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The Future of EU Differentiated Integration: The Tax Microcosm

Maria Kendrick[1]

Abstract

The EU's path of integration sees it adopt harmonising agendas in many areas of EU law. As they touch on areas of Member State sovereignty, these agendas are proving difficult to achieve, either without significant reform, or at all. As a consequence, the future development of EU law in the direction of continued integration is not certain. Differentiated integration may be the viable alternative. The research question this article therefore seeks to answer is: how far should harmonisation go in the EU? In answering this question, the adoption of a case study methodology allows for generalising from a specific example to the wider EU trajectory. Tax embodies the tensions between Member State sovereignty and EU law harmonising agendas, and in the context of the imperative to harmonise caused by the digitalisation of the economy, it is a microcosm. The tax microcosm demonstrates that there are limits to how far harmonisation can go in the EU, and that the future will likely see more differentiated integration.

Key words: Digital Tax, Digital Services Tax, Tax Harmonisation, EU Integration, Differentiated Integration

1. Introduction

"The ultimate – be it manifest, implicit, hidden or unsaid – goal of the European Union is to achieve full supranational integration, and law, policy and politics should bring us there".[2] This statement was made by Pistone in the context of advocating an increase in positive tax integration at the supranational level. The suggestion here is that law, being a manifestation of politics and policy, is to be used for the instrumental purpose of integration. Van Gestel and Micklitz identify an inference that as this occurs with law, so it also occurs with legal scholarship, consequently resulting in a pro-integration perspective adopted by legal research, "… an increased instrumentalisation of European law and legal research has … resulted in a lack of scholarly criticism towards European integration."[3] Advising caution against 'herd behaviour', they argue that "as far as some of the most important developments with respect to European integration are concerned, many legal scholars are not asking the right questions simply because they focus too much on EU lawmakers who see European integration as an ongoing process with no horizon and few constitutional limits."[4] In essence, this caution involves identifying law as being used as an instrument to achieve certain integrative ends, be they social, political and/or economic, and suggesting that legal scholarship can be caught up in this momentum, rather than operating independently to act as a check on the direction in which EU law is developing.[5]

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[2] P. Pistone, 'European Tax Integration: The Need for a Traffic Light at the Crossroads of Law, Policy and Politics', in P. Pistone (ed) *European Tax Integration: Law, Policy and Politics,* IBFD September 2018 xxxvii.

[3] U. Neergaard, R. Nielsen, and L. Roseberry (eds), *European Legal Method – Paradoxes and Revitalisation,* DJOF Publishing (Copenhagen 2011) p9.

[4] U. Neergaard, R. Nielsen, and L. Roseberry (n3) p9.

[5] R. van Gestel and H-W. Micklitz, 'Revitalising Doctrinal Legal Research in Europe: What about Methodology?' in U. Neergaard, R. Nielsen, and L. Roseberry (n3), p55.

The instrumentalisation of scholarship is not, however, a new phenomenon in Europe. The Enlightenment thinkers had been influenced by the philosophers who came before them, and similarly has the Enlightenment influenced the legal and philosophical scholastic thinking which followed.[6] Developing out of an apostatical shift towards the age of reason and rationality,[7] Kant's vision of the achievement of a single cosmopolitan state as a form of civic union[8] has in turn influenced Habermas in his propoundment of a "new narrative from the perspective of a constitutionalisation of international law that follows Kant in pointing far beyond the status quo to a future cosmopolitan rule of law: the European Union can be understood as an important step on the path towards a politically constituted world society."[9] Producing ideas of Idealism and Liberalism which envision the EU as a peacemaker[10] with a distinct role for law in this integrative process,[11] these ideas have promulgated thinking about legal methods in light of broader social and humanistic science approaches.[12]

Although some of these legal theories prominent in Europe, such as natural law, legal positivism and legal realism[13] pre-date the EU's existence, arguably this instrumentalisation has not stopped, with some schools developing subsequently and alongside the EU, such as New Legal Realism and New Formalism, for example.[14] The EU's creation and conception has therefore been influenced by, and has influenced, these theories.[15] As the EU project is one generally recognised as aiming at a steady process of integration through the creation of a 'new legal order'[16] leading to an 'ever closer union',[17] its aim is to achieve a uniform application of EU law. The concept of legal uniformity is defined by Grosswald Curran[18] as the homogenised application of law, which is considered, in light of Berman's analysis[19] to be used for the achievement of a 'new world order'[20] above the level, but presupposing the existence, of the nation State. We can see the influence of the Kantian and Habermas theories here. Within the

6 See, amongst many publications on this subject, M. Trapp, 'Socrates from Antiquity to the Enlightenment' (Ashgate 2007).
7 K. Swanson, 'Apostate: the men who Destroyed the Christian West', (Generations with Vision, USA 2013).
8 'Idee zu einer allgemeinen Geschichte in weltbyrgerlicher Absicht' English translation: 'Idea for a Universal History from a Cosmopolitan Point of View' in Lewis White Beck (ed) Kant On History (New York, Bobbs-Menill 1963) and P. J. Rossi, 'Globalization and Cosmopolitanism: Tracing a Kantian Trajectory to Peace', in I. Malek, S. Shastri and Y. Shastri, (eds) 'Quest of Peace: Indian Culture Shows the Path', Eds. (Delhi, India, Bharatiya Kala Prakashan 2006) pp162-174.
9 Habermas, 'The Crisis of the European Union in the Light of a Constitutionalisation of International Law' (2012) The European Journal of International Law 23:2, 335-348. See also for further examples of Habermas' thinking on this issue, 'A Political Constitution for the Pluralist World Society', in Habermas, 'Between Naturalism and Religion: Philosophical Essays' (Polity 2008).
10 See K. K. Patel, 'Project Europe: A History', (Cambridge University Press 2020) and B. Heuser, 'Brexit in History: Sovereignty or a European Union?' (Hurst & Company, London 2019).
11 The promotion of the rule of law has become the foundation of the 'new world order' according to Louchlin: M. Loughlin, 'The Apotheosis of the Rule of Law' The Political Quarterly 89:4 Oct – Dec 2018, 659-666.
12 U. Neergaard, R. Nielsen, and L. Roseberry (n3), p21.
13 R. van Gestel and H-W. Micklitz, (n5) p30.
14 See V. Nourse and G. Schaffer, Varieties of New Legal Realism: Can a New World Order Prompt a New Legal Theory?' 95 (2009) Cornell Law Review 61-137 and H. Dagan and R. Kreitner 'The New Legal Realism and the Realist View of Law' 43 (2) Law and Social Inquiry (2018) 528-553.
15 U. Neergaard, R. Nielsen, and L. Roseberry (n3), p8.
16 Case 26/62 Van Gend en Loos [1963] ECR 1, para 3.
17 Article 1 TEU.
18 V. Grosswald Curran, 'Romantic Common Law, Enlightened Civil Law: Legal Uniformity and the Homogenization of the European Union*'* (2001) 7 / 63 Colum. J. Eur. L. 111.
19 N. Berman, 'But the Alternative Is despair: European Nationalism and the Modernist Renewal of International Law' (1993) 106 Harv. L. Rev. 1792.
20 Ibid 1794.

