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Article

The Repartition of Tax Powers in Federal States within the Context of the European Union

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In 1962, when the Neumark Report was published, the issue of possible limitations under European law on the repartition of tax powers among sub entities by Member States did not seem to be under discussion explicitly. Of the six Member States at the time, only Germany and Italy had a federal structure. Moreover the regions in these countries had only limited tax autonomy. Today's European Union is made up of many more Member States which have in one way or another transferred tax powers to regions than in 1962. This paper examines to what extent Member States have to take into account EU law when they transfer tax powers to the regions. Especially the impact of the non-discrimination principle and the fundamental freedoms of the TFEU are examined, as well as the influence of EU's policy on state aid.

1 Introduction

The Report of the Fiscal and Financial Committee of 1962 (also known as the 'Neumark Report') –that the editors of *The EC Tax Review* have used as a basis for all the contributions to this jubilee issue – explicitly states that it was '*concerned with the disparities arising from the tax systems of the Member Countries (. . .)*". According to this report "*the objective must above all be to establish conditions of taxation and public expenditure similar to those that would exist within a unified economy (. . .)". Within this range of idea, it must be considered that (even) in a completely integrated State certain differences in the tax treatment of inhabitants can be accepted. On the other hand, as long as there does not exist an adequately developed solidarity within the E.E.C., such differences will give rise to psychological and political opposition to the Common Market'*.[1]

When this report was written in 1962, the issue of possible limitations under European law on the spreading of fiscal competences among national sub entities by the Member States did not seem to be under discussion explicitly, but the marked extract highlighted in bold type in the above quotation gives the impression that differences in fiscal treatment between citizens of the same Member State could be accepted. However, the report did not discuss the extent to which such differences could be the consequence of the spread of fiscal competences between different sub entities within a Member State. Of the six Member States at that time, only Germany and Italy had a federal structure, and the fact that the regions in these countries had only limited fiscal autonomy may well be linked to this[2].

The Neumark Report contains the remark that '*certain structural disparities (of the tax systems) only matter to the extent that they have an effect over the short and/or long term on the conditions of competition in the Common Market*'[3]. The Report mentions the following determinant factors in structural disparities of tax systems:

(i) disparities in the qualitative composition of tax systems (taxes are not levied at similar rates in all the Member States);
(ii) disparities of relative return from the tax systems, because the rates of taxes levied vary from one country to another;
(iii) disparities in the economic structure of Member States (e.g. the level and distribution of national income, the relative importance of different economic sectors and consumption habits, which derive from the climate and income levels, etc.);
(iv) the 'taxation mentality' of the population, as well as the quantitative and qualitative abilities of the tax administration.

Note that neither the political structure of a Member State, nor the repartition of fiscal competences is

[1] The Report of the Fiscal and Financial Committee, (unofficial translation prepared by Dr H. Thurston, IBFD, Amsterdam, 1963, p. 100 and 101),emphasis added. (see also the official Dutch Report pages 6–8)

[2] A. HAELTERMAN, 'Spoor A2, Capita Selecta Rechtsvergelijkende studie', *Steunpunt Beleidsrelevant Onderzoek 2007–2011. Fiscaliteit en begroting* 2007, http://www.steunpuntfb.be/pdf/STEUNPUNTFB_WP_A2A_3.pdf, 8p.

[3] H. Thurston, IBFD, op cit, p. 113 et seq. (p. 30 et seq. in the official Dutch report).

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mentioned in the report as a determining factor[4]. The report states that:

> that given the multiplicity of factors primarily responsible for structural disparities of taxation system (. . .), on the one hand, but also for the general reasons mentioned (above) on the other hand, any attempt *to unify completely the structure of taxation systems* of Member States of the Community is a priori *likely to be frustrated* because on the one hand, it would not be achievable politically, and on the other hand, because its success could not of itself alone remove all disturbance to competition due to national taxation policies. But as, all things being equal, important structural disparities of the tax systems must be considered undesirable because of the varied effects mentioned of the separate taxes, *a certain approximation of taxation structures* seems among other things to be desirable[5].

Today's European Union is made up of many more Member States which have in one way or another, transferred taxation powers to regional or local authorities (hereafter 'regions') than in 1962.[6]

In this Article, we will examine to what extent Member States have to take into account EU law when they delegate tax powers to the regions.

In theory, a Member State's federal government which wants to delegate tax powers to its regions must take into account the specific characteristics of the EU, although, of course, the EU institutions have no powers to intervene in any such decision.

Art. 4 (2) of the Treaty on European Union (hereafter 'TEU') imposes a general obligation on the EU to respect the fundamental political and constitutional structures of the Member States as regards '*regional and local self-government'*. Moreover, Art. 5(3)1 TEU explicitly states that, given the principle of subsidiarity, '*in areas which do not fall within its exclusive competence, the Union shall only act if, and in so far as, the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at a central level or at a regional and local level, but could rather, by reason of the scale of effects of the proposed action, be better achieved at Union level*' (emphasis added).

The Court of Justice of the EU (hereafter 'CJEU') has recognized that each Member State is free to regulate the internal repartition of competences and to implement EU law.[7] However, the Member States must correctly implement EU Directives. A Member State cannot use the (federal) repartition of powers to shirk its obligations under EU law.[8] The co-existence side by side of different regulations in different regions of a Member State is, in itself, not deemed to be illegal discrimination.[9] The prohibition of discrimination is thus not concerned, within a Member State, with any disparities in treatment which may result from divergences in legislation between regions.

Given the EU principle of sincere co-operation, the Member States must take all measures necessary to ensure their compliance to their obligations under the European treaties and EU secondary law (Article 4.3 TEU). This includes powers which they have transferred to the regions.[10] If any legislation passed by a region is in breach of EU law, the EU will hold the federal government responsible under EU law.[11]

The jurisprudence of the CJEU has influenced those Member States which have devolved tax powers to their Regions. This jurisprudence will be discussed below.

