



HM TREASURY

**The Government's review of  
the balance of competences  
between the United Kingdom  
and the European Union:**

**call for evidence on taxation**

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November 2012





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# Contents

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|   | Page |
|---|------|
| Executive summary   | 3    |
| Chapter 1      Introduction                                       | 5    |
| Chapter 2      Overview of competence                             | 7    |
| Chapter 3      Competence on taxation                             | 9    |
| Chapter 4      Other factors affecting the exercise of competence | 23   |
| Chapter 5      Questions  | 27   |
| Annex A        The law making EU institutions                     | 29   |



# Executive summary

|                                     |   |
|-------------------------------------|---|
| <b>Subject</b>                      | Analysis of the balance of competence between the EU and the UK.  |
| <b>Scope of this paper</b>          | Taxation. Primarily Articles 113 and 115 of the Treaty on the Functioning of the European Union (TFEU). Comments are also welcome on the effect of Articles 45, 49-55, 56-62, 63-66, 107 and 110-112 on taxation.   |
| <b>Who should read this</b>         | Anybody with interest or experience in taxation policy and its application.   |
| <b>Duration</b>                     | The call for evidence will run from 30 November for 12 weeks to 22 February 2013.   |
| <b>Overview</b>                     | <p>Competence on taxation at the EU level is primarily concerned with the operation of the internal market. However, unlike most internal market measures, which use qualified majority voting, the harmonisation of taxation is decided by unanimity. While a degree of harmonisation has been agreed on elements of indirect taxation, in particular VAT, there has been very limited harmonisation of direct taxation.</p> <p>There is an underlying tension here between a level playing field within the internal market and a reduction in burdens for cross-border business activities on the one hand, and the ability of Member States to respond to specific national circumstances and national choices through design of their own tax systems and rates on the other. Nevertheless, the ability of Member States to make such choices is affected by the overarching requirements of the Treaties as regards the free movement of people, goods, services and capital; and anti-discrimination and State aid. A tension also exists between taxation at the national, European and global level. These underlying tensions are central to considering the balance of competence on taxation.</p> <p>UK policy places priority on ensuring that the Government retains maximum flexibility to shape UK tax policy to suit UK economic circumstances. In line with the Coalition Agreement, the Government opposes any extension of EU competence in the area of taxation. Therefore, the Government believes that tax matters should remain subject to unanimity and upholding the veto on tax is a key priority.</p> |
| <b>How to respond and enquiries</b> | <p>Please respond by 22 February 2013 by emailing:<br/>BalanceofCompetences@hmtreasury.gsi.gov.uk.</p> <p>Or by post: Jennifer Haslett<br/>Balance of Competences Review: Taxation<br/>HM Treasury, 1 Horse Guards Road<br/>London. SW1A 2HQ.</p> <p>We will publish your response (unless you ask us not to) but not your name (unless you wish it included), in line with standard procedures. Please base your responses on answers to the questions in Chapter 5.</p>   |
| <b>Next steps</b>                   | <p>We invite expressions of interest to discuss this work further. The Government intends to hold a workshop to discuss views on the issues raised in this document in January or February. Please send your expressions of interest to Jennifer Haslett at the email address above by 4 January 2013. However, we cannot guarantee that we will be able to respond to every request.</p>   |





# 1

## Introduction

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### The Balance of Competence Review

**1.1** The Foreign Secretary launched the Balance of Competence Review<sup>1</sup> in Parliament on 12 July 2012, taking forward the Coalition commitment<sup>2</sup> to examine the balance of competences between the UK and the European Union (EU). The review will provide an analysis of what the UK's membership of the EU means for the UK national interest. It will not produce specific recommendations and will not prejudge future policy, nor will it look at alternative models for Britain's overall relationship with the EU.

**1.2** The review is broken down into a series of reports on specific areas of EU competence, spread over four semesters between autumn 2012 and autumn 2014. The review is led by the Government but will also involve non-governmental experts, organisations and other individuals who wish to contribute their views. Foreign governments, including our EU partners and the EU institutions, are also being invited to submit responses. The process will be comprehensive, evidence-based and analytical. The progress of the review will be transparent, including in respect of the contributions submitted.

**1.3** HM Treasury is leading on the strand of the review covering taxation and is seeking views from all interested parties on how the competence is used and what that means for Britain.

### Background to the call for evidence

**1.4** The review aims to deepen public and Parliamentary understanding of the nature of our EU membership and provide a constructive and serious contribution to the national and wider European debate about modernising, reforming and improving the functioning of the EU in the face of collective challenges at the national, EU and global level.

**1.5** This work will allow everyone, including those in Government, in Parliament and, most importantly, the British people themselves to understand better an important part of the governance of the UK. This will add to the evidence base, on which to ground and develop this country's policies in relation to the EU.

### Responding to the call for evidence on taxation

**1.6** We request input from anyone with relevant knowledge, expertise or experience. We would welcome contributions from individuals, companies, civil society organisations including think-tanks, governments, governmental bodies and the EU institutions.

**1.7** This call for evidence is your opportunity to express your views. It would be helpful if you could base your response as far as practicable on the questions set out in Chapter 5.

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<sup>1</sup> *Balance of Competences*, Hansard Official Report, 12 July 2012, Column 468.

<sup>2</sup> *The Coalition: our programme for government*, HM Government, 20 May 2010.

**1.8** Please send your evidence to [BalanceofCompetences@hmtreasury.gsi.gov.uk](mailto:BalanceofCompetences@hmtreasury.gsi.gov.uk) by 22 February 2013. If you have any queries on this work, please contact Jennifer Haslett on the above email address.

**1.9** Given the cross-cutting nature of the Balance of Competences Review, evidence submitted to the call for evidence on taxation may be relevant to other reviews. To ensure that evidence submitted to this review is used fully, evidence relevant to another review will be shared with the responsible Government department.

### **Confidentiality**

**1.10** We will expect to publish your response, unless you ask us not to, but we will not publish your name, unless you wish for it to be included. Please note that even if you ask us to keep your contribution confidential we might have to release it in response to a request under the Freedom of Information Act (FOIA).

