Can Economic integration be democratic ? The case of taxes

by Marco Greggi*

1. Introduction (A Brief Lesson from the Past)

Taxation has always been a social and legal phenomenon closely intertwined with democracy. In human history there are countless cases in which economic integrations of States or territories failed because of a taxation system not consistent with the fundamental issues of democracy.

Under another point of view, it could be said that in the past the first example of the issues discussed in this paper is probably the case of the Roman Kingdom, that evolved into a Republic to fall as an Empire. Obviously Romans were not the first ones in the so called Western world to levy taxes, but they were the first ones to develop, particularly in the latest stage of their history, a somehow modern and scientific way to asses and collect fees, taxes, tariffs and tributes.

They developed their taxes while attempting to integrate into one complex body (the Empire) States, territories and kingdoms conquered by the legions that were different under many aspects, such as for law, traditions, welfare (if any), economic tissue. Il could be said, under a very peculiar point of view, that also Romans attempted to harmonize (tax) law in the latest stage of their rule when the Emperor *Caracalla*[1] attributed Roman citizenship to all the inhabitants of the Empire and therefore abolished the distinction between *Cives* and other individuals dwelling in the Civilized world.

Even for Romans, centuries before the *Magna Charta libertatum* and of the always quoted maxim "No taxation without representation", tax was a way to collect economic resources accepted only with the consent of the taxpayers: that is, the Roman (male) citizens. In this respect, the Roman word for tax (*tributum*) makes reference to one of the basic social organization of the Early Rome during the Republican era: the Tribe. Some historians of Roman law are however in a different position: in their view the word *tributum* derives from the latin verb "*tribuere*" that is "to give", and therefore *tributum* is "something that must be given"[2].

Obviously taxes weren't born with the Republic and Democratic Institutions. There's evidence in Roman literature[3] and history that taxes were levied as well during the Kingdom of Rome

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[1] *Constitutio Antoniniana de Civitate* (a.D. 212).

[2] See also C. F. Balleine, *The 'Tributum Capitis'*, The Classical Review [20] 1906, 51. The second interpretation mentioned above seems to represent the mainstream position at the moment. The linguistic research is far beyond the capacity of the writer, however it's interesting to note that the ancient word in Old English for tax "*gafol*", while the Gaelic word was "*cáin*". Possibly the word tax derives therefore from *tithe* (the tenth part of) which was actually a *tax;* in any case the etymology of the word does not influence the current research.

[3] See for instance *Livius*, Ab Urbe condita libri 1, 43, 10.

(since the foundation till the rise of the Republic) on individuals on a lump sum basis (a sort of Poll tax) and the concept of tax was by Livy (*Titus Livius*) connected for the first time to the voting rights. However the fact that the Poll Tax (*tributum in capita*) was not levied on rich people casts more than a doubt on the authenticity of the record, particularly when taxes are levied by the later republic in a way more consistent with the ability to pay.

In other words, Livy tries to use the argument of taxes to emphasize the tyranny of the Kingdom (were affluent people didn't pay) in contrast to the democracy inspiring the Republic[4] where all citizens contributed to the welfare (and most certainly to the warfare) according to an (alleged) ability to pay, or at least in the respect of the principle of equality (rich people were not exempted from taxation).

In any case, a census is necessary for any kind of not arbitrary taxation consistent with the rule of law, and the first census recorded in that respect in the history of Rome was the one by King Servius Tullius[5]. On that occasion all citizens were counted and divided into Tribes in order to organize the army of the City - State. The more a citizen was rich, the better he could be armed (being the cost of the equipment at his complete charge) and the more he could contribute to the defense of Rome (later in the centuries this sort of "ability to defend" the country became the "ability to pay"): the *tributum ex censu* (tax on wealth) was then applied without any consideration to military duties, assessed and collected tribe by the Tribe[6]. It was the King who decided the amount of it and when to apply it.

During the Republic era, Rome experienced a period of military expansion financially supported by the defeated populations, and therefore found no need to levy taxes on (wealth of the) citizens with only few exceptions. Most of the revenue was raised either by Custom duties (*portoria*) or by royalties collected on the lease of public resources (lands, woods, mines, etc ...) to individuals.

A clear exception in this respect is the *lex Manlia*, which introduced the *Vigesima Libertatis* (literally "twentieth part for freedom"): it was a 5%[7] (indirect) tax levied when a slave was set free by a Roman citizen. It is interesting to note that this tax was proposed by a Consul and

[4] In the early development of Rome, the need for revenues originating from taxes was not so urgent as nowadays it is. Administrators of Rome (Kings and later the various higher Magistrates) used the economic resources obtained by the expansion of the City to the disadvantage of the neighbors in Italy and then in Europe, Middle East and Africa. The contributes, up to that period, were in kind (*operae*) or provided directly and spontaneously by some affluent clans, mainly for religious necessities as far as no welfare characterized the Kingdom.

[5] VI Century b.C.

[6] Every Roman citizen also belonged to a Tribe in the City. The concept of Tribe during late Kingdom and Republic hasn't to be intended as making reference to ethic or racial characteristics, but rather to geographical areas of the City the inhabitants lived in.

[7] The taxable base was the market value of the slave as decided by a Committee appointed for that purpose.

passed as law approved by the *Comitia Tributa* [8] gathered outside of Rome[9]. At that time there were no problem of democracy or representation, as far as every man counted and voted for himself in the assembly, and decisions based on majority were accepted.

To a certain extent, taxation as legal phenomenon was born in democracy and under the rule of law.

In any case, taxation was an exceptional event in the life of the *Res publica*, and the criticism of *Livius* towards the *Lex Manlia* is also a clear example of that. Just like income tax in United Kingdom centuries after[10], taxation was used only in cases of clear and present danger, such as the never ending Roman wars, and the need for a modern army equipped for warfare. In this respect, it's not easy to distinguish between taxes and compulsory loans (that had to be reimbursed later on by the Republic, using the goods looted to the defeated populations).

In the last stage of the Republic and during the the dawn of the Empire, tributes were not collected any longer, because there was no need for that. The burden and the cost of the welfare and of the warfare of the Roman machine was supported entirely by the defeated nearby nations and soon to become provinces of the always larger Empire.

Specific taxes (actually, lump - sum payments) were levied every year or occasionally depending on the duration of the war, on the resistance opposed to Rome, to the peace condition and according to other elements of the case.

A remarkable exception in this sense is the *Lex Titia*[11] passed during the first Triumvirate, that introduced a sort of 10% tax on wealth in Rome and it was levied on the provinces ruled by Romans. The tax was justified by the war against external enemies in a first time, and then by the Civil war necessities.

Even if there's no reasons here to get into details[12], it's worth while mentioning that in the dying Republic it was the Senate which passed and decided the amount of the contribute, later on, as was pinpointed, any reference to the Republican rule of law and separation of power was lost. Once more, taxes were introduced only via representative bodies, and being the Senate the latest one of these still functioning, although only an elite of the population was allowed there, it took the political responsibility for that.

The Roman Emperors greatly relied on (conquered) provinces to raise the money they need as Republic previously did but they generally felt somehow compelled to find a reason under law

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8 Direct participation of (male) citizens was always possible in the assemblies such as *Comitia Curiata* or *Tributa* or *Centuriata*, however the larger the City became, the more difficult was the participation. Moreover, according to the historic reconstructions, citizens living in the outskirts of Rome were systematically overrepresented in the *Comitia Tributa*. That's why republican Rome can be considered as a democratic society only in a very limited sense of the word. See O. F. ROBINSON, *The Sources of Roman Law*, London, 1997, 3.

9 *Livius*, Ab Urbe condita libri 7, 16, 7 and 8. The law was passed in 357 b.C.

10 Income tax was introduced in the United Kingdom (but not in Ireland) by William Pitt the Younger in 1799 as a means of paying for the war against Napoleon. It was repealed by Lord Addington in 1802 during a brief peace period and then introduced again the next year, when war erupted again in the continent.

11 43 b.C.

12 For further references see for instance N. Lewis and M. Reinhold, *Roman Civilization*, I, *The Republic and the Augustan Age*, New York, 1990, 237.

for that. And so, the 10% tax on wealth was justified in some cases according to ancient law before the arrival of the Romans, in consideration of the protection of the Emperor, or for various other reasons.

To a certain extent, taxes were the sinews of peace even centuries ago: the sinews of the *Pax Romana*.

The provinces conquered (preys, *praedia*) by Roman people and later controlled by the Emperor were therefore subject to the *praedia tributaria* just like, at least apparently, ancient Romans had to pay the tribute. The amount, the duration, the taxable bases were however demanded to the discretion of the Empire, just like the collection procedures were attributed to private business[13].

In this respect, the lesson we can learn from the Romans, as first attempt to understand the relation between Democracy, Taxation and Economic integration across Europe has come to an end.

Taxes were born on the continent as a sort of fee to be paid by every free men to the *Res Publica*. In this respect no taxes were levied without consensus of the taxpayers as far as the publicity (that is, the public purpose) that grounds the justification of the tax can't exist without that. There couldn't exist taxes outside a democratic environment and rule of law. Later on, as Livy seemed to emphasize, the tax (either direct or indirect) was refused as such by Romans, with the only exception of Customs, arguably because it was considered as a sort of payment in consideration for the usage of roads and ports.

