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Release from the Pressure of the EU Competition Law

1. Subject of analysis

Although harmonisation in tax law is exceptional, this does not mean that the Member States should not consider developments in another Member State in light of the internal market's smooth functioning, following the principle of equivalence.[2] Not only is the Member States' taxation power limited by the principle of equivalence in general,[3] but the tax rules of the Member States are increasingly subject to

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[2] In the framework of the Single European Act adopted in Luxembourg on 9 September 1985, a declaration was made under Art. 100b of the Treaty establishing the European Economic Community (OJ L 169, 29 June 1987, p. 20). This article aims to draft the internal market principle, which has become known as the principle of equivalence. It is also called the principle of mutual recognition. The implementation of this principle is set out in the Commission Communication from the Commission to the Council and the European Parliament – *Management of the Mutual Recognition of National Rules after 1992 – Operational conclusions reached in the light of the inventory drawn up pursuant to Article 100b of the EC Treaty*, COM/93/669 final, 15 December 1993.

[3] In the EU, taxation is within the competence of Member States. However, they are obliged to exercise their taxation power consistently with the EU law. See: CJEU, judgement, 14 February 1995, *Schumacker*, C-279/93, Para. 21. Member States must thus not ignore the EU environment while exercising their power. It is another aspect of the Member State's taxation power that Member States can unilaterally determine the territorial application of their tax laws, although following the principles recognised by international law. See: E. Traversa, A. Pirlot, *Tax sovereignty and territoriality under siege: how far should the EU freedoms of movement impact on the territorial allocation of taxing powers between Member States?*, [in:] C. Brokelind (ed.), *Principles of law: function, status and impact in EU tax law*, IBFD, Amsterdam 2014, pp. 364–367.

EU competition law. Under such circumstances, tax matters are increasingly heard by the European Commission and, subsequently, by the European judicial authorities.

Meanwhile, competition law considerations are brought to the fore, which serve globalisation and are foreign to the tax law's internal logic. However, special sectoral taxes appear to be an exception to the general trend. In recent months, sales taxes hitting large companies have aroused particular attention.

Hungarian and Polish special sectoral taxes are peculiar, first because they apply to specific sectors. Furthermore, they are levied on sales. Finally, strangely enough, they have progressive rates.

In practice, these taxes target businesses with significant turnover. The addressees are typically businesses operating in Hungary (or Poland) but owned by persons settled down in the other Member States. Because of the suspicion of unlawful state aid, the European Commission, as the European competition authority, took action against these taxes. The Commission, however, was not successful in defending its position in the Court of Justice of the European Union (CJEU).[4]

As the literature has revealed the judgments' shortcomings, it is sufficient to refer to them below.[5] In what follows is to share some thoughts on how the Member States' tax law has developed and may develop in the future in an EU environment where special sectoral taxes are accepted. Concerning the tax law problem of special sectoral taxes, the appropriate case law of CJEU will be briefly presented.

[4] See the cases as follows: CJEU, judgement, 16 May 2019, *Poland* v. *European Commission*, joined cases T-836/16 and T-624/17; CJEU, judgement, 16 March 2021, *European Commission* v. *Poland*, C-562/19 P; CJEU, judgement, 27 June 2019, *Hungary* v. *European Commission*, T-20/17; CJEU, judgement, 16 March 2021, *European Commission* v. *Hungary*, C-596/19 P; CJEU, judgement, 3 March 2020, *Vodafone*, C-75/18; CJEU, judgment, 3 March 2020, *Tesco*, C-323/18.

[5] See, in particular, the most comprehensive critique of the respective judgments with R. Szudoczky, B. Károlyi, *The troubled story of the Hungarian advertisement tax: How (not) to design a progressive turnover tax*, "Intertax" 2020, No. 1. See also: B. Károlyi, *Progressive turnover-based taxes and their legal repercussions under EU law*, "EC Tax Review" 2020, No. 6. Furthermore: R. Mason, *What the CJEU's Hungarian cases mean for digital taxes*, "Tax Notes International" 2020, No. 2; P. Nicolaides, *Multi-rate turnover taxes and state aid: A prelude to taxes on company size* , "European State Aid Law Quarterly" 2019, No. 3; L. Parada, *How the Vodafone Magyarország opinion affects EU debate on turnover-based digital taxes?*, "Tax Notes International" 2019, No. 5; D. Stevanato, *Are turnover-based taxes a suitable way to target business profits?*, "European Taxation" 2019, No. 11; G. Kofler, J. Sinnig, *Equalization taxes and the EU's' Digital Services Tax*, "Intertax" 2019, No. 2; R. Mason, L. Parada, *Digital battlefront in the tax wars*, "Tax Notes International" 2018, No. 12.