Union, this concept usually, and paradigmatically, refers to the uniform application of Union law enacted through unanimous voting, which achieves agreement by all Member States across all policy areas. It is uniformity that is said to be the goal. The epithets of uniformity are harmonisation, convergence and approximation, which in essence mean the same thing: the eradication of difference and the replacement with a single set of rules, principles, practices etc. Fahey suggests that "there are many terms which are synonyms for convergence and it becomes a vast literature of sub-disciplines to seek out commonly used narratives or terms for convergence, harmonisation and unification are two such examples …".[21]

Supranational legislative harmonisation intends to impact upon the differences between the Member States, and therefore the sovereignty of those Member States to legislate in their own territories. Raz, defines sovereignty as comprising a 'double immunity',[22] which he describes thus, "[a]n authority is sovereign if both internal authorities and external authorities acknowledge that they do not have the power to rescind or modify its decisions and rulings"[23] and therefore the State can escape the imposition of 'uniformities'.[24] The desire to maintain State sovereignty creates tensions with the apparently contrary desire for harmonisation in the EU. This can raise questions as to the future direction of the development of EU law.

In this context, Van Gestel and Micklitz question the assumptions which discourage legal scholars, in particular, from taking a critical perspective towards EU integration, "why are there so many implicit assumptions in scholarly legal publications, such as: harmonization of law is good and legal diversity is bad"?[25] This article intends to take a step back from this assumption and try to answer the research question: how far should harmonisation go in the EU? It will suggest that the answer is that there is a limit to EU harmonisation. This limit is identified in the EU's own difficulties in achieving legislative harmonisation. The answer for the future development of EU law, this article will suggest, is differentiated integration. This concept suggests that rigid adherence to uniformity is not necessary. Whilst there are many definitions, in essence, as Ott suggests, it is a "model of integration strategies that try to reconcile heterogeneity within the European Union and allow different groupings of Member States to pursue an array of public policies with different procedural and institutional arrangements".[26] The advantage of differentiated integration, is that it provides a means to consider integration from an alternative perspective.

In exploring the future of EU differentiated integration, this article adopts a research design comprising an innovative dual methodology, deployed rigorously to try to answer the research question. It includes consideration of historical attempts at legislative harmonisation and the

[21] E. Fahey, *Introduction* in E. Fahey (ed), 'Framing Convergence with the Global Legal Order: The EU and the World' (Hart Publishing 2020) p8.
[22] J. Raz, 'The Future of State Sovereignty' (2017) King's College London Law School Research Paper 2017-42, Columbia Public Law Research Paper 14-574, and Oxford Legal Studies Research Paper 61/2017, 21 November 2017, revised 1 February 2018, 7.
[23] Ibid 15.
[24] Ibid 15.
[25] R. van Gestel and H-W. Micklitz, (n5) p35.
[26] A. Ott, 'EU Constitutional Boundaries to Differentiation: How to Reconcile Differentiation with Integration?' in A. Ott and E. Vos (eds), *Fifty Years of European Integration: Foundations and Perspectives* (T.M.C. Asser Press 2009) 113. See also, amongst others, R. Adler-Nissen, *Opting Out of the European Union: Diplomacy, Sovereignty and European Integration* (CUP 2014) 2, referring to A. Kölliker *Flexibility and European Unification: The Logic of Differentiated Integration* (Lanham, Rowman and Littlefield 2006).

need to resort to differentiated integration. History is important,[27] because as this issue's introduction states, "[m]ost significant interventions in the field of EU law have predominantly always been backwards looking and historical, given the nature of integration - perpetually in want of a narrative to explain and expound its significance". Collingwood,[28] in advancing his principles of historical methodology, propounded that copy and paste history is not accurate history, but rather advocated referring to original sources.[29] This article therefore utilises sources, such as draft legislative proposals, Commission policy documents and impact assessments to answer the research question.

History is only one element of the research design, as the intention of this article is not just to produce an historical narrative, but a past, present and future narrative. To learn lessons from the past and provide that future narrative, this article will draw on Yin's exposition of the case study methodology,[30] which provides the lens through which to consider the issues of integration, harmonisation and differentiated integration occurring in one area of EU law, and from which lessons can be learnt and applied to other areas, via the process of analytic generalisation. Yin describes this as "the logic whereby case study findings can extend to situations outside the original case study, based on the relevance of similar theoretical concepts or principles".[31] This will assist in future-mapping the development of EU law in one, and consequently other, areas of EU law.