The Principate (the early Empire) on the other side clearly manifests an approach to taxation that was remarkably different from the one which inspired the behavior of the Emperors in other aspect of law. The evolution of Roman law clearly culminated in the *Corpus Iuris Civilis* by Justinian as the last attempt to harmonized and restate a multisecular experience: but it's no surprising that such a (nowadays) important aspect of Public law was not clearly restated (particularly for what regards the consensus of the taxpayer).

The reason were probably various: first of all, there was no tax law, but only taxation. In other words, taxes were levied outside any guarantee for taxpayers in the provinces, moreover, taxation was never intended as an instrument of integration of the different provinces into a larger entity, but rather an instrument to raise funds with a clearly discriminatory intent. Every province was taxed differently according to different traditions and consistently with the history of its annexation to the Empire. To this extent, Economic integration was driven by the Legions rather by the taxes, but no doubt that Provinces had no right to be heard by the Emperor or to provide a sort of consensus via representative bodies within the Empire.

2. Integration, Harmonization and the Roots of the EU Approach to Taxation

The attempt to compare the Roman experience to the progressive EU integration could appear at first glance as a little more than a *divertissement* without any specific utility both under a theoretical and a practical point of view.

On the contrary, I think that Roman law (and Roman approach to taxation) has still something to teach to modern lawyers as well, and probably can be helpful to provide an answer to the question we began with.

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[13] The *publicani*, perhaps the most known example of them is the Apostle and Evangelist Matthew.

The Treaty of Rome and the subsequent Treaties amending it, up to the latest Constitution [14] (and the condensed version of it[15]) had towards taxes and Taxation a pragmatic approach justified by the main purposes the Treaty was adopted to implement. The Community and the Union had to become geographical area where fundamental freedoms of movement of goods, persons, services and capitals were respected, and in this sense any limitation to these movements had to be progressively removed. In a common market common rules are needed only where the markets need them and where the single States, taken individually, could not do better.

This clearly functional approach to taxation had as a consequence the full integration of Customs law, as *condicio sine qua non* for Europe to be considered as a one as seen from outside, and the harmonization of turnover or indirect taxes considered as the most dangerous kind of taxes for a truly integrated market. To this extent it is undoubtedly true the fact that direct taxes have always been considered ad the *domanin reservée* of Sovereign States since XVIII Century and therefore Nations have always been quite reluctant to surrender their powers to the new born Communities, but it is also true, on the other side, that direct taxation was not a priority for the common marked, as far as its impact on goods and services delivered was, quite paradoxically, not as direct as the one delivered by indirect taxes.

While an excessive direct taxation could eventually push a business to move from one Country to another in a mid - long term, an indirect tax could prevent the same business to sell its products or services in another State, immediately frustrating the core purpose of the Treaty.

Indirect taxes harmonization was therefore considered a priority by the Community, consistently with the scope of the Treaty. For this reason the first directives implemented on VAT date back to 1967[16], when a general consensus on an harmonized turnover tax partially inspired by the one applied in France was reached.

The unanimity needed in the Council to pass such directives (and more generally any directive on direct taxation) was considered at the same time both a clear recognition of the importance of taxation for the Member States, as mentioned above, and also a sort of "second best" solution in the attempt to ground the decision making process under a democratic point of view.

It is well known that the European Parliament has a little or no influence at al in the adoption of Directives in the field of taxation as well, although it is the only representative body in the European constitutional framework: that's why many author questioned, under a theoretical point of view, the compatibility of EC (and later EU) power to tax with the National constitution (if any) and the generally recognized principle of "No taxation without representation". In this sense, the consensus of the Government needing the support of the Parliament to operate could be considered as a sort of "indirect" representation of the Nation States in the decision of the Union.

In any case, the compatibility of the EU decision making process and the reserve of law in taxation was only theoretically important as far as the Directives on direct taxes adopted in the past never imposed other duties on the taxpayers and had, as final outcome, the increase of the tax burden, perhaps with only one (indirect) exception.

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[14] The never approved text of the European Constitution signed in Rome on October 29th 2004.

[15] Reference is to the Treaty of Lisbon signed in Portugal on December 13th 2007.

[16] The first VAT Directive, 67/227/EEC, was adopted by the Council on April 11th 1967.

The democratic consensus to taxes is an *acquis* of the Western world and it is aimed at defining the possession of each individual against the need of the Leviathan - State. In this respect a deprivation of a property or of a possession is legitimate only insofar it takes place consistently with the will of the taxed person, expressed indirectly by the representative body. Under this perspective, therefore it could be argued that not every tax provision must be passed via Parliament or representative bodies, but only those that impose new economic burdens on the citizens or on the people living in a State, in a Region or in a specific territory.

Because of the unanimity require, in the history of the Community and of the Union, only a few provision affecting direct taxation were ever adopted. This had also a legal reason in the wording of the Treaty. Art. 293 clearly states that direct taxation, and particularly the issue of removal of double taxation, was demanded to bilateral initiatives of the States, fostered if necessary by the intervention of he Community[17]. From the letter of the article it was argued (interpreting it "*a contrario*") that the Community had no competence in Direct taxation and the limited interventions were possible only insofar they were absolutely necessary for the implementation of the market, respecting the rule of the subsidiarity and all in all as a sort of *extrema ratio*.

If we move from the theory to the practice of the EU Direct taxation, we discover however that the most relevant Directives affected dividends payment[18], interests, royalties[19] and M&A operations[20] (the so called "Passive income" an some corporate operations).

Despite the different nature of income involved, all the Directives had one clear objective: to minimize the international double taxation and the administrative burdens the taxpayer had to incur when moving outside the border of her Home Country.

This feature is particularly clear not only in the *consideranda* (Preliminary remarks) of the various directives[21], but also in their text. where generally the European legislator clearly says that the European rules are applicable only insofar they concur to reduce in international double taxation better than national or international rules are able to[22] and in this respect can be derogated both by National provisions or by International Treaties.

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[17] In this respect "*Member States shall, so far as is necessary, enter into negotiations with each other with a view to securing for the benefit of their nationals: ... the abolition of double taxation within the Community ...*".

[18] European Economic Communities (EEC) Council Directive No 435/1990 of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [1990] OJ L225, 6, later amended.

[19] European Community (EC) Council Directive No 49/2003 of 3 June 2003 on a common system of taxation applicable to interests and royalties payments made between associated companies of different Member States [2003] OJ L157, 49, later amended.

[20] We will discuss later in a different chapter the Directive on Taxation of savings that pursues a different aim while compared to all the others and in this respect is a unique case in the history of EU Tax Law.

[21] In the 2003/49/EC directive fo r instance is clearly stated that "*national tax laws coupled, where applicable, with bilateral or multilateral agreements may not always ensure that double taxation is eliminated, and their application often entails burdensome administrative formalities and cash-flow problems for the companies concerned*". See also M. Greggi, Taxation of Royalties in a EU Framework, Tax Notes International [46] 2007, 1151.

[22] A clear example of this approach, clearly inspired by the subsidiarity principle can be found din the 1990/435/EEC directive, at. 7 (2) that reads as follows "*This Directive shall not affect the application of domestic or agreement-based provisions designed to eliminate or lessen economic double taxation of dividends, in particular provisions relating to the payment of tax credits to the recipients of dividends*".

It is not the first case in legal literature where a source of law of upper level[23] potentially abdicates to its primacy in favor of a lower one, nonetheless this can be considered a clear symptom of the European cautious approach to tax issues.

Under this perspective, it could be argued, at least in direct taxation the democratic deficit of the European institutions (Commission and Council) is a serious theoretical issue but not so relevant in tax law. The Community carefully exercised its power in this field of law aiming only at the implementation of new rights and freedoms for the taxpayers with a prejudice (if any) to the State only. Even if the existence of a European tax law is a (complex) reality of the everyday practice of any European lawyer or academic, the key feature of the discipline is that (in direct taxation) EU law is aimed only at reducing the taxing power of the States, thus at decreasing the burden of taxes upon the taxpayer.

In this respect, the need for a democratic consensus is obviously not so urgent as it would be where European law should involve also new ways and means of collecting economic resources in addition to the ones implemented by the States.

This second hypothesis is clearly theoretical till now, and will be discussed in one of the next paragraphs[24] in a *de jure condendo* perspective.

There are however some remarkable exception to the above mentioned European approach to taxation: one involving indirect taxes such as Customs duties and VAT, and the other the 2003/48/EC directive, on the Taxation of savings.

The reasons which justified the harmonization of VAT and of the Customs duties are well known and even recently summarized in academic literature[25]. In the case of Custom duties, it was so obvious that the priority for the (soon to be) harmonized market was to neutralize any difference in Customs law (most notably, differences in the amount of the tariffs) in order to prevent any "Customs duties shopping" by the importers of goods in the Common market: it had to be perceived as unitary from outside[26].

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23 I'm making reference to the Italian legal system, where EU rules (Treaties, Regulations and Directives) have a specific primacy over international Treaties and national law. This primacy in Italy can be also directly applied by every judge, who can simply disregard the national provisions (or the Treaty as well) he think is conflicting with a European rule. The situation can be slightly different in other member states, but in any case the primacy of EU law over international Treaties and national law is clearly affirmed by the ECJ.

24 See § 8.

25 A. J. Menéndez, Taxing Europe: Two cases for a European Power to Tax, Columbia Jour. European Law, 10 [2004] 305.

26 A. J. Menéndez, cit., p. 301.

The same goes for VAT, but in this case the removal of internal[27] customs borders occurred only in 1993, when the barriers to the market where also physically taken away[28] and the VAT changed dramatically[29].

