

VAT AND THE EC INTERNAL MARKET: THE SHORTCOMINGS OF HARMONISATION

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From the outset, turnover taxes have played a fundamental role in the European integration process. Harmonisation of these taxes was perceived an integral part of achieving a common market, and for this reason it was given priority. Over forty years since the introduction of a common VAT system, VAT is usually regarded as a broadly harmonised tax. Paradoxically, however, it is precisely this high level of harmonisation which seems to have allowed the preservation of some aspects of VAT law which constitute an obstacle to the establishment of the EC internal market. The aim of this paper is to highlight the shortcomings of harmonisation within the VAT area, and namely how harmonisation has prevented the European Court of Justice (ECJ) from applying the EC Treaty provisions to the field of VAT, resulting in the maintenance of laws which could arguably be regarded as contrary to the EC internal market and as restrictions to the fundamental freedoms.

1. Introduction

From the very outset, turnover taxes have played a fundamental role in the European integration process. Harmonisation of these taxes was perceived an integral part of achieving a common market, both in the context of a sector-based common market – as in the case of the European Coal and Steel Community – and in the context of a generic common market – as was the case with the European Economic Community. For this reason their harmonisation

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was given priority: in 1967 a common VAT system was established,¹ and in 1977 a common VAT base was approved.² Over forty years – and many amending legislation – later, VAT is usually regarded as a broadly harmonised tax. Paradoxically, however, it is precisely this high level of harmonisation which seems to have allowed the preservation of some aspects of VAT law which may constitute an obstacle to the establishment of the EC internal market.

The aim of this paper is to highlight the shortcomings of harmonisation within the VAT area, and namely how harmonisation has prevented the European Court of Justice (ECJ) from applying the EC Treaty provisions to the field of VAT, resulting in the maintenance of laws which could arguably be regarded as contrary to the EC internal market and deemed as restrictions to the fundamental freedoms. Part two of the paper highlights how VAT has been very much at the centre of European integration from the outset and its harmonisation regarded as fundamental for the establishment of a common / internal market. In part three the hierarchy of EC norms, as well as the role of the ECJ in areas which have been subject to more or less extensive harmonisation, are analysed. The (in)compatibility of the current VAT law with the EC internal market will be considered in part four, with reference to the concept of internal market under the EC Treaty. Historical, practical and jurisprudential arguments will be presented, and a comparison between the ECJ approach to VAT and its approach to direct taxation will be undertaken. Part five concludes with considerations on the role of the ECJ as a constitutional court.

2. VAT: A Tax at the Centre of Internal Market Policy

The Treaty of Paris establishing the European Coal and Steel Community represented the first significant step towards harmonisation of turnover taxes, providing the institutional framework in which to initiate discussions on the introduction of a common turnover tax system. Although there was no specific reference to turnover taxes in the Treaty as a potential obstacle to the establishment of a coal and steel common market,³ there was an awareness of the potential negative impact that the application of different turnover taxes across Member States could have. It was this awareness that led the High Authority of the European Coal and Steel Community to set up in 1953 the Tinbergen Committee, a Committee of Experts

¹ First Council Directive 67/227/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes, OJ 71, 14/04/1967, 1301; and Second Council Directive 67/228/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes – Structure and procedures for application of the common system of value added tax, OJ P71, 14/04/1967, 1303. Hereafter “First VAT Directive” and “Second VAT Directive”, respectively.

² Sixth Council Directive 77/388/EEC of 12 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes – Common system of value added tax: Uniform basis of assessment, OJ L145, 13/06/1977, 1.

³ Article 4 ECSC Treaty lists several duties, measures, and subsidies which would be incompatible with the common market for coal and steel. However, there is no reference to turnover taxes.

entrusted with investigating the impact on the common market of the various turnover tax systems.⁴ The report presented by the Committee later the same year, known as the Tinbergen Report,⁵ concluded that the Community should adopt a new common turnover tax system applicable to the common market of coal and steel. This common turnover tax would be based on the principle of taxation in the country of destination, and exemptions or refunds would be limited to the amount of the tax on the final transaction. Although the recommendations of the Committee were never applied within the context of the European Coal and Steel Community, the report constituted a significant historical breakthrough in terms of the harmonisation of turnover taxes. For the first time in the history of European integration, the idea that different turnover taxes might constitute an obstacle to the proper functioning of the common market was expressed in an official document. Equally for the first time the suggestion was put forward that some kind of harmonisation – though the word was never used – should be pursued in the area of turnover taxes, in order to make the common market function effectively.

Soon after the publication of the Tinbergen Report, the Spaak Report, calling for the creation of a general common market was released. The Report contained a chapter devoted to the problems of “Distortion and Harmonisation of Legislation”, raising the issue of potential distortions to the common market which could result from different legislation and the need, in some cases, to harmonise the Member State legislations.⁶ This chapter seems to have been a direct result of the position adopted by France during the intergovernmental negotiations, which consistently pointed out that if it was to join the common market, some kind of variation of “harmonization of fiscal and social charges” had to be inserted.⁷ The considerations set out in this chapter, together with the stated aim of achieving a free movement of commodities are fundamental to the comprehension of what would later become the Treaty of Rome’s turnover tax provisions. Under the heading “Fiscal Provisions”, the EEC Treaty included several tax provisions, namely Articles 95 to 99.⁸ It has been said that “the chapter on Fiscal Provisions is formulated in the most limiting kind of language” and that “as regards taxation policy, the Treaty contains only the most timid of starting-points”.⁹ It should be noted, however, that if Article 99 represented only a starting point in terms of

⁴ Order No. 1-53 of 5 March 1953, Official Gazette of the Community of 7th March 1953.

⁵ *Report on the problems raised by the different turnover tax systems applied within the Common Market*, Report prepared by the Committee of Experts set up under Order No. 1–53 of the High Authority, dated March 5, 1953, Luxembourg, 8 April 1953.

⁶ See A. Schrauwen, Chapter xx above.

⁷ See R. Bertrand, “The European Common Market Proposal” (1956) *International Organization* X, 559–574, at 564-566.

⁸ In their original numbering; these provisions currently correspond to Articles 90 to 93, and are included under the heading “Tax Provisions”.

⁹ See W. Hallstein, former president of the European Commission, in *Europe in the Making* (London: George Allen & Unwin Ltd, 1972), at 156-157.

turnover taxes, it was undoubtedly an important one.¹⁰ It is clear from the wording of this provision that, following the Tinbergen Report, the authors of the EEC Treaty considered that the existence of different turnover tax systems would be incompatible with the objectives of the newly established Community.¹¹ The function of Article 99 was therefore to remove those incompatibilities, thereby initiating the process of harmonisation of turnover taxes.

Acting on the mandate provided by Article 99 of the EEC Treaty, the Commission set up several consecutive working groups in order to determine whether harmonisation of turnover taxes was indeed necessary “in the interest of the common market”, and if so, what were the available methods for achieving such harmonisation.¹² The first of these working groups was the so-called “Working Group No. I”, which in their report dated late 1959 concluded that “the maintenance of the diversity of tax systems currently applied in the different Member States is prejudicial in character to the good working of the common market and it is desirable [...] to go on toward a harmonisation of the differing legislation relating to turnover taxes”.¹³ In response to the report, the Commission decided to set up three further working groups and a committee: the working groups known as Sub-Groups A, B, and C were established in order to examine different aspects of the problem and various alternative solutions;¹⁴ whilst the Fiscal and Financial Committee, chaired by Professor Fritz Neumark, was in charge of studying the extent to which the disparities of public finance within Member States prejudiced the establishment of a common market which “guarantees conditions analogous to those of an internal market”.¹⁵ Despite the apparent broadness of the Fiscal and Financial Committee’s mandate, it was acknowledged from the outset that questions regarding indirect taxation, and particularly turnover taxes, would constitute one of the principal problems requiring the Committee’s attention.

¹⁰ See J. Reugebrink, “The Sixth Directive for the Harmonisation of Value Added Tax”, (1978) *Common Market Law Review* 15, 309-319, at 309.

¹¹ The differences between turnover taxes applied by Member States at the time were quite extensive. For a summary see K.V. Antal, “Harmonisation of Turnover Taxes in the Common Market” (1963) *Common Market Law Review* 1, 41–57, at 42–50.

¹² For a review of the historical evolution of the VAT harmonisation process see also C. Celorico Palma, “A hamonização comunitária do Imposto sobre o Valor Acrescentado – Quo Vadis?” in C. Celorico Palma (ed.), *Estudos de Imposto sobre o Valor Acrescentado* (Coimbra: Almedina, 2006), 9-54.

¹³ *The EEC Reports on Tax Harmonisation – The Report of the Fiscal and Financial Committee and the Report of the Sub-Groups A, B and C* (Amsterdam: IBFD Publications, 1963), at 13.

¹⁴ Sub-Group A was to study the potential removal of physical inspection at frontiers; Sub-Group B was to focus on the potential adoption of a single-phase general tax applied at the stage prior to retail trade, combined eventually with a tax on retailers; and Sub-Group C was to analyse the potential application of a common tax at the production stage, together with an entirely autonomous tax applied at the trading stage, or alternatively a common tax on added value, should occasion arise, combined with a tax levied at the trading stage. The Sub-Groups were to examine the extent to which each of these possibilities would allow the removal of the disadvantages put forward by the Report of the Working Group No. I.

¹⁵ *Mandate entrusted to a scientific committee for the study of fiscal and financial problems in the EEC*, Appendix A of the Report of the Fiscal and Financial Committee.

Both the Sub-Groups and the Fiscal and Financial Committee released their reports in 1962. Of these, the report of the Fiscal and Financial Committee known as the Neumark Report would undoubtedly turn out to be the most influential, predictably dealing in great detail with the issue of harmonization of turnover taxes. The overall conclusion was that those Member States which levied cumulative turnover taxes should replace them with a general system of value added tax, a conclusion that has been characterized as “audacious”, in light of the fact that at the time all Member States, with the exception of France, applied cumulative taxes.¹⁶ The report presented several reasons in support of this conclusion, in particular the fact that despite being the simplest type of turnover taxes the deficiencies of cumulative taxes were well documented, most notably the creating of the so-called cascading effect – i.e. tax upon tax which occurs as taxed products are passed from manufacturer to wholesaler to retailer.¹⁷ Moreover, the fact that taxation of services would be a much easier task under a VAT system was also perceived as a great advantage.¹⁸

In light of the recommendations of the Neumark Report, the European Commission submitted in late 1962 a proposal for a Directive which envisaged the adoption by Member States of a common system of VAT.¹⁹ Following difficult and lengthy negotiations, the Council finally adopted in 1967 the First VAT Directive and the Second VAT Directive. Ten years later it was the turn of the Sixth VAT Directive being approved amidst high expectations.²⁰ Progress in achieving further harmonisation remained slow in the years following the entry into force

¹⁶ See B. Terra and P. Wattel, *European Tax Law* (The Hague: Kluwer Law International, Fourth Edition, 2005), at 200–201. France is usually credited as being the first country in the world to introduce a value added tax system, see L. Ebrill *et al*, *The Modern VAT* (Washington D.C.: International Monetary Fund, 2001), at 4; although others point to the US state of Michigan, see R. Krever and D. White (Eds.), *GST in Retrospect and Prospect* (Wellington: Thomson Brookers, 2007), at vii.

¹⁷ In fact, it was reportedly trying to mitigate the disadvantages of the cascade element that a VAT, in its invoice-credit form, developed initially in France, see L. Ebrill *et al*, n. 16 above, at 6. On the introduction of a VAT system in France see also C.S. Shoup, “Taxation in France” (1955) *National Tax Journal* 8, 325-344.

¹⁸ The overall comparative advantages of introducing a VAT system, as well as other historical practical reasons, have made VAT one of the most popular taxes in the world, see L. Ebrill, n. 16 above, at 4-13; M. Keen and B. Lockwood, “The Value-Added Tax: its Causes and Consequences” (2007) *IMF Working Paper* WP/07/183; and R.M. Bird and P.P. Gendron, *The VAT in Developing and Transitional Countries* (New York: Cambridge University Press, 2007), at 16 et seq. This outstanding growth and spread of the tax has led authors to comment that “the nearly universal introduction of VAT should be considered the most important event in the evolution of tax structure in the last half of the 20th century”, and that “the rise of VAT is an unparalleled tax phenomenon”, see S. Cnossen, *Global trends and issues in value added taxation*, OCfEB Research Memorandum 9802, Erasmus University Rotterdam, The Netherlands, 1998, at 4; and A.A. Tait, *Value Added Tax – International Practice and Problems* (Washington D.C.: International Monetary Fund, 1988), at 3, respectively.

¹⁹ See Doc. IV/COM(62) 217.