**1.11** If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidentiality. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding.

# 2

## Overview of competence

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**2.1** The term “competence” is used to describe the powers conferred on the EU by the Member States to undertake specific actions. The EU’s competences are set out in the EU Treaties, which provide the legal basis for any actions taken by the EU institutions.<sup>1</sup> The EU can only act within the limits of the competences conferred on it by the Treaties. This means there must be a legal basis for the EU to act.

### **Box 2.A: Treaties of the European Union**

The European Economic Community (EEC) was established by the Treaty of Rome in 1957. This Treaty has since been amended and supplemented by a series of Treaties, the latest of which is the Treaty of Lisbon.

The Treaty of Lisbon, which entered into force on 1 December 2009, re-organised the two Treaties on which the European Union is founded: the Treaty of the European Union (TEU) and the Treaty Establishing the European Community (TEC), which was re-named the Treaty on the Functioning of the European Union (TFEU).

### **Types of competence**

**2.2** There are different types of competence:<sup>2</sup> exclusive, shared and supporting.

**2.3** Only the EU can act in areas where it has exclusive competence, such as the customs union and common commercial policy.

**2.4** In areas of shared competence, such as the internal market, environment and energy, either the EU or the Member States may act. To the extent that the EU exercises its competence, then the Member States are not free to exercise their competence,<sup>3</sup> but may do so again once the EU ceases to exercise the competence.

**2.5** In areas of supporting competence, such as culture, tourism and education, both the EU and the Member States may act; but action by the EU does not prevent the Member States from taking action of their own and the Treaties explicitly prohibit harmonisation of laws.

**2.6** Where the Treaties do not confer competence on the EU or the EU has not already acted,<sup>4</sup> the competence remains with Member States.

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<sup>1</sup> Annex A provides a summary of the three law-making institutions of the EU.

<sup>2</sup> Categories and areas of European Union competence are set out in Articles 2 to 4 TFEU.

<sup>3</sup> Where the EU adopts minimum standards, or “minimum harmonisation”, Member States can introduce more stringent requirements. Thus, for example, Article 193 TFEU provides that Member States can maintain or introduce more stringent protective measures for the environment than those adopted by the EU institutions. This is similar to social policy under Article 153 TFEU. This contrasts with the position for internal market measures, which are generally “maximum harmonisation” with strict limits on the ability of Member States to introduce additional provisions at the national level.

<sup>4</sup> This includes where the EU has ceased to act in areas of shared competence.

## Exercise of competence by the EU

**2.7** When the EU exercises its competence in the area of taxation, it must act in accordance with the general principles of EU law and fundamental rights, as set out in the Charter of Fundamental Rights.<sup>5</sup>

**2.8** The EU must also act in accordance with other articles in the Treaties, including adhering to the principles of “subsidiarity” and “proportionality” under Article 5 TEU. Under the principle of subsidiarity, where the EU does not have exclusive competence, it can only act if it is better placed than the Member States to do so, because of the scale or effects of the proposed action. Under the principle of proportionality, EU action must not exceed what is necessary to achieve the objectives of the EU Treaties.

## Call for evidence

**2.9** For the purposes of this review, a broad definition of competence is being used: competence is about everything derived from EU law that gives the EU power to act.

**2.10** Therefore, this call for evidence examines all the areas where the Treaties give the EU power to act, including giving the EU institutions the power to legislate, to adopt non-legislative Acts, or to take any other sort of action. In addition to this, it is also necessary to examine areas where the Treaties apply directly to the Member States.

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<sup>5</sup> *Charter of Fundamental Rights of the European Union* (2000/C 364/01).

# 3

## Competence on taxation

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### Overview

**3.1** Tax policy is important for supporting UK priorities on securing stable and sustainable tax revenues, managing effective public spending and pursuing economic growth.

**3.2** Competence on taxation is outlined in this report under three areas: indirect taxation, which is split between VAT, excise duties and other indirect taxation; direct taxation; and other issues, including fiscal measures in non-tax legislation and the interaction with non-EU countries.

**3.3** Competence on taxation at the EU level is primarily concerned with the operation of the internal market. Whereas most internal market measures within the EU are voted on using qualified majority voting (QMV), any harmonisation of taxation is decided by unanimity.

**3.4** The balance of competence on taxation is subject to an underlying tension between a level playing field within the internal market and a reduction in burdens for cross-border business activities on the one hand, and the ability of Member States to respond to specific national circumstances and national choices through design of their own tax systems and rates on the other.

**3.5** While recognising these tensions, UK policy places priority on ensuring that the Government retains maximum flexibility to shape UK tax policy to suit UK economic circumstances. In line with the Coalition Agreement, the Government opposes any extension of EU competence in the area of taxation. The Government believes that tax matters should remain subject to unanimity and upholding the veto on tax is a key priority. Under the terms of the European Union Act (2011), giving up the United Kingdom's national veto in a number of sensitive areas – including tax policy – would be subject to a referendum.

### The internal market

**3.6** The internal market of the EU is an area without internal frontiers designed to ensure the free movement of goods, services, capital and persons: the so-called “fundamental freedoms”.<sup>1</sup> Greater integration within an internal market reduces the autonomy of Member States to act independently, but can bring significant benefits as the barriers to trade between Member States are removed.

**3.7** Tax policy plays a part in ensuring the effective functioning of the internal market. However, any EU action on tax beyond administrative cooperation can have consequences for individual Member States' ability to raise revenue and to support domestic growth. This in turn can have an impact on the overall competitiveness of the EU.

**3.8** Each of the 27 Member States has a different tax system suitable to their specific circumstances. The interaction between these different tax systems and the operation of the internal market is a key theme to consider throughout the call for evidence.

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<sup>1</sup> The fundamental freedoms are: the free movement of persons (Article 21 TFEU), the free movement of workers (Articles 45-48 TFEU), freedom of establishment (Articles 49-55), freedom to provide services (Articles 56-62) and the free movement of capital (Articles 63-66).