2 The applicability of the principle of non-discrimination and the fundamental freedoms on the exercise by regions of their tax powers

The jurisprudence of the CJEU gives a clear indication that, against the background of the creation of the single internal market, the prohibition of discrimination and the fundamental freedoms (namely the free movement of goods, persons, services, capital and payments) have important repercussions on the organization and the exercise of tax powers by the regions and the federal governments of the Member States.

This prohibition and these freedoms prevent Member States and their regions from passing (fiscal) legislation which, without justification, treats similar situations

[4] However, the Neumark Report (H Thurston op cit p. 119; Dutch report p. 38) mentions that:

> it must not be forgotten that in cases where it exists, such as the Federal Republic of Germany for example, with a single tax on income with a uniform schedule, the parallel collection of business taxes by local authorities can engender in many respects an effect analogous to those produced by the juxtaposition of taxes on income and scheduled taxes.

[5] H. Thurston, *supra*, p. 117 (p. 34 et seq. in the official Dutch report). Emphasis added.

[6] A.o. K. Lenaerts and N. Gambien, *Regions and the European Courts: Giving Shape to the Regional Dimension of Member States*, Eur. L. Rev. 609 (2010) vol. 35, nr. 5.

[7] CJEU C-428/07, *Horvath* paras. 49-50, 3 Feb. 2009: concerning an English farmer who considered that he was being discriminated against, since the rules implementing an EU agricultural regulation were stricter in England than in Scotland, Wales and Northern Ireland. CJEU 15 Dec. 1971, Joined Cases 51/71 *International Fruit Company and Others*, 1971, ECR, 1107, para. 4.

[8] A.o. CJEU C-358/03, *Commission v. Austria*, para. 13, 16 Dec. 2004.

[9] CJEU C-428/07, *Horvath*, paras. 47–57, 3 Feb. 2009.

[10] As a result of this obligation, several Member States – including Belgium – have introduced a substitution scheme for tax matters, through which the ordinary rules on the delegation of powers are set aside to ensure that EU law is correctly implemented by the regions. For Belgium, this substitution scheme can be found in Article 169 of the Constitution.

[11] CJEU C-302/97, *Konle*, para. 62, 1 Jun. 1999; CJEU C-424/97, *Haim*, paras. 61–62, 4 Jul. 2000; CJEU C-224/01 *Köbler*, paras. 44–47 and 50, 30 Sep. 2003; CJEU C-358/03, *Commission v. Austria*, para. 13, 16 Dec. 2004; CJEU C-87/02 *Commission v. Italy*, para. 38, 10 Jun. 2004.

differently, on the basis of nationality or other criteria indirectly linked to nationality [12] (cf. *infra* sub 2.2).

The above-mentioned freedoms also prohibit the Member States and their regions from passing legislation which, without justification, prevents citizens of one Member State from moving to another Member State to work or develop an economic activity there. In addition, the freedom of movement of capital and payments includes third-party countries. The prohibition against unjustified hindrances affects all national legislation, irrespective of whether it is passed by the central government or by the regions.

2.1 Distinction between Purely Domestic Legal Situations and Other Situations

The CJEU's current jurisprudence does not appear to apply the treaty freedoms to purely domestic situations,[13] and thus affects commercial entities which operate exclusively in one Member State much less than those which operate in several Member States.

To further clarify this point, we discuss below, in chronological order, three decisions of the CJEU which merit special attention:

(1)*The Carrara* [14] case was about an ancient tax levied by Carrara Town Council on all marble quarried in Carrara and transported outside its territory.

Marble quarried in Carrara and used within the town council's territory was not taxed, and reduced rates of the tax were levied on marble quarried in Carrara and transported to a neighbouring town, whereas all Carrara marble transported outside the town council's territory was taxed at the full rate.

According to the Court, this tax was effectively equivalent to a Customs duty on exports and was in breach of EU law because it was levied on goods which remained within a single Member State (Articles 26 and 30, TFEU).

The reference to Article 26, TFEU (formerly Article 14.23, TCE) by the CJEU is interesting because this article does not distinguish between, on the one hand, borders between Member States and, on the other hand, internal borders within a Member State.

At first sight, it appears that the CJEU's decision is related only to purely internal situations. However, further examination of the decision can raise the question of whether or not the CJEU was indeed referring to an *exclusively and purely domestic* matter. The tax being discussed made no distinction between transport between Italian regions and between Member States. Consequently, it was impossible for the CJEU to distinguish purely domestic activities from intra-Community activities. This could explain why the CJEU declared itself competent to rule on the Carrara marble tax.

The CJEU later confirmed this point of view in *Jersey Produce Marketing Organisation Ltd*[15] a case concerning the tax levied on all exports of potatoes to the UK by potato farmers in Jersey (one of the Channel Islands), which the CJEU held to be in breach of Article 25 TEC and Article 30 TFEU.

(2)The case concerning the healthcare insurance scheme established by the Flemish Community in Belgium for individuals whose autonomy is reduced by serious and long-term disability[16]

The CJEU's decision in this case (also known as the *Vlaamse Zorgverzekering* case) demonstrated that it was not inclined to apply the European freedoms to purely domestic situations with no cross-border elements whatsoever. The ruling by the CJEU had been requested by the Belgian Constitutional Court, which had been asked to rule on whether or not the scheme was in breach of EU law.

The CJEU held that the scheme was in breach of Articles 45 and 49 TFEU (formerly Articles 39 and 43 TEC) because it prevented the free movement of workers and the freedom of establishment. Only

[12] Cf. a.o.: K. LENAERTS and L. BERNARDEAU, *« L'encadrement communautaire de la fiscalité directe »,* 43 Cah.dr.Eur., nrs 1–2, 19–109 (2007); M. Helminen, *EU Tax Law. Direct Taxation*, 47–128 (IBFD, 2009); J. Malherbe et al., *The Impact of the Rulings of the European Court of Justice in the Area of Direct Taxation 2010'*, Study requested by the European Parliament's Committee on Economic and Monetary Affairs, April 2011, 168.