As sovereignty asks which legal order should actually be supreme; the national or the supranational, it implies issues of territoriality as the "boundary line is the line of sovereignty".[32] The paradigmatic quality of a sovereign body is the power to tax,[33] because it is inextricably linked with the power to govern. Tax encapsulates this issue and is therefore a microcosm. The EU has a tax harmonisation agenda[34] precipitated by digitalisation of the economy,[35] but experiences reluctance from Member States to adopt it, or aspects of it. In taxation, it is therefore possible to map shifts in law-making and competence. The Commission and the EU have tried to utilise differentiated integration, such as enhanced cooperation[36] for the financial transaction tax,[37] transition periods for the Interest and Royalties Directive,[38]

[27] On the importance of the historical perspective see K. K. Patel, 'Project Europe: A History', (Cambridge University Press 2020) and B. Heuser, 'Brexit in History: Sovereignty or a European Union?' (Hurst & Company, London 2019).
[28] R. G. Collingwood, *An Autobiography* (first published 1938, OUP 1964).
[29] Ibid 62.
[30] R. K. Yin, Case Study Research: Design and Methods (Cosmos Corporation, 5th edn, SAGE Publications 2014).
[31] Ibid, 237.
[32] J. H. Beale, 'Jurisdiction to tax' (1919) 32 Harvard Law Review 587, 587-8.
[33] Ibid 588.
[34] Commission, 'Communication from the Commission to the European Parliament and the Council: A Fair and Efficient Tax System in the European Union for the Digital Single Market' COM (2017) 547 final.
[35] See W. Haslehner, G. Kofler, K. Pantazatou and A. Rust (eds), 'Tax and the Digital Economy: Challenges and Proposals for Reform' Series on International Taxation, No. 69, (Kluwer Law International 2019).
[36] Articles 20 TEU and 326 to 334 TFEU.
[37] Council Decision 2013/52/EU authorising enhanced cooperation in the area of financial transaction tax [2013] OJ L 22/11.
[38] Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States [2003] OJ L 157/49 and A. Cedelle, 'Enhanced Cooperation: A Way Forward for Tax Harmonisation in the EU?' Oxford University Centre for Business Taxation, October 2015, WP 15/33 reprinted from J. Englisch (ed), 'International Tax Law: New Challenges to and from Constitutional and legal Pluralism' (IBFD 2016) chapter 6.

minimum harmonisation with the Anti-Tax Avoidance Directive,[39] transition periods and minimum harmonisation for VAT,[40] and possibly minimum harmonisation or enhanced cooperation for the Common Consolidated Corporate Tax Base (CCCTB).[41] As will be explained in the following sections of this article, the necessity created by digitalisation of the economy[42] and a purported desire to make corporation tax 'fairer',[43] means that the Digital Services Tax (DST)[44] is the interim proposal to permanent restructuring including the CCCTB.[45] Therefore, if the CCCTB is likely to use differentiated integration the DST may also.[46] Digitalisation may increase the need for differentiated integration in future in the area of taxation. In answering the research question, this article will demonstrate that there is a limit to how far harmonisation should go in the EU, and that in future-mapping developments in EU law, more differentiated integration will be used. Tax, as a microcosm, shows this to be the case.

2. Future-mapping Differentiated Integration: The Tax Microcosm

A combination of globalisation[47] and the increasing emergence of the digital economy has prompted the EU to advertise a harmonisation agenda in the field of tax,[48] with the desire of the EU to increase its own resources, especially prominent in the context of Covid-19,[49] being an additional motivation. This agenda includes integration in the area of VAT, not yet fully achieved despite several decades in attempting to do so,[50] integration in the area of corporate

[39] Council Directive 2016/1164/EU of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market [2016] OJ L 193/1 and P. Pistone (n2).
[40] On which see analysis in the next section of this article.
[41] Commission 'Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB)' COM (2016) 683 final, Commission 'Proposal for a Council Directive on a Common Corporate Tax Base (CCTB)' COM (2016) 685 final (hereinafter "CCCTB") and A. Cedell (n38) p37.
[42] Y. Brauner and P. Pistone, "Adapting Current International Taxation to New Business Models: Two Proposals for the European Union," 71(12) Bull. Int'l Tax'n (2017); G. Kofler, G. Mayr, and C. Schlager, "Taxation of the Digital Economy: 'Quick Fixes' or Long-Term Solution?" 57(12) Eur. Taxation (2017); Kofler, Mayr, and Schlager, "Taxation of the Digital Economy: A Pragmatic Approach to Short-Term Measures," 58(4) Eur. Tax'n (2018); and Wolfgang Schön, "Ten Questions about Why and How to Tax the Digitalized Economy,"72(4/5) Bull. Int'l Tax'n (2018).
[43] V. Argyropoulou, 'Digital Tax, Making Enterprises Pay their 'Fair' Share', TILEC Discussion Paper No. DP 2019-007.
[44] Commission 'Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services' COM (2018) 148 final (hereinafter "DST Proposal").
[45] Communication from the Commission to the European Parliament and the Council, 'Time to establish a modern, fair and efficient taxation standard for the digital economy' COM (2018) 146 final, and European Commission, 'Fair Taxation of the Digital Economy' legislative proposals, 21 March 2018 https://ec.europa.eu/taxation_customs/business/company-tax/fair-taxation-digital-economy_en accessed 16 June 2020.
[46] A. Cedelle suggests it is "unavoidable" (n38) p37 and see also M. Lang 'The Principle of Territoriality and its Implications in the Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB)', WU International Taxation Research Paper Series No. 2012-09, p3.
[47] On which see E. Fahey, The Global Reach of EU Law (Routledge 2016) and A. Bradford, The Brussels Effect: how the European Union rules the World (OUP 2020).
[48] See Communications from the Commission (n34) and (n45).
[49] S. Stolton, 'Commission mulls digital tax to fund Europe's multi-billion euro recovery' (Euractiv 27 May 2020) https://www.euractiv.com/section/digital/news/commission-mulls-digital-tax-to-fund-europes-multi-billion-euro-recovery/ accessed 16 June 2020 and O. Stefan's article in this special issue.
[50] The lack of harmonisation has been recognised in the CJEU by Advocate General Sharpston, who stated that the 'somewhat cloudy legislative environment characterised by tension between a drive towards fiscal harmonisation at EU level and a desire of individual Member States for individual fiscal control' has resulted in this situation, C-434/05 Horizon College [2007] ECR I-04793, Opinion of AG Sharpston, paragraph 35.