## International obligations

**3.9** Whether at the national or European level, taxation is affected by a broader international context beyond the EU. The UK has to abide by international agreements that it has entered into, such as the European Convention on Human Rights and the World Trade Organisation's General Agreement on Tariffs and Trade (GATT). The review also considers how this wider international context can have an impact on the scope and effectiveness of EU-level action on tax. Similarly, wider international obligations can affect the UK's ability to set tax policy. This is covered in more detail in Chapter 4.

## Definition of tax

**3.10** For the purpose of this review, indirect taxation is broadly defined as a tax paid to the government on expenditure (including on imports) by consumers rather than on their income. The tax is often collected by the supplier of goods or services on behalf of the government. Value added tax (VAT) and excise duties are the main indirect taxes in the UK.

**3.11** For the purpose of this review, direct taxation is broadly defined as a charge on the income, profit or property of people or companies, who are responsible for paying the tax to the government. Income tax and corporation tax are the main direct taxes in the UK.

## Tax at the EU level

**3.12** Legislative proposals must have a legal base in the EU Treaties appropriate to the proposal. For indirect taxation, the EU has had shared competence<sup>2</sup> since the Treaty of Rome (1957).<sup>3</sup>

**3.13** The Commission can bring forward proposals for indirect taxation under Article 113 TFEU. Proposals under Article 113 are agreed by all 27 Member States acting in the Council of the EU by unanimity voting.

### Article 113 TFEU provides:

*The Council shall, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, adopt provisions for the harmonisation of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition.*

**3.14** The EU has no specific competence in the area of direct taxation, which remains primarily within the competence of each Member State. However, Article 115 TFEU<sup>4</sup> provides for legislation necessary for the establishment and functioning of the internal market to be adopted. Proposals relating to direct tax can be put forward under Article 115 TFEU, if there is judged to be a need for such measures to help the functioning of the internal market across the EU. Proposals under Article 115 are agreed by unanimity voting.

### Article 115 TFEU provides:

*Without prejudice to Article 114, the Council shall acting unanimously in accordance with a special legislative procedure and after consulting the European*

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<sup>2</sup> Articles 2(2) and 4(1) and (2)(a) & (c) TFEU.

<sup>3</sup> Article 99 Treaty of Rome provided for the Commission to consider how Member States' legislation concerning turnover taxes, excise duties and other forms of indirect taxation, could be harmonised in the interest of the common market and to submit proposals for decision by unanimity. This became Article 93 of the Treaty establishing the European Community then Article 113 TFEU.

<sup>4</sup> Article 100 Treaty of Rome was recast as Article 94 of the Treaty establishing the European Community. This became Article 115 TFEU.

*Parliament and the Economic and Social Committee, issue directives for the approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the internal market.*

**3.15** In addition to the creation of secondary legislation under Articles 113 and 115 TFEU, the EU may create tertiary legislation through the use of Delegated and Implementing Acts (as explained in Box 3.A).

**3.16** Article 114 TFEU allows for the adoption of provisions harmonising national laws, where it can be shown that removing disparities in national laws would improve the overall functioning of the internal market.<sup>5</sup> Proposals under Article 114 are agreed by qualified majority voting under the ordinary legislative procedure (see Box 3.A). However, Article 114(2) prohibits the use of Article 114 for the adoption of fiscal measures, so Article 114 should not be used as the legal base for taxation measures (although it may be used for administrative cooperation in relation to tax).

**3.17** The competence conferred under Article 114 TFEU will be discussed in detail in the Internal Market review.<sup>6</sup>

### Other Articles

**3.18** There are four other Articles in the TFEU that mention fiscal measures. However, these are not commonly used for proposals on taxation.

- Article 179 makes provision for the removal of legal and fiscal obstacles to cooperation in the field of research and technological development and space. No specific power is conferred on the Council to implement this and so there is an argument that the Council cannot legislate in this area.
- Article 192(2)(a) gives the Council the power to adopt environmental measures “primarily of a fiscal nature”, acting unanimously and after consulting the European Parliament, the Economic and Social Committee and the Committee of the Regions.
- Article 194(3) gives the Council a power to adopt energy measures “primarily of a fiscal nature”, acting unanimously and after consulting the European Parliament.
- Article 349 refers to fiscal policy in relation to French and Dutch overseas territories. This provision does not apply to the UK or its overseas territories.
- Article 352 gives the Council power to adopt measures, acting unanimously, to achieve one of the objectives set out in the Treaties where there is no corresponding legal base. Under Section 8 of the UK’s European Union Act (2011), Parliamentary approval will be required before the UK can agree to a proposal under Article 352 (subject to some exemptions in the Act).

### The legislative process

**3.19** Under Article 17(2) TEU, the Commission usually has the exclusive right to initiate legislative proposals. There are only limited situations where a legislative Act can be initiated by others, such as Member States, the European Central Bank or the European Court of Justice. This “right of initiative” enables the Commission to coordinate the EU’s legislative programme, although the Council and the European Parliament may also ask the Commission to put forward a proposal.

**3.20** The procedure for adopting legislation is set out in Box 3A.

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<sup>5</sup> Case C-376/98: *Germany v Parliament and Council (Tobacco Advertising Case)*, 2000, paragraphs 83 & 84.

<sup>6</sup> *Review of the Balance of Competences, Internal Market: Synoptic Review*, HM Government, 15 November 2012.

### Box 3.A: The legislative procedure for adopting taxation measures at the EU level

Article 289 of the TFEU makes provision for the use of the “ordinary legislative procedure” or the “special legislative procedure” to adopt legislative Acts. Proposals for taxation under Articles 113 or 115 TFEU follow the special legislative procedure. The special legislative procedure is set out in the relevant Treaty Article to which it applies. The Council of the EU is in practice the sole legislator. The Commission has a right of initiative to introduce proposals to the Council, who may only act with the unanimous agreement of all 27 Member States. Therefore, each Member State, including the UK, effectively has a veto on tax proposals.

This is in contrast to the ordinary legislative procedure, which is defined by Article 294 TFEU and involves the European Parliament as a co-legislator with equal footing to the Council. Voting under the ordinary legislative procedure is by qualified majority of Member States.