[13] Cf. in this respect: CJEU C-250/08, *Commission v. Belgium*, para. 41, 1 Dec. 2011; CJEU C-212/06, *Gouvernement de la Communauté française and Gouvernement wallon v. Flemish Government*, paras. 37 and 38,1 Apr. 2008. It is however worth mentioning that the CJEU declares in the latter decision that its interpretation of provisions of EU law can be useful for national judges, by helping them to avoid situations of reverse discrimination in situations that are considered to be purely domestic (CJEU C-212/06, *Gouvernement de la Communauté française and Gouvernement wallon v. Flemish Government*, para. 40, 1 Apr. 2008). However, in this case, the Belgian Constitutional Court did not comply with the CJEU's ruling (Belgian Constitutional Court nr. 11/2009, 21 Jan. 2009, concerning the healthcare insurance scheme established by the Flemish Region).

[14] CJEU C-72/03, *Carbonati Apuani,* 9 Sep. 2004.

[15] CJEU C-293/02, *Jersey Produce Marketing Organisation Ltd*. 8 Nov. 2005. According to the Court it is clear that for the purpose of the application of Arts 23, 25, 28 and 29 TEC, the Channel Islands, the Isle of Man and the United Kingdom must be treated as one Member State (para. 54). However, it appears that this tax did not cover purely domestic situations only. Therefore, in Consideration 65, the CJEU states:

> In this case, it must be observed, first, that, in view of the conclusion reached in Paragraph 54 of this judgment, a contribution such as that at issue in this case which is calculated by the PEMB by reference to the quantities of potatoes produced by the farmers and exported from Jersey to the UK certainly constitutes a charge imposed on goods despatched from one region to another in the same Member State. Second, it must be added that, even though the 2001 Act covers only potatoes despatched to the UK for consumption there, *that does not rule out the possibility that these potatoes, once within the UK, might then be re-exported to other Member States, with the result that the tax in question may be levied on goods which, after having passed through the UK in transit, are in fact exported to other Member States*. (Emphasis added)

[16] CJEU, 1 Apr. 2008, C-212/06, *Gouvernement de la Communauté française and Gouvernement wallon v. Flemish Government.*

residents of the Flemish Region (including individuals who worked in the Flemish Region but were domiciled in another Member State) could join the scheme and receive its benefits. This meant that non-Belgians domiciled in the Flemish Region, who had used the freedom of movement to move there were not able to join the scheme and were therefore treated less advantageously, because they could not receive the benefits that were available to non-Belgians in the two other regions of Belgium. The CJEU held that this was tantamount to limiting the choice of domicile of these individuals, thus impeding their freedom of movement. In its decision, although the CJEU stressed that EU law did not apply to purely domestic situations, it took the opportunity to strictly define what it meant by a "purely domestic situation": '*the Belgian nationals working in the territory of the Dutch-speaking region or in the bilingual Brussels-Capital Region but who live in the French- or German-speaking regions and have never exercised their freedom to move within the European Community (. . .). Community law clearly cannot be applied to such purely internal situations*'.[17]

This definition by the CJEU has limited the potential scope of a purely domestic situation.

However, the CJEU's argumentation in the Flemish healthcare insurance scheme cannot be directly applied to delegation of tax powers to regions. Indeed, the CJEU's decision in this case was about social security benefits, not tax and certainly not income tax.

At EU level, taxation has not been integrated. EU law does not impose connecting factors such as domicile, workplace or other criteria for levying tax,[18] where it does impose such factors for social security benefits. However, this has not prevented the CJEU from acknowledging the connecting factors (e.g. the domicile principle) applied by Member States in Double-Tax Treaties.

However, the CJEU's ruling in the *Flemish healthcare insurance scheme* case does have some relevance to tax matters. A number of principles were based on it by the CJEU that have become important in tax matters, taking into account the general phrasing used.[19]

In general terms, the conclusion to be drawn is that regions within Member States who have the power to decide who receives benefits (not only social, but also fiscal benefits), in principle must ensure that any residence requirement in the region they set must cover EU migrant employees and self-employed individuals (and their family members) who are working in the region. They may be able to obtain exceptions to this rule if they can make a convincing case for such a residence requirement.[20]

To avoid that delegating tax powers to regions needlessly leads to breaches of the European freedom of movement, we would advise federal governments to ensure that the power to levy taxes on residents and non-residents is given to the same authority. For

[17] CJEU, C-212/06, *Gouvernement de la Communauté française et Gouvernement wallon v. Flemish Government* (paras. 37 and 38, emphasis added), 1 Apr. 2008. The Court has also explicitly rejected the critique of Advocate-General Sharpston of the CJEU's case law on purely domestic situations. According to the Advocate-General, it is indeed 'deeply paradoxical (. . .) that, although the last 50 years have been spent abolishing barriers to freedom of movement between Member States, decentralised authorities of Member States may nevertheless reintroduce barriers through the back door by establishing them within Member States. One might ask rhetorically, what sort of a European Union it is, if freedom of movement is guaranteed between Dunkirk (France) and De Panne (Belgium) but not between Jodoigne and Hoegaarden'. (Opinion of Advocate-General Sharpston 28 June 2007, C-212/06, *Gouvernement de la Communauté française et Gouvernement wallon v. Flemish Government,* para. 116.

[18] This explains why, also in a European context, double taxation is still possible and not in breach of EU law. For example, see the recent judgment of the High Court of the Netherlands of 8 Apr. 2011, with the Conclusions of Advocate-General Ijzerman in a case concerning double (Belgian and Dutch) taxation.

[19] The following paragraphs in particular should be mentioned:- para. 33:

- 'it is settled case-law that the Treaty rules governing freedom of movement for persons and the measures adopted to implement them cannot be applied to activities which have no factor linking them with any of the situations governed by Community law and which are confined in all relevant respects within a single Member State';
- para. 34: 'any national of a Member State, irrespective of his place of residence and his nationality, who has exercised the right to freedom of movement for workers and who has been employed in another Member State, falls within the scope of those provisions';
- para. 39: 'the citizenship of the Union is not intended to extend the material scope of the Treaty to internal situations which have no link with Community law'.
- para. 44: 'all the provisions of the Treaty on freedom of movement for persons are intended to facilitate the pursuit by Community nationals of occupational activities of all kinds throughout the Community, and preclude measures which might place Community nationals at a disadvantage when they wish to pursue an economic activity in the territory of another Member State'.
- 5°) para. 45: 'Articles 39 and 43 TEC militate against any national measure which, even though applicable without discrimination on grounds of nationality, is capable of hindering or rendering less attractive the exercise by Community nationals of the fundamental freedoms guaranteed by the Treaty'(see also para. 50).
- The CJEU has repeated in a later (tax) decision dated 1 Dec. 2011 under reference to the aforementioned decision of 1 Apr. 2008 that EU law cannot be applied to a purely domestic situation (CJEU C-250/08, *Commission v. Belgium*, para. 41, 1 Dec. 2011).