In both cases, however, EC law didn't introduce any new tax in the member Countries, but limited its intervention to a progressive harmonization of already existing[30] ones. Consumption of goods and services on one hand, and the import of goods on the other were already considered facts capable of displaying a specific ability to pay on the purchaser or on the importer. Anyway, this is not the main reason leading to the justification of these kind of taxes in the light of a "Democratic clause". The main reason is that all these provisions and all these progressive harmonizing and regulating interventions were already enshrined in the Treaty of Rome, and then maintained in all the subsequent amendments and integrations, until the very recent Constitutional Treaty proposals.

In this respect no lack of democratic survey is recorded ad far as the consensus of the Parliament (if not by the population, with a *referendum*) was manifested on the approval of the Treaty. Obviously it only contains the general principle inspiring VAT and Customs taxation, not including for instance rates, rules applicable for the calculation of the taxable base and so forth, but all these details can be decided buy other non representative bodies even under national tax law of the most European Countries. In Italy for instance the reserve of law is considered as "relative" and allows the Government of other public bodies[31] (depending on the tax of the case) to decide rates, allowances and so on.

Under this perspective, and always using as an example the Italian situation, the Fundamental charter of the country clearly rules that (art. 11) limitations of sovereignty are allowed under the Constitution insofar they are necessary for Italy to join international organizations. It is well known that the Founding Fathers of the Italian republic introduced the mentioned article to allow the Italian accession to the UN, but it was used to join the EEC as well later on and

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27 That is, between member states of the Common market. That's why, in VAT law the sale of goods between two businesses resident in two different member States are qualified as exportations or importations until 1993 and from that year as "Intra - EC sales". The difference is not only a matter of words, but also of legal duties that must be respected during and after the contract (involving the invoicing procedure, the record of the sale and so forth.

28 In Italy, for instance, most of the Customs inspectors working at the borders where moved elsewhere, particularly at the airports and at the internal offices.

29 See the 1991/680/EEC Directive applicable since January 1st 1993.

30 No European Countries had a VAT when the Treaty of Rome was signed, with the only exception of France (which had a tax that was quite similar in its application to the current VAT, without being identical in all the respect); however, every Country had developed a specific way of taxing consumption, in some cases with a single stage tax (similar to the US Sales and Use Tax) or in other circumstances using a multiple stage tax. In this respect, it could be argued, EC didn't implemented a new tax, but rather harmonized an already considered taxable base: consumption of goods and services.

31 The most frequent case in the Italian experience (but the same arguably goes for every Country) is the one involving tax rates. It is well know that in several cases the Parliament attributes to other bodies (namely, Regions and Municipalities) the power to establish the rate of the tax between a minimum and a maximum. In Italian academic literature this characteristic is accepted and judged constitutionally compatible with the reserve of law in taxation (and therefore the implied principle of no taxation without representation) as far as the latter is considered as a *relative* reserve (on the contrary, for instance, the reserve in Criminal law is qualified as absolute and no leeway for any integration by other public bodies is accorded in that respect).

also other international organization demanding some quotas of sovereignty to be renounced by the State[32].

The case of the 2003/48/EC[33] is anyway completely different.

That directive deals with the taxation of saving in the Union and beyond. It is the (late) answer to an issue recorded for the first time in the mid eighties[34]: the significant tax evasion on income yielded by savings that individuals kept on bank account in other member states (and even outside the EU). As a matter of fact the evasion is simple to be realized, yet difficult to be discovered. Assuming that the taxpayer is taxed on the income produced according to the tax return she presents; the evasion was realized simply avoiding to declare the amount of interests (or of any other capital income) obtained on the savings abroad. Even if EC law had a number of directives dealing with the exchange of informations between tax authorities[35] to tackle this kind of violations, it was in any case nearly impossible for the National revenue Services (or Agencies) to require information on a specific taxpayer because she had no idea in advance on the individuals to ask informations on.

The mentioned "Saving directive" solves efficiently this problem, forcing the Tax Authority of the State where the bank account is open and active to communicate to the administration of the State where the beneficiary[36] of the account in resident his name and the income yielded in the form of interests. The automatic and massive exchange of information now makes that kind of evasion nearly impossible with a great advantage of the coffers of the Treasury.

Needles to say that the implementation of the directive didn't solve entirely the problem. Tax avoidance and evasion were (and are) still possible for two obvious reasons: the first one deals with the implementation of the schemes, whose complexity is such that can't be discussed in this context[37].

The second one deals with the involvement of third Countries with special relations with the EU, and this aspect rather that constituting another technicality of the discussion, plays a fundamental role in the current discussion.

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32 An accurate quotation of art. 11 of the Italian constitution should report as well that Italy renounces to a part of its sovereignty only insofar the other States do the same while joining the International organization and only if the aim of this organization is to foster the international peace and justice between nations.

33 Council Directive on the taxation of savings income in the form of interest payments adopted on June 3rd 2003.

34 J. A. Menéndez, cit., 335.

35 For instance the directive 77/799/EEC of December 19th 1977.

36 The directive uses the concept of "beneficial owner" in this respect.

37 Moreover the nature of the tax planning scheme is not important for the scope of the resent article. In any case, nearly all of the schemes currently implemented involve the use of a stepping stone company (or a Trust) to be considered as the owner of the foreign bank account, and incorporated in a favorable Country. In this case while the Tax Authority of the state where the bank account is opened has the duty to communicate it to the authority of the place where the individual is resident, it has not the duty to communicate it in case the bank account is at the disposal of a company or a Trust. This condition arose a significant criticism in Academic literature but was one of the condition for the Directive to be approved at the unanimity of the member States of the Union. While a look through approach is possible and some anti avoidance provisions are consistent with the directive, as a matter of fact the concrete effect of the European provisions is strongly limited by the application restricted *ratione subjecti* (that is, to individuals only).

When the directive was proposed for the first time by the Commission, many European Countries were afraid that the adoption of the directive would have determined a flows of capital from (just for example) Luxembourg[38] or Austria[39] to the advantage of countries like Switzerland or the Republic of San Marino thus both frustrating the effect of the Directive and reducing significantly the business of the most affected European countries. A compromise had to be found, and actually it was reached involving specific third Countries in the application of the European provisions.

Once more, it is not possible here to get into details, but the application o the Directive is easy in this respect, at least under a descriptive approach. In the case in which a EU resident citizen register a bank account (or another equivalent financial account[40]) in one of those countries, he has two options: (1) allow the Tax Administration of the state to communicate to her own tax administration the existence of the account, the interest yielded and any other useful information for assessing the due income on those profit or (2) refuse to allow the tax administration of the Bank account state to provide such information, but accept as exchange a withholding tax of a specific amount, that going to be higher and higher with the passing of time. These taxes are then transferred by the bank account state to the home State in order to (partially) prevent a full evasion on the income produced abroad[41].

Of course the consensus of Switzerland and of most of the other countries[42] was not for free, asking then in exchange the application of some other European freedoms to business resident on their territory and to individual[43].

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[38] A brief description of the tax system in Luxembourg and the effect of the mentioned directive can be found in J. P. Winandry, *Luxembourg report*, p. 1, that can be found here: www.eatlp.org/uploads/public/2006_Luxembourg_Report.pdf

[39] Luxembourg is well known in the Tax planning community for the flexibility of the financial services and for the particularly low level of taxation, while Austria is preferred for the bank secrecy.

[40] Art. 4 of the directive uses the concept of paying agent, which is of course broader than the concept of bank.

[41] Switzerland for instance paid to Italy a significant amount of money last year, being that amount the sum of all the withholding taxes applied on the interest yielded by money Italians have on their bank account in Switzerland and whose names are unknown to the Italian Tax Administration. In this respect, the Italian Revenue service doesn't know the name of the Italians (or of most of them) having a bank account in Switzerland, but has an idea of the overall amount of money present there and belonging to Italians.

[42] See art. 17 (2) (i) of the directive: it is che case of Swiss Confederation, Liechtenstein, San Marino, Andorra, Monaco and the United States of America.

[43] For example, in the agreement between the Union and Switzerland on October 26th 2004 the Confederation was allowed to step in the *Schengen* area.

In this respect, while Switzerland abandoned some of the advantages historically granted to people bringing money in the world famous coffers of her banks is still granting bank secrecy and more is enjoying[44] some European rights and freedoms just like it were part of the Union.

Under a purely European point of view, the directive constituted a unique event in the history of European tax law until now.

It was, in other words, the first case of a directive unanimously passed by all the member States, involving direct taxes and clearly aimed at the optimization of the tax burden amongst the taxpayers. It was not written, just like all the others before and the Directive 2003/49/EC of the same year to reduce the tax burden sustained by the companies investing cross-border, but its sole scope was to put the tax administration of each State in a better position in a fight against (possible) tax evasion and to know more about every taxpayer having interest income flowing from another country belonging to the Union.

In a very broad sense it was the first case in which, theoretically speaking, the principle "No taxation without representation" should have to be respected[45] because of the intrinsic value enshrined in it; that is, the more moneys the state requires from its citizens (taxpayer), the more it can do that consistently with the principle of democratic consensus.

With the implementation of this provision the European citizens (again, in a very broad sense[46]) have two options: surrender part of their rights as foreign bank customers, in favor of the revenue service of their home country or they must be ready to accept an higher level of taxation (perspectively up to 35% of the interests paid).