#### Enhanced cooperation

Where Member States cannot agree to adopt a proposal, nine or more Member States wishing to take forward the proposal can apply to do so under the enhanced cooperation procedure,<sup>7</sup> providing the requirements set out in the Treaties are met.<sup>8</sup>

One of the Treaties’ requirements for enhanced cooperation is that a proposal under enhanced cooperation shall “respect the competences, rights and obligations of those Member States which do not participate in it.”<sup>9</sup>

#### Delegated and Implementing Acts

For very technical measures, Delegated and Implementing Acts may be used for EU legislation, including on tax.<sup>10</sup> Delegated Acts are non-legislative Acts to amend or supplement legislative Acts. Implementing Acts are legally binding Acts which give effect to a legally binding Union Act.

## Tax at the national (UK) level

**3.21** On direct tax and where the EU has not exercised any competence in relation to indirect tax, the UK remains free to set its own tax policy, including tax rates. However, the UK is required to ensure that its provisions are consistent with EU law. In practice, this means that the UK Government must exercise its competence in areas of taxation consistently with the fundamental freedoms, avoid any discrimination on the grounds of nationality and comply with the rules on State aid. This affects UK tax policy-making and is covered in more detail in Chapter 4.

**3.22** In recent years, the Court of Justice of the European Union (CJEU) has ruled on a number of significant cases on direct tax issues. CJEU jurisprudence is binding on the Member States and has been an important element in defining the boundaries of respective competences.

**3.23** HM Treasury is the department responsible for setting tax policy. HM Revenue & Customs ensures the effective collection, administration and enforcement of tax revenues. The annual Budget delivered to the UK Parliament announces the UK’s fiscal policies and updates the nation on the state of the economy, public finances and progress against the Government’s economic

<sup>7</sup> Article 20(2) TEU and Article 329(1) TFEU.

<sup>8</sup> Notably Articles 326-327 TFEU.

<sup>9</sup> Article 327 TFEU.

<sup>10</sup> Article 290 TFEU and Article 291 TFEU provide the legal basis for Delegated Acts and Implementing Acts respectively (previously Article 202 EC and known as ‘comitology’).



objectives. This is a legal document, which Parliament debates and approves annually, that meets our obligations under Section 5 of the European Communities (Amendment) Act 1993 to inform the European Commission of our economic and budgetary position. This is also in line with our commitments under the EU's stability and growth pact as required by Articles 121 and 126 TFEU.

## 3.A Indirect taxation

**3.24** The EU has had an element of competence on indirect taxation since 1957, before the UK joined the European Economic Community (EEC).

### VAT

**3.25** In 1967, the Council of Ministers of the original six Member States of the EEC exercised the competence in Articles 99 and 100 of the Treaty of Rome (now Articles 113 and 115 TFEU) to enact the First<sup>1</sup> and Second<sup>2</sup> Council Directives on VAT. These Directives required Member States to replace their domestic systems of turnover taxes with a common system of VAT, a neutral turnover tax system, and to set out the basic mechanics of the system. This was done in order to minimise tax differences distorting competition and hindering trade.

**3.26** The UK joined the EEC in 1973 and implemented the VAT Directives, having negotiated some significant derogations from them, notably our zero rates. In doing so the UK replaced selective employment tax and purchase tax and extended the scope of indirect taxation to services as well as goods.

**3.27** The VAT regime is now largely harmonised to ensure consistency in the internal market. Member States have discretion over important areas, including VAT rates (within a defined framework) and how they control and collect VAT from their registered taxpayers. However, the introduction of the VAT system also limited Member States' ability to introduce additional turnover taxes.<sup>3</sup>

### VAT as an own resource

**3.28** In 1970, the EEC adopted a Decision under Article 201 of the Treaty of Rome to replace the financial contributions from Member States for the EEC budget with the Community's own resources.<sup>4</sup> One of these own resources is the "VAT own resource".

**3.29** VAT as an own resource is not a tax, but an own resource calculated with reference to expenditure liable to VAT. Therefore, this will be discussed in detail in the review of the EU Budget.<sup>5</sup>

### Excise

**3.30** The European Communities first exercised competence over excise in 1992 with the Directive on the general arrangements for products subject to excise duty.<sup>6</sup> This laid down the basic principles applicable for the holding, movement and monitoring of the products subject to excise duties, which are primarily tobacco, alcohol and energy. All EU Member States apply excise duties to these three product categories. The revenue from these excise duties accrues entirely to the Member States.

**3.31** The introduction of this Directive required Member States to remove their own domestic fiscal controls in this area. However, full harmonisation of the excise duty rates throughout the European Union was not considered necessary for the proper functioning of the internal market. Instead, a series of minimum rates were agreed by Member States. For example, the Directive on

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<sup>1</sup> Council Directive 67/227/EEC.

<sup>2</sup> Council Directive 67/228/EEC.

<sup>3</sup> A series of CJEU cases has established that taxes, duties and charges are to be regarded as being measures in the nature of turnover taxes, if they exhibit the essential characteristics of VAT, even if they are not identical to VAT at all points.

<sup>4</sup> Council Decision 70/243/ECSC of 21 April 1970 on the replacement of financial contributions from Member States by the Communities' own resources.

<sup>5</sup> The review of the EU Budget will begin in the autumn of 2013. Further information can be obtained by emailing [public.enquiries@hm-treasury.gov.uk](mailto:public.enquiries@hm-treasury.gov.uk).

<sup>6</sup> Council Directive 92/12/EEC.

the approximation of the rates of excise duty on alcohol and alcoholic beverages<sup>7</sup> sets down these minimum rates for alcohol taxation. Above these minimum rates Member States retain competence to set excise duty rates at the levels they consider appropriate according to their national circumstances.