[20] An example of such a justification can be found in the decision of the EFTA Court of 3 May 2006 in case E-3/05, *EFTA v. Norway* (see www.eftacourt.int). In this case, the application of a residence requirement was under discussion for granting an additional family allowance to inhabitants of the northern regions of Norway (Finnmark and part of Troms). The purpose of this additional family allowance was to prevent the depopulation of these regions and to grant additional financial support to inhabitants with children, because of the difficult living conditions in these regions. To receive the allowance, however, the families had to prove that they lived in these regions. Workers who worked in these regions but did not live there with their families were ineligible for the additional family allowance. The EFTA Court held that the regional residence requirement was justified in the public interest and was proportional to this public interest and therefore not in breach of Council Ordinance Number. 1408/71. Another example can be found in the already mentioned judgment dated 1 December 2011 (CJEU C-250/08, *Commission v. Belgium*, paras. 69–77, 1 Dec. 2011), where Belgium successfully justified a discriminatory eligibility criterion as essential to safeguard the cohesion of its tax system.

example, in a federal state such as Belgium, the federal government has given the power to levy inheritance tax to the three regions, not just on the estates of deceased Belgian residents, but also on the estates of deceased Belgian non-residents. The CJEU issued a ruling on inheritance tax for non-residents in *Eckelkamp* [21] (see sub 2.2), and the three Belgian regions all reacted differently to it.

When the power to levy tax is divided between the federal authorities and the regions, the power to tax non-residents should, in our opinion, be attributed to the authority which has the most tax power over residents[22].

(3) The *Regione Sardegna* case[23]

The Regione Sardegna case raises the question of whether or not the strict exclusion by the CJEU of 'purely domestic matters' needs to be qualified.

This case was about a tax levied by the regional government in Sardinia on aeroplanes or private pleasure boats which called at airports or ports in Sardinia for tourism purposes. The tax was only levied on airlines or boat owners who were domiciled for tax purposes outside Sardinia. The CJEU ruled that the tax was an unjustified limitation of the free movement of services, but drew no distinction between residents of other Italian regions and residents of other Member States.

However, as in the *Carrara* case (see sub 2.1), in our opinion the CJEU has not rendered a judgment about an exclusively and purely domestic situation. Although the tax was probably originally conceived as covering purely domestic situations, it had evolved to cover other situations, without making a significant distinction between the two. The CJEU therefore held that there was a restriction of the free movement of services for airlines and boat owners domiciled outside the region for tax purposes *and established in other Member States*[24].

2.2. Influence of the Non-discrimination Principle and the Fundamental Freedoms Guaranteed by the TEC on the Exercise of Regionalized Tax Powers

Several decisions of the CJEU make it clear that the regions when exercising their tax powers, also have to take into account, the fundamental treaty freedoms and the non-discrimination principle.

The CJEU's ruling in *Geurts and Vogten* (25 October 2007[25]) is a good example of this. The CJEU had been asked to rule on the compatibility of the 'employment condition' laid down in Article 60*bis* of the Flemish Region's Inheritance Tax Code, which exempted family businesses from inheritance tax. One of the conditions for this exemption was that the business had to have employed the equivalent of at least five full-time individuals in the Flemish Region for the three years before the death of the business's owner. As it was much easier for businesses which had been established in the region for some time to fulfil this condition, the CJEU held that it was indirect discrimination against businesses based on the place where their employees worked, thus impeding the freedom of establishment of such businesses (paras 21–22).

The Belgian federal government had attempted to justify the condition by its policy to encourage small and medium-sized businesses by making it easier for them to maintain all their employees following the death of the owner. Although the CJEU agreed with this reasoning to some extent, it added that there was no reason to limit the application of this policy to the Flemish Region. (para. 27): '*As regards the considerations put forward by the Belgian Government, it should be noted that the latter has not been able to show the need to limit the exemption at issue to "family" undertakings which maintain a given number of jobs in the territory of the Member State concerned. In the present case, in relation to the objective of preventing inheritance tax from jeopardising the continuation of family undertakings, and therefore the jobs which they bring, undertakings having their seat in another Member State are in a situation comparable to that of undertakings established in the first Member State*'.

The Belgian Constitutional Court has also given its opinion on this question in its decision dated 8 July 2010: it ruled that a region may not, through the exercise of its tax powers, damage the view that public order in Belgium is based on an Economic and Monetary Union ('EMU'), characterised by an integrated market and by a monetary union (para. B.7). However, the Court also held that a difference in inheritance tax between the regions was not, in itself, in breach of EMU (para. B.8, second indentation). According to the Court, maintaining the level of employment and the continuation of small businesses was insufficient

[21] CJEU C-11/07, *Eckelkamp*,11 Sep. 2008.

[22] As an example, see the recent agreement in Belgium on dividing the power to levy personal income tax between the federal authorities and the regions. Although the federal authorities continue to receive the majority of income tax, the regions have extensive powers to levy income tax surcharges and to award tax credits. The Belgian federal authorities have also chosen to retain the right to levy income tax on non-residents (cf. Institutional Agreement for the Sixth State Reform, 11 Oct. 2011, 63). (www.lachambre.be/kvvcr/pdf_sections/home/NLdirupo.pdf).

[23] CJEU C-169/08, *Presidente del Consiglio dei Ministri t. Regione Sardegna*, 17 Nov. 2009.

[24] According to the Court 'such legislation introduces an additional cost for stopovers made by aircraft or boats operated by persons having their tax domicile outside the territory of the region *and established in other Member States*, and thus creates an advantage for some categories of undertaking established in that territory' (para. 32; emphasis added).