In the traditional cost - benefit analysis it is self evident that the sacrifice of the many is clearly justified by the overall advantage that the mechanism set up shall provide in term of a minor tax evasion and therefore lesser need to find financial resources elsewhere (if everybody pay, they pay less) but in these cases the need for a complete privacy was just a little more than a fig leaf concealing an interest to evade the tax due.

In any case, if under a practical point of view the directive is reasonable, welcome and positively accepted by most of the States and by all the Revenue services, under a theoretical perspective it could be considered as the first violation of the principle "No taxation without representation" taken in the narrow sense (that I think more appropriate), which tends to read in the reserve of law a guarantee to be respected in favor o the taxpayer that does not

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[44] Actually, Swiss businesses and companies are enjoying them. Under a purely legal point of view, it's worth while mentioning that the agreement on the application of the Savings directive in respect of the Swiss Confederation was negotiated directly by the Union, with the effect on all the member States. It also constituted a blueprint for all the other bilateral agreements involving the EU and the third States such as San Marino etc. In this way, the Union supported some member States (for instance, the already mentioned Luxembourg, but also Austria and Belgium) which were afraid to loose some of their clients in favor of the companies and financial services of these non EU states. Yet some criticism is maintained as far as private investors, once lost the advantages of accounts in some European states and in the nearby countries (either because of the agreement such as Switzerland or because of the EU accession, such as Malta and Cyprus) are moving their financial reserves in tax heavens such as Singapore thus demonstrating that the preoccupation of the mentioned member States was not ill founded.

[45] The directive doesn't lead to a higher taxation but to a higher level of informations at the disposal of every tax authority on selected taxpayers. This higher level of information can possibly lead to a higher level of taxation when withholding taxes are levied.

[46] I don't share this view, but nonetheless it must be admitted that it is not ill founded in its entirety.

involve any tax provision, but only those making the position of taxpayer more burdensome both under a financial[47] or administrative aspects[48].

Whether this sort of violations are consistent with the spirit of the Treaty and with the aim pursued by the Founding Fathers it is a question for the academic to answer to.

Once more, the purely legal approach to this sort of problems is particularly inadequate and, to some extent, unsatisfactory. Most of the Supreme Courts answered to the question giving the title to this paper in a very clear sense: Violation of the reserve of law principle can not be questioned in front of the Court as far as the principle "No taxation without representation" can easily coexist with the current European decision making process applicable in the community as far as it was adopted until now and according to the provisions already mentioned[49].

That doesn't mean that the EU, in the view of the National Constitutional Court[50] has the power to tax or the power to implement tax provisions applicable also to Italian citizens thus violating art. 23 of the Italian Constitution[51], but its effective exercise until now is consistent with that provision.

3. The aftermath on national systems: (the case of Italy and) the theoretical approach to the relation between EU law and national law.

The relation between EU law and National law, at least in the Italian perspective, clearly mirrors the (need for) connection between democracy and legitimate decision making. The first problem academics and Courts had to solve in Italy after the accession to the Communities was the consistency of the European decision making process with the sinews of the national Constitution: two legal orders were in possible conflict both according to their content and under the compatibility of the decision making process of the former with the Constitution of the latter.

47 That is, introducing new taxes or increasing the ones already existing.

48 In could happen if the legislator should implement new burdensome administrative formalities to be respected by the taxpayers.

49 See the next paragraph for a detailed analysis of the reasoning followed by the Italian Constitutional Court, just to give an example.

50 I make reference to the Italian situation once more, but I think that the same conclusion can be extended to most of the continental countries with a "hard" constitution (hierarchically superior to the Acts passed by the Parliament) and a Constitutional (or Supreme) Court with powers analogous to the Italian one.

51 Art. 23 enshrines in the Italian system the many time mentioned principle of "No taxation without representation". Yet the literature discusses whether it could be considered as a founding principle of the italian democracy (just like the principle of equality, for instance) or just a fundamental rule of the legal system of the peninsula. The same literature discussed whether art. 23 of the Constitution is infringed by all European binding provisions, such as Directives and Regulations, or by the latter only. In the case of directive a national act implementing the European rules is always necessary, therefore, at least under a purely formal perspective, the principle seems to be respected. In the case of VAT for, instance, the discipline was blueprinted by a number of directives, but the national implementation was demanded to national acts (once more, in Italy VAT was introduced with a Presidential decree, n° 633, on October 22nd 1972).

The possible solutions arrived from the national Constitutional Court and from the ECJ: both called to solve the practical and the potential conflicts. Unfortunately (and apparently) until 2008 they shared different theories to declare the primacy[52] of EU law on National law.

The ECJ adopted, since the decision of the first cases, the monistic theory[53].

According to the ECJ point of view the Treaties instituted a legal system of their own, and the law created by the Community can be qualified as fully autonomous from the one of any member State. The latter accepted the limitation to their sovereignty entering into the Treaties under a reciprocity clause, and now it can't make national provision unilaterally prevail over Treaties, Regulations and Directives[54].

This solution was generally accepted by the academic literature supporting the monistic theory, the only point of uncertainty was related to the potential conflict between a national Constitutional provision and a Treaty article.

The ECJ was of the opinion that EC law had to prevail even on constitutional rules and general principles as far as each member State joining the Union accepted limitations to its sovereignty. This sort of self restraint obviously had to involve any source of national law since from regulations up to the Constitution founding the legal order within any Country[55].

The final outcome of this interpretation is that national law can't in any way limit the application of EC law, and the efficacy of the latter can't be different from State to State. EC law must be applied without conditions or restrictions in the same moment and with the same efficacy all across the territory covered by the Union. Eventually, the monistic theory was summarized by the Court in another case in the mid seventies[56]:

"*... in accordance with the principle of the precedence of community law, the relationship between provisions of the Treaty and directly applicable measures of the institutions on the one hand and the national law of the member states on the other is such that those provisions and measures not only by their entry into force render automatically inapplicable any conflicting provision of current national law but - in so far as they are an integral part of, and take precedence in, the legal order applicable in the territory of each of the member states - also preclude the valid adoption of new national legislative measures to the extent to which they would be incompatible with community provisions*".

The Italian Constitutional Court always maintained (at least until 2008) a completely different approach, inspired by the so called "dualistic theory".

In this perspective National and European laws are considered as they were two set of rules completely distinct from each other, although forced to coexist. The relationship between the former and the latter is not built on a rule of supremacy, but rather of different contexts and

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52 In the view on the Italian Constitutional Court the use of the word "primacy" would not have been entirely accurate for the reasons clarified later on in this paragraph.

53 EU and national law belong to the same order with the first hierarchically supra-ordinated to the second, just like in a kelsenian *stufenbau* construction. in this respect, every national rule not consistent or in conflict with a EU one had to be repealed by Courts or in any case hadn't to be applied to the case in the Court.

54 ECJ manifested this approach since the cases C-26/62 February 5th 1963, C-6/64 July 15th 1964 and C-11/70, December 17th 1970.

55 ECJ, C-48/71, July 13th 1972.

56 ECJ, C-106/77 March 9th 1978.

conditions for their application. Where EC law is applicable national one is not. The more EC law expands its field of application, the more national law withdraws.

The Constitutional Court clarified its position in a well know case[57], which is important not only for Italy but also for all those Countries which adopt the same legal theory, where first of all recognized that EC law steps into the national system thanks to art. 11 of the Constitution, and commenting art. 11 says that the article quoted:

"*... means that, when certain conditions are met, it is possible to enter into International Treaties limiting the state sovereignty and execute them trough a ordinary act of the Parliament ...*"

but at the same time the way in which Treaties get into the National system is also an intrinsic limit to their efficacy, and to this extent

"*... this doesn't generate any deviation to the rules applicable to the efficacy in the Internal system of the International obligations the State entered into together with other States as far as art. 11 of the Constitution doesn't bestow on the ordinary Act implementing the treaty of the case any different (superior) efficacy of the ordinary law ...*".

The Court went back on the same issues in a number of cases. Out of these, two are still relevant and useful nowadays to understand better what was the position of the Constitutional Court at that time.

In the second of these[58] the Court judged on the legal nature of the so called "Derivative" EEC law (that is, the rule of law stemming out from directives and regulations) according to art. 189 of the Treaty and clarified that in the Italian perspective:

"*... this power* [that is, to adopt directives and regulations] *is attributed to the organs of the Community for the fulfillment of their duties under the conditions specified by the Treaty; therefore each member state transferred part of its legislative powers to the community, according to a specific apportionment criterion based on the areas of European interest covered by the Treaty ...*".

It is also for this reason that some years before the Court was able to qualify as constitutionally compatible with art. 23 (reserve of law, and no taxation without representation) the EEC Regulations as far as art. 23 is applicable only to the rules and the acts of the national system, and not to the European one.

To a certain extent, the dualistic theory was the ground upon which European taxation could be justified even if missing the "democracy test", or, in other words, even in absence of a clearly manifested democratic consensus. In any case, the Court was aware that the decision would have been quite questionable in the light of the fundamental freedoms safeguarded by the Constitution, and therefore added, with particular reference to art. 23, that:

"*... the clear and specific provision of the Treaty* [of Rome] *provide an adequate warranty, therefore it is difficult to imagine (even theoretically speaking) that a European regulation could have an impact, on civil, social or politic rights inconsistent with the Italian Constitution ...*".

