Taxing and Spending in the Euro Zone: Legal and Political Challenges Related to the Adoption of the Financial Transaction Tax

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Keywords

Abstract

The article examines the recent high-level policy proposals to establish a fiscal capacity for the euro zone and discusses the relationship between taxing and spending in the Economic and Monetary Union (EMU) by analysing the need and possibility to levy taxes at the supranational level to sustain this new fiscal capacity. To this end, the article focuses on the pending legislation for the introduction of a Financial Transaction Tax (FTT) and considers the legality of resorting to enhanced co-operation to adopt a FTT among a sub-group of euro zone countries. While the use of enhanced co-operation in the area of FTT has been the object of recent challenges, the article discards these concerns and argues that the adoption of an FTT through enhanced co-operation is consistent with the constitutional function of this instrument, complies with the principles of the internal market and does not affect the rights of non-participating Member States—so it is legal. However, the article suggests that the use of enhanced co-operation to enact an FTT meets several political challenges, precisely because of the connection between taxing and spending in the euro zone. Since only 11 Member States have agreed to levy an FTT, it appears difficult to appropriate the revenues of the FTT for the benefit of a common euro zone budget. In the end, the establishment of a fiscal capacity for the euro zone requires further institutional reforms in the architecture of the EMU aimed at ensuring a more effective and legitimate decision-making process in fiscal affairs.

Introduction

Since the outburst of the euro crisis, the Member States and the institutions of the European Union have reacted by introducing important changes to the constitutional architecture of the Economic and Monetary Union (EMU). Most of the legal measures adopted so far have attempted to *reduce the risks* stemming from EMU, by strengthening fiscal discipline and budgetary constraints at the national and supranational level. Increasingly, however, calls have been made for new legal instruments at EU level that would allow the Member States to *share the risks* associated with EMU. In particular, several high-level policy documents—the report of the President of the European Council "Towards a Genuine EMU",[1] and the blueprint of the European Commission "For a Deep and Genuine EMU"[2]—have recently proposed the

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[1] President of the European Council, Final Report, *Towards a Genuine EMU* (December 5, 2012).

[2] Commission, "A Blueprint for a Deep and Genuine EMU: Launching a European Debate" (November 28, 2012) COM(2012) 777 final.

introduction of a fiscal capacity for the EMU, that is, a finalised budget for the euro zone to assuage the asymmetric shocks occurring within the EMU and to carry out those counter-cyclical policies no longer possible at the national level. The proposals to introduce a fiscal capacity for the euro zone, however, inevitably raise the question of how to levy the necessary resources to sustain an EMU budget.[3]

The aim of this article is to explore the interconnection between taxing and spending in the euro zone, focusing on the case of the Financial Transaction Tax (FTT). Originally conceived by the Commission as a way to endow the European Union with an authentic own resource for its fiscal policy, and at the same time to make the financial sector contribute to the costs of the crisis,[4] the proposal to introduce an FTT did not muster the unanimous support of all the EU Member States, and was therefore brought forward only by 11 euro zone countries through the mechanism of enhanced co-operation.[5] The use of enhanced co-operation to introduce the FTT, however, has been the object of legal and political challenges. In April 2013, the United Kingdom lodged proceedings before the Court of Justice of the European Union (CJEU) claiming that the Council authorisation to use enhanced co-operation for the introduction of the FTT unlawfully affected its right as a non-participating Member State.[6] In September 2013, moreover, the Legal Service of the Council leaked a confidential opinion in which it expressed concerns about the legality of the scope of application *ratione personae* of the FTT as proposed in the draft legislative text of the Commission.[7]