## Other indirect taxes

**3.32** Member States are able to maintain or introduce the following indirect taxes, provided that those taxes, duties or charges do not, in trade between Member States, give rise to formalities connected with crossing of frontiers:<sup>8</sup>

- taxes on insurance contracts;
- tax on betting and gambling;
- excise duties;
- stamp duties; and
- more generally, any taxes, duties or charges that could not be characterised as turnover taxes.<sup>9</sup>

**3.33** For example, the UK was able to introduce a higher rate of insurance premium tax (IPT) in 1997 on some VAT-exempt insurance premiums at the same IPT rate as the prevailing standard rate of VAT, because the EU had not exercised any competence in this area beyond Article 33 of the Sixth VAT Directive.

## Current proposals

### VAT

**3.34** The VAT Directive has been through several iterations<sup>10</sup> since its introduction to respond to developments, including the increased use of e-commerce. The Commission proposals to modernise the VAT rules for financial services<sup>11</sup> and vouchers<sup>12</sup> are current examples of this process. In addition, a European Commission Communication<sup>13</sup> (White Paper) on the future of VAT in the EU was published at the end of 2011, following an EU-wide consultation.

**3.35** The White Paper provides a high level plan for development and reform of the EU VAT regime. It highlights future priority areas for the VAT regime, set against four broad themes: simpler; more efficient; more robust and fraud-proof; and tailored to the single market.

**3.36** Legislative proposals arising from this will be subject to the unanimous agreement of all Member States, including the UK, as they are developed. Recently, as part of this process, the Commission has launched an EU-wide consultation on reduced VAT rates<sup>14</sup> with a view to presenting any proposals at the end of 2013.

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<sup>7</sup> Council Directive 92/84/EEC.

<sup>8</sup> Article 33 of the Sixth VAT Directive (now Article 401 of the Principal VAT Directive) expressly provides for this.

<sup>9</sup> A series of CJEU cases has established that taxes, duties and charges are to be regarded as being measures in the nature of turnover taxes if they exhibit the essential characteristics of VAT even if they are not identical to VAT at all points.

<sup>10</sup> The most recent iteration of the VAT Directive is the Principal VAT Directive (PVD) of 2006. This was done under Article 93 TEC (now Article 113 TFEU).

<sup>11</sup> Commission proposal for a Council Directive and Regulation as regards the VAT treatment of insurance and financial services, COM (2007) 747.

<sup>12</sup> Commission proposal for a Council Directive amending Directive 2006/112/EC on the common system of VAT as regards the treatment of vouchers, COM (2012) 206.

<sup>13</sup> COM (2011) 851.

<sup>14</sup> Available at [http://ec.europa.eu/taxation\\_customs/common/consultations/tax/2012\\_vat\\_rates\\_en.htm](http://ec.europa.eu/taxation_customs/common/consultations/tax/2012_vat_rates_en.htm).

## Other indirect taxes

**3.37** There are two indirect tax proposals not relating to VAT or excise that are under discussion by Member States. These are amendments to the Energy Tax Directive (ETD)<sup>15</sup> and a proposal for a financial transactions tax (FTT).<sup>16</sup>

**3.38** The ETD proposal, presented in 2011 under Article 113 TFEU, aims to update the existing rules on the taxation of energy products (e.g. gas, electricity, coal and road fuel) in the EU. This includes a number of elements, including revising the EU minimum rates for energy products. The proposal is currently under discussion between Member States.

**3.39** The FTT proposal, also presented under Article 113 TFEU, aims to create a common system of taxation for financial transactions. This includes, for example, the sale or purchase of shares where one party to the transaction is in a Member State. After some Member States made clear that they would not agree to adopt an FTT, Member States wishing to take forward the proposal requested to move to enhanced cooperation (see Box 3.A).

**3.40** Evidence is welcome on the use of enhanced cooperation for tax measures and the impact this might have on the balance of competence.

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<sup>15</sup> Commission proposal COM (2011) 169.

<sup>16</sup> Commission proposal COM (2011) 594.

## 3.B Direct taxation

**3.41** EU legislation to date on direct taxation has been aimed at removing particular tax obstacles within the internal market rather than establishing broader common tax frameworks or rates. Relatively few directives have been adopted on direct tax. Three notable examples are:

- The Mergers Directive;<sup>1</sup>
- The Parent-Subsidiary Directive;<sup>2</sup> and
- The Interest and Royalties Directive.<sup>3</sup>

**3.42** The Mergers Directive put in place a common system of taxation applicable to cross-border reorganisations of companies situated in two or more Member States. The Directive was first adopted in 1990<sup>4</sup> and subsequently updated under Article 94 TEC (now Article 115 TFEU).

**3.43** The Parent-Subsidiary Directive abolished withholding taxes on dividend payments between group companies residing in different Member States and prevented double taxation of the parent companies on the profit of the subsidiaries. The Directive was first adopted in 1990, amended in 2003 and recast in 2011<sup>5</sup> under Article 115 TFEU.

**3.44** The Interest and Royalties Directive put in place a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States. The Directive sought to abolish, wherever possible, withholding taxes on interest and royalty payments between associated companies of different Member States. The Directive was adopted in 2003 under Article 94 TEC, with amendments proposed in 2011 under Article 115 TFEU, but not yet adopted by Member States.

### The EU Code of Conduct

**3.45** The Code of Conduct group for business taxation was established in 1997. It is aimed at eliminating harmful tax competition in the EU, strengthening the internal market, and creating a level playing field for business.

**3.46** The Code of Conduct is a political arrangement between Member States, which uses the EU institutions. The Code of Conduct sets out that Member States should refrain from introducing any new harmful tax measures and should amend any laws or practices that are deemed to be harmful in respect of the principles of the Code.

**3.47** The Code of Conduct has no effect on the balance of competence on direct tax, because it is a voluntary mechanism between Member States to cooperate for their mutual interest.

### Current proposals

**3.48** At present there is one EU direct tax proposal under discussion by Member States. This is the Commission proposal<sup>6</sup> for a common consolidated corporate tax base (CCCTB), which was introduced in 2011 under an Article 115 TFEU legal base.

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<sup>1</sup> Council Directive 90/434/EEC as amended.

<sup>2</sup> Council Directive 90/435/EEC as amended.

<sup>3</sup> Directive 2003/49/EC.

<sup>4</sup> Under Article 100 Treaty of Rome and based on a Commission proposal presented in 1969.