2. Reference framework in the CJEU practice

The central question of the problem of prohibited state aid that may arise in connection with special sectoral taxes is determining the basis of comparison, i.e., a so-called frame of reference. It can be decided whether the examined tax measure can be classified as selective. As long as the European judicial authorities did not see any reason to find prohibited state aid concerning special sectoral taxes, they deviated from their previous practice or made an unconvincing distinction from previous cases.

They did not consider what the CJEU had already shown in *Humblot*[6] and much later in *Gibraltar*[7] that the legislative objective can be overridden if the effect of protectionism of the respective taxation can be shown. Moreover, the European judicial authorities deciding on special sectoral taxes have skipped discrimination, although it may well undermine the adequate protection of fundamental freedoms and discourage European solidarity.

In *Humblot*, a vehicle tax with steeply progressive rates provoked controversy. The tax was calibrated according to the vehicle's cylinder capacity, i.e., an objective criterion. The impact of this tax was to hit vehicles with a high cylinder capacity.

Such vehicles were only manufactured outside the Member State applying the restrictive tax rates. However, the tax application did not depend on whether the taxable product was of a domestic or foreign origin. The tax rule's effect was that imported products were subject to stricter taxation, a trade barrier. Such tax was therefore found discriminatory and protective.[8]

In *Gibraltar*, it could not be seen immediately that prohibited state aid occurred. It arose from a tax haven situation the offshore companies operating in Gibraltar could enjoy. No tax haven could be discovered from the respective regulatory system.

Offshore companies could avoid taxation because they did not have an employee or did not use commercial real estate to trigger taxation. The General Court did not identify a tax haven because it confined itself to examining the regulatory system. It missed disclosing the impact of regulation, however.

The CJEU criticised the General Court's judgment as follows: "The General Court's approach, based solely on a regard for the regulatory technique used by the proposed tax reform, does not allow the effects of

[6] CJEU, judgement, 9 May 1985, *Humblot*, 112/84.

[7] CJEU, judgement, 15 November 2011, *European Commission* and *Spain* v. *Gibraltar* and *the United Kingdom*, joined cases C-106/09 P and C-107/09 P.

[8] See: CJEU, judgement, 9 May 1985, *Humblot*, 112/84, Para. 14.

the tax measure in question to be considered and excludes from the outset any possibility that the fact that no tax liability is incurred by offshore companies may be classified as a 'selective advantage'."[9]

Taxation depended on the size of the turnover and seemed objective, but one had to bear in mind that domestic companies did not achieve higher tax rates while companies operating in Poland or Hungary, respectively, but owned by persons from the other Member States had high turnover that immediately had to be taxed at the highest rate. Similarly to *Gibraltar*, the Hungarian legislature constructed taxation in full knowledge of the easily predictable situation that taxation affected businesses operated by persons from the other Member States negatively while unilaterally favouring competing domestic companies. Concerning the reference framework, it is necessary to consider the legal structure of taxation and the market conditions under which tax rules are expected to apply.

In C-385/12 *Hervis*,[10] CJEU found that the taxation of turnover based on highly progressive tax rates was linked to the rule on the aggregation of taxable turnover of affiliated undertakings. It was concluded that the taxpayers belonging to company groups were taxed based on a "fictitious" turnover. The *Vodafone* and *Tesco* cases are different from *Hervis* as, in the special telecom tax and the retail trade tax, respectively, there is no aggregation rule.[11] The CJEU, therefore, ruled that, for lack of a combination of a progressive tax and an aggregation rule, the problem identified in *Hervis* no longer existed.[12]

3. A conflict between the EU's and the Member States' competences

The uncertainty surrounding the law on prohibited state aid and the Commission's practice of prohibiting state aid lies in the fact that it is impossible to know precisely how competences are divided between the EU and the Member States. In principle, taxation is a Member State competence. However, if a Member State takes specific measures, the possibility of prohibited state aid may arise. If so, the EU competition authority must already act.