tax, anti-tax avoidance, information sharing, and as an interim solution, a digital services tax.[51] The EU's digital strategy with regard to VAT, aims to use the impetus of the digital economy to adapt to a 'definitive' system[52] which, as will be discussed in more detail below, it has so far failed to achieve.[53] The DST overlaps with the EU's plans for reform of corporation tax, which includes proposals for a CCCTB.[54]

I. The Harmonisation Agenda

The DST has been described by the Commission as an 'interim' less preferred option to a comprehensive policy, which would see harmonisation of EU law on the subject of digital permanent establishments and profit allocation rules being incorporated into its proposals on the CCCTB.[55] The proposal for a common consolidated corporate tax base envisions harmonisation to the corporate tax base only, not corporate tax rates, including a facility to opt-in.[56] According to Lang, it is a relatively broad and ambitious proposal,[57] which has so far failed to be implemented in the EU, with many Member States opposed. It is because of the difficulty in achieving harmonisation of corporate tax on a broad scale, that use of differentiated integration has been considered,[58] and an interim digital services tax suggested.

The DST is proposed on the legal basis of Article 113 TFEU, which provides for the harmonisation of indirect taxation to the extent necessary to ensure the establishment and functioning of the internal market and the avoidance of distortion of competition. The Commission, in its Impact Assessment, states that the choice of Article 113 TFEU is justified as "ensuring that an immediate and harmonised response at EU level is provided to some of the identified problems [identified essentially as inadequate tax rules for the digital economy]. Additional fragmentation and distortions of competition could arise if unilateral actions were implemented by Member States before a comprehensive solution can be agreed. This requires the creation of a harmonised legislative framework within the EU concerning a new tax on digital activities. Given its (preferred) features, this tax would have more elements of an indirect tax, so it would need to be treated as an indirect tax other than turnover taxes and excise

[51] See Commission documents at (n34), (n44) and (n45) as well as Commission 'Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence' COM (2018) 147 final, Commission Recommendation of 21 March 2018 relating to the corporate taxation of a significant digital presence, COM (2018) 1650 final and Communication from the Commission to the European Parliament and the Council, 'Time to establish a modern, fair and efficient taxation standard for the digital economy' COM (2018) 146 final.

[52] European Commission Press Release, 'Towards a new and definitive VAT system for the EU, Brussels, 4 October 2017 https://ec.europa.eu/commission/news/towards-new-and-definitive-vat-system-eu-2017-oct-04_en accessed 16 June 2020.

[53] See, amongst others, A. J. Easson, 'The Elinimation of Fiscal Frontiers', in R. Bieber et al (eds), *One European Market? A Critical Analysis of the Commission's Internal Market Strategy,* (Baden-Baden: Nomos Verlagsgesellschaft, 1988) 241-260, at 260.

[54] Commission Staff Working Document Impact Assessment, Accompanying the document: Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence {COM(2018) 147 final}; and Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services {COM(2018) 148 final} {SWD(2018) 82 final} Brussels, 21.3.2018 SWD(2018) 81 final/2 (hereinafter "Impact Assessment"). See also CCCTB (n41).

[55] Impact Assessment (n54), see also (n45).

[56] M. Lang, (n46) p3.

[57] M. Lang, (n46).

[58] M. Lang, (n46).

duties".[59] There is debate[60] over whether the DST is a consumption tax, rather like VAT, or a turnover tax, contrary to the Commission's explanation[61] or whether it fills gaps in VAT.[62] Whilst this raises issues of competence to harmonise with the DST itself, this will be discussed further in the next section. It suffices for present purposes to consider the DST in the context of being the lesser preferred interim option.

In contrast to the DST, the legal basis for the comprehensive solution is Article 115 TFEU, which provides for approximation (harmonisation) of such laws of the Member States as directly affect the establishment or functioning of the internal market. Whilst this, like Article 113 TFEU, depends on unanimity in the Council and the special legislative procedure for its enactment, one can question whether it is sufficient in terms of EU competence to provide the legal basis for the Commission's aims of "introducing a comprehensive and modern framework for the taxation of the digital economy to address structurally the root-cause of the issue [of digitalisation]"[63] in a way which would "change the way the taxable nexus is established and profit is allocated to the taxable nexus. This approach could also be integrated into the CCCTB to provide for a comprehensive reform of the corporate income tax system…".[64] It is the extent of this proposed resolution to the issue of the digitalisation of the economy, especially as the Commission makes it clear in its impact assessment that the proposed CCTB / CCCTB would be in addition to specific digitalisation focused EU law,[65] that is causing the issues with achieving harmonisation. The Commission does not stop there, as there are other potential options for proposals that reach even further, including a unitary corporate tax with potential convergence with international models, specifically anticipating action via the OECD.[66] It is anticipated that in order to achieve what the Commission describes as global 'alignment' the proposals would anticipate an "approach [which] should be quite broad and flexible, while still providing Member States with a solid base to tax digital activity".[67]

What is problematic is that not a lot of explanation is given as to why the proposed level of integration, especially as to the comprehensive solution, should be enacted on these legal bases.[68] The stated reason relates more generally to why taxation needs to adapt to modern developments of digitalisation, rather than specifically as to why the extent of EU integration being proposed is the best solution. To answer the research question posed by this article, integration is not limitless. Rather, it is, and quite rightly so in accordance with the Treaties, dependent on the extent of conferred EU competence. This is why the choice of legal basis is important. Indeed, as Eckes observes, "[w]ithin the European Union, the choice of legal basis has constitutional significance. It is the manifestation of an omnipresent political struggle of who is in charge. … The choice of legal basis is highly relevant within the EU legal order