By examining the use of enhanced co-operation in the area of FTT in light of the Treaty rules and the jurisprudence of the CJEU—notably the April 2013 Grand Chamber judgment in *Spain and Italy v Council*,[8] dealing with the legality of enhanced co-operation for the creation of an EU unitary patent regime—the article argues that in this case resort by a vanguard group of EU Member States to the mechanism of enhanced co-operation passes all legal tests. Contrary to the view of the United Kingdom and the Council Legal Service, the adoption of an FTT through enhanced co-operation is consistent with the constitutional function of this instrument, complies with the principles of the internal market and does not affect the rights of non-participating Member States. However, the article suggests that the use of enhanced co-operation to enact an FTT generates several political difficulties, precisely because of the inter-linkages between taxing and spending in the European Union and the euro zone. Whereas the initial proposals to introduce an FTT were finalised to raise a new EU revenue, the fact that only several Member States participate in the venture raises hurdles for the ability to use the revenues of the FTT to create a true fiscal capacity.

In other words, while the article claims that the adoption of the FTT through enhanced co-operation is legal and sets aside any opinion to the contrary, it suggests that the use of enhanced co-operation is a politically inadequate tool towards the establishment of a euro zone fiscal capacity. In the European Union, as in any constitutional system, spending and taxing constitute two sides of the same coin. On the one

[3] Note that in the article I will use the expressions "EMU" and "euro zone" interchangeably. According to art.119 TFEU, the Member States agree to co-ordinate their economic policies and create a single monetary union (the EMU) whose currency is the euro (hence the expression "euro zone"). Participation in the EMU is an obligation for all EU Member States. At the date January 1, 2014, however, only 18 of the 28 EU Member States were participating in the EMU: two states, instead, have obtained a specific opt-out from the single currency, while eight states do not yet fulfil the technical criteria to become part of it. See also P. Padoan, "EMU as an Evolutionary Process" in D. Andrews et al. (eds), *Governing the World's Money* (Ithaca: Cornell University Press, 2002), p.105.

[4] Commission Proposal for a Council Directive on a Common System of FTT (November 28, 2011) COM(2011) 594 final.

[5] Commission Proposal for a Council Directive Implementing Enhanced Cooperation in the Area of a FTT (February 14, 2013) COM(2013) 71 final.

[6] *United Kingdom v Council* (C-209/13), Application lodged on April 18, 2013.

[7] Council of the EU, *Opinion of the Legal Service*, JUR 448 (September 6, 2013) (Confidential Document Interinstitutional File: 2013/0045 (CNS)).

[8] *Spain and Italy v Council* (C-274/11 and C-295/11) [2013] 3 C.M.L.R. 24.

hand, the proposals for a new fiscal capacity require authentic EU or euro zone taxes. On the other hand, taxes must be levied uniformly throughout the European Union or the euro zone if they are going to be used for common budgetary purposes. However, as long as unanimity remains the prescribed requirement for the adoption of tax legislation at EU level, the chances of reaching consensus in this field appear limited. In prospect, therefore, the proposals to endow the euro zone with a fiscal capacity must be associated with a reform of the EMU decision-making process in fiscal affairs, which allows a more efficient and legitimate framework of governance based on qualified majority voting (QMV) and the full involvement of the EU Parliament. It is only in a Union that binds anew taxing and spending at the supranational level, in fact, that the EU citizens and Member States can regain the power to control those activities that now escape any form of fiscal regulation at the national level—as is the case of the FTT.[9]

A preliminary warning is in order: this article examines the introduction of an FTT from a legal point of view. The article does not consider the FTT from an economic perspective. Unsurprisingly, economists disagree about the virtues and vices of this tax, as of any other.[10] The aim of the article is to discuss whether the instrument of enhanced co-operation provides an adequate tool to introduce the FTT for a number of EU Member States. Whether this is sound policy or economic suicide is ultimately for the political process to decide, in the Union and the Member States. The article, however, explores the political challenges of using enhanced co-operation for the introduction of an FTT, emphasising the link between taxing and spending in the euro zone. The article is structured as follows. First, it surveys the recent proposals to create an EMU fiscal capacity. Secondly, it discusses the problem of raising revenues at EU level to sustain a fiscal capacity and explains why EU taxes—and not inter-State transfers—must be the basis of a new EMU budget. Thirdly, it examines the legislative history and the content of the Commission proposal to introduce the FTT through enhanced co-operation. Fourthly, it considers the legal challenges against the use of enhanced co-operation to adopt the FTT, and discards them. It then considers the political challenges, and it finally concludes by outlining several prospects for future reform.

