

Rita Szudoczky

The Sources of
EU Law and Their
Relationships:
Lessons for the
Field of Taxation

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32

The Sources of EU Law and Their Relationships: Lessons for the Field of Taxation

Why this book?

In the current state of EU law, basic conceptual and methodological questions – such as the nature and status of the sources of law, their place in the normative hierarchy, the scope of various fundamental norms and the methods of analysis required by their application to national (tax) rules – are still unclear. This is due to the fact that EU law is rarely examined as a legal system. This book aims at bridging this gap by analysing systematically the relationship of the various sources of EU law with a focus on the field of taxation.

The interactions between the rules of the founding Treaties, the general principles of EU law, fundamental rights and the legal acts of the EU institutions are examined in both hierarchical and horizontal relationships. With regard to hierarchical relationships, it is demonstrated that the Court of Justice applies a low standard in substantively reviewing the compatibility of secondary law with primary law and it is argued here that a stricter review would be necessary both as a constitutional guarantee and a reinforcement of the internal market vis-à-vis EU legislation. In the field of taxation, where the unanimity rule for the adoption of EU legislation has resulted in some dubious compromises in the existing directives, a meaningful review would be particularly necessary.

As regards horizontal relationships, a comparison is provided of the methods of analysis conducted by the EU Courts under the free movement provisions and the State aid rules when applying them to national tax measures. The analysis shows a gradual convergence of these methods. It is suggested that the ensuing overlaps between the two regimes should be resolved by perceiving the State aid rules as general rules over which the more specific free movement provisions prevail.

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Introduction

1.1. Research question and its relevance

The research question of this thesis is what rules and principles govern the relationships of the different sources of EU law and how those rules and principles need to be interpreted and applied in order to reflect and reinforce the constitutional character and system nature of EU law. In essence, we aim at describing and explaining relationships between the elements of a legal system, identifying organizing principles, such as hierarchy of norms, clarifying the scope of different norms, comparing various methods of analysis and devising an analytical framework for the purpose of enhancing the consistent application of a legal regime. If this sounds far too abstract for an introduction which ought to raise interest in the next few hundred pages of this thesis, the reader can rest assured that in the context of EU law and, more specifically, EU tax law these questions translate into very real and practical problems. This Introduction gives a preview of those problems.

Admittedly, the abstract starting point and the systematic approach that we have chosen for accessing this subject is not commonplace in our fields of research. Academic research in EU law and especially, EU tax law starts out, most of the times, from a concrete problem, a specific conundrum which entails concrete theoretical and practical difficulties that calls for a solution. Conversely, our research sets out from the rather general and abstract observation that in EU law, and within that EU tax law, basic conceptual and methodological questions – such as the nature and status of the sources of law, their place in the normative hierarchy and their relationships, the scope of various fundamental norms and the methods of analysis required by their application – are still very unclear despite the more than half a century history of EU law and the abundant legal research that has been produced during this long history. In our view, this situation is due to the fact that EU law is rarely analysed as a legal system. Approaching EU law from a systematic viewpoint may not be self-evident, as EU law was born as a functional legal order of an organization initially aimed at purely economic integration which, according to some, prevents it from being postulated as a fully-fledged legal system. This would entail that EU law can only be analysed by examining the positive law and the case law of specific and isolated areas, amongst which there is no connection and therefore, no

general guiding rules, principles and theories can be drawn which would apply to the whole of EU law. Contrary to this, in this thesis, we examine the relationships between the different sources of EU law on the basis of the assumption that these various sources are the building blocks of a coherent whole, a unity, in other words, the system of EU law which can be understood and explained through a systematic method of analysis.

Apart from the systematic approach, the subject matter of this thesis may also be considered, to a certain extent, unconventional. EU law is the law of a supranational organization or, as we will describe the Union in this thesis, a federal formation and as such, the main issue it presents for legal research is the relationship between the national and supranational legal order. In contrast, our research is predominantly focused on the internal legal order of the EU, that is, the interrelations between the various norms of EU law in which context the usual problem of ‘national law – EU law’ surfaces only as an ancillary, although inevitable, question.