It could be argued, therefore, that the democratic consensus is not necessary for European directives and regulations as far as these are intrinsically consistent with the (national) law.

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[57] Italian Constitutional Court, March 7th 1964, n° 14.

[58] Italian Constitutional Court, December 27th 1973, n° 183.

Obviously, this is not the end of the story, with the ECJ on one side affirming the unity of the national legal system, and the Constitutional Court still ruling that it was possible to have one "system and two laws". It was not only a theoretical issue, as it could emerge from the last mentioned paragraph of the sentence n° 183.

As a matter of fact, the adoption of one theory or the other had also an effect on the decision about the most influent Court in the legal system of the Country. In the case of the monistic theory, obviously the ECJ has the power to test the compatibility of any provisions (including Constitutional rules) with the European law; on the contrary (dualistic theory) the Constitutional Court is ultimately in charge to decide the limit of the retreat of the national law in favor of the European one, and ultimately to set limits (basically of Constitutional nature) to the European derivative law.

A balance between the two vision was later reached when the supremacy of the fundamental principles and Human rights over European law was acknowledged by both the Court, which as a matter of fact demanded to a third body (the European Court of Human rights[59]) to assess the nature and the identity of the fundamental rights and freedoms enshrined in every Constitution that neither the Treaty of Rome nor the derivative european law could infringe. Needless to say that the issue was absolutely theoretical and by now in never had a concrete application nor arguably will ever have.

In any case the decision by the ECJ, answering to the Constitutional Court is relevant in the development of this research as far as it insert in the dichotomy between Europe and Nation - State the role of the Fundamental rights and the European Convention on Human rights and fundamental freedoms[60]. In this respect the field of the analysis in widened to another multilateral Treaty EU is bound to respect just like the States. Anyway, the States are members of the Council of Europe, but the Union is only self bound to respect the fundamental rights and the Convention[61].

In this respect, the test of democracy to be passed by any decision involving taxes could be reformulated to a "Human rights test" for any tax to be consistent with national and European law. In this perspective, the analysis ceases to be purely theoretical as far as there were in the past cases in which the tax sovereignty of European Countries was tested according the ECHR, and in some of these taxes had to be reshaped in a way consistent with the fundamental rights and freedoms. And even were these amendments were not needed, the Court in Strasbourg set out principles of general application that could be relevant as well for most of the European Countries.

4. Continues: the role of the Fundamental rights. The European convention on Human rights and taxation.

In the text of the ECHR there are many provisions which are important for the application of taxes such as art. 5 (right of freedom of any individual), art. 6 (due process of law), art. 14 (non discrimination). Moreover, Article 1 of the first Protocol to the Convention ensure

[59] ECtHR, from now on.

[60] ECHR, from now on.

[61] Art. 6 (1) of the Treaty reads as follows "*The Union is founded on the principles of liberty, democracy, respect for human rights and fundamental freedoms, and the rule of law, principles which are common to the Member States ...*".

everybody the peaceful enjoyment of their possessions. Even if it was inserted in the Protocol to protect every individual from arbitrary deprivation, it's evident that some taxes could reach the same result and therefore the article could be used even in our context[62].

For what concerns the principle of non discrimination, the one capable of having the most significant impact on National tax law, the Court of Strasbourg[63] highlighted that it:

"... complements the other substantive provisions of the Convention and the Protocols. It has no independent existence since it has effect solely in relation to the enjoyment of the rights and freedoms safeguarded by those provisions.".

The outcome of this interpretation is therefore a significant reduction of the possibilities for art. 14 to be applied in favor of the taxpayer, being it useful only when read in conjunction with another article of the Treaty[64].

In any case, and not counting EU law[65], the ECHR is the only Treaty effectively protecting taxpayers rights in an international context, despite the nature (truly democratic[66] or not) of the legal process of tax implementation in each Country. It is not easy to find out general principles of international law to be considered as limits to the (taxing) power of a State beyond that Treaty.

In this respect the Permanent Court of International Justice, in the case *Lotus*, underlined that "*... Now the first and foremost restriction imposed by international law upon a State is that -... - it may not exercise its power in any form in the territory of another State...*"[67].

The taxpayer position, in other words, has no international guarantees but international Conventions on double taxation and (if applicable due to the residence or citizenship) EU law,

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[62] And it was, just like in the case *Darby* v. *Sweden*, October 23rd 1990, n° 11581/85. That's probably why taxation is specifically excluded from the scope of the article in § 2.

[63] Case *Rasmussen* v. *Denmark*, November 28th 1984, n° 8777/89, at § 29.

[64] Perhaps one of the most interesting reading in conjunction of art. 14 is with art. 1 of the First protocol. In a number of cases commented later in this research, the Court said that even if art. 1 can't be directly applied to tax law because of the clear exclusion in § 2, nonetheless the peaceful enjoyment of the possession must be guaranteed consistently with non discrimination principle. Therefore a tax unreasonably discriminatory can be considered as in violation of art. 1 of the Protocol taken in conjunction with art. 14 of the Convention, thus using the latter article as overriding provisions of the exceptions enumerated in art. 1. The first Protocol to the European Convention on Human rights was adopted in Paris on March 20th 1952.

[65] And also the bilateral Conventions on Double taxation that many countries enter into according to the O.E.C.D. Model Convention.

[66] Whilst the democratic nature of the state is a fundamental prerequisite (a sort of *condicio sine qua non*) for the accession of the Country of the case to to he Council of Europe, it is not necessary that the "test of democracy" had to be passed even in a purely fiscal perspective.

[67] *S.S. Lotus*, Collection of judgments, Publications of the Permanent Court of international justice, n°10, Series A-10, Leyden, 1927, p. 18. The case mentioned however did not involve a fiscal issue.

obviously and unluckily democracy is not a fundamental or an "*a priori*" condition for the exercise of taxing power[68].

Anyway, after the Second World War the Countries belonging to the Council of Europe pointed out that the protection of some, well identified, Human Rights hadn't to be left to the single national system. A minimum level of guarantee had to be recognized by the democratic nations in any case.

The first positivisation of this political issue was however taken by the UN: art. 38 of the Statute of the International court of Justice adopts the "*... general principles of law recognized by civilized nations...*" to solve conflicts between different Countries.

Far from being an absolute reform, it is to say that a similar provision was enshrined in the former statute of the Permanent court of International Justice (operating in the Society of Nations). It's worth while to remember that these principles have both to be found enforceable "*in the most part of the Countries*" and they must be seen as compulsory under the point of view of the International law, in order to obtain a general international acknowledgment.

In this perspective, the question this paper began with could be observed from a completely different perspective. The test of democracy taxation should (could) pass is not related only to the procedure to be adopted to implement new taxes (approval by Parliaments or other representative bodies) but also to the content of the taxing provision, to the identification of the taxable base, and so forth.

It could be argued that some taxes and some ways and means to implement them are not democratic if they are not consistent with Human rights and the Conventions protecting them (first of all the ECHR, at least in Europe). The concrete application of this sort of "substantial condition" (while the former, traditional one could be considered therefore formal, but only for the sake of a easier explanation) depends obviously on the impact of the Human rights and particularly of the European Convention on the legislation of every State which joined the Council of Europe[69]. It is an issue not very different front he one discussed in the former paragraph in respect to the EU law.

To a certain extent, therefore, it is not so surprisingly that the "human right issue" was raised in the past by some National constitutional Court as a limit to the supremacy of the European law in the monistic construction brought forward by the ECJ, and that the ECHR was implicitly referred to by the ECJ in an attempt to reduce the discretion of the the national Courts in the application of the EU law.

The case of Germany is evident. Art. 23 of the *Grundgesetz* allows the transfer of sovereignty to the European institutions with the only limit of the respect and protection of the Fundamental Rights as enshrined in the Constitution. The Court referred clearly to the national principles as limit to the EU law, sending back to the "core provisions" of the

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[68] However in this latter case some italian authors noted that it is difficult then to draw a line between taxation and arbitrary deprivations of properties and possession. This reasoning finds an echo in the case *The National & Provincial Building Society, the Leeds permanent Building Society and the Yorkshire building society* v. *The United Kingdom*, October 23rd 1997, n°117/97, at § 79. In that paragraph the Court seems to acknowledge that double taxation is, as a matter of fact, an expropriation.

[69] In a provocative sense, the title of the paper could be reshaped also in ... "*Can Economic integration be but democratic? The case of taxes*".

Grundgesetz. The Italian Constitutional Court in a similar way[70] recognized the primacy of the European sources of law in the comparisons with the national ones, respecting however the "*... fundamental principles of our constitutional order and the inviolable rights of the human person...*", thus limiting the influence of the EU law.

It is therefore evident the importance of the ECHR in tax law, and particularly in the relation between taxes and democracy: the application of the principle of "No taxation without representation" and the subsequent, possible, reserve of law in this respect.

Actually, the Court faced this issue (namely: the possibility to implement tax provisions without involving a representative constitutional body): it happened in 1999 in the so called "*Spacek"*[71] case, from the name of the company involved and which raised the issue of the compatibility of Czech law with the ECHR.

In 1991 the individual enterprise *Spacek SW* carried on his business holding a single-entry book keeping, as far as it was allowed by the law of that time, and changed his accounting method to the double-entry only in the next year, due to the incorporation in *Spacek s.r.o.* In April, 1993, the Czech Internal revenue service assessed the corporation for omitted payment of due taxes in the passage from an accounting system to the other.