Proposals for a euro zone fiscal capacity

The proposals to endow the EMU with a fiscal capacity are very recent. The October 2010 report of the task force chaired by the President of the European Council, "Strengthening Economic Governance in Europe", which served as the basis for most of the reforms in the architecture of the EMU adopted to respond to the euro crisis, did not contain any hint about this idea.[11] In fact, the first time the term "fiscal capacity" is used in an EU official document is in the October 2012 interim report of the President of the European Council, "Towards a Genuine EMU".[12] Although already in its June 2012 inaugural report[13] the President of the European Council had suggested that "a fully fledged fiscal union would imply the development of a stronger capacity at the European level, capable to manage economic interdependences, and ultimately the development at the euro area level of a fiscal body, such as a Treasury office",[14] it is in the October 2012 report that one finds a first articulate presentation of the idea of fiscal capacity and its

[9] See also M. Maduro, *A New Governance for the European Union and the Euro: Democracy and Justice*, Report commissioned by the European Parliament Constitutional Affairs Committee, PE 462.484 (2012).

[10] For an economic analysis of the pros and cons of the FTT see Z. Darvas and J. von Wiezsäcker, *Financial Transaction Tax: Small is Beautiful*, Report commissioned by the European Parliament Economic and Monetary Affairs Committee, PE 429.989 (2010).

[11] See Report of the Task Force of the European Council, *Strengthening Economic Governance in the EU* (October 21, 2010) (identifying five pillars for reform, namely: (1) greater fiscal discipline; (2) broader economic surveillance; (3) deeper economic co-ordination via the European Semester; (4) More robust framework for crisis management; (5) stronger institutions for more effective economic governance).

[12] President of the European Council, Interim Report, *Towards a Genuine EMU* (October 12, 2012).

[13] President of the European Council, Report, *Towards a Genuine EMU* (June 25, 2012).

[14] Report, *Towards a Genuine EMU*, p.5.

form. In its discussion about the next pillars of EMU reform—a banking union, a fiscal union, an economic union and a new framework for democracy, legitimacy and accountability—the President of the European Council stated that "strengthening [fiscal] discipline is … not sufficient" and suggested that "in the longer term, there is a need to … go beyond the current steps to strengthen economic governance to develop a fiscal capacity for the EMU".[15]

According to the President's interim report, a fiscal capacity would pursue functions which are not covered by the EU budget, the so-called Multi-Annual Financial Framework (MFF). In particular, "one of the functions of such a new fiscal capacity could be to facilitate adjustments to country-specific shocks by providing for some degree of absorption at the central level".[16] At the same time, "[a]nother important function of such a fiscal capacity would be to facilitate structural reforms that improve competitiveness and growth".[17] These ideas were later developed by the President of the European Council in the December 2012 final report,[18] where the establishment of a fiscal capacity was clearly linked to the creation of a "shock-absorption function" to improve the resilience of EMU.[19] As the President's final report underlined, in fact "while the degree of centralization of budgetary instruments and the arrangements for fiscal solidarity against adverse shocks differ, all other currency unions are endowed with a central fiscal capacity".[20] The economic rationale of this instrument lay in the reduction of the impact of country-specific shock and in the prevention of contagious effects across the currency union.[21] Because of its "insurance-type" nature, at the same time, the President's report suggested alternative macro or micro economic approaches to set up a fiscal capacity,[22] and emphasised that its design would still have to avoid "the risk of moral hazard inherent in any insurance system".[23]