[59] Impact Assessment (n54) p20.
[60] See Y. R. Kim, 'Digital Services Tax: A Cross-Border Variation of the Consumption Tax Debate', University of Utah College of Law Research Paper No. 371 (2020) and V. Argyropoulou (n43).
[61] Daniel Bunn, 'A Summary of Criticisms of the EU Digital Tax' Tax Foundation, 2018, p2.
[62] B. R. Zegarra, 'The Interactions Between VAT and the Digital Services Tax Regime in Market Jurisdictions: Is the DST Filling the Gap Regarding the Taxation of the Digital Economy?' 60 European Taxation 7 (2020) IBFD Journals section 1 and I. Roxan, 'Is VAT Also a Corporate Tax? Untangling Tax Burdens and Benefits for Companies' LSE Legal Studies Working Paper 2/2020 (16 March 2020).
[63] Impact Assessment (n54) p20.
[64] Impact Assessment (n54) p20.
[65] See generally Impact Assessment (n54).
[66] See generally Impact Assessment (n54).
[67] Impact Assessment (n54) p43.
[68] See, Michael P. Devereux and John Vella, 'Taxing the Digitalised Economy: Targeted or System-Wide Reform?' British Tax Review Issue 4 (2018) 387

because the Union may only act within the competence conferred to it."[69] Taxation, demonstrates some dubious choices as to the legal basis on which to develop EU law and integration, particularly in the field of corporate tax, which should arguably be an express competence in itself rather than relying on general internal market justifications in the legal bases selected. Whilst it is true that development of the internal market has been an impetus historically, the current proposals extend far beyond this. Therefore, in answering the research question, the tax microcosm shows that generally worded legal basis relating to harmonisation connected with the internal market should not be used to provide the legal basis to extend EU law into a new field and attempt to harmonise it.

The difficulty in trying to achieve harmonisation, especially to the extent proposed, means that differentiated integration, which is a feature of the Union's constitutionalized structure[70] is much more realistically, and arguably more legitimately, achievable. Transition periods and minimum harmonisation, being legal forms of differentiated integration, have been the response to the difficulty in achieving integration, sometimes combined with information sharing. 'Minimum' harmonisation measures set a floor above which Member States are free to differentiate, usually by applying stricter or more far-reaching standards.[71] In essence, Member States retain the competence to either keep the more stringent measures they already have in place, or adopt new measures. VAT, is held up as the paradigmatic example of the process of harmonisation of tax law in the EU, but has seen the use of both differentiation mechanisms. The Commission, by its own admission, does not consider the EU VAT system to be definitive and totally harmonised.[72] Even in the follow up to the Action Plan on VAT, the Commission states that the VAT system in the EU has been based on the transitional arrangements form of differentiation, "[t]oday, the EU VAT system is too fragmented and too prone to fraud. As part of its agenda for a fair and efficient tax system in the EU, the Commission aims at rebooting the VAT system to ensure it remains an asset for the future."[73]

The historical emergence of VAT, including differentiation, began in the 1960s, with the Newmark Committee's report recommending the harmonisation of sales taxes into VAT.[74] The European Commission responded to the report by producing a draft Directive[75] for partial harmonisation. Essentially, the European Commission was proposing a common form of tax for business-to-business transactions only, to be introduced in several stages over a number of

[69] C. Eckes, 'EU Powers Under External Pressure: How the EU's External Actions Alter its Internal Structures' Oxford studies in European Law (Oxford University Press 2019) p113 and Article 5 (2) TEU.
[70] S. Weatherill, 'Cases and Materials on EU Law' 12th edn (OUP 2016) p573.
[71] E. Vos, 'Differentiation, Harmonization and Governance' in B. De Witte, D. Hanf and E. Vos, *The Many Faces of Differentiation in EU Law* (Intersentia 2001) 148.
[72] See Commission 'Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee: On the follow-up to the Action Plan on VAT, Towards a single EU VAT area -Time to act' COM (2017) 566 final, (hereinafter "VAT Action Plan follow-up").
[73] VAT Action Plan follow-up (n72) at 3. See also Commission 'Action Plan on VAT Towards a single EU VAT area – Time to decide' COM (2016) 148 final. From the initial Action Plan, outlined in April 2016, the Commission made several proposals for implementation, including: 'Proposal for a Council Directive amending Directive 2006/112/EC and Directive 2009/132/EC as regards certain value added tax obligations for supplies of services and distance sales of goods' (COM(2016) 757 final; 'Proposal for a Council Implementing Regulation amending Implementing Regulation 282/2011/EU laying down implementing measures for Directive 2006/112/EC on the common system of value added tax' COM (2016) 756; 'Proposal for a Council Regulation amending Regulation 904/2010/EU on administrative cooperation and combating fraud in the field of value added tax' COM (2016) 755; and 'Proposal for a Council Directive amending Directive 2006/112/EC as regards rates of value added tax applied to books, newspapers and periodicals' COM (2016) 758.
[74] Neumark Report 'Report of the Fiscal and Financial Committee on Tax Harmonization in the Common Market' Report 21, Document SD-32 (EEC Commission, 1962).
[75] [1964] OJ 2512.

years. This proved to be too hesitant an approach, and the European Commission produced more comprehensive proposals in 1965,[76] which were adopted in early 1967, and became the First and Second VAT Directives.[77]

The First VAT Directive was fundamental to the VAT system, because it contained the principles on the basis of which the system was ultimately designed.[78] The Recitals to the First VAT Directive stated, and Articles 2 and 5 of that Directive enacted,[79] what could be considered a mechanism of differentiated integration in the form of a transitional arrangement or, with hindsight, a form of the minimum harmonisation mechanism. It provided that:

> Whereas, however, the application of that tax to retail trade might in some Member States meet with practical and political difficulties; whereas, therefore, Member States should be permitted, subject to prior consultation, to apply the commom [sic] system only up to and including the wholesale trade stage, and to ap- ply[sic], as appropriate, a separate complementary tax at the retail trade stage, or at the preceding stage;
>
> Whereas it is necessary to proceed by stages, since the harmonisation of turnover taxes will lead in Member States to substantial alterations in tax structure and will have appreciable consequences in the budgetary, economic and social fields.[80]