In the Czech republic, just like in many Western Countries, the enterprise taxable income is determined through the accounting balance sheet. However while in other tax systems the income is taxed according to special rules of law, in the Czech Republic it was the Ministry of Finances who decided the taxable bases and the ways to calculate it: as a consequence (and as a matter of fact) the amount of the tax due was left to the decision of the Ministry.

The taxpayer in the case raised various issues of incompatibility of the Czech system with the ECHR, being the reserve of law not only a mean to safeguard the participation of the taxpayer to the decision involving their assets, but also an adequate legal instrument for the effective knowledge of the tax provisions by the taxpayers[72].

The assessment of the amount of tax due (and much more of the fines in case of evasion) was relevant according to art. 1 of the first Protocol to the ECHR. The taxpayer argued that even if art. 1 of the Protocol is limited in its application by § 2, nonetheless it requires a law to regulate taxation in every Country, and therefore two solutions were possible for the case in discussion.

According to the first one, art. 1 of the Protocol enshrines implicitly the principle "No taxation without representation": being this true, the Czech legislation is in violation of the ECHR. According to the second one, even if the principle in not inserted in art. 1, nonetheless its *non* application to taxes (according to § 2) is possible only insofar there is a law of a State that rules on taxation. Basically, art. 1 is not applied in favor of the taxpayer against a national law, but can be applied in full extension against a national Ministerial Regulation, such as the one in the case in question. In this respect the sovereign fiscal interest receives a particular

[70] Italian Constitutional Court June 8th 1984, n° 170.

[71] *Spacek s.r.o.* v. *Czech Republic*, November 11th 1999, n°26449/95. Even if the judgement was delivered in 1999 the issue was raised in 1991.

[72] Apparently, it was not the same in the case of the Ministerial regulations that were allegedly difficult to be found or known in time.

protection inside the Protocol (§ 2 of the provision voids of most of the effect of the article in tax area), but only if exercised through the instrument of a “law[73]”.

The ECtHR, however, reasoned in a different way.

In the interpretation of the Court, the concept of “law” (and consequently “reserve of law” embedded to the axiom “non taxation without representation”) must not to be read in a formal sense (that is, inserted in a tidy system of sources), but in a substantial one, including not only the Acts passed by the Parliament but also the Rulings of the Courts, and some Regulations of the Government. In a democratic State under the rule of law, representation in taxation is not necessary to the latter to be consistent with the fundamental rights of the individual, the Court seems to say.

The concept of "Normative Act" as understood in the Italian system is perhaps closer (although not coincident) to the meaning of “law” as expressed in the first Protocol in the reading of the Court.

The ECtHR moved on finding in the presence of some qualitative requirements (specifically those of “accessibility” and “foreseeability”) the conditions of conformity of the laws to the ECHR. In this respect, the publicity system of the laws enacted (which is far more complex for the Parliamentary Acts than the Regulations of the Ministries) therefore is underestimated to simple instrument of information. The enactment of the Regulation of the case can consequently be preceded by some advertise on papers different from the Official Gazette or the Federal register, deprived of that presumption of knowledge of the act that the publication on those papers is capable to create.

The rejection of the taxpayer’s requests is relevant even in the different perspective of this research.

Firs of all, it teaches that representation and democratic consensus are not necessary in the ECHR to have taxes consistent with the Fundamental Rights of the individual, and even if taxation as overall phenomenon must still be consistent with other principles of the Convention, as mentioned above, no reserve of law (more to the point, reserve to the Parliament to decide on fiscal issues) is compulsory.

Obviously, the importance of this principle is evident for all those who support the theory of the taxing power of supranational bodies, such as the European union. The fact that no limits are to be found in the ECHR clearly remove a possible argument against a EU tax. Rather than be determinant in this respect, the ECtHR decision in *Spacek* can be easily used to indirectly support under a legal and political level this solution.

5. Levels of integration: States, Regions and territories the vertical effect of the EU law

As mentioned in the former paragraph and in § 3 the relationship between the Constitutional Court and the ECJ was never straightforward nor clear.

This complexity was due to the peculiar effects EU law has on the national one, and the case of Italy is paradigmatic of many other Countries on the continent.

[73] Arguably, Spacek’s view, an Act passed by the Czech Parliament.

In this respect a recent case[74] decided by the Italian Constitutional Court however is helpful to understand better the current trends of this relation and at the same time to assess the impact of the European provisions on taxing power of non sovereign territorial entities such as regions, provinces municipalities and so on.

The case discussed involves the consistency of some regional taxes with the Italian Constitution (principle of ability to pay, equality and reserve of law) and within the EC Treaty (art. 87 and 49) with freedom of establishment and non discrimination.

It happened that Sardinia, a special region in the Italian Constitutional system, with autonomous taxing powers and therefore the possibility to introduce different taxes from the ones implemented on the continent, decided to pass[75] a number of new taxes later qualified by the press al "Luxury taxes"[76] as far as they were applicable only to certain goods or services of high value.

The aim pursued by the Governor of the region, who proposed the Acts to the Regional assembly, was all in all reasonable. He tried to tax the use of luxury ships, yachts, private airplanes and helicopters in Sardinia and use the resources obtained in this way to support the development of the internal areas of the region, that being outside the flows of the high wealth tourists are still underdeveloped.

The flow of income yielded by such taxes was undoubtedly high as far as Sardinia is qualified by an elite tourism and an impressive use of luxury goods such as the ones mentioned above and other specified by the law.

However, while drafting the text, Mr. Soru, the Governor, probably tried to get a bridge too far. In the law it was specified that the tax was due only by those business providing transport services (using yachts, private helicopters and so on) insofar their residence was outside of the region.

As matter of fact, a Sardininan company providing this kind of services[77] to affluent people was tax exempt, while an Italian (but continental) one or a European as well were not.

The reasons for such a discrimination were founded by the Sardinian assembly on the fact that companies resident in the region were not "free riding" the beauties of the land and were already paying taxes to the region, while the non resident companies were making profits exploiting for free the international appeal of the region[78].

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[74] April 15th 2008, n° 102.

[75] According to the regional statute of Sardinia taxes are passed with Act approved by the Regional assembly, a sort of regional parliament.

[76] The taxes were introduced and later amended by two regional Acts: May 29th 2007, n° 2 and May 11th 2006, n° 4.

[77] The tax was not only applicable to the goods, but to the services themselves as far as it was calculated on the income produced by, for instance, the business providing shuttle services to and from Sardinia with luxurious devices (airplanes, etc).

[78] In other words, the Governor argued that part of the profits of these companies was due to the fact that affluent people rented airplanes as a taxi to go from their home or office in the world to Sardinia. And while Sardinia supported the costs of this service, considered as an higher pollution, for instance, not a cent of the profits of such companies (or not enough of them) was given to the coffers of the Region.

Obviously these taxes were adopted in the framework of the special statute enjoyed by Sardinia caused the harsh reaction of the Italian Government, which appealed to the Constitutional Court for a number of reasons[79], partially mentioned above, considering the new taxes as unconstitutional. At the same time however, and in front of the Court, it also raised issues of compatibility of such taxes with the EC Treaty: and namely with art. 49 and 87.

Going beyond the details of the fact, it is evident that the decision of the Italian Government under this second perspective could have been considered as ill founded. The fact is that in a purely dualistic theory where the constitutional Court find herself as a *superiorem non recognoscens* body of the judiciary it would be quite difficult (although not impossible) for her to raise a question to the ECJ according to art. 234 of the Treaty.

This is not the case for the Court in 2008. The Judges decided that all in all the Constitutional Court can be considered as any other judge in the Italian legal system, thus fully entitled to raise questions of compatibility under art. 234 of the Treaty of Rome, as amended[80]. While the case has still to be decided by the ECJ, the raise of the issue by the Italian Court is enough in this respect for the aim of this research.

First of all, it probably establish the first stone of a bridge linking together the two theories mentioned above, and aimed at the ultimate overtaking of the dualistic one. The Italian legal system is progressively (even if slowly) moving towards a monistic theory as wished by the ECJ.

On the other side, it is evident that the progressive economic integration within the common market is also relevant for regions and other non-national or non sovereign legal bodies, such as the Italian Regions. Even when these enjoys special statutes of autonomy, allowing them to levy taxes also to non resident citizens[81], they can to that only consistently with the Treaty of Rome, on the contrary, their acts can be challenged in front of the ECJ just like any other act passed by the National Parliament.

6. The ECJ driven integration: some cases from the recent past and the effect on the Member States

[79] First of all, the violation of the principle of equality was pinpointed by the Government in front of the Court.

[80] See § 8.2.8.3 of the Sentence, which reads as follows (unofficial translation by the Author): "*This Court* [the Constitutional Court], *even if quite peculiar in its nature, being a constitutional Organ appointed to guarantee the respect of the Constitutional charter by the Parliament, is a judge to all the effects and, more to the point, it is the only and exclusive judge for constitutional issues (as far as no appeal is possible against any decisions, according to art. 137 (3) of the Constitution). The Court therefore in any judgment involving the constitutionality of the law is allowed to apply art. 234 (3) of the EC Treaty, thus raising issues of compatibility of national law with the EU one*".