[25] CJEU C-464/05, *Geurts-Vogten*, 25 Oct. 2007.

justification to limit the condition to the Flemish region (para. B.9)[26].

Furthermore, the power of the Belgian regions to tax the transfer of property *causa mortis* was also referred to in the CJEU's ruling in *Eckelkamp* dated 11 September 2008 (C-11/07) already mentioned above. This case concerned the estate of a woman who was domiciled for tax purposes in Germany at the time of her death and who owned property in Flanders on which a mortgage debt existed. Her heirs were asked to pay the Flemish Region's tax on the transfer of property *causa mortis*, which was calculated on the estate's gross value, without deduction of debts and liabilities.

The CJEU held that this tax was incompatible with the free movement of capital because it did not allow the heirs to deduct debts and liabilities from the estate's gross value, whereas it would have allowed these deductions had the deceased been tax-resident in the Flemish Region at the time of her death.[27] In this ruling, the CJEU appears to have recognised the existence of different regional inheritance taxes within the same Member State (cf. a.o. paras 17, 62 and 63).

Subsequently all three Belgian Regions amended differently their inheritance tax legislation to avoid such discrimination.

Later, the CJEU also ruled in *Missionswerk Werner Heukelbach eV,* a case which challenged the Walloon Region's inheritance tax rule that subjected legacies to Belgian and EU charities to a tax at 7% (Art. 59, 2° j° Art. 60 § 1 Walloon Inheritance Tax Code)[28]. However, the 7% rate was only levied on legacies to charities which had a centre of operations in the Member State where the deceased resided or worked at the time of his or her death, or where he or she had formerly resided or worked. In all other cases, the legacy was taxed on a sliding scale, of up to 80%. This meant that the tax had the effect of restricting the movement of capital by reducing the value of legacies to foreign charities (para. 24). Referring to the decision in *Persche*[29] the CJEU also ruled that levying a higher rate of tax on cross-border movements of capital than on domestic Belgian movements of capital made cross-border movements less attractive, as, to avoid the higher tax, Belgian residents would not leave legacies to beneficiaries established in Member States in which the Belgian residents had neither lived nor worked (para. 25). The CJEU held that this tax was therefore a restriction on the free movement of capital for the purposes of Article 63(1) TFEU (para. 26), and rejected the Belgian federal government's argument that the difference in treatment was justified because the tax aimed to 'level the playing field' for charities such as the applicant (a religious charity established in Germany) to make them receive equal treatment with charities based in Belgium. The Belgian federal government had claimed it was entitled to require a close link between charities and the communities in which they operate in return for granting tax benefits. In this case, the Belgian community at large had benefited from the tax levied on the estate. However, the CJEU concluded that the tax did not enable this objective to be achieved (para. 35): '*By taking the centre of operations of the body concerned as the criterion for establishing the existence of a close link with the Belgian community at large, not only does the legislation at issue in the main proceedings treat bodies which have their seat in Belgium differently from those which do not, even where the latter have a close link with that community, it also treats all bodies which have their centre of operations in Belgium in the same way, whether or not they have established a close link with that community*'. (para. 36).

Finally, the decision of the CJEU dated 1 December 2011[30] must also be mentioned. It deals with an appeal by the European Commission against the Flemish Region's so-called portability system whereby registration duty paid on the purchase of a principal residence in the Flemish Region (but not elsewhere) could be deducted from the registration duty payable on the acquisition of another principal residence in the Flemish Region. This means that individuals who move their principal residence from one of the other two Belgian regions to the Flemish Region are unable to deduct the registration duty paid in the other two regions from the registration duty due to the Flemish Region.[31] The CJEU ruled that EU law could not be applied to such a purely domestic situation, where there was no question of restricting the freedom of movement within the European Union (cf. supra)[32]. The Flemish Region's portability system also excludes first-time buyers of principal residences in the Flemish Region who sold their principal residence in another Member State, from deducting the registration duties paid there from the duty due to the Flemish Region. From this angle, the CJEU held that the portability system was a restriction of the movement of capital, but one that was justified by the need to safeguard the cohesion of the tax system,[33] and because it allowed the Flemish region to achieve its policy objective.[34]

[26] Constitutional Court, nbr. 83/2010, 8 Jul. 2010, *Belgisch Staatsblad*, 12 Oct. 2010.

[27] Compare in the same context concerning The Netherlands: CJEU C-43/07, *Arens-Sikkens*, 11 Dec. 2008.

[28] CJEU C-25/10, *Missionswerk Werner Heukelbach eV*, 10 Feb. 2011.

[29] CJEU C-318/07, *Persche*, para. 38, 27 Jan. 2009.

[30] CJEU C-250/08, *Commission v. Belgium*, 1 Dec. 2011. Compare with CJEU, C-253/09, *Commission v. Hongary*, 1 Dec. 2011.

[31] *Id.*, at para. 39.

[32] *Id.*, at para. 41.

[33] *Id.*, at para. 77.

[34] *Id.*, at para. 82.

2.3 The Tension between the Harmonization of Tax Law at the European Level and the Transfer of Tax Powers by Member States to Regions

We will now consider the question of to what extent Member States can transfer tax powers to regions when these tax powers have already been, more or less harmonised at EU level.

First, only a limited number of taxes so far have been harmonized at EU level. Most of the taxes that have been harmonized are indirect taxes such as VAT, Customs and excise duties and taxes on capital increases. Far fewer direct taxes have been harmonised: to date only part of income tax (via the Directives on mergers, 'mother-daughter companies', savings rates, royalties and interest rates).

It is thus much easier for Member States to transfer powers to regions to levy taxes that have not been harmonized at EU level, and it has become almost impossible for them to transfer powers to regions to levy taxes such as VAT, excise duty and the indirect taxes on capital increases. However, it is worth mentioning that the Directives mentioned above sometimes still anticipate regional differentiations in their application. For example, the VAT Directive allowed Portugal to continue to levy VAT at a lower rate in the Azores and Madeira than in mainland Portugal (Art. 105, Directive 2006/112/EC)).