<sup>5</sup> Council Directive 2011/96/EC.

<sup>6</sup> Commission proposal COM (2011) 121.

**3.49** The CCCTB proposal aims to establish a single set of rules that companies operating within the EU could use to calculate their taxable profits. This would mean that a company or qualifying group of companies would have to comply with one EU system for computing its taxable income, rather than different rules in each Member State in which they operate. This is currently under discussion by Member States.

## 3.C Other issues

### Tax as an ancillary matter

**3.50** Tax measures are sometimes introduced as an ancillary measure in a predominantly non-tax proposal on a non-tax legal base.

**3.51** Tax proposals are decided by unanimity with Finance Ministers deciding policy at the Economic and Financial Affairs Council (ECOFIN). Generally, non-tax proposals are usually decided outside of ECOFIN on a non-tax legal base through the ordinary legislative procedure, where the voting is by qualified majority. Therefore, there is a possibility that tax measures, which would be subject to unanimity voting were they introduced under Articles 113 or 115 TFEU, could be decided by qualified majority voting if contained within a non-tax proposal.

**3.52** There has been CJEU case law on whether it is necessary to use the appropriate legal base for each element of a proposal covering different policy areas. The CJEU has said in a number of judgments that a measure may have a clear main purpose, and only incidentally pursue some secondary objective. In those circumstances, the only necessary legal basis is the one corresponding to the main purpose. The Court has expressed the principle as follows:

*If examination of a Community [now EU] measure reveals that it pursues a twofold purpose or that it has a twofold component and if one of these is identifiable as the main or predominant purpose or component whereas the other is merely incidental, the act must be based on a single legal basis, namely that required by the main or predominant purpose or component.*<sup>1</sup>

**3.53** Therefore, it is possible for a fiscal provision to be adopted using a non-tax legal base, where the fiscal provision is essentially ancillary. For example, the European Emissions Trading Scheme Directive<sup>2</sup> was amended on an environmental legal base and the Eurovignette Directive<sup>3</sup> was updated on a transport legal base, but both contained fiscal elements.

**3.54** In these cases, the UK entered a statement<sup>4</sup> into the minutes of the Council proceedings to express publicly that the measure should have cited a tax legal base.

### Tax administrative cooperation

#### Information exchange

**3.55** There are a number of EU instruments relating to administrative cooperation to exchange information and help tackle tax evasion. Some measures relate to specific taxes, while others cover a range of both direct and indirect taxes. Where the EU has legislated, Member States no longer have competence to act of their own accord in that specific area.

**3.56** An example is the European Union Savings Directive (EUSD), which was originally agreed in 2003.<sup>5</sup> The Directive aims to counter cross-border tax evasion by requiring the collection and automatic exchange of information about individuals who receive savings income in accounts held outside their Member State of residence. In 2008, the European Commission proposed a

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<sup>1</sup> See for instance Case C-155/91, *Commission v Council*, 1993.

<sup>2</sup> Council Directive 2003/87/EC.

<sup>3</sup> Council Directive 1999/62/EC.

<sup>4</sup> Available at <http://register.consilium.europa.eu/pdf/en/08/st14/st14243-ad01re02.en08.pdf> for the EU Emissions Trading Scheme, 28 October 2008; and available at [http://www.parlament.gv.at/PAKT/EU/XXIV/EU/06/96/EU\\_69658/imfname\\_10015437.pdf](http://www.parlament.gv.at/PAKT/EU/XXIV/EU/06/96/EU_69658/imfname_10015437.pdf) for the Eurovignette Directive, 28 October 2011.

<sup>5</sup> Council Directive 2003/48/EC.

revision<sup>6</sup> to the Savings Directive and related agreements with non-EU jurisdictions to provide for the automatic exchange of a wider range of information on savings income. This is currently under discussion between Member States.

**3.57** Other measures in this area include the Administrative Cooperation Directive,<sup>7</sup> Council Regulation 904/2010 on Combating Fraud in the Field of VAT and Council Regulation 389/2012 on Excise Administrative Cooperation.

**3.58** In addition, there is an administrative cooperation programme, which aims to share best practice and increase cooperation between Member States and candidate countries, their administrations and officials on both direct and indirect taxation. The current programme – Fiscalis 2013 – is governed by a Council Decision, with an Article 95 TEC (Article 114 TFEU) legal base.<sup>8</sup> A proposal<sup>9</sup> for a new programme to begin in 2014 named Fiscalis 2020 is currently under discussion. As well as the Fiscalis 2020 programme on tax, there is a related Customs 2020 programme. The Customs Programme will be discussed in detail in the review of the internal market: free movement of goods.<sup>10</sup>

### Recovery of taxation

**3.59** Mutual assistance for the recovery of taxes, customs and other fees between Member States was established in 1976 by the original Mutual Assistance Recovery Directive (MARD).<sup>11</sup> This Directive was extended<sup>12</sup> to cover the recovery of VAT, excise duties and taxes on income, capital and insurance premiums. This legislation was consolidated in 2008<sup>13</sup> and the CJEU have since confirmed that Articles 93 and 94 TEC (now Articles 113 and 115 TFEU) are the correct legal bases for this Directive.

**3.60** The current MARD,<sup>14</sup> agreed in 2010, repealed and replaced the previous legislation. The current Directive allows for the recovery of tax debts and duties, which includes service of documents and exchanging information in connection with the recovery of claims.

### External representation and agreements with third countries

**3.61** Where agreed by the Council, the EU can enter into international agreements with third countries (non-EU countries) that contain tax provisions. Where there is agreement from the Council, the EU can also enter into tax specific agreements as envisaged under the EU Savings Directive.

**3.62** In 2011, Member States agreed general arrangements for EU representation that stated “external representation and internal coordination does not affect the distribution of competences”.<sup>15</sup> The Arrangements are not legally binding, but rather are a political understanding. Therefore, where a co-ordinated EU-level statement is pre-agreed by the Council on tax, there is an understanding that the balance of competence in that area will not be affected by the EU making such a statement.