On the basis of the observation that a systematic and conceptual approach to the understanding of the whole of EU law is largely lacking today in the scholarship on EU law, the mission of this thesis is to take some – undeniably small – steps in the direction of bridging this hiatus. Some important qualifications need to be made to this ‘mission statement’. The criticism regarding the lack of systematic approach refers to the examination of EU law as a whole; it would not be correct to say that legal research of certain specific fields, areas and legal regimes of EU law is not sufficiently systematic or methodological. Furthermore, legal research on the relationship of EU law and other legal orders at the national, international, or global level cannot be accused of not being sufficiently conceptual or theoretical. Finally, the criticism refers primarily to English language academic scholarship, as German legal science, which is rooted in the idea of systematization and methodization of law, follows such approach also to EU law.

It also needs to be emphasized that a systematic approach to EU law does not mean an exclusive focus on abstract rules and theories and ignoring the role of case law, which – especially in the context of EU law that has been developed into a legal system principally by the Court of Justice – cannot be overstated. Hence, our systematic approach is closely entangled with an in-depth analysis of the case law. As has been expressed by others in words more eloquent than our words: “Theoretical concepts do not just appear out

of nowhere. Cases inspire the methodological imagination of jurists, and decisions of the courts, correct and incorrect, are the very basis of jurisprudential systematising analysis.”¹

Now, in more concrete terms, we approach the broad subject matter of the relationships of different sources of EU law from three different angles. First, we describe the normative landscape of the European Union outlining the general features of its legal order, the various sources of EU law and the basic principles, rules and tenets that govern the relationships between these sources (Part I). Second, we focus on the relationship of primary law, specifically, the Treaty’s free movement provisions (‘fundamental freedoms’)² and secondary law, thus, analysing what is essentially a relationship of a hierarchical nature (Part II). Third, we examine the interaction between two fundamental norms of the internal market – namely, the Treaty’s free movement provisions and the State aid rules – which both rank as primary law, thus, being at the same level of the legal order (Part III).

Within this structure, in Part I, the basic system-characteristics of EU law are laid out, most importantly, the hierarchy of norms of EU law, according to which primary law is superior to secondary law. The subsequent analysis in Part I and Part II aims to establish how strict this hierarchical relationship is – taking into account first, the federal constitutional structure of the Union and second, the willingness of the Union Courts to enforce primary law standards of a constitutional status *vis-à-vis* the Union institutions by reviewing the legality of their acts. Accordingly, we examine the case law of the Court on the scrutiny of secondary law in the light of various norms of primary law (general principles of EU law, fundamental rights and Treaty’s free movement provisions) and draw conclusions as regards the intensity of such scrutiny. Having regard to the conclusion – i.e. the intensity of substantive judicial review of Union legislation is very low – the question arises how the Court avoids facing conflicts between secondary law and primary law. In this regard, we identify and categorize the various techniques employed by the Court in order to keep away from addressing the compatibility of secondary law with higher ranking substantive standards of EU law. The techniques vary according to whether the issue before the Court is (i) the relationship of national law – secondary law – primary law, or (ii) the interpretation of secondary law, or (iii) the actual review of legality of secondary law. The techniques are used in various contexts whether

1. T. Kingreen, *Fundamental freedoms*, in: *Principles of European Constitutional Law*, Second Revised Edition (A. Von Bogdandy and J. Bast eds., Hart Publishing 2010), pp. 515-549, at p. 518.

2. For the use of terminology, see Section 5.3.1.

secondary law collides with the general principles of EU law, the fundamental rights or the Treaty's free movement provisions and irrespective of the field of EU law where the conflict arises. We demonstrate the use of these techniques specifically in the field of taxation. Thus, in Part I and Part II of the thesis, our principal goal is to analyse different segments of the case law and deduct common rules and principles that govern the relationship of secondary and primary law. By distinguishing various categories of cases we aim to show that the Court applies the same techniques and interpretations methods in various fields of EU law and in conflicts between various types of EU law norms.