As far as direct taxes are concerned, the harmonization is not that advanced yet. Transfers of tax powers to the regions in that area seems still possible. However, Member States must ensure that any such transfers of power – and more particularly in the domain of corporate taxes – do not infringe the EU rules on state aid (see below sub 3).

3 The Repartition of Tax Powers and the European State Aid Regulation

Any form of state aid which distorts, or threatens to distort, competition, is, in principle, incompatible with the TFEU, whose Article 107 (1) states:

> *Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever, which distorts, or threatens to distort, competition by favouring certain undertakings or the production of certain goods shall, insofar as it affects trade between Member States, be incompatible with the internal market.*

However, it should be noted that Article 107.2 TFEU does not prohibit state aid[35]. Indeed, Article 107 2 and 3 lists a number of types of state aid which are compatible with the internal market (e.g. social security aid to individual consumers, aid to repair damage caused by natural disasters, and '*aid to facilitate the development of certain activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent that is contrary to the common interest*'). The European Commission has interpreted these definitions very broadly[36].

The prohibition of state aid has been clarified by the jurisprudence of the CJEU and the General Court of the European Union (EGC), which also covers tax powers.[37] This subject has also widely been discussed by legal scholars in articles.[38]

Five constitutive elements can be extracted from Article 107 (1) TFEU, that can serve as a benchmark for the assessing whether or not (fiscal) aid measures are compatible with EU law[39] :

(1) the measure is financed with state funds;
(2) the measure contains an economic advantage;
(3) the measure is selective;
(4) the measure distorts (or threatens to distort) competition;
(5) the measure has a negative effect on trade between the Member States.

[35] See a.o.: A.C. Dos Santos, *La régulation communautaire de la concurrence fiscale: une approche institutionnelle*, doctoral thesis, 2005, UCL, Louvain-la-Neuve, 423–601.

[36] *Id.*, at 424, n. 3, with further references.

[37] For instance CJEU C-387/92, *Banco Exterior de Espana*, para.14, 15 March 1994; CJEU C-173/73, *Italy v. Commission*, para. 36–39, 2 July 1974. For a good overview of the most important fiscal state aid cases, see P. Rossi-Maccanico, 'Commentary of State Aid Review of Multinational Tax Regimes', Eur. St. Aid L. Quarterly I, 25–41 (2007).

[38] A.C. Dos Santos, *supra* p. 424 a.f., with extensive references in n. 4; R. Greaves, *Autonomous Regions, Taxation and EC State-Aid Rules*, 34 Eur. L. Rev., 1 (2009); V. Guerrero, *Defining the Balance between Free Competition and Tax Sovereignty in EC and WTO Law: The "Due Respect" to General Tax System*, 5 Ger. L. J. 87–100 (2004); A. Haelterman, A. Kuypers & V. Oyen, 'Corporate Income Tax Regionalisation. Feasibility, Compliance Issues and EU Requirements. The Belgian Case', KUL, 2007, <www.steunpuntfb.be>. 17 p.; K. Lenaerts & N. Gambien, *Regions and the European Courts: Giving Shape to the Regional Dimension of Member States*, 35 Eur. L. Rev., 609, 629–633 (2010); R. Luja, *Tax Treaties and State Aid: Some Thoughts*, 44 Eur. Taxn, (2004); 234–238; P. Nicolaides, '*Fiscal State Aid in the EU: The Limits of Tax Autonomy*' 27 World Competition 365–396 (2004). P. Nicolaides, *The Boundaries of Tax Autonomy*, Eur. St. Aid L. Qtly 119–121 (2006) ; C.H. Panayi, *State Aid and Tax: the Third Way?*, 32 Intertax 283–306 (2004); C.H. Panayi, *Limitation on Benefits and State Aid*', 44 Eur. Taxn. 83–98 (2004); C. Pinto, *EC State Aid Rules and Tax Incentives: A U-Turn in Commission Policy?*, Eur. Taxn. 295–309 and 343–354 (1999); P. Rossi-Maccanico, *State Aid Review of Member States' Measures Relating to Direct Business Taxation*, Eur. St. Aid L. Qtly 229–251 (2004); P. Rossi-Maccanico, 'Community Practice in the Application of State Aid Rules to Direct Business Tax Measures', *Fiscalité européenne: actualités et points sensibles*, 61–82 (Bruylant, 2009); E. Traversa, "L'autonomie fiscale des Régions et des collectivités locales des Etats membres face au droit communautaire. Analyse et réflexion à la lumière des expériences belge et italienne", *Fondements du droit fiscal*, Brussels, Larcier, 2010, 572 p.; E. Traversa, '*Is there still room left in EU law for tax autonomy of Member States' regional and local authorities ?*', 19 EC Tax Rev., 4–15 (2011).

[39] E. Mattioli, M. Vervoort and T. Bruyninckx, "Fiscale voordelen vanwege regionale en lokale overheden: onder staatssteunbedreiging?" *T.F.R.*, 2009, no. 361, p. 388.

In general, (4) and (5) above are assessed together.[40]

A particular problem which has been highlighted in the recent jurisprudence of the CJEU and the EGC is fiscal state aid by Member States to their regions.[41] In this, the condition of selectivity is important. Only aid which materially or geographically favours certain companies, sectors or products is prohibited.

The European Commission and the CJEU have accepted that the exercise by regions of delegated powers to levy taxes is not geographically selective state aid. However, this does not mean that the Member States can avoid the prohibition on geographically selective state aid through the transfer of tax powers to regions.

Three situations, two of which involve situations where tax powers are delegated to local authorities, can be distinguished[42].

The first situation is when the central government of a Member State decides unilaterally to reduce the rate at which a national tax is levied within a defined geographical area. This is clearly selective, as the central government has decided to select part of the geographical territory within its competence for the application of this change.[43]

The second situation is when all the local authorities in a Member State (regions, districts or others) have the autonomous power to decide the rate at which a national tax will be levied in their territories. This is clearly *not* selective (in the sense of Article 107 (1) TFEU) because there is no national benchmark rate for this tax[44]. In our opinion, this would also be the situation when a national government transfers the right to levy a tax to regions. Subsequent changes to the rate at which such taxes are levied cannot be considered as state aid, not even for the region which decided to levy the tax at the lowest rate.