Although the purpose of the Second VAT Directive,[81] was to set out more of the necessary details, it only addressed some of the issues which would require resolution in order to establish a truly common form of VAT. It allowed Member States to retain significant derogations from a Community wide version of VAT. The main differences between the Member States which the Second VAT Directive maintained, related to the tax base. The Member States retained the discretion to decide which goods and services were going to be subject to the tax and which were to going to be exempted from it.[82] Furthermore, the Directive stated, at Article 10(3), that "Each Member State may, subject to the consultations mentioned in Article 16, determine the other exemptions which it considers necessary".[83] According to Williams, there was consequently a 'fundamental deficiency' in the 1967 framework.[84] Article 13 of the Second VAT Directive also provided for derogations, and Article 17 was a fine example of the transitional provision mechanism of differentiated integration. The Annexes to the Second VAT Directive also provided for exemptions to the tax base. Other national differences which were maintained related to identifying who should be subject to VAT, and how VAT was to be applied to both imported goods and cross-border supplies of services.[85] Differentiation applied to the tax rates as well as the tax base.

[76] [1966] OJ 561. Also see D. Williams, *EC Tax Law* (European Law Series, Longman 1998) 80-1.
[77] First Council Directive 67/227/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes [1967] OJ 1301/67, Spec Ed 14, (hereinafter "First Directive") 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 [1967] OJ 1303/67 Spec Ed 16 (hereinafter "Second Directive").
[78] Recitals and first two Articles, First Directive (n77).
[79] First Directive (n77).
[80] First Directive (n77).
[81] Second Directive (n77).
[82] D. Williams, (n76) 82.
[83] Article 10 (3) Second Directive (n77).
[84] D. Williams (n76) 82.
[85] D. Williams (n76) 82.

However, the pressure for harmonisation of the VAT tax base came not from concerns about competition distortions, but from the then Community's need to find itself an income and the subsequent 1970 Decision introducing the Community's Own Resources.[86] In light of this imperative to raise funds, the Community viewed the maintenance of so many exceptions as unsustainable. Change needed to occur. The Sixth VAT Directive[87] was the instrument chosen by the then Community to effect such change. However, Williams considers that this 'still fell far short of being the same tax in each state',[88] because important Member State derogations remained.[89] Although the Community had succeeded in providing itself with an income, the system was not exactly one of total harmonisation. In fact, many of the terms depended on national law for their definition, 'taxable person' being one such example, and the narrow patchwork tax base continued, providing the Member States with the ability to introduce other taxes, such as stamp duties, for example.

Other Directives followed and so between 1992 and 2006, the European Commission made several efforts to rationalise the VAT Directives, including attempts to harmonise VAT rates[90] and abolish the Member State-specific derogations.[91] However, the Member States could not agree on any of these proposals, and they were subsequently abandoned. As a result, the rate variations and derogations of the 1992 VAT Directive were maintained, mostly unchanged, in the current Principal VAT Directive.[92] In 2011, after nearly twenty years of failed efforts to further harmonise VAT rates and abolish these country-specific exemptions, the European Commission and the Member States concluded that the transitional approach should instead become the "definitive" system.[93] History demonstrates the EU's difficulties in its attempts to harmonise VAT. This conclusion is reinforced by the fact that when the Commission issued new proposals entitled, 'Towards a single EU VAT area',[94] it stated that 'The current VAT system dates from 1993 and was intended to be a transitional system. It is fragmented and overly complex for the growing number of businesses operating cross-border … domestic and cross-border transactions are treated differently and goods or services can be bought free of VAT within the Single Market'.[95] VAT is an example of where an historical assessment of the process of harmonisation in tax demonstrates that there is more differentiation than one might think, essentially due to the difficulty of achieving unanimous agreement between all the Member States.

[86] Council Decision 70/243/ECSC/EEC/Euratom of 21 April 1970 on the Replacement of Financial Contributions from Member States by the Communities' Own Resources [1970] OJ L 94/19 Spec Ed 224.
[87] Sixth Council Directive 77/388/EEC 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 [1977] OJ L 145/1 (hereinafter "Sixth Directive").
[88] D. Williams (n76) 82-3.
[89] Article 20 of the Sixth Directive (n87).
[90] [COM (1996) 328];
[91] [COM(2003) 397 final]. See also on the lack of total harmonisation in relation to VAT and the Commission's efforts to resolve this, R. de la Feria, 'VAT and the EC Internal market: The Shortcomings of Harmonisation' in D. Weber (ed.), Traditional and Alternative Routes to European Tax Integration (Amsterdam: IBFD, 2010), 267-308 and Oxford University Centre for Business Taxation Working Paper, WP09/29.
[92] EU Principal VAT Directive (Council Directive 2006/112/EC of 28 November 2006 on the common system of values added tax [2006] OJ L 347/1 as amended.
[93] Rita de la Feria, 'The Definitive VAT System: Breaking with Transition' 27 (3) (2018) EC Tax Review 122, at 122.
[94] See the legislation detailed at (n72) and (n73).
[95] European Commission Press Release 'European Commission proposes far-reaching reform of the EU VAT system' (Brussels, 4 October 2017).