In Part III, our main objective is to develop and deduce the common theoretical and methodological features of two fundamental rules of the internal market set out in the TFEU – the fundamental freedoms and the State aid rules. We compare the methods of analysis which the Court applies to national tax measures under these two regimes and we draw attention to a gradual convergence between the two methods – a trend which has become more visible in the recent case law of the Court. We point out that such convergence can be explained by the fact that both the fundamental freedoms and the State aid rules are the expression of the general principle of equality in their specific field of application. As they have a common root, it is, in fact, reasonable that they involve a similar methodology. However, this or, in fact, the State aid analysis of fiscal measures itself, is far from being clear. The interpretation and application of the conditions of State aid under Article 107(1) TFEU to fiscal measures by the Commission, on the one hand, and the Union Courts, on the other, have not resulted in anything that could be called a consistent methodology. To date, the doctrine of EU State aid law has not put forward comprehensive suggestions for a consistent method of analysis which could help the Courts and the Commission make their fiscal State aid law and practice clearer and more predictable. Having regard to this, in this thesis we develop and propose a comprehensive analytical framework to be applied under the State aid rules to tax measures. The analytical framework builds on the idea of common methodology with the fundamental freedoms thereby it reinforces the convergence between the two methods of analysis. Finally, in Part III we also endeavour to resolve potential overlaps between the fundamental freedoms and the State aid rules by defining priority rules in their application.

This thesis is as much on EU tax law as it is on EU law. Taxation is the specific area to which we apply and where we test the general rules, principles, observations and tenets which we established in a general context as regards the relationship of primary law and secondary law. It is also national tax

measures in relation to which we compare the methodologies applicable under the fundamental freedoms, on the one hand, and the State aid rules, on the other. The reason for this is that the field of taxation displays some specific characteristics and some relevant differences compared to other policy fields under EU law. A specific characteristic is that within the field of taxation the area of direct taxation and indirect taxation differs to a great extent. Most indirect taxes are comprehensively harmonized under Union law which means that in these areas, we find a relatively large body of secondary Union law governing, *inter alia*, value added tax, customs and excise duties. In contrast, in the area of direct taxation, the Member States have largely retained their sovereignty. Harmonization in this area is, therefore, scarce represented by a handful of directives which are narrow in scope and which regulate only certain specific aspects of direct taxation. Due to this divergence, the field of taxation offers an opportunity to examine the interaction between primary and secondary Union law in very different contexts. The VAT Directive, may, in principle, have greater potential to be at odds with various norms of primary law merely because of the fact that the large number of specific rules it contains are more likely to come into conflict with other, higher ranking norms than the much fewer provisions of the direct tax directives. On the other hand, the direct tax directives may also infringe, at least in theory, primary EU law norms due to their limited – some say deficient – scope which may leave potential beneficiaries out of their scope and thus, without relief. Hence, the questions and problems that arise in these two areas of taxation with regard to the relationship of primary and secondary law are rather different, which makes taxation an ideal terrain to explore as many of the potential problems as possible.

As far as the analysis of national tax measures in the light of the fundamental freedoms and the State aid rules are concerned, these measures differ in some important respects from other (non-tax) measures. In particular, the fundamental freedoms are interpreted by the Court in a way that they prohibit only discriminatory tax measures but not indistinctly applicable tax provisions which could nevertheless restrict free movement. This is an important difference as compared to non-tax measures which can be caught by the freedoms even when applied equally to cross-border and purely domestic situations. Likewise, the application of the State aid rules to tax measures shows some specifics compared to the application of the same rules to non-tax measures. The best proof of this is the fact that the Commission had issued, as early as 1998, separate guidelines for the application of the State aid rules to measures of business taxation. As will be explained in the forthcoming part of this thesis, the crucial questions in the application of the State aid rules to (direct) tax measures are (i) how

to distinguish selective tax measures from general ones, and (ii) on what grounds *prima facie* selective tax measures may be justified. Selectivity involves a comparability analysis of the same kind as discrimination; the fundamental freedom analysis includes an examination of possible justification of an apparent infringement just as the State aid review. Thus, the analysis of tax measures under the State aid rules and the fundamental freedoms boils down to essentially the same two-stage test. If we take into account, in addition to the common method of analysis, that the fundamental freedoms entail only a discrimination analysis in relation to tax measures, the result is a considerable overlap between the scope of the State aid rules and the fundamental freedoms in cases when they are applied to tax measures. Thus, the field of taxation appears to be a nurturing ground for conceptual challenges inviting legal research which the author of this thesis could not resist.