The third situation is one in which the power to levy a tax is divided between the national government and the regions. This can occur in one of two ways:

(a) *all* the regions have the same power to decrease or increase the tax as the national government (symmetrical repartition of tax powers); or

(b) *certain* regions have more tax-levying autonomy than others or than the national government (asymmetrical repartition of tax powers).

The consequences of these types of repartition of tax powers as regards the prohibition on state aid can be summarised as follows:

(1) An increase of the tax rate in a specific geographical territory does not constitute illegal state aid, as it can be categorized as a 'specific burden' in that territory and does not give taxpayers an advantage.[45] Thus it is easier for regions to increase former national taxes that were levied at low rates, than to decrease former national taxes that were levied at high rates.[46] This explains the policy adopted by the Belgian federal government, for example: most of the tax powers it has delegated to the local authorities are levied as supplements and surcharges based on property taxes, personal income tax and vehicle tax, which can all be classed as 'specific burdens' and not as 'advantages' or 'state aid'.[47]

(2) A decrease in a tax rate by a region will be considered as being (regionally) selective, and therefore illegal, only if it is possible to determine a national benchmark tax rate. According to the CJEU, a national rate can be determined if the region concerned does *not* have sufficient autonomy in proportion to the national government.

In this context, the following landmark judgments of the CJEU can be mentioned: *Commission v. Portugal* (6 September 2006, C-88/02)[48] and *Union General de Trabajadores de La Rioja* (11 September 2008, C-428/06 to C-434/06)[49]. The first case concerned the tax regime applicable in the Azores, an autonomous region of Portugal, which had reduced in the rate of personal income tax to 20% and corporation tax to 30% for taxpayers domiciled there. The Rioja cases concerned a tax measure adopted in 2005 by the three Basque Provinces of Spain which reduced the rate of corporation tax from 35% to 32.5% and introduced a series of deductions that were not available in the other Provinces.

When assessing whether or not the region(s) concerned had sufficient autonomy from the national

40 Opinion Adv-Gen. L.A. Geelhoed dated Oct. 20, 2005, Case C-88/03, *Portugal v. European Commission*, para. 44. *See*, e.g., CJEU C-169/08, *Presidente del Consiglio dei Ministri v. Regione Sardegna*, para. 52, 17 Nov. 2009.

41 See among others M. Merola & L. Cappeletti, "Une analyse des derniers développements en matière d'aides fiscales et de sélectivité régionale dans le cadre des tendances actuelles du contrôle des aides d'Etat" *Fiscalité européenne: actualités et point sensibles* 83–20 (Bruylant, 2009).

42 Opinion Adv.Gen. L.A. Geelhoed, *supra* paras. 50–54. This subdivision was also mentioned later by Adv. Gen. J. Kokott in her Opinion dated May 8, 2008, for the cases C-428/06 to C-434/06 *UGT-Rioja*, paras. 45–47.

43 CJEU C-88/02, *Portugal v. European Commission*, para. 64, 6 Sep. 2006; Opinion of Advocate-General Geelhoed, *supra*, para. 51.

44 CJEU C-88/02, *Portugal v. European Commission*, para. 64, 6 Sep. 2006; Opinion of Advocate-General Geelhoed, *supra*, paras. 52–53.

45 Opinion of Advocate General L.A. Geelhoed, *supra*, para. 49, with reference to his Opinion on the ruling dated 29 Apr. 2004, C-308/01, *GIL Insurance* among others.

46 B. Peeters, *European Guidelines for Federal Member States Granting Fiscal Competences c.q. Tax Autonomy to Sub-national Authorities*, 18 EC Tax Rev. 50 (April 2009).

47 E. Mattioli, M. Vervoort and & T. Bruyninckx, 'Fiscale voordelen vanwege regionale en lokale overheden: onder staatssteunbedreiging?' *T.F.R.*, 2009, no. 361, p. 399, who make a reservation if this 'burden' is not imposed on certain businesses.

48 CJEU, C-88/02, *Portugal v. European Commission,* 6 Sep. 2006.

49 CJEU, Joined cases C-428/06 to C-434/06 *Unión General de Trabajadores de La Rioja,* 11 Sep. 2008.

government, the CJEU[50] applies three cumulative conditions: institutional autonomy, procedural autonomy and economic and financial autonomy (the so-called triple autonomy test, see below)[51]. For the CJEU, those are the only conditions which must be satisfied for a region to be defined as an infra-Member-State body[52]. Any region which fails to satisfy one or more of these conditions would therefore be deemed to have received illegal selective state aid within the meaning of Article 107 (1) TFEU.

According to the CJEU, the tax change must have been taken by a region which, from a *constitutional point of view*, is politically and administratively separate from the central government (institutional autonomy). Furthermore it must also be autonomous from the central government from a *procedural point of view* and the tax change must have been made without intervention from the central government as regards its content (procedural autonomy). Finally, the region has to be autonomous from the central government from an *economic and financial point of view*, and the financial consequences of the reduction in the tax rate for undertakings in the region must not be offset by aid or subsidies from other regions or from the central government[53] (economic and financial autonomy).

These cases before the CJEU and the EGC (formerly the Court of First Instance (CFI)) all involved Member States with a so-called asymmetrical system of devolution of tax powers, where certain regions enjoyed more autonomy than others when determining tax rates. This would appear to indicate at first sight that the 'triple autonomy test' only applies to asymmetrical systems and not to symmetrical systems. To date, we are not aware of any case law on regionally selective state aid in Member States with symmetrical systems. In our opinion, this different treatment of the two types of system is unjustified.[54] Why should the economic and financial autonomy requirement not count for symmetrical systems? For does not a symmetrical system require the regions to assume full financial responsibility for their tax measures? Or conversely, why are the regions in Member States with asymmetrical systems subjected to such a severe autonomy test?