II. The Digitalisation Imperative

Considering the past, present and future of tax harmonisation, it is pertinent to analyse the current state of play with VAT. The EU is trying to achieve harmonisation in the context of its attempts to achieve a digital single market.[96] The Commission has therefore produced proposals, commencing with its 2016 VAT Action Plan,[97] to introduce provisions for the implementation of the legal 'cornerstones',[98] that aim to achieve a definitive VAT system by 2022, introducing reforms in a piecemeal fashion, some applying from 1 January 2019 and others due to come into effect from 1 January 2021.[99] The success of the current proposals,[100] and their influence upon future-mapping the development of EU law, depends on whether the EU's integrative methods are successful, as de la Feria suggests, "[l]ike with previous initiatives regarding the EU VAT system, success is largely dependent on the Commission's ability—or inability—to harness critical economic and political moments in EU history for real reform. At present it seems that the digitalisation of the economy may succeed where others have failed".[101]

The digital imperative is leading to a shift in focus of VAT to a destination, rather than an origin, based tax. The failure to achieve a definitive VAT system based on the 'origin' principle of taxation of cross-border supplies of goods in the Member States of their origin, is 'one of the most important and obvious' failures of the harmonisation attempts in the field of VAT, according to Owsiany-Hornung.[102] As this article attempts to map the future development of EU law, we again see that differentiation is needed with regard to the destination principle, as in respect of both VAT rates[103] and the VAT base, there is still a lack of harmonisation in the new proposals, which de la Feria suggests leaves VAT in a state of 'disharmonisation', "they are based on the wrong assumption, namely that full destination-based taxation removes the need for harmonisation of the base. It is true that taxation at destination is likely to remove the incentives to re-location; but wrong to infer that these incentives are the only reason for

[96] European Commission, A Digital Single Market Strategy for Europe, Communication from the Commission to the European Parliament, the Council, the EESC and the Committee of Regions, COM (2015) 192 final, 6 May 2015. See also, Florian S. Zawodsky 'Value Added Taxation in the Digital Economy' British Tax Review Issue 5 (2018) 606.

[97] See the legislation detailed at (n72) and (n73).

[98] European Commission Press Release (n95).

[99] See the legislation detailed at (n72) and (n73) and: European Commission, Proposal for a Council Directive amending Directive 2006/112/EC as regards harmonising and simplifying certain rules in the value added tax system and introducing the definitive system for the taxation of trade between Member States, COM(2017) 569 final, 4 October 2017; Council Directive (EU) 2017/2455 of 5 December 2017 amending Directive 2006/112/EC and Directive 2009/132/EC as regards certain value added tax obligations for supplies of services and distance sales of goods, OJ L 348, 29.12.2017, p. 7- 22; Council Implementing Regulation (EU) 2017/2459 of 5 December 2017 amending Implementing Regulation (EU) No 282/2011 laying down implementing measures for Directive 2006/112/EC on the common system of value added tax, OJ L 348, 29.12.2017, p. 32–33; and Council Regulation (EU) 2017/2454 of 5 December 2017 amending Regulation (EU) No 904/2010 on administrative cooperation and combating fraud in the field of value added tax, OJ L 348, 29.12.2017, p. 1-6.

[100] See the legislation detailed at (n72), (n73), (n99) and Commission 'Towards a single EU VAT area - Time to act - Amended proposal for a Council Regulation amending Regulation (EU) No 904/2010 as regards measures to strengthen administrative cooperation in the field of value added tax COM (2017) 706 final. For a further account see I. Lejeune and C. A. Herbain, 'Recent developments on EU VAT: VAT Digital Single Market package, British Tax Review Issue 1 (2018) and Rita de la Feria (n93).

[101] Rita de la Feria (n93) at 127.

[102] M. Owsiany-Hornung, 'Infringement Procedure as a Tool for VAT Harmonisation' in M. Lang, P. Pistone, A. Rust, J. Schuch, C. Staringer, and D. Raponi, (eds), *CJEU – Recent Developments in Value Added Tax 2016* (Linde 2017) 16.

[103] On which see I. Lejeune and C. A. Herbain A revamped flexibility on VAT rates for Member States British Tax Review Issue 2 (2018) 161.

harmonising VAT rates, and thus that their removal somehow legitimises disharmonisation. As the Commission implicitly acknowledges, the proposed disharmonisation is expected to increase the levels of both rates discrepancy – across Member States –, and rates differentiation – across products – but as opposed to what it argues, these increases can have far reaching effects … It is therefore difficult to see how this proposal can in any way improve the functioning of the Internal Market or remove distortions to competition, as required by Article 113 TFEU. To use that Article as a legal basis for the proposal seems, therefore, to be in strict contravention of the EU principle of conferral of powers."[104]

The research question which this article seeks to try and answer, is how far should harmonisation go in the EU? If tax is generally thought of as a Member State competence, as illustrated by the limited options for legal bases for the reforms, then the answer should be not very far, and/or there should be increased differentiation. In light of the imperative of digitalisation, as de la Feria forcefully illustrates, differentiation seems to have been deliberately adopted. Treating tax as a microcosm and applying the analytic generalisation aspect of the case study methodology, it is then possible to future map the development of EU law by suggesting that use of differentiated integration will increase.

The DST reinforces this conclusion. In its Communication to the European Parliament and Council on 'A Fair and Efficient Tax System in the European Union for the Digital Single Market',[105] the Commission declared the establishment of the digital single market as one of its ten political priorities. This was in 2017.[106] Since then, the DST,[107] explained previously as an interim measure forming part of the harmonising agenda in taxation, has so far failed to be adopted, following a negative vote in the Council in March 2019.[108] This is even on a proposal of limited scope, which had reduced the DST to a sales tax on digital advertising services.[109] The previous, comparatively extensive, proposal was for a uniform tax rate of 3%[110] on revenues generated by selling online advertising space, from digital intermediary activities between users for facilitating the sale of goods and services, and from the sale of data generated from the user-provider information.[111] It would have applied only to companies with total worldwide revenues above 750 million Euros and EU revenues of 50 million Euros.[112]

The reasoning behind attempting to adopt an EU wide DST, in the absence of an international DST achieved through the OECD, is to obtain harmonised application of such taxation so as to, according to the stated objective of the proposal,[113] protect the integrity of the single market and to avoid the fragmentation which would occur if the Member States adopted their own DSTs on an individual basis.[114] Seemingly contrary to this intention, is the Joint Declaration