[9] See: CJEU, judgement, 15 November 2011, *European Commission* and *Spain* v. *Gibraltar* and *the United Kingdom*, joined cases C-106/09 P and C-107/09 P, Para. 88.

[10] CJEU, judgment, 5 February 2014, *Hervis*, C-385/12.

[11] Following the judgment in *Vodafone* and *Tesco*, the aggregation rule exists in the newly introduced retail trade tax, but taxpayers are now entitled to opt out. See: HU, Act XLV of 9 June 2020 on the retail trade tax.

[12] See: CJEU, judgement, 3 March 2020, *Vodafone*, C-75/18, Para. 55 and CJEU, judgment, 3 March 2020, *Tesco*, C-323/18, Para. 75.

There are two views on the future development of the EU state aid law: 1) inter-governmentalism: the masters of integration are the Member States, 2) neo-functionalism: the European authorities (above all the Commission) can act autonomously in the general interest of the Union. According to the literature, lawyers are more pro-independence and political scientists are, in turn, more pro-union.[13]

There may be no valid legal doctrine when a Member State measure is distortive, but no legal doctrine is required under Art. 107 TFEU to demonstrate a distortive effect. In practice, the mere identification of state aid is sufficient, which does not require a conceptual distinction between general and specific measures. In the absence of a general definition, the finding of prohibited state aid becomes a matter of discrimination, as the case law shows, for example, in the case of *Gibraltar*.

Due to neo-functionalism considerations, Cees Peters does not accept without reservations the tax lawyers' current view that, given the requirement of legal certainty, Member States can act autonomously in what constitutes prohibited state aid and harmful tax competition.[14] If the Member States do not agree on a harmonisation law to eliminate the state aid procedure's uncertainties, EU competence will inevitably increase as the Commission fills the gaps. In practice, high-taxing Member States may already be more robust in enforcing different EU tax harmonisation policies than the low-taxing Member States, which tend to apply tax competition to attract additional capital to the Member State.

On a global scale, the reality is that Member States' powers are being involuntarily eroded. It would be pointless for the Member States to insist on the critical requirement of legal certainty in tax law once multinational companies are interested in breaking down administrative barriers to cross-border competition as quickly and as entirely as possible. Then, the academic debate might be decided against the will of the Member States.

4. A lesson to be drawn: a gloomy future of tax law as a particular branch of law

The right to control state aid is part of competition law in the broadest sense. Prohibited state aid can be implemented through tax and non-tax means. In the former case, the EU authorities may examine taxes, now not

[13] C. Peters, *Tax policy convergence and EU fiscal state aid control: In search of rationality*, "EC Tax Review" 2019, No. 1, p. 9.

[14] *Ibidem*, p. 14.

for tax but for competition law purposes. The relevant EU authorities may want to determine whether the Member States' tax measures in question have a distorting effect on competition.

In any case, tax law as a particular branch of law has had to date a limited effect in the EU legal environment. On a global stage of capital movements, particular law branches tend to be pushed into the background. Such an event happened, e.g., in recent decades with the company law.

With the development of the digital economy and growing capital mobility, there is a need to simplify the regulatory environment of company law, resulting from the trend that national company law is becoming empty of meaning.[15] The underlying national company law is being replaced by restrictions of other legal branches, which are not tailored to its legal type but its size, and apply thresholds linked to turnover, staff, or other business features.

In such cases, tax law considerations are often subordinated to the interests of the freedom of global capital markets. In the field of tax regulation, global capital market movements require, for example, an extension of tax consolidation even to cross-border company groups[16] while devaluing traditional transaction-based transfer pricing methods.