In the vision outlined in the President's final report, therefore, the fiscal capacity of the EMU would largely operate as a sort of "rainy day fund"—that is, like a savings fund to which Member States contribute in times of economic upswing and from which they would be able to draw in times of economic downswing, to cushion the effects of a recession.[24] In fact, although the final report leaves open the possibility that the fiscal capacity may be funded by own financial resources, including a capacity to borrow via the establishment of an EU treasury,[25] the acknowledgement that "the financial implications for national budget would depend on the [fiscal capacity's] precise design and parameters"[26] suggests that State contributions would be, at least in the short term, the main sources of its funding. In terms of timing, moreover, the President's final report suggested the possibility to achieve a fiscal capacity in stages. In a first phase, "limited, temporary, flexible and targeted financial incentives"[27] would be developed to support structural reforms in those Member States in fiscal difficulties that are willing to enter into contractual arrangements

[15] Interim Report, *Towards a Genuine EMU*, p.4.
[16] Interim Report, *Towards a Genuine EMU*, p.5.
[17] Interim Report, *Towards a Genuine EMU*, p.5.
[18] President of the European Council, Final Report, *Towards a Genuine EMU* (December 5, 2012).
[19] Final Report, *Towards a Genuine EMU*, p.5.
[20] Final Report, *Towards a Genuine EMU*, p.9.
[21] Final Report, *Towards a Genuine EMU*, p.10.
[22] Final Report, *Towards a Genuine EMU*, p.11. (distinguishing between a macroeconomic approach, which looks at contribution to, and disbursement from, the fiscal capacity in light of fluctuations in the economic cycle; and a microeconomic approach, focused instead on specific public functions such as unemployment insurance).
[23] Final Report, *Towards a Genuine EMU*, p.10.
[24] On the "rainy day" fund mechanism in the US system of fiscal federalism see R. Inman and D. Rubinfeld, "Fiscal Federalism in Europe: Lessons from the United States Experience" (1992) 36 *European Economic Review* 654, 655.
[25] Final Report, *Towards a Genuine EMU*, p.12.
[26] Final Report, *Towards a Genuine EMU*, p.11.
[27] Final Report, *Towards a Genuine EMU*, p.9.

with the EU institutions, while in the long run a more stable instrument to provide "fiscal solidarity … over economic cycles" would have to be put in place.[28]

Analogous ideas for the establishment of a fiscal capacity were also advanced by the European Commission. The November 2012 blueprint "For a Deep and Genuine EMU"[29] endorsed the idea of a fiscal capacity to underpin structural reforms at the national level and provide a stabilisation tool at EMU level to support adjustment to asymmetric shocks. Moreover, the Commission also suggested distinguishing between a short term, in which "the economic governance framework should be strengthened further by creating a 'convergence and competitiveness instrument' [CCI] within the EU budget to support the timely implementation of structural reforms, on the condition that 'contractual arrangements' are concluded between Member States and the Commission",[30] and a medium-long term in which a real fiscal capacity for the euro area would be fully established. In this light, the Commission presented as a first step a Communication for the introduction of a CCI in March 2013, emphasising the link between structural reform and financial support to be provided by Member States.[31]

These proposals for the creation of a fiscal capacity have found a mild endorsement by the EU Heads of States and Governments congressed in the European Council. Tellingly, while the Conclusions of the December 2012 European Council largely endorsed the President's report and followed in its footsteps to outline the process of future reforms of the EMU, no reference is made to the term "fiscal capacity".[32] More modestly, the Conclusions refer to "solidarity mechanisms"[33] aimed at supporting Member States who agree through contractual arrangements to undertake structural reforms, as suggested both by the President's report and the Commission's blueprint. However, the proposal to endow the euro zone with an autonomous budget has received the individual support of prominent institutional players within the European Council. While German Chancellor Merkel had already embraced the idea in a speech before the European Parliament in November 2012,[34] recently also French President Hollande and Italian Prime Minister Letta indicated their support for it. [35]

Moreover, the idea of a fiscal capacity has found increasing backing in the European Parliament. In its November 2012 resolution, "Towards a Genuine EMU",[36] the Parliament had underlined how "the innovative idea of a central budget for the euro area funded by members of the euro area is now being proposed as the ultimate guarantee for … financial solidarity"[37] and expressed its view,

> "that a 'genuine EMU' cannot be limited to a system of rules but requires an increased budgetary capacity based on specific own-resources … which should in the framework of the Union budget, support growth and social cohesion addressing imbalances, structural divergences and financial emergencies which are directly connected to the monetary union."[38]

[28] Final Report, *Towards a Genuine EMU*, p.9.