[104] Rita de la Feria (n93) at 127-8.
[105] Commission Communication (n34).
[106] Commission Communication (n34).
[107] See Council of the European Union, Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services – General approach, Doc. No. 14886/18 FISC 511 ECOFIN 1149 DIGIT 239, 29 November 2018.
[108] Outcome of Council Meeting 7368/19, 6 (March 12, 2019)
[109] European Parliament Briefing, 'Interim digital services tax on revenues from certain digital services, December 2018.
[110] DST proposal (n44) Article 8.
[111] DST Proposal (n44) Article 3.
[112] DST Proposal (n44) Article 4
[113] DST proposal (n44) Preamble, p3
[114] M. Lamensch, Digital Services Tax: A Critical Analysis and Comparison with the VAT System, 59 European Taxation 6 (2019) section 2.1, Journals IBFD published online 17 May 2019.

submitted by France and Germany at the 4 December 2018 ECOFIN Council meeting,[115] which urged the adoption of a DST on the more limited tax base described as 'referring to advertisement',[116] but stated that a Directive enacted on this basis 'would not prevent Member States from introducing in their domestic legislation a digital tax on a broader base',[117] which France, among other Member States, has subsequently done.[118] The first, most obvious observation, is that such a limited approach may seem a contradiction to the stated objective of protecting the integrity of the single market. This observation is however crucial when considering the legal basis for this proposal is Article 113 TFEU, which permits EU legislative integrative action to the extent that it is necessary to ensure the establishment and the functioning of the internal market. In essence, if the eventual DST, should it actually be adopted along the lines of the French – German proposal, permits or even encourages fragmentation then it is questionable – in addition to the issue as to whether the DST is in fact an indirect tax[119] - whether this is an appropriate legal basis,[120] as the tax seems to aim at achieving a fragmentation contrary to the justification for EU action contained in the Treaty Article itself. However, this is another instance where tax can be seen as a microcosm of the issues surrounding differentiated integration. What one could argue is proposed by France and Germany is a Directive which could become a minimum harmonisation measure, providing for a DST and setting the rate at 3% with the same revenue thresholds, but limiting the tax base to advertisements, thereby allowing Member States to differentiate outside of this. As minimum harmonisation is a recognised form of differentiated integration[121] permitted by the Treaty, maintaining differing systems in a sensitive area of Member State sovereignty can help provide a solution. Differentiated integration can be a solution in the case study of tax and therefore can be analytically generalised to answer the wider question of how far should integration go in the EU. The future development of EU law is an increased use of and reliance on differentiated integration.

It is pertinent to reiterate, as discussed earlier in this article, that the DST was not the Commission's most desirable option for addressing the digitalisation of the economy. On the contrary, the DST has been described by the Commission as an 'interim' less preferred option to a comprehensive policy, which would see harmonisation of EU law on the subject of digital permanent establishments and profit allocation rules being incorporated into its proposals on the CCCTB.[122] This solution was preferred, in part to prevent what has subsequently happened, which is some Member States, and the UK as well, implementing their own versions of a DST, although at varying tax rates and varying qualifying revenue thresholds.[123] The alternative for

[115] The text of the Declaration entitled 'Franco-German joint declaration on the taxation of digital companies and minimum taxation' is available at https://www.consilium.europa.eu/media/37276/fr-de-joint-declaration-on-the-taxation-of-digital-companies-final.pdf accessed July 2020.
[116] Joint Declaration, (n115).
[117] Joint Declaration, (n115).
[118] See M. Szczepanski, 'Digital Taxation: State of Play and Way Forward' European Parliamentary Research Service Blog, 19 March 2020 https://epthinktank.eu/2020/03/19/digital-taxation-state-of-play-and-way-forward/ accessed 15 July 2020.
[119] On which see M. Lamensch (n114).
[120] J. Backer and J. Englisch, 'EU Digital services Tax: A Populist and Flawed Proposal' Kluwer International Tax Blog, 16 March 2018 http://kluwertaxblog.com/2018/03/16/eu-digital-services-tax-populist-flawed-proposal/?doing_wp_cron=1594366177.2683420181274414062500 accessed 11 July 2020.
[121] Vos (n26).
[122] Impact Assessment (n54).
[123] HM Revenue and Customs Digital Services Tax policy paper, 11 March 2020 https://www.gov.uk/government/publications/introduction-of-the-digital-services-tax/digital-services-tax accessed 17 June 2020 and Elke Asen, 'Digital Tax Update: Digital Services Taxes in Europe' Tax Foundation, 16 March 2020, https://taxfoundation.org/digital-tax-europe-2020/ accessed 17 June 2020.

the EU is to attempt to influence[124] and achieve agreement to global initiatives by the end of 2020, failing which it is back to the drawing board to attempt an EU wide solution yet again.

That the so far failed attempts to introduce the DST were as a result of the current unsuccessful attempts to introduce the 'comprehensive' solution to the digitalisation of the economy, which would have incorporated some harmonisation to taxation in the corporate sphere, speaks volumes for the future-mapping of differentiated integration. The fact that the EU's harmonising and integrative attempt has so far failed to introduce, not just this comprehensive proposal, but also a reduced form of the lesser preferred interim solution, does seemingly cast aspersions on the prospects of achieving total harmonisation in the future. Again, there will be a greater need for differentiation in future. Analytic generalisation provided through the case study methodology informs this mapped future. As this article has demonstrated, tax is a microcosm, from which it is possible to analytically generalise, suggesting that there are other areas of EU law which may find their future development in the direction of harmonisation equally difficult to achieve, and therefore differentiated integration should feature more significantly in the future than it has in the past.

3. Conclusion

In answering the research question, how far should integration go in the EU?, there are lessons to be learned from history and the application of the case study methodology, particularly analytic generalisation. This article has demonstrated that there are limits to harmonisation and in actual fact it appears that the more the EU tries to harmonise the more it requires the use of the mechanisms of differentiated integration. The lesson that can potentially be learnt from the tax microcosm, is that differentiated integration will need to be utilised more in the future. This is especially so, if the EU attempts to integrate through legislative harmonisation in areas which impact on Member State sovereignty.

[124] On which see A. Bradford, (n47).