[81] To a certain extent, it could be argued that even in a sub-national level the principle of "No taxation without representation" is wounded once more, as far as the Sardininan Parliament, for instance, voted a tax potentially applicable to all the italians managing a specific business in the region without their implicit consent as non resident (thus non voting) in Sardinia.

The unanimity required to approve directives in the field of direct taxation[82] has always been the most significant obstacle to the economic integration in the case of taxes.

It was difficult to reach it when the Community moved its first step, it is even more difficult now when 27 Countries have to give their assent for new taxing rules to be applied. The *particularisme* of every State, the nature of the investments developed on the territory[83] of the case and the subsequent cost - benefit analysis which follows every time a new proposal is introduced by the Commission makes the decision making mechanism (even without the relevant involvement of the Parliament) lengthy and possibly able to take decades before a single Directive were adopted: this is the case of the 2003/49/EC Directive mentioned above, for instance.

National States have always been jealous of their tax sovereignty, especially when it involves direct taxes. For this reason, when the Treaty of Rome was signed in 1957, a progressive harmonization was considered in indirect taxes such as VAT and customs duties, but not in personal income or corporate taxes.

In these latter fields, the Treaty used self-restraint to foster the bilateral relations between nations, especially through the so called "Double Taxation Conventions".

In subsequent years, however, it became more and more evident that the DTCs, although fundamental, were not enough to guarantee the full free movement of capitals and businesses across the Union and that the remaining differences between Member States could constitute a limit to foreign investments in the common market as well.

The ECJ played (and still plays) a fundamental role in this respect. The basic idea of the ECJ case law is that, even if direct taxation is excluded from an intervention by the Council, nonetheless the fundamental freedoms [84] enshrined in the Treaty must be respected, such as the freedom of establishment, the free movement of capital, labour, etc[85].

Where a direct intervention is lacking, a progressive interpretation of the four freedoms and the principle of non-discrimination could be successful, although in a sort of "second-best" approach. In recent years, academics and practitioners have recorded an ever-increasing number of cases decided by the ECJ using the Treaty in the field of direct taxes.

Despite the efforts of the ECJ, it is evident that a harmonization of such a complex field as direct taxation can't be demanded to the activity of the judiciary and to the interpretation of specific cases based on peculiar circumstances.

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[82] The words must be interpreted consistently with what mentioned above in § 3. Although the possibility for the EU to levy a tax is debated by the academics nowadays, with most of the lawyers on the position that this is not possible, for a number ofd reasons analyzed in the subsequent paragraphs, this does not mean that the implementation of directives in the field of taxation is not possible. In this respect, the Commission can propose, and the Council approve directives necessary to fully implement a common market, even involving direct taxes if this is necessary to ensure the goal while respecting the proportionality and subsidiarity principles. Actually this did happen in the past, as specified above in this paper.

[83] It was the case, mentioned above, of some relatively small states which blocked the adoption of the 2003/48/EC directive for years, being afraid that its implementation would have been too expensive for their financial market oriented economies.

[84] And the principle of non discrimination.

[85] In the EC Treaty: art 12 (prohibition of discrimination), 23 (goods), 39 (workers), 43 (establishment), 49 (services), 56 (capitals and payments).

More to the point, it is fundamental for the business to know exactly and in advance the amount of taxes to be paid and, even more to the point, what State would legitimately exercise its taxing powers in the EU framework. Only respecting this basic condition a subsequent economic integration is conceivable[86].

The case law and of the Court and the inspiring jurisprudence of it was mainly aimed at the achievement of this goal, particularly in the last years. It is generally true that the case law made integration is negative, being grounded on cases that demolish national rules and obstacles to the integration, it is even truer in case of taxes.

Here the *pars denstruens* of the ECJ case law is evident in reasonably recent cases such as the *Cadbury Schweppes*[87] where national anti avoidance provisions, aimed at the recapture of otherwise lost income, were declared incompatible with EU law. After *Cadbury*, new (tax) rules are introduced by the Court in EU (tax) law, but they are not aimed at the taxation of people or companies resident in Europe or at broadening their tax base, but rather at restricting the taxing power on the member State, also directly affecting their sovereignty in tax law. In this respect the importance of the case is also emphasized by the fact that it deals with an issue which has always been of extreme importance in national academic writings, but that has been unveiled only recently in a European context: the notion of abuse of law and its assessment in a fiscal context.

The facts and the circumstances of the case are well known and not relevant in this research. It is significant anyway to focus attention on the fundamental freedoms allegedly infringed (art. 43 and 48 of the Treaty: freedom of establishment) and on the anti-avoidance rule challenged in front of the Court: the British CFC regulations, considered as a choice of the sovereign state to tax specific companies in a peculiar way (thus a fully discretionary choice, particularly in UK Constitutional law).

In this case, the Cadbury Group set up an Irish-controlled company to take advantage of the lower tax rates of that Country, when compared to the UK ones. The tax saving was then reached through a leasing and financing operation from the latter to the former: the interests were tax deductible in the UK and, of course, taxed at a lower rate on the Irish subsidiary.

In order to avoid this tax deferral, the UK, just like many other European countries, introduced CFC regulations, attributing to the resident parent company the profits (or part of them) realized by the non-resident subsidiary, without any necessity to wait for the distribution of dividends by the foreign subsidiary.

At first glance, provisions like these could impair the freedom of establishment because a resident company could be prevented from establishing a subsidiary abroad if this decision could then immediately and directly increase its taxable base.

The UK CFC rules, considered alone, were reasonable because aimed at preventing the foreign allocation of profit where this decision is inspired mainly by tax considerations: the abuse in this case could consist of a business activity developed abroad (and not in the homeland) only for tax purposes.

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[86] This problem was particularly evident when flows of dividends, interests and royalties were considered, because of the more volatile nature of the underlying assets (while compared to business income or profit from real estate investments) and thus also the need for a level playing field across Europe was (and still is) more urgent.

[87] *Cadbury Schweppes plc, Cadbury Schweppes Overseas ltd* v. *Commissioners of Inland Revenue*, C-196/04.

Surprisingly or not, the conclusions and the underlaying reasoning were not so straightforward in the Union.

In the view of the Advocate General Legér (and then of the ECJ) tax planning across Europe is a legitimate way to spare taxes and the delocalisation of subsidiaries or branches of a company only for tax reasons cannot be challenged by the home State Tax Administration. It could be said, then, that a certain level of tax competition amongst Member States is not only tolerated but reflects the need of a Common Market. In other words, tax motives are, in themselves, legal motives.

The Advocate general clearly pointed out in his final remarks that when a parent company chooses another Member State in which to establish a company only because in the latter the taxation is significantly lower, it isn't abusing the freedom of establishment enshrined in the Treaty. This conclusion was, all in all, already upheld in the *Centros*[88] case, even if the latter was not exactly a tax case.

For instance, in *Centros* the freedom of establishment was defended by the ECJ even if, in the specific circumstances, the seat of the company set up in the UK was merely artificial, as the main business was developed in Denmark. The same goes for a case in which the company was set up according to a Member State commercial law and then was transferred to the UK or elsewhere. In these circumstances, the company tried to circumvent only commercial law provisions and no abuse is assessed even if the main seat abroad is fictitious or not effectively involved in any business at all.

In tax cases, such as *Cadbury*, the distinction is not so straightforward, and the artificial nature of the subsidiary could constitute a reasonable limit to the fundamental freedoms of the Treaty.

Of course *Centros* and *Cadbury* have a significant common ground. In both cases the Court ruled that the nationals of any Member States can't use EU law to "improperly circumvent" the national legislation or, in another point of the decision, that they are not allowed to "improperly or fraudulently" take advantage of the community law.

When such conditions are not met, then no restriction to the freedom of establishment is allowed in a EU perspective, unless, and this is specifically a case relevant to tax law, other overriding reasons of public interest do not emerge. And even in this case the derogations and the limits to the fundamental freedoms must be appropriate, proportional and consistent with the aim pursued. The sovereignty of the State has met therefore a new border settled by the ECJ, and particularly in one of the most important issues in taxation: the battle against tax avoidance (and evasion).

It is self-evident that the need of every Member State for specific countermeasures to tax avoidance falls into one of the overriding reasons of public interest, but those provisions must be proportionate to the aims pursued and to the actual dangers. If this condition is not met, then it is the Member State that abuses this possibility.

That's why the Court plays a fundamental role in defining the notion and the condition of abuse: defining tax avoidance, it also contributes to the definition of abuse of right by the Member State.

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[88] *Centros ltd. v. Erhvervs-og Selskabsstyrelsen*, C-212/97. In this case the UK was chosen because of the lesser conditions to be met in order to set up a limited company, in comparison to those in Denmark.

In EU law this is particularly true: the abuse of the taxpayer is counterweighted by the abuse of the Member State; both subjects are, to a certain extent, in an equal position in front of the Court.

Clearly in the specific view of this research it's interesting to note that the ECJ consider at the same level (and ultimately making the latter prevail) the sovereignty of the State in direct taxation, the interest of every country to defend as far as it could the taxable base on one side and the right of the taxpayer to set up even very aggressing tax planning schemes only insofar these don't reveal to be pure apparent constructions void of any business purpose other than pursue a tax reduction.

The lesson taught by the ECJ is quite bitter in this respect. There is a sort of "negative" tax law in EU, already in force an applicable, built up on the Fundamental Freedoms (namely, on market values) aimed at limiting the taxing power of the States. It's quite surprising (although legally founded) that limits to exercise of taxing power by representative bodies derive from others that aren't.