[29] Commission, "A Blueprint for a Deep and Genuine EMU: Launching a European Debate" (November 28, 2012) COM(2012) 777 final.

[30] Commission Memo, "A Blueprint for a Deep and Genuine EMU" (November 28, 2012), MEMO/12/909, p.2.

[31] Commission, "The Introduction of CCI" (March 20, 2013) COM(2013) 165 final.

[32] *European Council Conclusions* (December 13–14, 2012), EUCO 205/12.

[33] *European Council Conclusions* (December 13–14, 2012), EUCO 205/12, p.5.

[34] See European Parliament, Communiqué de Presse, "Angela Merkel donne sa vision d'une UE renouvelée" (November 7, 2012).

[35] See F. Hollande, President of France, "Intervention liminaire de lors de la conférence de presse" (May 16, 2013), p.7 (speaking in favour of a "une nouvelle étape d'integration avec une capacité budgétaire qui serait attribuée à la zone euro"). See E. Letta, Prime Minister of Italy, *Keynote Speech* at Annual Dinner Bruegel (September 9, 2013), p.5 (arguing that "there is room to reflect on a fiscal capacity for the euro area").

[36] European Parliament Resolution, "Towards a Genuine EMU" (November 20, 2012), P7_TA(2012)0430.

[37] European Parliament Resolution, "Towards a Genuine EMU" (November 20, 2012), P7_TA(2012)0430, para.CR.

[38] European Parliament Resolution, "Towards a Genuine EMU" (November 20, 2012), P7_TA(2012)0430, para.11.

In its recent May 2013 resolution "On Future Legislative Proposals on EMU",[39] then, the Parliament clarified that it considered the CCI proposed by the Commission as a set of "building blocks towards a genuine fiscal capacity".[40] And it expressed its clear wish that,

> "this mechanism should be funded by means of a new facility triggered and governed under the Community method as an integral part of the EU budget, but outside the MFF ceiling, so as to ensure that the European Parliament is fully involved as a legislative and budgetary authority."[41]

Overall, therefore, there seems to be a slow but growing institutional consensus within the European Union toward the idea of complementing the constitutional architecture of EMU with a form of fiscal capacity. As the fiscal discipline side of EMU is made ever more secure by being entrenched in constitutional norms at EU and State level,[42] the awareness becomes greater on the necessity to create new supranational instruments to support fiscal adjustments in the EMU.

Problems of raising revenues for a fiscal capacity

The proposals in favour of endowing the euro zone of a fiscal capacity inevitably raise the question of where to draw the resources needed to feed an EMU budget from. As the previous section underlined, the reports of the President of the European Council and the blueprint of the Commission appear ambiguous in this regard, hinting that the fiscal resources necessary for a euro zone fiscal capacity may be based—at least initially—on direct contributions from the Member States, but leaving open the possibility that they may derive—in the mid to long term—from a real EU revenue power. The European Parliament, on the contrary, has been adamant in claiming that a euro zone fiscal capacity must be immediately based on authentic EU own resources. This implies an EU power to tax, and to borrow money. In its November 2012 resolution "Towards a Genuine EMU", the Parliament recommended to the Commission to "return to the spirit and letter of the [Treaties]"[43] and develop a budgetary capacity *funded by own resources*. In its resolution the Parliament emphasised especially the economic advantages of this move: at a time of budget consolidation at the national level, the existence of EU own resources would free the Member States from the duty to increase their contributions to finance a fiscal capacity of the EMU. Nevertheless, the Parliament's proposal would also have a clear political advantage. This becomes apparent in light of the deep asymmetry which characterises the Member States of the European Union.

