seq.; *Von DM-Nationalismus zum Euro-Patriotismus*, id., at pp. 87 et seq.

When the financial, debt and euro crisis hit the EMU, Vanistendael identified two major issues that needed to be given priority:[91] integrated budgetary policies for the EMU and closing the missing tax links for the internal market. He proposed that the euro crisis could be solved by an "emergency euro governance" or "temporary federalism".[92]A Euro state, with uncontrolled budgetary deficits, should transfer its economic governance for a limited period of time to a Euro authority.[93] The latter would be granted taxing and spending powers and would be able to decide on budget conditions.[94] Such a transfer of sovereignty was justified because of the debt guarantee from other Euro states and the need for quick and decisive action.[95] Still, according to Vanistendael, "[d]ecisions on Emergency Euro Government can be taken by qualified majority of Euro-Members".[96]

From the viewpoint of the principle of people's sovereignty in the EMU, Vanistendael's proposal would have been preferable to the actions so far taken (bailouts of some Member States and/or their banks), but it is still dubious if that proposal would overcome the need for more democracy in Europe, since the European Parliament would only be granted a ratification role.

In order to avoid similar crises in the future and to create the legal basis for a sound EMU it is herein contended that the future of the European Union depends on a fiscal union, which includes a tax union, to be planned in a period of stability and which may be entered into by some of the Member States, taking into account that it is not possible to achieve unanimity at the moment.

From an ideal viewpoint, leaving aside political difficulties, democratic legitimacy should focus on harmonization of taxes and on EU taxes. The latter aspect should appear in the context of integrated budgetary policies and future federalism.

In contrast, an emergency situation may not justify creation of EU taxes, since the emergency context is not fully compatible with the necessary discussion and argumentation in a context of plurality and controversy of opinions.

Democratic legitimacy on harmonization of taxes and removal of obstacles to fundamental freedoms should focus on requiring public debate not only at the level of the Commission (tax platforms), but also at the level of the European Parliament, in connection with public debate at the national level, on any harmonization measures – financial transaction tax (FTT), interest from savings, CCCTB.

On the basis of such democratic discussion the Commission would draft proposals for directives and regulations, which should take into account the "missing links", as suggested by Vanistendael[97] and the base erosion and profit shifting (BEPS) Action Plans as adapted to the EU needs. In general, public debate on cross-border obstacles should be handled both at the level of the European Parliament and the Member States' parliaments after a decision by the ECJ or when an infringement procedure has been initiated. Both controversial and *acte clair* clusters should be identified and discussed by the EU Parliament and by national parliaments.

Federal decision-making will focus on EU public goods and on the classical fiscal and budgetary functions: stabilization of cyclical movements, efficient allocation of resources and equitable distribution of burdens. All these functions require EU taxes that should be subsidiary to national taxes, as in the United States under the commerce clause.

EU taxes could either correspond to taxes on cross-border transactions[98] as in the United States,[99] or taxes falling on the most mobile factors. Both options would mean that EU taxes could comprise a higher amount of VAT, a part of corporate income tax and income from savings in an EU Member State.

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91. F. Vanistendael, *EU at the Crossroads in 2011: EMU and/or Internal Market?*, in Dourado ed., *supra* n. 56, at sec. 2.1.
92. Vanistendael, *supra* n. 91, at p. 39
93. Vanistendael, *supra* n. 91, at pp. 40-43.
94. Vanistendael, *supra* n. 91, at p. 40.
95. Vanistendael, *supra* n. 91, at p. 40.
96. Vanistendael, *supra* n. 91, at p. 41.
97. Vanistendael, *supra* n. 91, at pp. 46-53.
98. *See* the proposal of Miguel Poiares Maduro on a corporate income tax: *A New Governance for the European Union and the Euro: Democracy and Justice*, EUI WP, 2012/11.

Without EU taxes, the EMU will require its Member States to become more and more debt states, exclusively focused on budgetary stabilization. It will be hard to convince EU citizens to pay higher national taxes that are destined to pay national debt and any appeals to tax patriotism will be meaningless and paradoxical. In fact, the internal market and the fundamental freedoms will not legitimize higher taxes basically paid by those taxpayers who are less mobile. A switch from residence to citizenship as a connecting element in income taxes in order to avoid tax exiles is a restriction on the exercise of a fundamental freedom. Even if it is settled case law that Member States are free to choose their connecting elements (life and death of an individual or a company are to be dictated by a Member State),[100] taxing citizens on income obtained in their Member State of residence and sourced abroad implies a weak or nil allegiance to the Member State of citizenship. If taxes are justified by a social contract, the call to tax patriotism in this context as a measure to compensate for the absence of a fiscal and budgetary union, would be abusive and would lack validity.

99. In the United States, the competence to create taxes belongs to the states and the federal state can only create a tax under the commerce clause: *see* Supreme Court of the United States, *National Federation of Independent Business et al. v. Sebelius, Secretary of Health and Human Services et al.*, n. 11-393, argued March 26, 27, 28, 2012 – decided June 28, 2012 (together with n. 11-398, *Department of Health and Human Services et al. v. Florida et al.*, and n. 11-400, *Florida et al. v. Department of Health and Human Services et al.*, certiorari to the same court.

100. Opposing a complete freedom: HU: Opinion of Advocate General Maduro, 22 May 2008, Case C-210/06, *Cartesio Oktató és Szolgáltató bt*, para. 31, ECJ Case Law IBFD.