Obviously a *pars construens* of the European tax law is needed, but probably this is a duty to be taken by political scientists and not by lawyers, involving the mediation between conflicting interests of the States, cultures and traditions. Until now, only tidy attempt by the Commission and by academics are advanced in this respect. The idea to introduce a EU tax is undoubtedly seducing, even if a different context[89] probably would be necessary in this respect.

7. On limits and possibilities: the need for a EU tax in the eyes of the Commission.

The need for a EU tax and the necessity to find new ways and means to find financial resource to the Union has been recently put forward by the Commission in a Report on the operation of the own resource system[90].

The pages written by the Commission constitute probably the better example of the current situation in the Continent: plenty of theoretical possibilities (each one with advantages and drawbacks) on one side, lack of wide consensus on one or the other by the Member States and possibility of legal background in the Treaty, as will be discussed in the following paragraph.

The Report start from a basic consideration: the current financial mechanism is inadequate both under a qualitative and quantitative aspects to match the needs of the larger Union.

The qualitative lacks are to be found, in the view of the Commission, in the absence of a specific link between the Financial necessities of the Union and the individual citizens[91], as far as in the current system the cost of the Union in mainly supported by the Member States (thus indirectly by the citizens only).

The quantitative lacks (even if not directly specified, for obvious reasons) are to be found in the need of adequate resources for the always more demanding necessities of the Union,

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[89] A European Constitution (either in a short or extended version) could be useful to emphasize those social rights that have already been pinpointed by academics and should constitute the background of a EU tax.

[90] COM (2004) 505 final.

[91] See p.12 of the English version of the Report (§6).

particularly in order to offer common resources to face common problems or needs: welfare necessities on one side, irregular immigration on the other, just to cite two different kind of issues affecting all of the states (the first one) and the borderline ones (the second one).

The aspect that struck the eye of the reader when analyzing the mentioned Report is the absence of any reference to a European tax, just like the word itself could hurt the sensibility of some states. It is probably for this reason that the conclusions of the report mention the necessity for a "Tax - Based Own Resource", and not, straightforwardly, for a Tax.

The linguistic carefulness clearly pinpoint better than any other reference the cautiousness inspiring the behavior of the Commission.

The compatibility of a "Tax - Based Own Resource" with the Treaty is not discussed in depth by the Commission, being more a technical body than a political one is focused at proposing possible technical solution, leaving to other bodies, namely to the Council and the Parliament[92] to establish the political conditions for the passage from this system to a future, more efficient one.

In the eyes of the Commission, three solutions are feasible, involving (1) the taxation of energy consumption, (2) the reference to the national VAT base and finally (3) the possible implementation of a CCCTB (Common Consolidated Corporate Tax Base).

There's no need here to analyze in depth the reasons which took the Commission to focus the attention on these kind of taxes, but it is interesting to underline that two on three are related to consumption of goods (of a specific one in the tax on fuel, and on all of them in the second), while only the third is based on the income generated by specific taxpayers (the companies and some other legal entities).

The project of a CCCTB although recommended by the Commissioner to Taxation and Customs Union Mr. László Kovács[93] did not encountered the expected feedback despite the extreme quality of the model and the lack of reliable alternatives on the harmonization of the corporate tax base. The issues is not related to the lack of democracy in the definition of the features of the new system, but rather, as emerged, that some of the Member States are afraid to loose a significant part of their competitive advantage towards the others and thus their capacity to attract foreign investments (such as it is happening in the States of the recent accession).

In this perspective it seems that the most significant barriers to a EU tax in the perspective shall be raised not under a purely legal point of view, emphasizing the lack of democracy in the process of the economic integration, but rather by a short - term cost - benefit analysis by each State, afraid to lose ground in respect to the others.

This is also true in the respect of the two other provisions, namely the application of a EU tax on the VAT base (perspectively making VAT a fully EU tax) or on the consumption of fuel, not counting that some of the EU countries can't afford at the moment a significant reduction of the flow of income produced (this is also the case of Italy) and were the EU tax had to be

92 And to the singular member states, for those who believes that a EU tax would lack of the proper legal justification in the current set of the Treaties: to a certain extent "No taxation without recognition of the specific power in the Treaties".

93 M. Tenore and F. J. Almeida, Conference report: Common Consolidated Corporate Tax Base: the possible content of Community law provisions, [38] Intertax 2008, 400.

intended as a new fee for the Union that would seriously reduce the support of the European citizens towards an always more expensive institution[94].

8. Continues: the legal background to the proposal and the feasible alternatives

As was mentioned din the former paragraph, the proposal by the Commission and by the Commissioner received a feedback by the tax lawyers across Europe, while nearly all of them were in favor of a perspective EU Tax, it was also noted in many cases that the state of the art of the harmonization across Europe and the letter of the Treaty don't allow it or discourage the implementation.

This is probably an interpretation inspired by a *black letter* approach to the Treaty, but nonetheless it must be taken into account that the progressive slow down of the Constitutional step up of the Treaties, the adverse reactions of some Countries (Ireland and Poland in the very last minute) the widespread (although unreasonable) disaffection towards the EU institutions work against the adoption of a Tax[95] in the current historical moment.

Anyway, the attempt to implement a EU Tax should be made on the basis of art. 269 of the Treaty reading "*Without prejudice to other revenue, the budget shall be financed wholly from own resources ...*". Clearly the mentioned provision was introduced to determine a sort of apportionment of taxing powers between the Member States and the Community[96]. taken in this perspective, it can't justify a taxing power, but only the subdivision of an (already applied) tax. The attempt to extend the meaning of the first part of the provision in order to encompass a possible EU tax could be done according the theory of the implied powers of the Union, but eventually would be too far reaching, as was mentioned by authors cited.

Other possible legal grounds to establish a EU tax on are art. 175[97] and 308 of the Treaty, the first one regarding environmental taxes and the second one being a sort of last instance instrument that can be used only while pursuing a specific goal on in a specific context of the market.

Theoretically speaking art. 308 is the only one that could now justify from a purely legal point of view the implementation of a new tax (or a different apportionment of an already existing tax), but yet the problem scientifically speaking shifts from a legal to a political perspective, and therefore outside the scope of this research.

9. Concluding remarks (escaping the Sieyes's curse)

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94 The effect on the inflation on a national scale should be considered as well.

95 In the Treaty there is not a definition of tax nor any reference to any possible form of it, see S. Heidenbauer and R. Piscopo, *Report on the Conference: 'EU - Taxes'*, [35] Intertax 2007, 653.

96 More to the point, it is clearly a provision used as a legal basis to allocate income from national taxes to the Community.

97 Particularly at § (2). it was also noted that in this case no violation of the principle "No taxation without representation" would occur as far as the environmental tax would have to be implemented by every national Parliament.

One of the greatest lawyers of the French revolution, Emmanuel - Joseph Sieyès[98] considered that radical reforms or political innovations were possible only along breaking lines (*rupture*) of the constitutional order. Of course his impressions derived from the peculiar situation France was facing on those days before the *ètats généraux* were summoned by the King.

In any case, I think that the French lesson could somehow be useful nowadays to inspire the reasoning on the relation between democracy, economic integration and taxes.

The three concept are not randomly written, but ordered according to a priority which also derives from the personal convictions of the writer.

Democracy stands first, economic integration follows and taxes are to be considered only a means amongst various ones[99] to provide resources for the first and the second.

Economic integration could not need directly taxes, or direct taxes by the Union. Other ways and means could be found in the European Central Bank (or better the European Investment Bank) and on the possibility to issue bonds or an European debt to be used for the purposes the Council (or better, the Parliament) will judges as worthy to be pursued, possibly according to a revised conditionality mechanism as that used by the IMF, deprived by the elements that lead in the past to so much criticism by some authors and academics.

The Union is still to young to be in a legitimate position to request specific taxes; to a certain extent, the sacrifice of the personal possession (protected by the ECHR) to the advantage of a supranational body will be politically conceivable only when citizens in the continent shall begin to think to themselves more in term of Europeans rather than Spaniards, French, Italians and so forth. Speeding up this mechanism is theoretically possible, but the economic asymmetries[100] still present in the continent would be difficult to be politically overtaken and and the introduction of a European tax can be all but a zero sum game.

The Union as it is, particularly its blueprint in the treaty of Rome is the outcome of one of the most tremendous *rupture* world had ever experienced. The people who witnessed the forties and worn on their skin the scars of the war were so brave and far-sighted to build Europe from the ashes of the conflict.

As a matter of fact, the more that generation extinguishes, the more the European harmonization process slow down and the national *particularisme* raises, and taxation is possibly the edge of that.

It's on the current policy-maker to decide whether to test the accuracy of Sieyés prediction once more or set aside in the more convenient way the national egoism in favor of a larger home for everybody.

Probably Europe won't stand another *rupture*, and most certainly the younger generations does not deserve it.

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98 E. J. Sieyès, *Qu'est-ce que le tiers état?*, Paris, 1789, particularly at § 6.

99 It was already theoretically considered the possibility to introduce a *seignorage* fee on the emission of the Euro currency, then discarded by the reason that it would left unsolved the problem of the countries belonging to the Union (most notably UK) and still preserving their national currency.

100 To be interpreted as "diversities", thus in a very broad meaning, see D. G. Mayes and M. Virén, *Asymmetries in the Euro area economy*, bank of Finland Discussion Papers, 2004, 8.