²⁰ Sixth Council Directive 77/388/EEC of 12 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes, OJ L145, 13/06/1977, 1. Hereafter “Sixth VAT Directive”. Some commentators going as far as to consider the Sixth Directive as an “European VAT Code”, see P. Miconi, “Razões Justificativas da Introdução de um Sistema de Imposto sobre o Valor Acrescentado” (1979) *Ciência e Técnica Fiscal* 244/246, April/June, at 429; and A. E. Genot, “Fiscal Harmonisation and European Integration: A 1978 Appraisal” (1978) *European Law Review* 3, 355–369, at 360.

of the Sixth Directive,²¹ and it was not until the publication of the White Paper and the introduction of the internal market policy that real development was attained.

In June 1985, the Commission presented the White Paper for the completion of the internal market. The paper laid down a series of measures with a view to establishing an internal market by 1992, divided under three headings: removal of physical barriers; removal of technical barriers; and removal of fiscal barriers. Under the heading “removal of fiscal barriers”, the paper contained several measures in the field of VAT. The role of this tax within the overall aim of achieving an internal market was clearly acknowledged by the Commission:

“It is clear [...] that the harmonisation of indirect taxation has always been regarded as an essential and integral part of achieving a true common market. Momentum has been lost in recent years but this was due essentially to the impact of the recession on the economic policies of Member States and preoccupation with other problems. But progress is being resumed and now we must proceed vigorously if we are to achieve the target date of 1992 for the completion of the Internal Market.”²²

As regards what level of harmonisation of VAT was required in order to establish the internal market, the White Paper’s highlighted that “complete harmonisation, which has come to imply absolute identity in every respect, is not essential” – however, a close level of “approximation” was required. This approximation had to be “sufficiently close that the operation of the common market is not effected through distortions of trade, diversion of trade, and effects on competition”.²³ In order to attain this level of “approximation”, progress had to be achieved in three areas of the system: tax base or coverage; tax rates; and arrangements applicable to cross-border transactions.²⁴ In the summer of 1987, following the White Paper strategy, the Commission issued a Global Communication outlining its proposals

²¹ One important development during this period, however, was the approval of the Directives regarding the refund procedure for taxable persons not established in the territory of the country: Eighth Council Directive 79/1072/EEC of 6 December 1979, OJ L331, 27/12/1979, 11; and Thirteenth Council Directive 86/560/EEC of 17 November 1986, OJ L 326, 21/11/1986, 40. Hereafter “Eighth VAT Directive”.

²² *Completing the Internal Market – White Paper from the Commission to the European Council*, COM(85) 310, 14 June 1985, at 42; hereafter “White Paper”. It is interesting to note that the White Paper is not the first European Commission’s document where the connection between establishing, or completing, the internal market and VAT harmonisation was established, albeit the only one containing detailed instructions on how to attain this objective. In fact, in the years prior to the release of the White Paper, the Commission had issued several documents highlighting the need for further harmonisation of VAT, and particularly the abolition of fiscal frontiers – amongst other measures – in order to establish a genuine internal market. See *Strengthening the Internal Market*, Communication from the Commission to the Council, COM(82) 399 final, 24 June 1982, at 2-5; and *Consolidating the Internal Market*, Communication from the Commission to the Council, COM(84) 305 final, 13 June 1984, at 9-34.

²³ White Paper, n. 22 above, at 46.

²⁴ *Id* at 52.

for indirect taxes with a view to the completion of the internal market.²⁵ The proposals (and one working paper) presented during that same period became known as the 1987 proposals and envisaged major changes to the Community VAT system then in force. These were, however, widely regarded as very ambitious in both their aims and their prospected methods for achieving these aims.²⁶ By late 1989 the Commission realised that the Council would fail to reach agreement. The focus thus shifted towards agreeing upon a VAT system which continued to be based on the principle of taxation in the country of destination, but which at the same time permitted the abolition of border controls. The idea of a transitional phase started to take shape.

During the period between 1989 and 1991, a series of key meetings of the ECOFIN Council of Ministers took place, from which emerged the basic shape of the VAT arrangements to be applied to intra-Community trade after 1993. These were to become known as the “transitional VAT system”. In the summer of 1996 the European Commission presented a work programme with a view to adopting a definitive VAT system.²⁷ Unfortunately, the 1996 approach proved as difficult to implement as the 1987 one, and very little progress was made on the Commission’s proposed programme. By 2000, therefore, the Commission had decided to put forward a new VAT strategy based on a dual premise: on one hand, that the VAT transitional system contained a number of shortcomings which required urgent action; on the other hand, that it was unlikely that progress in establishing a definitive VAT system would be achieved. The introduction of a definitive system has, thus, been postponed indefinitely as a long term goal. In the short term, the Commission’s intends to pursue its new “viable strategy” to overcome the shortcomings of the transitional VAT system.²⁸ As the new Commission’s strategy unfolds and begins to bear fruit it is clear that over fifty years since the Tinbergen Report, VAT continues to be very much at the centre of the EC internal market policy.

²⁵ *Completion of the internal market: approximation of indirect tax structures and harmonisation of indirect tax structure. Global Communication from the Commission, COM(87) 320 final, 5 August 1987.*

²⁶ A.J. Easson expressed a widely felt skepticism when he commented: “to expect to achieve an alignment of tax rates by 1992, by the end of the century or even by the middle of the next one, is to be completely unrealistic. The approach which has been exposed by the Commission for the past 25 years or so is doomed to fail”, in “The Elimination of Fiscal Frontiers”, in R. Bieber *et al* (eds.), *1992: One European Market? A Critical Analysis of the Commission’s Internal Market Strategy* (Baden-Baden: Nomos Verlagsgesellschaft, 1988), 241–260, at 260.

²⁷ See *A common system of VAT – A programme for the Single Market, COM(96) 328 final, 22 July 1996.*

²⁸ See *A strategy to improve the operation of the VAT system within the context of the Internal Market, Communication from the Commission to the Council and the European Parliament, COM(2000) 348 final, 7 June 2000; and Review and update of VAT strategy priorities, Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee, COM(2003) 614 final, 10 October 2003.*

3. Hierarchy of EC Norms and the Role of the ECJ Post Harmonisation

3.1 Hierarchy of EC norms

Established initially by the ECJ in *Costa*,²⁹ the principle of supremacy – the Community’s constitutional principle according to which Community law takes precedent over conflicting national law – has long been firmly recognised by Member States.³⁰ Yet, within the EC legal order norms establishing hierarchies of norms is considerably less clear. For many years the concept of “hierarchy” within EC norms was somewhat neglected, probably as a result of the lack of basic written principles on the settlement of conflicts of norms.³¹ This despite the fact that hierarchy of norms in the European legal order has been enshrined in the Treaty from the outset,³² and that the Court has been referring to the hierarchy of norms as an unwritten principle of European law for several decades.³³

One hierarchy, however, is generally accepted to exist: that between norms of fundamental character, such as those set out in the Treaties, and implementing norms,³⁴ i.e. between primary EC law and secondary EC law.³⁵ Whilst the reference to the EC Treaty as the “constitutional charter of the Community” can be traced back to *Les Verts*,³⁶ its primacy within the hierarchy of EC norms has been recently re-emphasised by the ECJ in *Kadi*:

“[...] the Community is based on the rule of law, inasmuch as neither its Member States not its institutions can avoid review of the conformity of their acts with the basic constitutional charter, the EC Treaty, which established a complete system of legal

²⁹ Case 6/64, [1964] ECR 1141.

³⁰ Despite years of controversy – for a comprehensive review of Member States’ progressive recognition of the principle of supremacy, see P. Craig and G. de Búrca, *EU Law – Text, Cases and Materials*, Third Edition (Oxford: Oxford University Press, 2003), at 353-377. Paradoxically Member States remain in their capacity as EC legislator in a superior position in respect of the exercise of this supremacy, see F.E. Dowrick, “A Model of the European Communities’ Legal System” (1983) *Yearbook of European Law* 3, 169-237, at 225-237.

³¹ See R. Bieber and I. Salome, “Hierarchy of Norms in European Law” (1996) *Common Market Law Review* 33(5), 909-932, at 911-912.

³² See amongst others Articles 220 and 234 of the EC Treaty as regards the competence of the ECJ and the preliminary ruling procedure, respectively.

³³ See cases 38/70, *Tradax/Einfuhr-u. Vorratsstelle*, [1971] ECR 145; 34/78, *Yoshida / Kramer van Koophandel*, [1979] ECR 115; 145/79, *Roquette*, [1980] ECR 2917.

³⁴ Id at 920. The concept of hierarchy has been rejected by M. Poiars Maduro and substituted by that of “contrapuntual law”, although the author does recognise that “[the Treaty] is to a certain extent the higher law of the Union and the criteria of validity of secondary rules and decisions as well as of all national legal rules and decisions within the scope of application of EU law”, see “Interpreting European Law – Judicial Adjudication in a Context of Constitutional Pluralism” (2008) *Working Paper IE Law School WPLS08-02*, at 11; see also M. Poiars Maduro, “Contrapuntual Law: Europe’s Constitutional Pluralism in Action” in N. Walker (ed.), *Sovereignty in Transition* (Oxford: Hart Publishing, 2003), 501-537. See also cases 25/70, *Koster*, [1970] ECR 1161; C-240/90, *Germany v Commission*, [1992] ECR I-5383; C-156/93, *Parliament v Commission*, [1995] ECR I-2019; and C-417/93, *Parliament v Council*, [1995] ECR I-1185.

³⁵ For a definition of primary EC law and its relationship with secondary law, see T-113/96, *Dubois*, [1998] ECR II-140, at paragraph 41.

³⁶ Case 294/83, *Les Verts v Parliament*, [1986] ECR 1339.

remedies and procedures designed to enable the Court of Justice to review the legality of acts of the institutions.”³⁷

3.2 Hierarchy of EC norms applied to VAT

In light of the above, one might assume that as Community secondary law VAT legislation had been subject to some level scrutiny of the ECJ in light of the Treaty provisions - its compatibility with the Treaty provisions assessed, or at the very least its interpretation done in light of those provisions undertaken, similarly to what has taken place as regards direct taxation. However, this cannot be further from the truth. There were a few rulings until the early 1990s – and the abolition of fiscal frontiers – which assessed the compatibility of national VAT legislation with Article 90 (ex Article 95) of the EC Treaty in respect of imports from other Member States.³⁸ Overall, however, in over thirty years of VAT jurisprudence the ECJ has only assessed compatibility of EC secondary VAT legislation with the Treaty on very few occasions.

Gaston Schul concerned the compatibility of Sixth VAT Directive provisions with what is now Article 90 of the EC Treaty.³⁹ *Gaston Schul*, a company established in the Netherlands, imported a second-hand pleasure and sports boat on the instructions and on behalf of a private person. The Netherlands revenue authority levied VAT on importation at the rate of 18% – which was the normal rate applied within the country on the sale of similar goods – under the national provision which transposed Article 2 of the Sixth VAT Directive. *Gaston Schul* brought an action before the Dutch courts, claiming that the VAT charged was contrary to what are now Articles 28 and 29 of the EC Treaty on free movement of goods, and Article 90 of the EC Treaty on indirect taxes. It argued in essence that charging VAT on this import was incompatible with the Treaty, insofar as similar supplies within the territory of a Member State by a private person were not subject to VAT. It contented further that levying VAT on importation of products from another Member State supplied by a private person gave rise to an overlapping of taxes since, unlike supplies made by taxable persons, there was no remission in respect of VAT levied in the export Member State. Consequently, VAT levied on the importation of such products should be considered as a charge having an effect equivalent to a customs duty or as discriminatory internal taxation, for the purposes of Articles 28 and 90 of the EC Treaty, respectively.

³⁷ Joined cases C-402/05 P and C-415/05P, [2008] ECR I-6351, at paragraph 281.

³⁸ See cases 39/82, *Donner*, [1983] ECR 19; 42/83, *Denkavit*, [1984] ECR 2649; 278/83, *Commission v Italy*, [1985] ECR 2503; 39/85, *Bergeres-Becque*, [1986] ECR 259; 200/85, *Commission v Italy*, [1986] ECR 3953; 104/86, *Commission v Italy*, [1988] ECR 1799; 299/86, *Drexel*, [1988] ECR 1213; C-120/88, *Commission v Italy*, [1991] ECR 621; C-119/89, *Commission v Spain*, [1991] ECR I-641; C-159/89, *Commission v Greece*, [1991] ECR I-691; and C-276/91, *Commission v France*, [1993] ECR I-4413.

³⁹ Case 15/81, [1982] ECR 1409. See also, *Gaston Schul II*, case 47/84, [1985] ECR 1491.