As is well known, in the European Union Member States differ in size, wealth and economic performance. This asymmetry plays a heavy influence on the decision-making process concerning the EU budget—the MFF. The EU budget is nowadays made up for the most part of contributions by the Member States. As a result, the decision-making process concerning the EU budget has been characterised by endless negotiation among the Member States about the precise costs and benefits that each Member State would incur.[44] Because no Member State is willing to transfer its money to the EU budget for the benefit of *other*

[39] European Parliament Resolution, "On Future Legislative Proposals on EMU" (May 23, 2013), P7_TA(2013)0222.

[40] European Parliament Resolution, "On Future Legislative Proposals on EMU" (May 23, 2013), P7_TA(2013)0222, para.22.

[41] European Parliament Resolution, "On Future Legislative Proposals on EMU" (May 23, 2013), P7_TA(2013)0222, para.26.

[42] See F. Fabbrini, "The Fiscal Compact, the 'Golden Rule' and the Paradox of European Federalism" (2013) 38 *Boston College International & Comparative Law Review* 1.

[43] European Parliament Resolution, "Towards a Genuine EMU" (November 20, 2012), P7_TA(2012)0430, Recommendation 2.4.

[44] See R. Perissich, "Le risorse finanziarie e il bilancio europeo: cenni storici" in M. Salvemini and F. Bassanini (eds), *Il finanziamento dell'Europa. Il bilancio dell'Unione e i beni pubblici europei* (Firenze: Passigli, 2010), p.23. (overviewing from an historical perspective the difficulties of the Member States to agree on the revenues of the EU budget).

Member States, the discussion about the MFF has become increasingly costly and decreasingly effective—every Member State having a veto power on how much resources the European Union should raise and how much it should spend. The events relating to the MFF for 2014–2020 provide the latest evidence of this.[45]

The asymmetry between the Member States in size, wealth and economic performance, and the implication of this state of affairs on EU fiscal policy, however, has been magnified by the euro crisis. The intergovernmental method by which the euro crisis has been handled, and the wide recourse that Member States have made to international agreements outside the EU legal order, have deepened the differences between the Member States, exacerbating the division between creditor countries (States which have been net contributors to the newly created mechanisms of stabilisation of the EMU) and debtor countries (States which have largely benefited from financial transfer to address their fiscal troubles).[46] As has been argued, the euro crisis and the responses to it have weakened the balance between Member States and favoured their polarisation.[47] Member States which were net contributors to the rescue of the EMU have become increasingly impatient towards debtor States and as a result have demanded harsh programmes of economic adjustments to assisted countries as a condition for further help. At the same time, Member States which were net benefiters of rescue measures have become increasingly impatient toward creditor States and have perceived the austerity measures conditioning rescue packages as forms of hegemonic rule.

Yet, a system of fiscal governance that is unable to neutralise the challenge of asymmetry presents shortcomings, which threaten its capacity to endure in the long run. As Miguel Maduro has argued, in terms of effectiveness, such a system leaves the governance of the euro "dependent on a permanent 'negotiation' with national democracies [boosting] the uncertainty as to the extent of financial and political support underlying the common currency".[48] At the same time, in terms of legitimacy, this system fosters mistrusts between States:

> "States paying will think they are carrying other states on their shoulders and rewarding moral hazard. [States] being 'disciplined. will take it as being governed by those loaning the money."[49]

The unsustainability of a fiscal union based on financial transfers between Member States has been acknowledged by multiple quarters. Expressing the concerns of creditor States, German Chancellor Merkel made clear in February 2012 that further steps toward closer economic ties in the EMU should not open the door toward a "transfer union", with permanent payments from richer to poor States.[50] At the same