In our opinion, the triple autonomy test should also be used in Member States with symmetrical systems. [55]

Finally, it remains to be seen whether or not the fact that a region is deemed not to have 'sufficient' autonomy according to the autonomy test has any negative consequences for competition in the internal market. It cannot be denied that this is the fundamental criterion under Article 107 (1) TFEU. Traditionally it was the Member State that was taken as the framework for assessing whether or not a tax measure was selective or not, not the entire EU internal market. It has always been acceptable for the different Member States within the internal market to use their national fiscal sovereignty to steal a march on each other [56] (the so-called disparity of fiscal systems). However, within the Member States, the EU seems to be more suspicious and more willing to intervene when a region fails the triple autonomy test.[57] In addition, EU jurisprudence and practice have interpreted regionally selective state aid very broadly, which has adversely affected inter-Member-State trade and competition. For any (fiscal) aid which gives one undertaking an advantage over its competitors in the internal market could be deemed adverse, without attaching much weight to the amount of the aid, the size of the beneficiary or the proportion of the internal market affected.[58] Also, the fact that similar, competing

[50] CJEU C-88/02, *Portugal v. European Commission*, paras. 67–78, 6 Sep. 2006; CJEU Joined cases C-428/06 to C-434/06 *Unión General de Trabajadores de La Rioja*, paras. 51 and 60, 11 Sep. 2008. It should be noted that the Court of First Instance also made reference to these three conditions. See CFI Joined Cases T-211/04 and T-215/04 *Government of Gibraltar and United Kingdom v. European Commission*, concerning a tax measure adopted by the Gibraltar government, which taxed companies in Gibraltar at a lower rate than was generally applicable in the UK. The CFI ruled that the territory of Gibraltar and not the territory of the UK constituted the appropriate reference framework for assessing whether or not the tax measure was selective; The CFI came to this conclusion because Gibraltar passed the triple autonomy test.

[51] See also, B. Peeters, *Social Federalism: The Creation of a Layered Welfare State. The Belgian Case*, 227, 240–245 (Intersentia, 2011).

[52] CJEU Joined cases C-428/06 to C-434/06 *Unión General de Trabajadores de La Rioja*, para. 87, 11 Sep. 2008.

[53] CJEU C-88/02, *Portugal v. European Commission*, para. 67, 6 Sep. 2006; Opinion of Advocate-General Geelhoed *supra* para. 55.

[54] B. Peeters, *Social Federalism: The Creation of a Layered Welfare State. The Belgian Case*, 227, 247 (Intersentia, 2011).

[55] *Id.*, at 247. *See also* Lenaerts and Gambien, *Regions and the European Courts: giving shape to the regional dimension of Member States*, 35 Eur. L. Rev. 633 (2010).

[56] A reservation should be made concerning the European intervention by means of 'soft law' against harmful tax competition between Member States (cf. Code of Conduct for Business Taxation).

[57] According to F. Vanistendael, a possible explanation for this apparently paradoxical attitude is the unlimited use of national tax sovereignty by Member States, which makes the CJEU and the European Commission oppose regional tax autonomy. They want to prevent tax autonomy developing into tax sovereignty which could harm competition policy ('*Wellicht is de ongebreidelde uitoefening van de nationale fiscale soevereiniteit de reden waarom zowel de Europese Commissie als het Hof van Justitie zoveel wantrouwen hebben ten aanzien van de regionale fiscale autonomie en willen zij voorkomen dat fiscale autonomie zou uitgroeien tot fiscale soevereiniteit, die het concurrentiebeleid volledig zou kunnen ontwrichten*' (F. Vanistendael, *Maatschappelijk Heffen*, 611 (D.A. Albregtse & P. Kavelaars eds., Kluwer, 2006)).

[58] The Notice on the application of the state aid rules to measures relating to direct business taxation issued by the European Commission (*O.J.* Dec. 10, 1998, C 98/ 384/03, edge number 11 (with references to jurisprudence of the CJEU), states: 'Under settled case law, for the purposes of this provision, the criterion of trade being affected is met if the recipient firm carries on an economic activity involving trade between Member States. The mere fact that the aid strengthens the firm's position compared with that of other firms which are competitors in intra-Community trade is enough to allow the conclusion to be drawn that intra-Community trade is affected. Neither the fact that aid is relatively small in amount, nor the fact that the recipient is moderate in size or its share of the Community market very small, nor indeed the fact that the recipient does not carry out exports or exports virtually all its production outside the Community do anything to alter this conclusion'.

tax measures have been taken in other Member States does not seem to justify them. Each instance of fiscal aid is assessed against the background of the tax regime in the Member State concerned.[59] Would it not be better to use as a benchmark the normal level of competition in the internal market? Unfortunately, attempting to answer this question would exceed the scope of this contribution.

4 Conclusion

First, the non-discrimination principle and the fundamental freedoms of the TFEU restrict the way national and regional governments exercise their tax powers. From this perspective, the EU certainly has an influence. However, the EU does not get involved in the transfer of tax powers from the national governments of Member States to their regions, because it regards this as domestic policy of the Member States. The CJEU has applied the non-discrimination principle and the fundamental treaty freedoms to tax changes by the Member States and their regions without distinction.

Second, the EU's policy on state aid has also influenced the exercise of tax powers by the Member State national and regional governments. In assessing whether or not a regional tax measure constitutes selective state aid, the CJEU has attached considerable importance to the constitutional structure of the Member State and to its devolution of powers in general and of tax powers in particular. The CJEU has accepted that national territory of the Member State cannot always provide a benchmark for tax changes: taw changes adopted by regions can only be benchmarked against the region itself if it is sufficiently autonomous of the national government. The CJEU's triple autonomy test uses rather strict criteria (institutional, procedural and economic autonomy). From the state aid perspective, the CJEU also respects the fundamental political and constitutional structures of the Member States as regards '*regional and local self-government*'. However, the Member States are not allowed to enact purely formal internal divisions of power in order to circumvent the EU rules on state aid.

59 *Id.*, at edge number 24 (with references to jurisprudence of the CJEU and E. Mattioli, M. Vervoort & T. Bruyninckx, "Fiscale voordelen vanwege regionale en lokale overheden: onder staatssteunbedreiging?" *T.F.R.*, 2009, no. 361, p. 391, edge no. 16).