The Court started by dismissing the claim as regards the provisions regarding free movement of goods, stating:

“[Harmonising directives] have established a uniform taxation procedure covering systematically and according to objective criteria both transactions carried out within the territory of the Member States and import transactions. [...] As a result the tax in question must be considered as an integral part of a general system of internal taxation for the purposes of article 95 of the Treaty and its compatibility with Community law must be considered in the context of that article and not of that of Articles 12 et seq. of the Treaty.”⁴⁰

As regards the application of Article 90, Member States, as well as the Council and the Commission, took the view that the elimination of overlapping of taxes within the Community, however desirable, could only be achieved “by means of the gradual harmonisation of the national taxation systems under article 99 or 100 of the treaty and not by applying article 95”. Furthermore, they contended that “the establishment of a system ensuring the complete neutrality of internal taxation with regard to intra-Community trade could take place only by strict application of the principle of taxation in the Member State of destination and that would mean full remission of tax on all products at the time of exportation. It is for the political institutions of the Community to adopt such a solution since it involves a political choice”.⁴¹ The ECJ accepted the argument.

Since its inception in 1992 the Intrastat system – a statistical system set up to monitor intra-Community transactions after the abolition of fiscal frontiers – has been surrounded by controversy, most notably due to the difficulties and extra compliance costs which it creates for traders. In 1996 the Court was called to decide on what was for a long time the main Intrastat legislative instrument, Council Regulation No. 3330/91.⁴² *Kieffer and Thill* did not concern the interpretation of specific provisions of that Regulation, but rather the nature of the Intrastat system itself, and namely its compatibility with the free movement of goods provisions in the EC Treaty.⁴³ The defendants in the main proceedings, Kieffer and Thill, were managers of a company operating in Luxembourg, which engaged in intra-community transactions. Having failed to submit Intrastat returns, Mr. Kieffer and Mr. Thill were charged by the Luxembourg authorities with infringing the obligation under Regulation No. 3330/91

⁴⁰ Id at paragraph 21.

⁴¹ Id at paragraphs 25 and 37, respectively.

⁴² Council Regulation (EEC) No. 3330/91 of 7 November 1991 on the statistics relating to trading of goods between Member States (OJ L316, 16/11/1991, 1), actually introduced the Intrastat system. This regulation has been now substituted by Regulation (EC) No. 638/2004 of the European Parliament and of the Council of 31 March 2004 on Community statistics relation to the trading of goods between Member States and repealing Council Regulation (EEC) No. 3330/91, OJ L102, 07/04/2004, 1.

⁴³ Case C-114/96, [1997] ECR I-3629.

to transmit information on imports and exports by their company. Both defendants acknowledged that the business conducted by the company they managed exceeded the simplification threshold, and that they should, therefore, have submitted Intrastat monthly returns. They argued, however, that to comply with this obligation they would have to either take on staff, or have the obligations carried out by third parties, incurring additional expense in either case. These additional expenses they claimed would have the effect of curbing, at least indirectly, their efforts to export in excess of the annual threshold and would encourage the sale of goods on the national market.

The referring court in Luxembourg considered that the detailed declaration required by Regulation No. 3330/91 did indeed constitute an additional constraint to which traders doing business in the national market alone were not subject. Moreover, it stated that the requirement to make that declaration, and the consequent increase in the obligations to be complied with by the undertakings concerned, could have a deterrent effect on small and medium-sized undertakings in Luxembourg whose activities extend beyond the national territory. In those circumstances, it considered that it should be ascertained whether such an impediment was justified from the point of view of the objectives of the Regulation and whether those objectives could not be attained by means constituting less of a constraint. Therefore, it essentially asked the ECJ the following: whether the obligations imposed upon traders under Regulation No. 3330/91 should be regarded as measures having equivalent effect to quantitative restrictions within the meaning of (former) Articles 28 and 29 of the EC Treaty; and alternatively, whether these same obligations constituted a restraint upon traders that is unjustified and disproportionate having regard to the objective of general interest pursued, and thereby in breach of the principle of proportionality as defined in Article 5 of the EC Treaty.

The ECJ acknowledged that “it is common ground that the detailed nature of the declarations required and the fact that it is obligatory to make a declaration in both the Member State of consignment and that of destination of the goods have restrictive effects with regard to the free movement of goods”.⁴⁴ It therefore accepted that the Intrastat obligations constituted restrictions to the free movement of goods. However, the Court noted that such restrictions may be justified if they are essential in order to obtain reasonably complete and accurate information on movements of goods within the Community, and in this context, it considered that the obligations imposed by Regulation No. 3330/91 were not “measures having equivalent effect to quantitative restrictions” for the purposes of Articles 28 and 29 of the EC Treaty. Nor were they disproportionate:

⁴⁴ Id at paragraph 28.

“[W]hile the obligation to make declarations under the Regulation does specifically affect cross-frontier trade, and drawing up the declarations takes time and involves expense, particularly for small and medium-sized undertakings, it does not necessarily follow that those restrictive effects are disproportionate to the aim pursued.”⁴⁵

Société Générale des Grandes Sources d'Eaux Minérales Françaises concerned the interpretation of Article 3(a) of the Eighth VAT Directive and the requirement to submit original invoices therein.⁴⁶ *Société Générale*, a French company, submitted an application to the German authorities in order to obtain refund of the German VAT incurred under the Eighth VAT Directive. As the original invoices had been lost in the post when sent to lawyers instructed to process the claim, *Société Générale* attached instead duplicates of the original invoices. The German authorities then refused to grant the refund based on the lack of required documentation, i.e. the original invoices – even though a taxable person established in Germany was allowed to deduct VAT on production of a duplicate or photocopy of the invoice, where the original invoice was lost for reasons beyond the taxpayer’s control. The ECJ was therefore asked, amongst other questions, whether where a taxpayer established in a Member State may prove his entitlement to a refund of VAT by submitting a duplicate or photocopy of the invoice if the original invoice was lost for reasons beyond his control, it follows from the principle non-discrimination that such a possibility should be extended to taxpayers not established in that Member State. The Court held that the principle of non-discrimination did indeed required that such possibility be extended to non-nationals.⁴⁷

In *Lease Plan* the ECJ was asked whether it was contrary to Article 6 of the EC Treaty setting out the principle of non-discrimination, and Article 49 of the EC Treaty on free movement of services, for national rules to provide that taxable persons not established in a Member State, who apply for a refund of VAT in accordance with the Eighth VAT Directive, are entitled to interest only from such time as notice to pay was served on that Member State, and at a lower rate than that applied to the interest paid to taxable persons established in the territory of that State automatically on the expiry of the statutory time-limit for reimbursement.⁴⁸ The Belgian government submitted that discrimination could only arise where different rules were applied to comparable situations, and this was not the case as regards the rules on the payment of interests. It argued that taxable persons established in the Member State concerned, who sought a refund of VAT paid on a transaction effected in a second Member State, could not be compared with that of taxpayers established in the second Member State and who either pursue a taxable economic activity on an irregular basis there or seek refund of the VAT on a

⁴⁵ Id at paragraph 34.

⁴⁶ Case C-361/96, [1998] ECR I-3495.

⁴⁷ Id at paragraph 38.

⁴⁸ Case C-390/96, [1998] ECR I-2553.

transaction of a not exclusively business nature. The Court disagreed: it considered that national VAT rules to provide that taxable persons not established in a Member State, who apply for a refund of VAT in accordance with the Eighth Directive, are entitled to interest only from such time as notice to pay was served on that Member State and a lower rate than that applied to the interest paid to taxable persons established in the territory of that State automatically on the expiry of the statutory time-limit for reimbursement was indeed contrary to the EC Treaty provisions on free movement of services.

Teleos and Others concerned the exemption applicable to intra-Community supplies of goods.⁴⁹ Amongst other questions, the national court asked the ECJ whether the provisions in the VAT Directive should be interpreted as precluding the competent authorities of a Member State from requiring a supplier, who in good faith submitted evidence which established a right to exemption on an intra-Community supply of goods, to account for VAT when that evidence is found to be false. In this regard, *Teleos and Others* submitted that in cases where it is shown after the acquisition that the purchaser committed fraud and the goods never actually left the territory of the Member State, the imposition by the tax authorities of a Member State of the entire burden of proof, as well as the liability to account for VAT on the intra-Community supply of goods, adversely affected the proper functioning of the single market and interfered with the free movement of goods. The Court started by stating that preventing possible tax evasion, avoidance and abuse is an objective recognized and encouraged the Directive, and thus in certain circumstances justify restrictions on the free movement of goods. It went on to state, however, that:

“Whilst it is true that the regime governing intra-Community trader has become more open to fraud, the fact remains that the requirements for proof established by the Member States must comply with the fundamental freedoms established by the EC Treaty, such as, in particular, the free movement of goods.”⁵⁰

The ECJ ultimately concluded that the VAT Directive provisions should be interpreted as precluding tax authorities from denying a supplier of intra-Community transactions the right to exemption, where this supplier acted in good faith and no evidence of participation in fraud could be established. Although, throughout analysis of the freedoms was never undertaken, the Court seems to be indicating that the practice carried out by the tax authorities constituted a restriction to the free movement of goods, which could potentially be justified for combating tax evasion, but was ultimately deemed disproportional. Unfortunately, this step-by-step detailed analysis was however not undertaken by the Court.

⁴⁹ Case C-409/04, [2007] ECR I-7797.

⁵⁰ *Id* at paragraph 63.

Gaston Schul remains as an example of assessment of compatibility of the main VAT Directive with an EC Treaty provision; *Kieffer and Thill* and *Teleos and Others* as examples of application of the ECJ established approach to the fundamental freedoms to VAT legislation; *Société Générale des Grandes Sources d'Eaux Minérales Françaises* and *Lease Plan* as examples of national VAT norms transposing Directives' provisions being regarded as incompatible with EC Treaty provisions.⁵¹ As of yet, the Court has never assessed the compatibility of the main VAT Directive's provisions themselves with EC Treaty provisions concerning the concept of internal market and those regarding the fundamental freedoms. The obvious question which emerges is why?

3.3 Role of the ECJ post harmonisation

It is settled case law that free movement provisions apply not only to national measures but also to measures adopted by Community institutions.⁵² In principle, therefore, secondary Community law is subject to the judicial review of the ECJ in light of Treaty provisions, and there should be no reason why provisions in the VAT Directive should be exempt from such a review. This is, however, not the end of the story. Since the 1970s, the Court has also been holding – in a reasonably consistent manner – that in subject areas where harmonisation has taken place, application of EC Treaty provisions on free movement of goods and services is subject to limitations.⁵³ These provisions will only apply where: harmonisation is not exhaustive, i.e. it is minimal;⁵⁴ the harmonising legislation itself allows for application of the Treaty; or the harmonising legislation allows for Member States' discretion on transposition or derogations.⁵⁵ Moreover, the Court also seemed to rule in *Bellamy* that national measures correctly transposing Community secondary legislation cannot be regarded as constituting an obstacle to free movement.⁵⁶ Does this constitute an inversion of hierarchies, or can it be reconciled with the above considerations on the hierarchy of EC norms? In a recent working

⁵¹ Another case concerning the application of the principle of non-discrimination in Article 6 of the EC Treaty is currently pending at the ECJ, see (...).

⁵² See joined cases 80 and 81/77, *Ramel*, [1978] ECR 927; and cases 15/83, *Denkavit Nederland*, [1984] ECR 2171, at paragraph 15; C-15/93, *Meyhui*, [1994] ECR I-3879, at paragraph 11; and C-114/96, *Kieffer and Thill*, [1997] ECR I-3629, at paragraph 27; and joined cases C-402/05 P and C-415/05P, *Kadi*, [2008] ECR I-6351, at paragraph 281, cited above.

⁵³ Although it has been defended that the same basic principles should apply to other freedoms, namely free movement of persons, see P.J. Slot and M. Bulterman, "Harmonisation of Legislation on Migration EU Citizens and Third Country Nationals: Towards Uniform Evaluation Framework" (2005) *Fordham International Law Journal* 29, 747-789, at 787.

⁵⁴ See cases 5/77, *Tedeschi*, [1977] ECR 1577; C-99/01, *Linhartand Biffl*, [2002] ECR I-9375, at paragraphs 17-21; C-470/03, *AGM-COS.MET*, [2007] ECR I-2749, at paragraph 50; and C-265/06, *Commission v Portugal*, [2008] ECR I-2245, all on free movement of goods. See case C-6/98, *ARD*, [1999] ECR I-7599, on free movement of services.

⁵⁵ See cases C-322/01, *DocMorris*, [2003] ECR I-14887, at paragraph 64; and more recently C-205/07, *Gysbrechts*, Judgment of 16 December 2008.