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<sup>6</sup> Commission proposal COM (2008) 727.

<sup>7</sup> Council Directive 2011/16/EU.

<sup>8</sup> Council Decision No 1482/2007/EC of the European Parliament and of the Council of 11 December 2007 establishing a Community programme to improve the operation of taxation systems in the internal market (Fiscalis 2013) and repealing Decision No 2235/2002/EC.

<sup>9</sup> Commission proposal COM (2012) 465.

<sup>10</sup> This review will begin in the spring of 2013. Further information can be obtained by emailing [balanceofcompetences@hmrc.gsi.gov.uk](mailto:balanceofcompetences@hmrc.gsi.gov.uk).

<sup>11</sup> Council Directive 76/308/EC.

<sup>12</sup> Council Directive 79/1071/EC, Council Directive 92/108/EC and Council Directive 2001/44/EC respectively.

<sup>13</sup> Council Directive 2008/55/EC.

<sup>14</sup> Council Directive 2010/24/EC.

<sup>15</sup> ‘General Arrangements for EU statements in multilateral organisations’, endorsed by the Council, 22 October 2011. Hansard reference is <http://www.publications.parliament.uk/pa/cm201012/cmselect/cmeuleg/428-xlix/42821.htm>.



**3.63** Member States are themselves able individually to conclude tax agreements with other EU countries or non-EU countries through intergovernmental arrangements. For example, this may be done bilaterally in the form of a Double Tax Treaty, of which the UK has over 100, a Tax Information Exchange Agreement, including the *UK-US Intergovernmental Agreement to Improve International Tax Compliance and to Implement FATCA*,<sup>16</sup> or agreements like the *UK-Swiss Tax Agreement*.<sup>17</sup> Alternatively, agreements may be effected multilaterally, such as in the Multilateral Convention on Mutual Administrative Assistance in Tax Matters.

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<sup>16</sup> *Intergovernmental Agreement to Improve International Tax Compliance and to Implement FATCA (and amending Protocol)*, HM Government, 12 September 2012.

<sup>17</sup> *Agreement between the Swiss Confederation and the UK on co-operation in the area of taxation*, HM Government, 6 October 2011.



# 4

## Other factors affecting the exercise of competence

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### Discrimination and free movement

**4.1** When the UK proposes changes to taxation, the Treasury must do so in line with EU law.

**4.2** There are general primary law EU provisions contained in the TFEU that can impact actions at the Member State level:

- Article 18 TFEU (formerly Article 12 EC) which contains a general non-discrimination provision.<sup>1</sup>
- Article 21 TFEU (formerly Article 18 EC) on the free movement and residence of EU citizens.<sup>2</sup>
- Articles 45 – 48 TFEU (formerly Articles 39 – 42 EC) on the free movement of workers.<sup>3</sup>
- Articles 49 – 55 (formerly Articles 43 – 48 & 294 EC) on the freedom of establishment.<sup>4</sup>
- Articles 56 – 62 (formerly Articles 49- 55 EC) on the freedom to provide services.<sup>5</sup>
- Articles 63 – 66 (formerly Articles 56 – 59 EC) on the free movement of capital and payments.<sup>6</sup>
- Article 110 (formally Article 90 TEC) which prohibits Member States directly or indirectly imposing internal taxation on the products of another Member State in excess of that imposed on similar domestic products.<sup>7</sup>

**4.3** The competence conferred under these Articles will be covered in detail by other reviews. However, the Treasury welcomes evidence on the practical effect and impact of the above EU law provisions on the exercise of the UK's competence on taxation.

### State aid rules and tax

**4.4** The UK's power to act in relation to taxation, whether direct or indirect, must also be exercised in accordance with State aid rules. State aid is any form of government funded support that could distort competition and affect trade between Member States by favouring certain undertakings or the production of certain goods; and is, generally, incompatible with the

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<sup>1</sup> The competence conferred under this Article will be part of the review on social and employment. This review will begin in the autumn of 2013. Further information can be obtained by [balanceofcompetences@bis.gsi.gov.uk](mailto:balanceofcompetences@bis.gsi.gov.uk).

<sup>2</sup> The competence conferred under these Articles will be part of the review on the internal market: free movement of persons. This review will begin in the spring of 2013. Further information can be obtained by emailing [balanceofcompetences@bis.gsi.gov.uk](mailto:balanceofcompetences@bis.gsi.gov.uk).

<sup>3</sup> Ibid.

<sup>4</sup> Ibid.

<sup>5</sup> The competence conferred under these Articles will be part of the review of the internal market: free movement of services. This review will begin in the autumn of 2013. Further information can be obtained by emailing [balanceofcompetences@bis.gsi.gov.uk](mailto:balanceofcompetences@bis.gsi.gov.uk).

<sup>6</sup> The competence conferred under these Articles will be part of the review of the internal market: free movement of capital. This review will begin in the autumn of 2013. Further information can be obtained by emailing [BalanceofCompetences@hmtreasury.gsi.gov.uk](mailto:BalanceofCompetences@hmtreasury.gsi.gov.uk).

<sup>7</sup> Or to impose taxation on the products of another Member State so as to afford indirect protection to other products.

internal market. There is a general prohibition against State aid under Article 107 TFEU. However, State aid can be permitted, subject to certain conditions and guidelines, where aid is deemed to be compatible with the Treaties. For example, UK film tax credits are deemed to be a State aid because they support a specific sector; however, they are considered to be compatible with State aid rules in that they address market failure and support common European goals for culture in a proportionate way.

**4.5** Other examples of approved State aid on taxation include certain reliefs from the climate change levy and the Enterprise Management Incentives scheme.<sup>8</sup>

**4.6** Approved State aid can only be operated within the terms laid down by the European Commission. The EU has exclusive competence in establishing the competition rules necessary for the functioning of the internal market. This is ensured through the enforcement of State aid rules.

**4.7** This review welcomes evidence on the impact of State aid rules on the UK's competence on tax, although the balance of competence on State aid rules generally will be covered in detail by the review on competition.<sup>9</sup>

## **International obligations**

**4.8** There are a number of international obligations which also affect the UK's power to tax.

### **European Convention on Human Rights (ECHR)**

**4.9** When exercising its competence on taxation, the UK must comply with the legal obligations contained within the European Convention on Human Rights.