[45] See European Council (November 22–23, 2012) (failing to reach agreement on the MFF 2013–2020); *European Council Conclusions* (February 7–8, 2013), EUCO 37/13 (finding a minimum level convergence leading to the reduction of the size of the overall budget); European Parliament Resolution "On the MFF" (March 13, 2013), P7_TA(2013)0078, para.1 (rejecting the agreement reached by the European Council as inadequate); *European Council Conclusions* (June 27–28, 2013) (reaching political agreement on MFF with the Parliament and Commission); European Parliament Resolution "On the Political Agreement on the MFF" (July 3, 2013), P7_TA(2013)0304, para.1 (approving new political agreement).

[46] See S. Fabbrini, "Intergovernmentalism and its Limits: Assessing the European Union's Answer to the Euro Crisis" (2013) 20 *Comparative Political Studies* 1.

[47] See E. Chiti and P. Teixeira, "The Constitutional Implications of the European Responses to the Financial and Public Debt Crisis" (2013) 50 C.M.L. Rev. 683.

[48] M. Maduro, *A New Governance for the European Union and the Euro*, Report commissioned by the European Parliament Constitutional Affairs Committee, PE 462.484 (2012), p.18.

[49] Maduro, *A New Governance for the European Union and the Euro*, Report commissioned by the European Parliament Constitutional Affairs Committee, PE 462.484 (2012), p.18.

[50] See T. Czuczka, "Merkel Says Euro-Area Fiscal Union won't be 'Transfer Union'" (February 7, 2012), BloombergBusinessweek, *http://www.businessweek.com/news/2012-02-07/merkel-says-euro-area-fiscal-union-won-t-be-transfer-union-.html* [Accessed February 19, 2014].

time, debtor States have experienced increasing discomfort for the harsh conditionality that has accompanied financial aid.[51] In light of this problem, calls have been made to disentangle the EMU fiscal capacity from the contributions of the Member States and to connect it, instead, with the wealth that the Union generates (e.g. through the functioning of the internal market).[52]

By breaking the wrong equation between fiscal capacity and inter-State transfers, the introduction of authentic EU taxes to feed a euro zone fiscal capacity would neutralise the challenge of asymmetries that exist in the EMU, while simultaneously contributing to a clearer justification of the project of European integration by making clear to the European citizens what the European Union does.[53] If a system of own resources independent from the financial contributions of the Member States were in place, the euro zone fiscal capacity would avoid the difficulties that now characterise the debate about fiscal policy in the European Union.[54] From a strictly legal point of view, otherwise, it appears that the EU Treaties offer room for the introduction of EU taxes. A first acknowledgement of the competences of the European Union in tax affairs is made in art.113 TFEU, which empowers the Council, acting unanimously and after consulting the European Parliament, to,

> "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."

Yet, this clause, which is located in the TFEU's Title on Common Rules on Competition, Taxation and the Approximation of Laws, is not directly finalised as the introduction of a new European tax, but rather as the harmonisation of tax rates across the Member States.

However, art.311 TFEU states that "the Union shall provide itself with the means necessary to attain its objectives and carry through its policies". And although this clause, which is located in the TFEU's Title on Financial Provisions, does not mention explicitly a taxing power for the European Union, it affirms that "without prejudice to other revenue, the budget shall be financed wholly from own resources". Moreover, whereas the old text of art.269 TEC only allowed the Council to lay down provisions relating to the system of own resources of the Community, which it shall recommend to the Member States for adoption in accordance with their respective constitutional requirements, the Lisbon Treaty has now modified art.311 TFEU, enlarging the power of the Council to shape the own resources of the European Union. Pursuant to art.311(3) TFEU, in fact, the Council, acting unanimously and after consulting the European Parliament shall.

> "adopt a decision laying down the provisions relating to the system of own resources of the Union. In this context it may establish new categories of own resources or abolish an existing category. That decision shall not enter into force until it is approved by the Member States in accordance with their respective constitutional requirements."