⁵⁶ Case C-123/00, [2001] ECR I-2795, at paragraph 21.

document as regards the operation of the free movement of goods provisions, the European Commission offers an explanation:

“[...] harmonising legislation can be understood as substantiating the free movement of goods principle by establishing actual rights and duties to be observed in the case of specific products. Therefore, any problem that is covered by harmonising legislation would have to be analysed in the light of such concrete terms and not according to the broad principles enshrined in the Treaty.”⁵⁷

Indeed whilst it is clear that secondary EC legislation is bound by the Treaty rules – and as set out above this hierarchy is now settled case law – how it should be reflected in practice is a matter of more debate. This is the case in particular as regards the relationship between secondary law and the free movement provisions. Two different positions have been defended: (i) the Community legislator is bound in the same way as Member States;⁵⁸ (ii) the Community legislator is bound but not to the same extent as Member States. Most authors adopt the second view, i.e. that the Community is bound by Treaty rules, although enjoying a certain margin of discretion.⁵⁹ This position does seem to be the one which seats better with the ECJ case law on the manner – whether as a matter of principle this should actually be the case is another issue altogether.

What does this mean for VAT? Assuming that (a), the case law above on primacy of secondary law where exhaustive harmonisation has taken place is compatible with the principle of hierarchy of EC norms, on the basis that secondary Community law although bound by the Treaty is subject to higher level of discretion. Still, the Court has stated on different occasions, as has the European Commission, that VAT is not an area exhaustively harmonised.⁶⁰ Moreover, many provisions of VAT law allow for Member States’ discretion on transposition or derogations. Both factors which would indicate that the case law on non-application of Treaty provisions should not apply, and thus VAT law should still be interpreted in light of these provisions, and its compatibility with those assessed. What if they did apply? Assuming then that (b), as it currently stands VAT is regarded as an exhaustively harmonised area of law, and thus secondary VAT law should take primacy over EC Treaty

⁵⁷ See *Free Movement of Goods – Guide to the Application of Treaty Provisions Governing Free Movement of Goods (Articles 28-30 EC)*, Commission Staff Working Document, SEC(2009) 673 final, 12 May 2009, at 8-9.

⁵⁸ See E.U. Petersmann, “National Constitutions, Foreign Trade Policy and European Community Law” (1992) *European Journal of International Law* 3, 1-35, at 9 et seq.

⁵⁹ See K. Morterlmans, “The Relationship Between the Treaty Rules and Community Measures for the Establishment and Functioning of the Internal Market – Towards a Concordance Rule” (2002) *Common Market Law Review* 39(6), 1303-1346, at 1312-1316.

⁶⁰ In *Denkavit* the ECJ stated, “[...] the fact that the Sixth Directive provides for partial harmonisation of national tax laws does not exclude the application of Article 95 of the Treaty”, in case 42/83, [1984] ECR 2649, at paragraph 27; see also *Gaston Schul*, case 15/81, [1982] ECR 1409, at paragraph 13. Of course the level of harmonisation in 1984 was much lower, but the statements are still significant.

provisions in VAT cases. This still does not exclude the possibility of judicial review. Notwithstanding the above, the ECJ nevertheless retains the possibility of assessing the compatibility of secondary VAT law with the Treaty. These above considerations are all the more significant in light of the fact that arguably the current EU VAT legal system does not fulfil, nor has the potential to fulfil through jurisprudential developments strictly based on interpretation of secondary law, the conditions of an internal market.

4. (In)compatibility of VAT Law with the EC Internal Market⁶¹

Historical, practical, and jurisprudential arguments support the thesis that the current European VAT law does not meet the conditions of an internal market. Presentation of these arguments should, however, be preceded by analysis of the concept of internal market itself.

4.1 The concept of EC internal market

What is the EC internal market? The central provision in terms of the internal market policy is currently Article 14 of the EC Treaty.⁶² This provision contains three basic rules.⁶³ The first of these could be characterised as a definitional rule: paragraph two sets out the legal definition of internal market. The second is a competence rule: paragraph one establishes that the Community has the competence to adopt measures in order to establish the internal market, i.e., the Community's legislative competence in this area. Finally, paragraph three can be classified as a procedural rule, establishing the Council's obligation to determine the guidelines and conditions to ensure a balanced progress in establishing an internal market. Although the third rule – the procedural rule – is of less significance,⁶⁴ the two others are fundamental to comprehension of the internal market policy.

Internal market is defined in paragraph two of Article 14 of the EC Treaty as “an area without internal frontiers in which the free movement of goods, persons, services, and capital is ensured in accordance with the provisions of this Treaty”. This definition has remained

⁶¹ This section presents a summary of the arguments originally set out in R. de la Feria, *The EU VAT System and the Internal Market* (Amsterdam: IBFD, 2009).

⁶² The numbering of these has been altered on two occasions: prior to the entry into force of the TEU (OJ C191, 29/07/1992), it was Article 8a EEC Treaty, as amended by the SEA; post TEU it was Article 7a(2) EC Treaty, until the passage of the Treaty of Amsterdam, which altered the provision's numbering to the current Article 14(2) EC Treaty, OJ C340, 10/11/1997.

⁶³ Article 22a of the yet to be fully ratified Treaty of Lisbon includes similar rules, albeit some important differences, in particular as regards the reference to a time limit, OJ C306, 17/12/2007, 53.

⁶⁴ In fact, it emerged during negotiations for the European Constitution, that this rule had never been used. It was, therefore, suggested by the working party of experts nominated with a view to making technical adjustments to the EC Treaty, that the paragraph should be deleted, see European Convention, *Part Two of the Constitution – Report by the working party of experts nominated by the Legal Services of the European Parliament, the Council and the Commission*, CONV 618/03, 17 March 2003, at 15. The recommendation was not, however, taken up and the paragraph was kept in the TCE, and afterwards in the Treaty of Lisbon.

unchanged since its introduction in the EEC Treaty by the Single European Act (SEA), and that will continue to be the case under the new Treaty of Lisbon.⁶⁵ Yet, despite this definitional coherence, and as the Commission itself has implicitly acknowledged, its interpretation is far from clear.⁶⁶ The definition has dual components: first, “an area without internal frontiers”; and second, “in which the free movement of goods, persons, services, and capital is ensured”.⁶⁷

The expression “an area without internal frontiers” has been the subject of intense controversy: severely criticised by some,⁶⁸ and regarded as the “key part of the definition” by others.⁶⁹ Its origins seem to be rooted in the Commission’s White Paper Programme, which revolved around the idea of “abolition of frontiers”, divided into physical, technical, or fiscal frontiers. The IGC discussions confirm this assumption to the extent that the expression was included in the SEA on the basis of Commission’s proposals.⁷⁰ It has been suggested that the expression was put forward by the Commission in order to include within the scope of the internal market other aspects, which might not be covered by the Treaty provisions relating to free movement, in particular as regards free movement of persons.⁷¹ This would seem to indicate that the scope of “an area without internal frontiers” is broader than that of free

⁶⁵ Several amendments were suggested during the discussions held by the European Convention for the European Constitution, most of which maintained the essence of the definition, but added other elements to it, such as reference to approximation of laws and free competition. See the suggestions put forward by an independent group of lawyers at Cambridge University, so-called “Cambridge Text”, released as European Convention, *Contribution by Mr. P. Hain, member of the Convention – Constitutional Treaty of the European Union*, CONV 345/1/02, 16 October 2002; the suggestions of a Franco-German research working group, known as “Freiburg Draft”, released as European Convention, *Contribution submitted by Mr. Erwin Teufel, member of the Convention: “Freiburg Draft of a European Constitutional Treaty”*, CONV 495/03, 20 January 2003; and the contribution of Mr. Elmar Brok, member of the European Convention, released as European Convention, *Contribution by Mr. Elmar Brok, member of the Convention: “The Constitution of the European Union”*, CONV 325/2/02, 7 March 2003. Ultimately, however, Article III-130(2) TCE only included a minor change to the current text: the substitution of expression “this Treaty” by “the Constitution”, OJ C310, 16/12/2004; and a similar approach was adopted by the Treaty of Lisbon.

⁶⁶ See A.A.M. Schrauwen, *Marche Interieur – Recherches sur une notion*, Doctorate Thesis, University of Amsterdam, 1997, at 138. Equally, G. de Búrca comments that “internal market” is one example of “terms which are highly significant within the EU legal and political context, but which remain nonetheless or even deliberately uncertain in scope and meaning”, in “Reappraising Subsidiarity’s Significance After Amsterdam”, *Harvard Jean Monnet Working Paper Series*, WP 7/99, at 9.

⁶⁷ Some add a third part to this formulation: “in accordance with the provisions of the Treaty”, see A.A.M. Schrauwen, *id.* at 144-145. However, even if regarded as a separate part of the definition, this sentence is of considerably less importance, as accepted by Schrauwen herself.

⁶⁸ See Pescatore, who comments “what does Article 8A mean when it speaks of ‘an area without internal frontiers’? What are frontiers in this context?” in “Some critical remarks on the ‘Single European Act’ (1987) *Common Market Law Review* 24, 9-18, at 16.

⁶⁹ See C.D. Ehlermann, “The Internal Market following the Single European Act” (1987) *Common Market Law Review* 24, 361–409, at 364.

⁷⁰ However, the formula suggested by the Commission was slightly different: it referred to “an area without internal frontiers ... under conditions identical to those obtaining within a Member State”, see C.D. Ehlermann, *id.* at Annex III and 408. The final sentence was ultimately omitted and substituted by “in accordance with the provisions of this Treaty”.

⁷¹ See C.D. Ehlermann, n. 69 above, at 366.

movement. If this was in fact the Commission's intention, the tactic might have worked slightly too well: the expression is potentially so broad that some commentators, and the Court alike, have tended to concentrate on the other aspect of the definition of internal market: the so-called four freedoms.⁷² The most significant exception to this tendency has been the Court's ruling in *Rundfunk and Others* where it stated that the recourse to Article 95 of the EC Treaty as a legal basis for Community legislation did not presuppose the existence of an actual link with free movement.⁷³ Implicitly, therefore, the Court is acknowledging that there is more to the "establishment and the functioning of the internal market" than just free movement.

This approach, however, is not universally accepted amongst commentators, with some arguing to the contrary: that free movement is a broader concept than "an area without internal frontiers" and that even where internal borders have been abolished, free movement might still not have been attained.⁷⁴ For these authors, the attainment of an area without internal frontiers can be judged by whether any border controls still exist on the free movement. Notwithstanding the controversy, however, and even if one accepts the narrower approach to the interpretation of the expression "an area without internal frontiers", i.e. that it entails only the abolition of border controls, it seems clear that in some areas, such as VAT, this aim has not (yet) been attained. In fact, insofar as VAT is concerned there are still border controls albeit taking a different format from those applicable before 1993.

The separate reference to the four freedoms in Article 14 has also been the target of criticisms.⁷⁵ Once again, as with the expression "an area without internal frontiers", the main difficulty seems to be the lack of precision, i.e. when can it be said that goods, persons, services, and capital move freely within the Community? There are two possible answers to this question, which reflect two different criteria, as follows: a narrower (and perhaps easier) criterion, according to which free movement will be attained once the White Paper programme has been accomplished; and a wider criterion, according to which in order for free

⁷² See A.A.M. Schrauwen, who comments "les horizons de l'espace sans frontières étant larges, ses limites devront venir des autres caractéristiques essentielles", n. 66 above, at 142.

⁷³ Joined cases C-465/00, C-138/01, and C-139/01, [2003] ECR I-12971. For an analysis of this case in the concept of the Community's internal market competence, see D. Wyatt, "Community Competence to Regulate the Internal Market", *University of Oxford Faculty of Law Legal Studies Research Paper Series*, Working Paper No. 9/2007, July 2007, at 36–40.

⁷⁴ See P. Craig and G. de Búrca, n. 31 above, at 1180.