**4.10** Article 1 of Protocol 1 of the European Convention on Human Rights (ECHR) states that "no one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law". However, Paragraph 2 contains a specific exception for enforcement of tax law and the Courts recognise that governments have a fairly wide margin of appreciation in tax matters,<sup>10</sup> meaning Member States have discretion in exercising tax powers.

### **World Trade Organisation (WTO)**

**4.11** The UK adheres to trade obligations under the World Trade Organisation (WTO). Article III: 2 of the WTO's *General Agreement on Tariffs and Trade* (GATT), states that an imported product "...shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like products". The WTO's *General Agreement on Trade in Services* (GATS) and WTO principle of 'most favoured nation' (MFN) treatment also applies to remove barriers to trade.

**4.12** The WTO provisions cannot generally be invoked in the Courts, but the WTO operates a dispute settlement mechanism under the Disputes Settlement Understanding (DSU), which enables Contracting Parties to challenge actions they consider not to be in compliance with the GATS.

**4.13** The EU acts in the WTO for most purposes, including dispute settlement, because trade is an area of exclusive EU competence.

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<sup>8</sup> Governed by sections 527-541 of, and Schedule 5 to the Income Tax (Earnings and Pensions) Act 2003.

<sup>9</sup> The review on competition will begin in the autumn of 2013. Further information can be obtained by emailing [balanceofcompetences@bis.gsi.gov.uk](mailto:balanceofcompetences@bis.gsi.gov.uk).

<sup>10</sup> *National & Provincial Building Society and Others v United Kingdom* (1997)25 EHRR 127.

## **Organisation for Economic Cooperation and Development (OECD)**

**4.14** As a member of the OECD, the UK is subject to non-legislative agreements on taxation. Typically members of the OECD agree to adhere to minimum international standards on taxation, such as exchange of information under the Multilateral Convention on Mutual Assistance in Tax Matters, or standards contained within the OECD Model Tax Convention.

**4.15** These obligations are not legally binding, but undertaken voluntarily by countries in order to achieve an international standard on taxation. The UK has incorporated some OECD standards into UK law. For example, by requiring that legislation on transfer pricing is read in a manner which best secures consistency with the latest OECD Transfer Pricing Guidelines.



# 5

## Questions

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**5.1** Having set out the broad boundaries of EU and national competence on taxation, the Government welcomes views on what the current balance of competence means for the national interest. HM Treasury is seeking evidence on the following questions in particular. Where possible, please give relevant examples.

### Impact on the national interest

- 1 What evidence is there that EU-level action on taxation advantages the UK?
- 2 What evidence is there that EU-level action on taxation disadvantages the UK?
- 3 What do you think are the main considerations in determining the appropriate level for decisions to be made on tax policy?
- 4 Are there any other impacts of EU action on taxation that should be noted, including as regards the process for taking action (for example unanimity versus qualified majority voting)?

### Future options

- 5 How might the UK benefit from the EU taking more action on taxation? Please provide specific examples, identifying where possible the pros and cons.
- 6 How might the UK benefit from the EU taking less action on taxation? Please provide specific examples, identifying where possible the pros and cons.
- 7 How could action on taxation be undertaken differently? For example:
  - a Could more action be taken at the national level? If so, what domestic legislation would be needed on taxation in the absence of EU legislation, for example to take account of issues around international trade and cross-border transactions?
  - b What action could best be taken at other international levels (by a different body or institution)?
- 8 What future challenges and opportunities might the UK face on the balance of competence on taxation? What impact might different scenarios for the future development of the EU have on the national interest?

### General

- 9 Are there any general points on competence you wish to make that are not captured above?





# A

# The law making EU institutions

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## The European Parliament

**A.1** The European Parliament is made of up representatives (MEPs) who are directly elected by the public in their country of origin. The European Parliament has three core functions:

- debating and passing European laws, as co-legislators with the Council;
- scrutinising the other EU institutions to ensure they are working democratically and acting within their vires; and
- debating and adopting the EU's budget, with the Council.

## The Council

**A.2** The Council consists of national Ministers from each Member State and meets to adopt laws and co-ordinate policies. The Council has a number of functions, primarily:

- making policy and passing EU laws;
- approving agreements between the EU and third countries;
- approving the annual EU budget; and
- developing the EU's foreign and defence policies.

**A.3** The Council does not have a fixed membership as such; rather, Council meetings are attended by the national Minister with responsibility for the policy under discussion. For example, Finance Ministers decide tax policy at the Economic and Financial Affairs Council (ECOFIN).

## The European Commission

**A.4** The European Commission consists of 27 Commissioners – one from each Member State. Commissioners are appointed for a five year term and in that time will be given a specific area of responsibility. For example, Commissioner Algirdas Šemeta from Lithuania is responsible for taxation and the customs union, audit and anti-fraud.

**A.5** The President of the Commission is nominated by the European Council. The Council also appoints the other Commissioners in agreement with the nominated President.

**A.6** The appointment of all Commissioners, including the President, is subject to the approval of the European Parliament. In office, the Commissioners remain accountable to the European Parliament, which has sole power to dismiss the Commission.

**A.7** The Commission has a number of roles, most notably:

- proposing new laws to the European Parliament and the Council;
- managing the EU's budget and allocating funding; and
- enforcing EU law (together with the Court of Justice of the European Union).





### **HM Treasury contacts**

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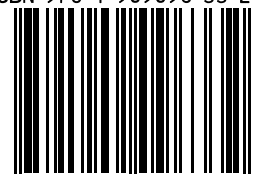
If you require this information in another language, format or have general enquiries about HM Treasury and its work, contact:

Correspondence Team  
HM Treasury  
1 Horse Guards Road  
London  
SW1A 2HQ

Tel: 020 7270 5000

E-mail: [public.enquiries@hm-treasury.gov.uk](mailto:public.enquiries@hm-treasury.gov.uk)

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