Cooling of financial activity requires continuous regulatory oversight of capital market activity while regulators constantly adapt to changing markets. A tax instrument that can be used to curb financial market hyperactivity is, e.g., the imposition of a financial stability contribution on financial enterprises (this is the so-called "bank levy"), proposed by the IMF already in 2010.[17] Similarly, it is a chance to introduce a financial transaction tax in the European framework.[18]

A further difficulty for tax law is the frequent use of estimation when assessing financial performance or market judgment. Flexibility is needed in changing market conditions, but such a development makes it difficult to enforce legal certainty that is a crucial feature of tax law. The resilience of regulators is meaningful in economics, but it can hardly be coordinated with a legal system's stability.

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[15] European Commission, *Communication from the Commission on a simplified business environment for companies in the areas of company law, accounting and auditing*, Brussels, 10 July 2007, COM(2007)394 final. See, in particular, Para. 3.1.

[16] Proposal for a Council Directive on a Common Corporate Tax Base, Strasbourg, 25 October 2016, COM(2016)685 final (first step – common tax base); proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), Strasbourg, 25 October 2016, COM(2016)683 final (second step – unitary taxation).

[17] IMF, *A fair and substantial contribution by the financial sector. Final report for the G-20*, June 2010, https://www.imf.org/external/np/g20/pdf/062710b.pdf (accessed: 1.03.2021).

[18] Proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax, Brussels, 14 February 2013 COM(2013)71 final.

Competition law considerations suggest measures to be taken on a global scale because a proper compass of the authorities' intervention is the global economic impact. In such an environment, legal doctrines are depreciated. Debates are constant, e.g., when looking for how the reference framework should be defined to establish selectivity while examining state aid. From a competition law point of view, a reference framework's choice could be extensive, which often seems unacceptable from a tax law perspective.[19]

Although freedom of competition is in the public interest, competition may dissolve itself because of the endless pursuit of profit individual actors seek. Heated competition law is a consequence of the emergence of global capital, against which the authorities endeavouring to enforce the obligations of national legal branches appear to act in the public interest. Nevertheless, the contradiction cannot be avoided because the nation-state's public interest is local, while the capital interested in breaking down the administrative barriers to freedom of competition is global. It is only possible to take the proper position on a case-by-case basis in whether the local public interest or the global private interest deserves priority.

From a competition law point of view, consolidated and non-consolidated companies operating in the same market are compared. Such a comparison is not appropriate because of the tax law regime developed to date. It is logical for the Commission, as a competition authority, to shape the reference framework for turnover tax in a way to provide for a flat-rate tax that does not allow exceptions while the Member States, in contrast to this aspiration, may wish to include redistributive logic in their tax legislation.

A lawyer can easily find that unreflected competition law may lead to fictions in the real world of the market imperfections. If this scepticism against market competition is well founded, then – but only then – progression in taxation can be included within a single frame of reference, even in the case of taxation levied on turnover. The question, then, is how far lawyers specialising in taxation can enforce their considerations while resisting global influence.

Global capital is sending a message through competition law, under the pressure of which the nation-state's legal toolbox often crashes. On a case-by-case basis, a balance should be struck between the free movement of capital and nation-state sovereignty, but the pendulum often transcends somewhere in this and somewhere in that direction. In the case of progressive taxes on turnover, for the time being, defenders of

[19] The General Court also ruled against the Commission's decision in the *Apple* case, finding that the Commission had failed to prove the existence of a tax advantage. This decision reflects growing doubts about the extension of EU competition law. CJEU, judgment, 15 July 2020, *Ireland* and *Others* v. *European Commission*, joined cases T-778/16 and T-892/16 (under appeal; see: *Ireland* v. *European Commission*, C-465/20 P).

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Abstract

What follows is to share some thoughts on how the Member States' tax law has developed and may develop in the future in an EU environment where special sectoral taxes are accepted. Tax law considerations are increasingly subordinated to the interests of the freedom of global capital markets. Flexibility is needed in changing market conditions, but such a development makes it difficult to enforce legal certainty, which is a crucial feature of tax law. The resilience of regulators is meaningful in economics, but it can hardly be coordinated with a legal system's stability.

Concerning progressive taxes on turnover, for the time being, defenders of nation-state sovereignty seem to gain against those who want to open European capital markets and further harmonise the relevant regulations to remove administrative barriers from the freedom of capital. However, the future tells us how much national tax law systems can preserve their cohesion in the EU, an integral part of the global economy.

Keywords: progressive taxes on turnover, reference framework, legal certainty