⁷⁵ P. Verloren van Themaat, former Advocate General at the ECJ, comments that the separate reference to the free movement, without mention of fair competition and unity of market, constitutes an "artificial separation", which cannot but create "practical, political, and legal problems", in "The Contributions to the Establishment of the Internal Market by the Case Law of the Court of Justice of the European Communities", in R. Bieber *et al* (eds.), *1992: One European Market? A Critical Analysis of the Commission's Internal Market Strategy* (Baden-Baden: Nomos Verlagsgesellschaft, 1988), at 115. P. Pescatore also points out that in his opinion the reference to free movement is merely informative and does not merit the qualification as legal definition, see A.A.M. Schrauwen, n. (...) above, at 142-143.

movement to be attained several other measures have to be put in place in addition to those contained in the White Paper.⁷⁶ Indeed, there is an undeniable link between the White Paper programme and achieving free movement, to the extent that it has been said that “the 1992 programme and the SEA are inseparable from one another”.⁷⁷ Such connection is confirmed by Declaration 3 annexed to the SEA, entitled “Declaration on Article 8a EEC Treaty”, which states:

“The conference wishes by means of the provisions in Article 8a to express its firm political will to take before 1 January 1993 the decisions necessary to complete the internal market in those provisions, and more particularly the decisions necessary to implement the Commission’s programme described in the White Paper on the Internal Market”.⁷⁸

Relying on this connection, some authors have defended that “if the White Paper’s strategies are applied correctly and with dexterity, there is a real chance of achieving the free movement of goods, persons, services, and capital”.⁷⁹ Others, however, have argued that the White Paper programme is “the tip of an iceberg” and several others measures would need to be taken before free movement was achieved.⁸⁰ The continued reference to the “internal market policy” post-1992 in Community official documentation does indeed seem to confirm this wider approach. However – and in parallel with what has been said as regards “an area without internal frontiers” – even if the narrower approach was to be adopted, i.e. that free movement would be attained once the White Paper programme was fully implemented, then the conclusion would still have to be that, insofar as VAT is concerned, free movement has not been attained. In fact, as set out below, the measures set out in the White Paper in respect of VAT have yet to be implemented. Moreover, if the wider, more dynamic – and most probably correct – approach to the meaning of free movement is adopted, it is clear that current VAT law does not fulfil the criterion, as also demonstrated below through the analysis of the practical problems caused by this system.

⁷⁶ There is of course a third possible answer, which reflects an even narrower criterion, that is that free movement can be achieved without the implementation of the measures set out in the White Paper. This, however, does not seem to be a credible criterion in light of the history of SEA, the IGC negotiations and the link between the SEA and the White Paper.

⁷⁷ See D. Allen, “European union, the Single European Act and the 1992 programme”, in D. Swann (ed.), *The single European market and beyond – A study of the wider implications of the Single European Act* (London: Routledge, London, 1992), at 50.

⁷⁸ OJ L169, 26/06/1987, 24.

⁷⁹ See S.H. von Sydow, “The Basic Strategies of the Commission’s White Paper”, in R. Bieber *et al.* (eds.), *1992: One European Market? A Critical Analysis of the Commission’s Internal Market Strategy* (Baden-Baden: Nomos Verlagsgesellschaft, 1988), 79-106, at 106.

⁸⁰ See P. Craig, “The Evolution of the Single Market”, in C. Barnard and J. Scott (eds.), *The Law of the Single European Market – Unpacking the Premises* (Oxford and Portland, Oregon: Hart Publishing, 2002), at 15.

The ECJ case law as regards the Community's legislative competence in respect of the internal market provides further guidance as regards its concept. In *Titanium Dioxide* the Court stated that "in order to give effect to the fundamental freedoms in [Article 14], harmonising measures are necessary to deal with disparities between the laws of the Member States in areas where such disparities are liable to create or maintain distorted conditions of competition".⁸¹ The Court's ruling in *Titanium Dioxide*, and in particular the adoption of such a wide interpretation of the concept of internal market, gave rise to intense controversy at the time of its release.⁸² It was said at the time that it endangered the rule of law,⁸³ and that it constituted a clear sign of the decline of the principal of conferral of powers.⁸⁴ The Court's ruling in *Waste Directive* two years later appears to narrow down the scope of the internal market competence.⁸⁵ However, it was not until a few years later, in *Tobacco Advertising*, that the Court seemed to put these fears definitively to rest by attempting to establish the boundaries of the internal market concept.⁸⁶

The case concerned the use of Article 95 of the EC Treaty as a legal basis for a directive on advertising of tobacco products. The Court ruled that measures referred to in Article 95 must be intended to improve the conditions for the establishment and functioning of the internal market, and that the article did not vest in the Community the general power to regulate the internal market.⁸⁷ Implicit in the judgment, therefore, is the distinction between measures intended to improve conditions for the establishment and functioning of the internal market, on one hand; and measures intended to regulate the internal market, on the other hand. The Community's competence under Article 95 is limited to the first aspect.⁸⁸ Moreover, according to the Court "the mere finding of disparities between national rules and of abstract risk of obstacles to the exercise of fundamental freedoms or of distortion of competition" was

⁸¹ Case C-300/89, *Commission v Council*, [1991] ECR I-2867, at paragraph 15.

⁸² Although the reference to elimination of distortions to competition as part of the concept of internal market was not original, see J. Usher, "Case C-376/98, *Germany v European Parliament and Council (tobacco advertising)*. Judgment of the Full Court of 5 October 2000, [2000] ECR I-8419" (2001) *Common Market Law Review* 38, 1519-1543, at 1527 et seq.

⁸³ See S. Crosby, "The Single Market and the Rule of Law" (1991) *European Law Review* 16, 451-465.

⁸⁴ See R. Barents, "The Internal Market Unlimited: Some Observations on the Legal Basis of Community Legislation" (1993) *Common Market Law Review* 30, 85-109; although the author's comments seem to come as praise, rather than criticisms, for the Court's ruling.

⁸⁵ The Court ruled in this case that "the mere fact that the establishment or functioning of the internal market is affected is not sufficient for Article 100a of the Treaty to apply. It appears from the Court's case law that recourse to Article 100a is not justified where the measure to be adopted has only the incidental effect of harmonising market conditions within the Community", see C-155/91, [1993] ECR I-2869, at paragraph 19.

⁸⁶ Case C-376/98, [2000] ECR I-8419.

⁸⁷ Id at paragraphs 83 of the judgment.

⁸⁸ The same rationale should apply *mutatis mutandis* to Article 93, as well as to all other Treaty provisions, which refers to adoption of measures with a view to "the establishment and functioning of the internal market".

not sufficient to justify the choice of Article 95 as a legal basis.⁸⁹ On the specific aspect of distortion of competition, the Court limited the interpretation adopted in *Titanium Dioxide* by ruling that only where the distortion is “appreciable” can a measure be adopted on the basis of Article 95 as “in the absence of such a requirement, the powers of the Community legislature would be practically unlimited”.⁹⁰ Advocate General Fennelly had further suggested in his Opinion that in order to determine whether a Community measure pursues internal market objectives, a two-part test has to be fulfilled: first, it must be ascertained whether the “preconditions for harmonisation exist”, i.e. disparate national rules which either constitute barriers to the exercise of the four freedoms or distort conditions of competition in an economic sector; and second, the action taken by the Community must either intend to eliminate those barriers or intend to eliminate the distortions of competition.⁹¹ Although not explicitly referring to it, the Court essentially follows this test, with some important qualifications, namely to the first requirement: the existing obstacles to the four freedoms must be *concrete* and existing distortions of competition must be both *concrete* and *appreciable*.⁹²

The Court ultimately annulled the Directive on the grounds of lack of competence,⁹³ thus giving rise to the claim that the decision constituted one of the most important ever delivered by the Court on Community legislative competence, and one which reversed a long trend towards the expansive interpretation of the legislative competence of the Community.⁹⁴ Such enthusiastic claims seem to have somewhat overestimated the impact of the ruling.⁹⁵ Key questions remain such as, what is the scope of harmonisation envisaged by the EC Treaty, or

⁸⁹ Case C-376/98, [2000] ECR I-8419, paragraph 84 of the judgment. D. Wyatt argues that in order for the measure to fall within the scope of Article 95 *obstacles* must be “actual or potential, direct or indirect (but not, it seems, if the effect is too remote and indirect to hinder trade)”, in “Constitutional Significance of the Tobacco Advertising Judgment of the European Court of Justice”, *CELS Occasional Paper 5*, July 2001, 19–31, at 23.

⁹⁰ Case C-376/98, [2000] ECR I-8419, paragraphs 106 and 107 of the judgment; see also paragraphs 89 and 90 of the Advocate General’s Opinion.

⁹¹ Id at paragraph 93 of Advocate General’s Opinion.

⁹² The use of the expression “distortion of competition” in this ruling has been the target of criticism, namely that it does not “adequately capture the normative concern that the Court of Justice is plausibly trying to address”, see M. Kumm, “Constitutionalising Subsidiarity in Integrated Markets: The Case of Tobacco Regulation in the European Union” (2006) *European Law Journal* 12(4), 503–533, at 505 and 508–515.

⁹³ As S. Douglas-Scott comments, the first case in which the Court did so, “thus presenting itself as the first full application of the principle of limited powers by the Court”, in *Constitutional Law of the European Union*, First Edition (Essex: Longman, 2002), at 168. See also G. de Búrca, “The Tobacco Advertising Saga: Political Aspirations and Constitutional Constraints”, *CELS Occasional Paper 5*, July 2001, 5–18, at 7; and C. Hillon, “Tobacco Advertising: If you must, you may” (2001) *Cambridge Law Journal* 60(3), 486–489, at 488–489.

⁹⁴ See G. Tridimas and T. Tridimas, “The European Court of Justice and the Annulment of the Tobacco Advertising Directive: Friend of National Sovereignty or Foe of Public Health?” (2002) *European Journal of Law and Economics* 14(2), 171–183, at 179; and P. Craig, n. (...) above, at 32–33.

⁹⁵ See in particular cases C-491/01, *Tobacco Labelling*, [2002] ECR I-11453; C-210/03, *Swedish Match*, [2004] ECR I-11893; and C-380/03, *Tobacco Advertising II*, [2006] ECR I-11573.

how much harmonisation is constitutionally permitted, and constitutionally required?⁹⁶ As defended below, answers to these questions are not absolute, applicable to all subareas of the internal market policy, but rather casuistic, dependent on the specific field in question.

4.2 Why the current VAT law is incompatible with the internal market

It has been defended that the institutional choices regarding the allocation of regulatory powers within the Community may be represented in three ideal constitutional models of the European Economic Constitution: a centralised constitutional model; a competitive constitutional model; and a decentralised constitutional model. The centralised model favours a process of market regulation by the replacement of national laws with Community legislation. The basic principle behind this model is that Member States' domestic legislation is incompatible with the aim of an integrated market, and should therefore, be replaced by harmonised Community legislation. The competitive model promotes competition between legal orders, namely through the principle of mutual recognition. The basic idea here is that market forces will work to create an integrated and more efficient market. In the decentralised model, Member States will retain regulatory powers, but are prevented from developing protectionist policies.⁹⁷

In practice, however, these constitutional models are not applied separately within the Community. Instead, there is an interaction between the three in different Community policy areas: within the internal market policy it is clear that, although the presence of the decentralised model is less apparent,⁹⁸ there is a continuous interplay between the centralised and the competitive models. As regards VAT policy, the reference in Article 93 of the EC Treaty to "harmonisation of legislation concerning turnover taxes" clearly indicates that the legislator has favoured a centralised approach. Moreover, the use of the word "shall" in the beginning of the provision indicates that not only is the Treaty conferring competence on the Community to harmonise VAT laws, but that there is an obligation on the European institutions to do so. Notwithstanding this, the establishment of limits to this harmonising competence in Article 93 – the fact the Community only has competence to harmonise "to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market" – signals that there is still room for competition between legal orders

⁹⁶ See S. Weatherill, "Supply of and demand for internal market regulation: strategies, preferences and interpretation", in N. Nic Shuibhne (ed.), *Regulating the Internal Market* (Cheltenham and Northampton: Edward Elgar, 2006), 29-56, at 29-38.

⁹⁷ See M. Poyares Maduro, *We, the Court – The European Court of Justice & the European Economic Constitution* (Oxford: Hart Publishing, 1998), at 108-149. Although the author is referring primarily to market regulation under Article 30 of the EC Treaty, the distinction between these alternative models is useful for other areas of what he refers to as the "European Economic Constitution".

⁹⁸ This is mainly because under the decentralised model Member States retain their regulatory powers, whilst it is clear that as regards the internal market policy the Community has competence.

within the area of VAT. Competition between legal orders will therefore be allowed in areas which do not interfere with “the establishment and functioning of the internal market”.⁹⁹ For this reason, it seems that the legislator has adopted within the VAT policy what can be designated as a “mitigated centralised model”: one that is based on a centralised approach, but under which a limited level of competition between legal orders is not only allowed, but mandatory.

Yet, as will be demonstrated in the following sections, “a mitigated centralised model” is not in place within the VAT area: there are many aspects of the tax which constitute serious obstacles to either the establishment, or the functioning of the internal market and where competition between legal orders is still a reality. Moreover, even where harmonisation has taken place, Member States have been allowed a broad scope of flexibility and differentiation at both macro and micro level. In fact, macro-flexibility can be witnessed through the inclusion within the VAT Directive of general exceptions, options, and in some areas of the system, a high degree of discretion as regards the implementation of provisions;¹⁰⁰ whilst micro-flexibility is evidenced by the numerous authorisations granted to Member States to derogate from the VAT Directive provisions. As it will be demonstrated below, the lack of harmonisation in areas which impact on the establishment or functioning of the internal market, together with these different levels of differentiation, have had disastrous consequences for the Community’s VAT system.¹⁰¹

The arguments presented to substantiate the above statement have a tripartite nature – historical, practical, and jurisprudential analyses indicate that current European VAT law does not meet conditions of an internal market. Historical analysis demonstrates that the current law has failed to reach the minimum level of harmonisation traditionally regarded as a prerequisite for the establishment of the internal market. From a practical perspective, existing law gives rise to serious difficulties, which qualify as obstacles not merely to the functioning of the internal market, but to its very establishment. Finally, analysis of ECJ VAT jurisprudence demonstrates that these obstacles cannot be overcome through incremental interpretative developments emerging from the Court as regards secondary VAT law.