Finally, there is another reason for which the field of taxation has been chosen as the specific policy area where the general findings of this thesis are put into a concrete context. In particular, as is widely-known and discussed in EU (tax) law circles, the Commission has recently stepped up its efforts as regards tax coordination in the Union by issuing several initiatives either for new harmonizing measures or substantially revamping existing measures.³ Most notably, in 2011, the Commission tabled a proposal for a Directive on a Common Consolidated Corporate Tax Base (CCCTB) proposing a common system for calculating the tax base of companies operating in the EU.⁴ In the same year, the Commission submitted a proposal for a Directive on Financial Transaction Tax,⁵ which failed to receive unanimous support by the Member States; however, 11 of them have been authorized to continue with the introduction of such tax in the framework of enhanced cooperation.⁶ The proposal on this is now pending in the Council.⁷ These developments are important, also, from the point of view of the relationship of primary law and secondary law. As the role of positive integration and in turn, the volume of secondary legislation is expected to grow in the

3. See for an overview ECOFIN Report to the European Council on tax issues, 11802/12, Brussels, 25 June 2012 and for further developments Council of the European Union Press Release 11260/13, 3248th Council meeting Economic and Financial Affairs, Luxembourg, 21 June 2013.

4. COM(2011) 121/4, see European Commission Press Release IP/11/319, European corporate tax base: making business easier and cheaper, Brussels, 16 March 2011.

5. European Commission Press Release IP/11/1085, Financial Transaction Tax: Making the financial sector pay its fair share, Brussels, 28 September 2011.

6. Council Decision 2013/52/EU, see Council of the European Union, Financial transaction tax: Council agrees to enhanced cooperation, Brussels, 22 January 2013, 5555/13, PRESSE 23.

7. Proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax, COM(2013) 71 final, Brussels, 14.2.2013.

field of taxation, the potential for interactions and conflicts between primary and secondary law also increases.⁸ Our research is intended to shed light on the basic rules and principles, as well as some underlying legal-constitutional-political relations in the Union, on the basis of which potential conflicts between the tax harmonization instruments which may come into life and primary Union law can be accessed, understood and solved. In this way, we also hope to lay the foundations for future research on this emerging subject in EU tax law

1.2. Methodology

As it appears from the above introduction to the subject matter, the main inquiries in this thesis are driven by the demand for systematization and conceptualization insofar as we subtract generally applicable rules and principles from the case law, categorize judicial techniques and identify them in different fields of EU law, deduct common methodological features from norms which seemingly use differing methods of analysis, develop an analytical framework with the aim of increasing consistency of application of a norm and define and delimit the scope of potentially overlapping norms. As regards the systematic approach to law, it is normally pointed out that it refers to the current state of affairs of the law. The starting point and the subject matter of such approach is the existing set of norms, the law as it stands, i.e. *lex lata*.⁹ Only a system can be examined by a systematic approach. A systematic approach to EU law presupposes that the latter is a system, that is, a coherent unity of norms. This perception of EU law can be contested. In opposition to the system-nature of EU law one could refer to the fact that it is not complete. An aspect of this non-completeness is related to the fact that the EU was established with the limited aim of economic integration. Its central idea and objective was the internal market and therefore, its competences, activities and the laws that its institutions enacted had all been geared towards that objective. Evidently, the EU has evolved over time into much more than an economic community. Its competences have been greatly enhanced, it has developed policies and activities affecting the most variable aspects of social and political life, such as fundamental rights

8. A good indication for this is that the UK has already challenged the legality of the Council Decision authorizing enhanced cooperation on the Financial Transaction Tax (see pending Case C-209/13 *UK v Council*), which envisages possible challenges to the Directive, if and when adopted, also on substantive grounds, such as restricting the free movement of capital.

9. K. Riesenhuber, *English common law versus German Systemdenken? Internal versus external approaches*, 7 *Utrecht Law Review* 1 (2011), pp. 117-130, at p. 118.

protection, environment, culture, public health, education, employment, justice, immigration and even defence, security and foreign policy. Legal acts or non-binding instruments adopted by the Union may affect all these different areas. Therefore, from the point of view of the reach and scope of EU law, the argument that it is not complete is hardly tenable. Admittedly, in certain areas of law the presence and significance of positive EU rules is still low (e.g. contract law or even direct taxation). While this could cast a doubt as to whether certain specific areas of EU law constitute a coherent whole which could be qualified as a system, it does not call into question that EU law, in general and as a whole, constitutes a legal system. The features which enable EU law to be qualified as a system will be extensively discussed in Chapter 3. Here we only mention a few arguments on the basis of which the system-nature of EU law is usually contested and we show why they are unfounded.