⁹⁹ As former Advocate-General W. van Gerven has recently been pointed out, uniformity of law is not an objective in itself, consequently harmonisation should only take place where there is a good justification – such justification consists primarily in the necessity to operate an internal market within a reasonable level playing field, see “Two Twin-Principles of EU Law: Democracy and Accountability, Consistency and Convergence” in U. Bernitz, J. Nergelius and C. Cardiner (eds.) *General Principles of EC Law in a Process of Development* (The Hague: Kluwer Law International, 2008), at 44.

¹⁰⁰ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ L347, 11/12/2006, 1–118. Hereafter the VAT Directive

¹⁰¹ For an analysis of the potential negative effects of micro flexibility and differentiation within the internal market policy in general, see G. de Búrca, “Differentiation within the Core: The Case of the Common Market”, in G. de Búrca and J. Scott (eds.), *Constitutional Change in the EU – From Uniformity to Flexibility?* (Oxford: Hart Publishing, 2000), 133–171, at 142 et seq.

4.2.1 Historical arguments

Despite the European Commission's commitment and the real and significant progress achieved since the introduction of the transitional VAT system – in particular in the last few years in the context of the 2000 VAT strategy – it is clear that the level of VAT harmonisation, which the White Paper regarded as fundamental for the establishment of the internal market, has not yet been achieved.

The 1987 proposals envisaged three major changes to the Community VAT system then in force, as follows:¹⁰² abolition for intra-Community trade of the system of exempting (or zero rating) of tax exports and imposing tax on imports; introduction of a VAT clearing mechanism, to ensure fair allocation of revenues; and, approximation of VAT rates.¹⁰³ These three changes were interlinked and to a certain extent interdependent. The principal argument advanced by the Commission to support this package was of an instrumental nature: it argued that the approval of its proposals was fundamental for “completing the internal market”,¹⁰⁴ i.e. harmonisation was advocated as an instrument through which a desired objective (the establishment of an internal market) would be achieved, rather than as an end in itself.¹⁰⁵ The instrumental nature of these VAT proposals in relation to the establishment of the internal market is of crucial importance: if the approval of these proposals was regarded by the Commission as fundamental to the establishment of the internal market, and as these proposals were never approved, there is a significant basis to argue that the internal market, as regards VAT, was never established.

¹⁰² Not all of these proposals related to VAT, many focusing instead on excise duties: see *Proposal for a Council Directive completing the common system of value added tax and amending Directive 77/388/EEC – Approximation of VAT rates*, COM(87) 321 final, 21 August 1987; *Proposal for a Council Directive completing and amending Directive 77/388/EEC – Removal of fiscal frontiers*, COM(87) 322 final, 21 August 1987; *Completing the internal market – the introduction of a VAT clearing mechanism for intra-Community sales*, Working document from the Commission, COM(87) 323, 5 August 1987; *Proposal for a Council directive instituting a process of convergence of rates of value added tax and excise duties*, COM(87) 324 final, 21 August 1987; and four proposals on the approximation of cigarette taxes, of manufactured tobacco other than cigarettes, of excise duties on mineral oils and of excise duties on alcoholic beverages and other products containing alcohol, COM(87) 325 to 328, 21 August 1987.

¹⁰³ B.J. Terra and J. Kajus identify four changes, making a distinction between the proposed administrative treatment of intra-Community supplies of goods and the new substantive treatment proposed for intra-Community supplies of services, see *A guide to the Sixth VAT Directive – Commentary to the Value Added Tax of the European Union*, Loose-leaf (Amsterdam: IBFD Publications, 1993–2001), at 65 et seq.

¹⁰⁴ It is also indicative that several of the Commission's 1987 proposals and working documents used this expression in the title.

¹⁰⁵ The instrumental nature of the arguments advanced by the Commission is defended by C. Lee, M. Pearson and S. Smith. However, these authors consider the ultimate objective to be the abolition of fiscal frontier controls, see *Fiscal Harmonisation: An analysis of the European Commission's proposals*, (London: The Institute for Fiscal Studies, 1988), at 10. This assessment is, if not incorrect, at least limited: the abolition of fiscal frontiers was in itself regarded, since first proposed in the White Paper, as an instrument to achieve the ultimate objective of establishing the internal market.

As it happens, the VAT 1987 proposals were not approved, and the level of harmonisation envisaged by those proposals has never been attained. Instead a transitional VAT system was approved.¹⁰⁶ The main change under the new system was the abolition of fiscal controls at internal frontiers from 1 January 1993 – the taxable event, i.e. the intra-Community acquisition must therefore be reported on the internal VAT return rather than to customs officials at the borders.¹⁰⁷ New administrative obligations were also established: the abolition of the physical control and the control of documents to be presented upon importation, required the establishment of a VAT Information Exchange System (the “VIES”) in order to combat potential fraud,¹⁰⁸ as well as new system of collecting statistics on the trading of goods between Member States of the European Union, known as the Intrastat.¹⁰⁹ A new rate structure was approved, but it differed massively from the one proposed by the Commission in 1987.¹¹⁰ Largely a product of political compromises, and an example of the victory of politics over economical efficiency, the new structure was extremely complex and comprised two types of rules: general rules; and temporary measures, which would apply only during the transitional system.¹¹¹

The VAT transitional system was supposed to be in place for a period of four years following the elimination of fiscal frontiers on 1 January 1993. A time plan was, therefore, agreed upon according to which the Commission would bring proposals forward by the end of 1994, with a view to implementing a definitive VAT system by 1997. Unfortunately, the Commission was unable to fulfil this time plan and it was not until the summer of 1996 that a work programme was presented for the adoption of the definitive VAT system. In order to achieve the proposed definitive VAT system, the 1996 programme set out a provisional timetable, which extended to mid-1999.¹¹² Sadly the 1996 approach proved as difficult to implement as the 1987 one. In 2000 the Commission presented a VAT strategy based on a very different approach – a “viable strategy” to overcome the shortcomings of the transitional VAT system. This strategy is based on four main objectives: *simplification* of current EU VAT rules; *modernisation* of those same rules; more *uniform application* of current rules; and *stronger* administrative cooperation. In order to achieve these objectives, the Commission’s

¹⁰⁶ For an analysis of the arrangements under the new transitional system, see C. Celorico Palma, “O IVA e o mercado interno – reflexões sobre o regime transitório” (1998) *Cadernos de Ciência e Técnica Fiscal* 178, 193–225.

¹⁰⁷ Council Directive 91/680/EEC of 16 December 1991 (OJ L376, 31/12/1991, 1), known as the “Abolition of Fiscal Frontiers Directive”.

¹⁰⁸ The VIES was introduced by the Administrative Cooperation Regulation, see Council Regulation (EEC) No. 218/92/EEC of 27 January 1992, OJ L24, 01/02/1992, 1.

¹⁰⁹ Council Regulation (EEC) No. 3330/91 of 7 November 1991, OJ L316, 16/11/1991, 1.

¹¹⁰ Council Directive 92/77/EEC of 19 October 1992, OJ L316, 31/10/1992, 1.

¹¹¹ The temporary nature of these measures is, however, questionable, in view of the fact that more than ten years after their approval, they remain in force.

¹¹² See COM(96) 328 final, 22 July 1996, n. 28 above.

communication set up a detailed action plan.¹¹³ This new approach has proved moderately successfully, and has led over the last decade to the approval of various legislative instruments, which have amended the European VAT system.¹¹⁴ However, the abandonment of a more ambitious approach, as set out in the White Paper, has come at a heavy cost.

4.2.2 Practical arguments

The European VAT system currently in place is complex, inefficient, and susceptible to fraud. Measures have been taken in some areas to ameliorate the functioning of the system (like the new legislation on administrative cooperation, or the new VAT package legislation) including areas where the competing interests involved are difficult to reconcile (new Intrastat Regulation). However, the bulk of the VAT system remains a serious concern. As the Commission has acknowledged:

“It is accepted that the current transitional arrangements have a number of shortcomings, because they are complicated, susceptible to fraud (the problem of the so called “carousel fraud” is becoming of increasing concern) and are out of date.”¹¹⁵

As it currently stands, the system causes difficulties to national administrations and traders alike. It prevents Member States from fulfilling their full revenue potential, and consequently – due to the Community’s own resources system – the Community’s full revenue potential.¹¹⁶

¹¹³ See COM(2000) 348 final, 7 June 2000 and COM(2003) 614 final, 10 October 2003, n. (...) above.

¹¹⁴ See in particular new Intrastat rules, Commission Regulation (EC) No. 1982/2004 of 18 November 2004, OJ L343, 19/11/2004, 3; new conferment of implementing powers and the procedure of adoption derogations, Council Directive 2004/7/EC of 20 January 2004, OJ L27, 30/01/2004, 44; publication of VAT Committee decisions, Council Regulation (EC) No. 1777/2005 of 17 October 2005, OJ L288, 29/10/2005, 1; rationalisation of derogations, Council Directive 2006/69/EC of 24 July 2006, OJ L221, 12/08/2006, 9; the already mentioned Recast of the Sixth Directive, n. 100 above. See more importantly perhaps the new VAT package: Council Directive 2008/8/EC of 12 February 2008, OJ L44, 20/02/2008, 11–22, as regards place of supply of services; Council Directive 2008/9/EC of 12 February 2008, OJ L44, 20/02/2008, 23–28, as regards a new refund arrangements for taxable persons not established in the Member State of refund, but established in another Member State which will substitute the former arrangements, under the soon to be repealed Eighth Directive; and Council Regulation (EC) No. 143/2008 of 12 February 2008, OJ L44, 20/02/2008, 1–6, and a new administrative cooperation rules aimed at enhancing information exchange on place of supply of services and the new refund procedure.

¹¹⁵ In COM(2000) 348 final, 7 June 2000, n. 29 above, at paragraph 10.

¹¹⁶ Currently, the main legislative instrument in this area is Council Decision 2007/436/EC, Euratom of 7 June 2007, OJ L163, 23/06/2007, 17–21. However, it is important to note that the system is not as simple as these basic principles may suggest. In fact, the rules regarding Member States’ calculation of their VAT own resources base are quite complex. The general rules can be found in Regulation (EEC, EURATOM) No. 1553/89 of 29 May 1989 regarding the definitive uniform arrangements for the collection of own resources accruing from VAT, OJ L155, 07/06/1989, 9, as last amended by Council Regulation (EC) No. 807/2003 of 14 April 2003, OJ L122, 16/05/2003, 36–62. However, in order to simplify calculations, several Member States have requested authorisations to derogate from these general rules, see R. de la Feria, *A Handbook of EU VAT Legislation*, Volumes 1, 2 and 3, Loose-leaf (The Hague/London/New York: Kluwer Law International, 2004 onwards) for a compilation of all VAT legislation to date.

It increases administration and compliance costs,¹¹⁷ diminishing economic efficiency.¹¹⁸ In some cases it distorts competition within the Community, and represents an obstacle to intra-community trade. Ultimately, as it stands VAT law constitutes an obstacle to the establishment and the functioning of the internal market as defined by the EC Treaty.

Although it is impossible to analyse all the areas of the current VAT law which give rise to difficulties, four problematic areas can be chosen for analysis as a sample of the overall system: inter-jurisdictional issues, convergence of VAT rates, deductibility of input VAT, and VAT treatment of public sector bodies. The criterion used for their selection is a general assessment (admittedly subjective) of their importance as a basis of the whole system or for the functioning of that same system. They can then be divided between areas which constitute an obstacle to intra-community trade, and free movement of goods and services – inter-jurisdictional arrangements and VAT rates – and areas which constitute an obstacle to achieving the market's full potential, either directly – deductibility of input tax – or indirectly – VAT treatment of public sector bodies. The division between obstacles to intra-community trade and obstacles to achieving the market's full potential is purely conceptual, but fundamental. It is the difference between establishing an internal market as regards VAT, and having an internal market which in terms of VAT has achieved its full potential. The criterion for the distinction is interlinked with the analysis of the concept of internal market undertaken above – it is aimed at reflecting the intensity of distortions caused to the internal market. As regards the distinction between direct and indirect obstacles to achieving the market's full potential, the criterion used has been the way in which these obstacles impact on the Community market – direct obstacles are those areas of VAT which create obstacles to traders engaging or wishing to engage in intra-Community trade; indirect obstacles are those areas of VAT law which do not relate directly to intra-Community trade, and are rather seen as internal VAT areas, but which indirectly have a negative impact on the overall efficient functioning of the system.

4.2.2.1 Inter-jurisdictional issues

¹¹⁷ Preliminary estimates presented by the Commission in 1996 indicated that, on average, the costs for companies of administering transactions carried out in other Member States is five or six times more than costs would be for similar transactions in their home countries. As the Commission accepted, these costs are likely to constitute an insurmountable barrier to Small and Medium Enterprises (SMEs) wanting to penetrate the Internal Market, see COM(96) 328 final, 22 July 1996, n. 28 above, at 3-4.

¹¹⁸ The OECD has recently carried out a cross country comparison on VAT efficiency levels, defined as the share of VAT revenues to consumption divided by the standard rate. Although, the study does not assess the efficiency of the EU VAT system as a whole, it ranks the efficiency of Member States' individual VAT systems, thus indirectly providing an insight into the functioning of that system. The results are disheartening: Member States' VAT systems tend to rank below the OECD efficiency average, which stands at 52.9, with maximum efficiency represented by 100 points, see D. Snell, "GST – Revenue and Business Risk", in R. Krever and D. White (Eds.), *GST in Retrospect and Prospect* (Wellington: Thomson Brookers, 2007), 423-430, at 426.

Inter-jurisdictional issues include place of supply rules as well as all the ancillary rules setting out administrative obligations, such as VIES, Intrastat and foreign VAT refund procedures. As they currently stand, these rules create significant compliance and administrative costs with direct and indirect negative consequences, as follows:¹¹⁹ *administrative costs* act as an incentive to tax administrations to obstruct, or refuse altogether, refund claims – this significantly undermines the principle of the right to deduct VAT, a core principle of the EU VAT system; *compliance costs* are a deterrent for companies to use the procedure, undermining the principle of the right to deduct VAT; *administrative costs* are an impediment for Member States to achieve VAT's full revenue potential; *compliance costs* can also subvert the use of other VAT rules, namely the place of supply rules, undermining the function of the whole VAT system; and, finally, *compliance costs* can also act as an obstacle to intra-Community trade – mostly to SMEs – which would rather not engage in intra-Community trade in order to avoid the use of the procedure.

4.2.2.2 VAT rates

The current rate structure, and more specifically the lack of convergence of these rates, causes significant economic distortions from the perspective of businesses. *Increased compliance costs*: the difficulty establishing the VAT rate applicable to a determined supply in another Member State, amplifies companies' compliance costs, thus decreasing economic efficiency. Engaging in the most basic business transaction in another Member State entails extensive study of the rates applicable in that State, and in many situations, the resort to external tax expert advice,¹²⁰ creating a significant additional financial burden.

Infringement of the principle of VAT's neutrality and distorted competition: the wide disparity of VAT rates across the EU can potentially cause significant distortions of competition by infringing the principle of VAT's neutrality vis-à-vis the conditions of competition. There are strong indications that lower and reduced rates can be a factor in corporate profitability – thus companies trading in a Member State applying a lower standard rate, a reduced or zero rate of VAT may be able to take higher profit margins, giving them an advantage over competitors in other Member States. This is confirmed by the Copenhagen Economics 2007 Study, which concludes that “conflicts between the desirability of fiscal neutrality between like products

¹¹⁹ For a detailed analysis of the difficulties caused by the current inter-jurisdictional rules, see R. de la Feria, “Place Where the Supply/Activity Is Effectively Carried Out as an Allocation Rule: VAT v. Direct Taxation” in M. Lang *et al* (eds.), *Value Added Tax and Direct Taxation - Similarities and Differences* (Amsterdam: IBFD, 2009), 961-1014, at 970 et seq.

¹²⁰ As the European Commission has acknowledged, see *Proposal for a Council Directive amending Directive 77/388/EEC as regards reduced rates of value added tax*, COM(2003) 397 final, 23 July 2003, at paragraph 42.

and protecting a well functioning internal market to be an issue of probably rising importance”.¹²¹

Distortions of competition can also arise from a form of VAT avoidance labelled by the Parliament’s Directorate General for Research, as the “place of establishment option”.¹²² Where transactions are taxed on the place of establishment of the business (e.g. under general rule for supply of services, Article 43 of the VAT Directive), differences in VAT rates (can) act as the decisive factor for businesses’ location decisions: where companies have places of establishment in several Member States, invoices would as far as possible be issued from those in lower-taxed Member States. Additionally, some companies, namely within the services industry, take the “place of establishment option” further, and on a VAT planning motivated shift, locate themselves in Member States which apply lower rates of VAT, such as Luxembourg.¹²³

Creates obstacle to intra-community trade: the difficulty determining the VAT rates applicable in other Member States, because of the high compliance costs it entails, can constitute a deterrent for traders, namely for small and medium size businesses, to engage in intra-community trade. Again, this conclusion is confirmed by the Copenhagen Economics 2007 Study:

“Without doubt, a bewildering set of different VAT rates across EU for the same products will create some barriers to the internal market as non domestic sellers will have to spend more time finding how about the proper VAT rate in other countries and therefore be at the margin more hesitant about marketing products in other countries. As for compliance costs, it is likely that such barriers are most important when the VAT variation is at the first level of aggregation, i.e., when you have to study very carefully what VAT to apply when you sell your goods and services to other countries.”¹²⁴

By increasing the compliance costs, the lack of convergence of VAT rates stops companies from fulfilling their potential in terms of competitiveness. Thus, it has a preventive impact, stopping the EU market from achieving the objectives set out in the Lisbon Strategy: “to become the most competitive and dynamic knowledge-based economy in the world”.¹²⁵ By infringing the principle of neutrality of VAT, the lack of convergence of VAT rates negates

¹²¹ See Copenhagen Economics, *Study on reduced VAT applied to goods and services in the Member States of the European Union*, Taxation Papers, Working Paper No. 13, 2008, at 85.

¹²² See *Options for a definitive VAT system*, Working Paper, Economic Affairs Series, E 5, October 1995, at 84.

¹²³ Luxembourg currently has the lowest VAT rates within the EU – for a more detailed analysis of the VAT rates applicable in the several Member States, the Commission has been publishing, on an annual basis, a document listing the VAT rates applied to a range of products across the EU, *VAT Rates Applied in the Member States of the European Community*, January 2008.

¹²⁴ See n. 121 above, at 99.

¹²⁵ *Lisbon European Council, 23 and 24 March 2000 – Presidency Conclusions*, at paragraph 5.

one of the basic principles of the EU VAT system, as set out in the VAT Directive. By distorting competition within the Community, the lack of convergence of VAT rates negates one of the main EU economic principles, as set out in Article 3 of the EC Treaty, namely undistorted competition, and the concept of internal market. Finally, by creating an obstacle to intra-community trade, the lack of VAT rates convergence constitutes an obstacle to the free movement of goods and services.

4.2.2.3 Non-deductible input tax

As regards the lack of harmonisation of non-deductible of input tax related to some business expenses, it is clear that the current situation is not consistent with the requirements of an internal market, namely because it gives rise to serious difficulties for traders, which have a clearly negative impact and directly impair the functioning of such a market. In fact, the following consequences arise from the current legal framework.

Inequality between traders established in different Member States: thus distortions of competition within the internal market – traders established in a Member State in which tax is fully deductible (except for the general limitations) are in a beneficial situation in comparison with traders established in Member States which limit or exclude the right to deduct in relation to expenditure on specific goods or services. Economic inefficiencies within the internal market by *increasing compliance costs for businesses engaging in intra-community trade:* due to the disparities between Member States' domestic legislation, it is somewhat difficult for businesses engaging in intra-community trade to establish which expenditure is deductible in other Member States without resource to external tax experts. This is particularly problematic in the case of Eighth Directive refunds, as the refund is subject to the rules on deductible input tax applicable in the Member State of refund. Additionally, further inefficiencies arise within the internal market by *creating economic drawbacks for industries,* which are specifically affected by limitations to the right to deduct. As reported by the Commission, the fact that certain Member States limit the right to deduct in relation to expenditure on specific goods or services has economic drawbacks for the industries involved in the trade of those goods or services, e.g., the motor vehicle industry and the hotel and catering industry.¹²⁶

As opposed to the situation in relation to inter-jurisdictional issues and rates of VAT, the current rules regarding non-deductible input tax create lower intensity distortions, and thus do not constitute an obstacle to the establishment of the internal market. However, they do give rise to serious difficulties which have a negative impact in the functioning of that market. In

¹²⁶ See *Proposal for a Twelfth Council Directive on expenditure not eligible for deduction of value added tax*, COM(82) 870 final, 25 January 1983, at 2.

this context, the creation of an efficiently functioning internal market demands their alteration.

4.2.2.4 Public sector bodies

Finally, insofar as the current VAT treatment of public sector bodies is concerned, it gives rise to serious consequences, at both legal and economic levels.¹²⁷ From a legal perspective, the current regime gives rise to definitional and interpretative problems, creates difficulties in calculating the portion of deductible VAT, constitutes an incentive for engaging in aggressive tax planning, and has the additional problem of being conceptual incoherent with the general principles of European VAT law. From an economic perspective, the restrictions to the deduction of input tax, which are the consequence of the current regime, have also resulted in considerable distortions. In addition, there is no definite economic evidence that exclusion of the products supplied by public sector bodies from full taxation, achieves the social and distributional aims that are often pointed out as the main reason for their current EU treatment.¹²⁸ These inefficiencies should be contextualised in the demands of the EMU and the Lisbon Strategy. In this light, it is argued that the current VAT treatment of public sector bodies constitutes an indirect obstacle to achieving the full potential of the internal market.

4.2.3 Jurisprudential arguments

In the last forty years, the ECJ has developed an extremely vast body of case law in relation to VAT. The positive impact of this case law in this respect is demonstrated by the fact that in some aspects of the VAT system, such as the definition of fixed establishment, the Commission has considered that it is superfluous to introduce legislation based on the fact that the Court's case law already provided sufficient guidance.¹²⁹ In other areas such as VAT rates, the Court seems to have attempted to overcome the lack of legislative developments by adopting a harmonising role, diminishing the existing divergences across Member States'

¹²⁷ Many of these difficulties are common to those faced by charities and other nongovernmental organisations, see J. Warburton, "Charities and Business: A VAT Conundrum" (2007) *British Tax Review* 1, 73 et seq. The relevance of those difficulties for these bodies is demonstrated by the fact that in its 1997 report on reduced rates the Commission admitted that some exempt bodies, like charities, had put forward requests advocating the application of reduced VAT rates, instead of exemptions for their supplies, see *Report from the Commission to the Council and to the European Parliament in accordance with Article 12(4) of the Sixth Council Directive of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment*, COM(97) 559 final, 13 November 1997, at 17. Although recognising the advantages that such a shift would bring for exempt bodies, namely in terms of deduction of input tax, the Commission refused the requests arguing that the application of reduced rates to these supplies would be contrary to the basic goal of simplifying the VAT system and reducing compliance costs.

¹²⁸ For a detailed analysis of the legal and economic difficulties, see R. de la Feria, "The EU VAT Treatment of Public Sector Bodies: Slowly Moving in the Wrong Direction" (2009) *Intertax* 37(3), 148-165.

¹²⁹ In *Proposal for a Council Directive amending Directive 77/388/EEC as regards the place of supply of services*, COM(2003) 822 final, 23 December 2003, at 9.

VAT legislations.¹³⁰ However, this by its nature an unsatisfactory solution, which can only be temporary. In its communication on a new VAT strategy, the Commission expressed its intention to present legislative proposals which would reflect the Court's decisions in key areas, pointing out that:

“A number of Court judgments concerning the application of VAT to transactions by holding companies, sales promotion of products in the form of discount vouchers and activities by public bodies have highlighted the fact that some provisions of the Sixth Directive are ambiguous, incomplete or out of date. The Commission may consider making a proposal to the Council to change these provisions”.¹³¹

Whilst the Commission's expressed intention undoubtedly reflects the positive impact of the Court's case law in these areas, it also highlights the limitations of the Court, as it is clear that the Commission feels that only legislative measures could resolve the difficulties which the Community VAT law has given rise to. In fact, the Court's role in the resolution of the problems raised by the current law should be subject to two questions: first, can the Court efficiently resolve these problems? and second, even if it can, should it? The answer to the first question can be found in the methods of interpretation adopted by the Court on VAT cases and the analysis of the general shortcomings of jurisprudential developments vs. legislative measures. The second question concerns the issue of judicial activism.