The incompleteness argument may also refer to the fact that the Union's legal order, when perceived in its relations with the national legal systems or international law, exists side by side with other legal orders that make claims for final authority which compete with the similar claim of the Union. This confers on EU law a sort of contested or negotiated normative authority.¹⁰ The fact that the EU exists under the conditions of legal/constitutional pluralism cannot distract from the system nature of EU law. If we accepted such argument, we would have to question the system nature of all the national legal systems as well. Pluralism only means that the various sources of authority in the international legal sphere, amongst them the EU, cannot (any longer) make claims for exclusive sovereignty and authority.

A further doubt can be raised with regard to the system characterization of EU law by reference to its decentralized enforcement. An important characteristic of any collection of legal rules which amount to a legal system is the uniform and consistent application of the law by the authorities entrusted with such task. EU law is enforced, first and foremost, by the authorities and courts of the 28 Member States. This is, undeniably, a potential source of divergence and inconsistency in the application of EU law. As a counterbalance, the Court of Justice of the European Union is entrusted to ensure, as a final arbiter, the uniform interpretation and application of EU law throughout the Union. However, frequently, the Court of Justice itself is accused of being inconsistent in its case law and thereby creating serious

10. M. P. Maduro, *Interpreting European Law: Judicial Adjudication in a Context of Constitutional Pluralism*, European Journal of Legal Studies (EJLS) Vol.1. No. 2 (Working Paper IE Law School WPLS08-02 05-02-2008), p. 1.

uncertainties in the interpretation and application of EU law. While in certain areas of its jurisprudence such criticism may, indeed, be justified, it has to be recalled that an imperfect case law record is not unique to the highest court of the Union. Many national Supreme Courts could face similar criticism, although in their case, no one would question whether the law they apply is a legal system.

Contrary to the critical voices, we consider that the Court of Justice has played an immense and indispensable role in the development and constitutionalization of EU law and thus, it is largely due to the Court that EU law can function as a legal system. It is sufficient to refer here to such fundamental concepts as supremacy and direct effect, which established the autonomous character of EU law and guaranteed its effective enforcement or fundamental rights protection, which played a key role in the constitutionalization of EU law. In addition, the development of the general principles of EU law by the Court has greatly contributed to EU law's featuring as a 'coherent whole'. Such principles have an essential gap filling and interpretative function within the framework of EU law completing the existing positive rules and enhancing their consistent interpretation. In the words of Advocate General Jacobs: "... it is largely by the use of such principles that the Court has been able to fashion the Treaties and Community legislation into a coherent legal order".¹¹

Moreover, the Court treats its own case law as a system. In its decisions, the Court refers to previous cases and treats them as an authority, besides the text of the Treaties and secondary law. Most of the times, it reasons its decisions in the context of previous judgments and makes an effort to fit the new decision in with the underlying rationale of the case law. Thus, the Court presents its body of case law as a coherent whole and approaches it in a systematic manner. Conversely, it is sometimes considered that the fact that the Court uses the teleological interpretation method accompanied by a strong *effet utile* doctrine as its main interpretation method indicates that Union law is "primarily (or even essentially) a functional legal order".¹² True, teleological interpretation plays a dominant role in the Court's jurisprudence; the

11. F.G. Jacobs, *The Evolution of the European Legal Order*, 41 Common Market Law Review (CMLRev) 2 (2004), pp. 303-316, at p. 312.

12. See the reference to such views by Hesselink in M.W. Hesselink, *How many systems of private law are there in Europe? On plural legal sources, multiple identities and the unity of law*, in: Pluralism and European Private Law (L. Niglia ed., Hart Publishing 2013), pp. 199-247; Centre for the Study of European Contract Law Working Paper Series No. 2012-03; Amsterdam Law School Research Paper No. 2012-59; Postnational Rulemaking Working Paper No. 2012-04, at p. 5. Available at SSRN: <http://ssrn.com/abstract=2046964>.

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