As regards the first question, it is doubtful that the ECJ current approach to VAT law is either an effective or an efficient approach. The jurisprudence of the Court can – and to some extent has been – an instrument of harmonisation and integration within the field of VAT. However, this harmonisation or integration by its own nature can only be negative, i.e. the Court can interpret secondary VAT provisions in light of the principles of the European VAT system or the general principles of Community law, but it cannot introduce new provisions, or re-write existing ones.¹³² Moreover, as recently pointed out the ECJ has never declared a VAT law provision to be invalid, on the basis of being contrary of these principles.¹³³

Additionally to the issue of negative harmonisation, the impact within the VAT law of the jurisprudence of the ECJ faces another limitation: decisions of the Court are just that, decisions, and as such are based on a given set of facts. As general as the Court tries to be in

¹³⁰ See amongst others cases C-83/99, *Commission v Spain*, [2001] ECR I-445; C-276/98, *Commission v Portugal*, [2001] ECR I-1699; C-481/98, *Commission v France* [2001] ECR I-3369; C-267/99, *Adam*, [2001] ECR I-7467; C-384/01, *Commission v France*, [2003] ECR I-4395; C-109/02, *Commission v Germany*, [2004] ECR I-12691; C-305/03, *Commission v United Kingdom*, [2006] ECR I-1213; and C-442/05, *Zweckverband*, [2008] ECR I-1817.

¹³¹ See COM(2000) 348 final, 7 June 2000, n. 29 above, Annex, point 2.3.

¹³² These jurisprudential limitations are, of course, not exclusive to VAT and the problem of negative integration has already been highlighted by many others in relation to the Court's jurisprudence on direct taxation.

¹³³ See J. Englisch, Chapter xx below.

its judgments, as opposed to legislation which is naturally general and abstract, Court decisions are by their own nature concrete and specific. Consequently, extrapolating general principles from the Court's decisions and applying those to distinct factual scenarios is a dangerous task. Not solely because given a distinct set of facts the Court might have decided differently, but equally because applying those principles to other circumstances might actually raise serious difficulties. In this context, problems of complexity and factual minutiae proliferate. As demonstrated by the current process regarding the new principle of prohibition of abuse of law, the introduction of a principle in a given judgment will demand extra qualifications and explanations by the Court in future judgments.¹³⁴ The tendency whenever the Court issues a decision based on a given set of circumstances, namely on controversial areas such as exemptions and the right to deduct, is to request the Court to determine whether the same conclusion would apply if the circumstances were only slightly different. Whilst this practice has undoubtedly allowed the Court to develop certain areas of the EU VAT system, it also has created a complex set of case law, where minimal factual details govern.¹³⁵ In this context, the level of legal uncertainty grows and situations of potential abuse, where traders advised by VAT experts artificially "play" with the Court's judgments as a form of tax planning, may flourish.

The above highlights the limitations faced by the Court in attempting to resolve the failings of Community VAT law. However, even assuming that the Court could overcome these limitations and resolve (at least some) of those failings, the question which should be asked then is whether it is appropriate for it to do so. Since the mid-1980s, the Court of Justice has often been the target of criticisms by academic commentators who accused it of assuming powers which go beyond its judicial function and of adopting a quasi-legislative role.¹³⁶ The controversy surrounding the Court's so-called judicial activism has mostly focussed on the Court's interpretation of the Treaties and the Court's approach to constitutional issues,¹³⁷ such as the introduction of the principle of direct effect, giving rise to consequent passionate

¹³⁴ See R. de la Feria, "Prohibition of Abuse of (Community) Law – The Creation of a New General Principle of EC Law Through Tax" (2008) *Common Market Law Review* 45(2), 395-441, at 418 *et seq*; and R. de la Feria, "Weald Leasing. Reference for a preliminary ruling in a UK case regarding the application of the abuse of law test to leasing structures. Court of Appeal" (2009) *Highlights & Insights on European Taxation* 7, 61-64.

¹³⁵ As J. Swinkels comments: "the case law of the ECJ, on one hand, provides clarifications on the existing provisions of the Sixth Directive but, on the other hand, also makes application of those provisions more difficult. Every ECJ judgment appears to give rise to new questions", in "Combating VAT avoidance" (2005) *International VAT Monitor* 4, 235-246, at 246.

¹³⁶ One of the earliest commentators to adopt this perspective seems to have been H. Rasmussen in *On the Law and Policy in the European Court of Justice* (Martinus Nijhoff, 1986).

¹³⁷ Although, the use of term "judicial activism" is wide-spread, it has been criticised by T. Tridimas, "The Court of Justice and Judicial Activism" (1996) *European Law Review* 21, 199-210.

arguments from both the critics of the Court and its defenders.¹³⁸ Although the question of judicial activism as regards the Court's case law on VAT has not (as yet) been raised by academic commentators,¹³⁹ it has been implicitly invoked by Member States' governments in several cases such as *Gaston Schul*, *Commission v United Kingdom*, and *Commission v Ireland*.¹⁴⁰

4.3 ECJ approach: VAT vs. direct taxation

The light of the arguments presented above, supporting the incompatibility of the current VAT law with the EC internal market, it would seem only natural for one to consider what would have happened had the Court adopted the same approach for VAT as it has been adopting for direct taxation. Clearly not only would the compatibility of national VAT provisions with fundamental freedoms be assessed, but also that of Community VAT provisions.¹⁴¹ Potential accusations of judicial activism could be easily dismissed, on the basis that the Court would be merely fulfilling its function as constitutional court. The analysis undertaken above suggests that many VAT provisions would not pass the so-called restriction test, as developed by the Court as regards the fundamental freedoms.¹⁴² Obviously, even if regarded as restrictions, VAT provisions could still be deemed to be justified and proportional. Amongst others, possible justifications which could be accepted by the Court on this regard would be the insufficiently developed nature of EC law – as it was argued on

¹³⁸ The arguments put forward by both parties will not be analysed here. For a critical view of the Court of Justice, see amongst others, and in addition to the above: H. Rasmussen, "Between Self-Restraint and Activism: A Judicial Policy for the European Court", (1988) *European Law Review* 13, 28; P. O'Neill, "The European Court of Justice: A Case Study in Judicial Activism", Lords Selected Committee on the European Communities, Minutes of Evidence (Session 1994–95, 18th Report, H.L. Paper 88); T.C. Hartley, *The Foundations of European Community Law* (Oxford: Oxford University Press, Fifth Edition, 2003), at 79-83. For a supportive view of the Court of Justice see amongst others: A.G. Toth, "The Authority of Judgments of the European Court of Justice: Binding Force and Legal Effects" (1982) *Yearbook of European Law*, 1-78; M. Cappelletti, "Is the European Court of Justice 'Running Wild'?", (1987) *European Law Review* 12, 3; J. Weiler, "The Court of Justice on Trial" (1987) *Common Market Law Review* 24, 555; F. Mancini and Keeling, "Democracy and the European Court of Justice" (1994) *Modern Law Review* 57, 186; A. Arnall, "The European Court and Judicial Objectivity: A Reply to Professor Hartley" (1996) *The Law Quarterly Review* 112, 411-423; and A. Zalasinski, Chapter xx above.

¹³⁹ This is not to say that the Court's overall jurisprudence on VAT has not been subject to criticisms, see L. Maublanc-Fernandez and J.P. Maublanc comments in "La Jurisprudence Communautaire relative à la TVA" (1994) *Revue du Marché Commun et de l'Union Européenne* 380, 460–470.

¹⁴⁰ Cases 15/81, *Gaston Schul*, [1982] ECR 1409; 415/85, *Commission v Ireland*, [1988] ECR 3097; and 416/85, *Commission v United Kingdom*, [1988] ECR 3127.

¹⁴¹ For an analysis of the ECJ jurisprudence as regards the application of EC Treaty provisions in the context of the Direct Tax Directives, see G. Kofler and M. Tenore, Chapter xx below.

¹⁴² For a general analysis of the Court's jurisprudence as regards the fundamental freedoms, see amongst others C. Barnard, *The Substantive Law of the EU: The Four Freedoms* (Oxford: Oxford University Press, 2007); for a comprehensive analysis of the Court's jurisprudence in this regard but when applied to direct tax matters, and the concept of restriction as applied to tax, see as a paradigmatic example F. Vanistendael (ed.), *EU Freedoms and Taxation*, EATLP International Tax Series, Volume 2 (Amsterdam: IBFD, 2006).

earlier cases concerning Article 90 of the EC Treaty – or the need to combat tax avoidance or evasion.¹⁴³ Unfortunately, this type of analysis has so far never been undertaken by the ECJ.

5. Conclusion: The Constitutional Function of the ECJ

Faced with lack of legislative progress the Court acquired a vital role in the development of the Community tax policy – a prime example of what has been designated as the “use of normative supranationalism to overcome the deficiencies of decisional supranationalism”.¹⁴⁴ It has been argued that this role can be qualified as that of both a Constitutional Court and a Supreme Court: Constitutional Court where it makes a direct application of the Treaty provisions; and Supreme Court where it guarantees the uniform interpretation of regulations or national legislation implementing directives.¹⁴⁵ Jurisprudence within the field of taxation indicates that the Court has tended to separate these functions according to subject matter: acting as a Constitutional Court in areas not yet harmonised, or subject to very limited and partial harmonisation, such as direct taxation, whilst adopting the almost exclusive role of Supreme Court in areas which have been the target of relatively extensive harmonisation, such as VAT. This approach can possibly be explained by a conjugation of factors. Firstly the above referenced case law on non-application of Treaty provisions to exhaustively harmonised areas, and Court’s preference for not departing from previous case law.¹⁴⁶ Secondly, and perhaps more importantly, the peculiar constitutional nature of the European legal system and namely what has been designated as the EU’s constitutional pluralism.¹⁴⁷

Whether these arguments are sufficient justification for the Court’s approach is however questionable. In particular attention should be paid to its potential negative effects, not least the fact that such an approach will unavoidably lead to a gap in the level of judicial review between harmonised and non-harmonised areas. The paradoxal nature of this outcome is even more evident when considered against the background of the EC internal market policy. Areas which have been subject to extensive harmonisation are often, by its very nature, those

¹⁴³ See B. Terra and P. Wattel, n. 16 above, for the analysis of justifications accepted by ECJ within the field of direct tax.

¹⁴⁴ See P. Craig, n. 80 above, at 7. The sentence is used in the context of the Court’s jurisprudence regarding the freedom of establishment and Article 43 of the EC Treaty, but undoubtedly the same can be said of the Court’s jurisprudence in relation to tax in general.

¹⁴⁵ See F. Vanistendael, “The role of the Court of Justice as the supreme judge in tax cases” (1996) *EC Tax Review* 3, 114–122

¹⁴⁶ As recently stated by C. Costello, “while the ECJ has shifted legal position in light of changed institutional circumstances quite often, express overruling is a rarity”, in “*Metock*: free movement and “normal family life” in the union” (2009) *Common Market Law Review* 46(2), 587-662, at 599. Amongst the most high profile exceptions of this type are: case C-10/89, *Hag II*, [1990] ECR I-3711; joined cases C-267/91 and C-268/91, *Keck*, [1993] ECR I-6097; and case C-127/08, *Metock*, [2008] ECR I-6241.

¹⁴⁷ See M. Poiars Maduro, n. 34 above.

traditionally regarded as more crucial to the establishment and functioning of the internal market – as is the case with VAT. It seems therefore bizarre that those areas regarded as more fundamental for the internal market, are precisely those being subject to lower standards of judicial review.

It has been said that the efficiency of hierarchy of EC norms depends on the existence of a judicial instrument to ensure its respect.¹⁴⁸ In a way, so does the effectiveness and uniform application of EC law, which was the Court’s primary argument for the establishment of the principle of supremacy of European law over national law.¹⁴⁹ By refusing to assess the compatibility of Community secondary law with EC Treaty provisions and applying lower levels of judicial review to areas such as VAT the Court is putting into question all of the above. As Advocate General Poiares Maduro has recently stated:

“The duty of the Court of Justice is to act as the constitutional court of the municipal legal order that is the Community.”¹⁵⁰

It would appear that as regards specific areas of European law – like VAT – the Court is unwilling to fully embrace this constitutional role. As set out above, there may indeed be good arguments to justify the Court’s approach. The risk, however, is that in the process it might be putting into question the very fundamental principles on which the Community legal order is based upon, and which it aims to protect.

¹⁴⁸ See R. Bieber and I. Salome, n. 32 above, at 927.

¹⁴⁹ See cases 26/62, *Van Gend en Loos*, [1963] ECR 3; 6/64, *Costa*, [1964] ECR 1141.

¹⁵⁰ Opinion of the Advocate General in joined cases C-402/05P and C-415/05, *Kadi*, [2008] ECR I-6351, at paragraph 37.

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