[51] See A. Higgins, "Europe Pressed to Reconsider Cuts as Cure", New York Times, April 27, 2013.

[52] See e.g. I. Pernice et al., *Challenges of Multi-Tier Governance in the European Union*, Report commissioned by the European Parliament Constitutional Affairs Committee, PE 474.438 (2013).

[53] Pernice et al., "Challenges of Multi-Tier Governance in the European Union", PE 474.438 (2013).

[54] In this article I am focusing on the capacity of the European Union to appropriate fiscal resources by raising taxes. It is clear, however, that a taxing capacity would in prospect justify a borrowing capacity. See I. Rodriguez-Tejedo and J. Wallis, "Fiscal Institutions and Fiscal Crises" in P. Conti-Brown and D. Skeel Jr (eds), *When States Go Broke* (Cambridge: Cambridge University Press, 2012), p.9 (explaining how the capacity of a public authority to tax is the condition for it to borrow money on the markets, as the tax base operates as a guarantee that the authority will be able to pay its debts).

The exact interpretation of these provisions is a matter of debate among tax lawyers.[55] In principle, the Treaties could be construed restrictively, arguing that the own resources clause is intended simply to prohibit the Member States from refusing to contribute to the budget of the Union. The Commission, however, has construed art.311 TFEU in a more constructive manner and argued that, and, if combined with art.133 TFEU, it could be read as granting to the European Union the power to adopt new taxes for the benefit of the EU budget. In its June 2011 Proposal for a Council Decision on the system of own resources of the European Union,[56] in fact, the Commission proposed to the Council to introduce as a new category of own resources under art.311 TFEU an FTT, to be collected by the Member States and transferred to the EU budget in lieu of other contributions currently in place. And in its subsequent proposal for a Council directive on an FTT,[57] the Commission indicated that its draft legislative text would be based on art.133 TFEU, thus the harmonisation clause in the TFEU, but that the revenues of the tax would be appropriated by the European Union with the aim to feed the EU budget.

Nevertheless, it is clear that arts 113 and 311 TFEU raise a constitutional challenge on the road towards the establishment of a euro zone fiscal capacity. Pursuant to art.113 TFEU, in fact, the adoption of any legal measure for the harmonisation of tax laws must be taken by the Council *unanimously*. At the same time, under art.311 TFEU the establishment of new own resources for the European Union requires a *unanimous* decision by the Council—to be approved moreover by every Member State in accordance with its constitutional requirement. The existence of a unanimity rule in the field of taxation places a formidable burden on the ability of the European Union to advance in the process of European integration. Joseph H.H. Weiler famously emphasised how the "shadow of the veto" shaped policy-making in the European Union before the introduction of QMV.[58] As has been stated, "[u]nder the prevailing unanimity rule in fiscal matters, an individual Member State can adamantly oppose to any surrender of tax sovereignty to the EU level".[59] Member States' opposition to EU taxation may be due to political reasons—such as the "often visceral rejection of anything that suggests a federal state of affairs"[60]—but also for economic reasons, namely the preservation of States' interest in protecting the fiscal status quo.

In sum, the proposals in favour of a fiscal capacity for the euro zone inevitably pose the question of how to raise resources for an EMU budget. Because of the asymmetry of the EMU, it appears that a euro zone fiscal capacity could only be sustained by authentic EU revenues. But the taxing power of the European Union is currently subject to a unanimity requirement, which renders the exercise of this revenue-raising authority virtually impossible. It is in this context that resort to enhanced co-operation emerged as an option to get out of the EU conundrum in taxing affairs. The case of the FTT provides the emblematic example in this regard.

Enhanced co-operation for the introduction of an FTT

The debate about the introduction of an FTT—originally proposed by US economist James Tobin in the 1970s—saw a rise in popularity in the aftermath of the financial crisis of 2008.[61] The International Monetary

[55] See E. Traversa and A. Maitrot de la Motte, "Le fédéralisme économique et la fiscalité dans l'Union européenne", paper presented at the conference "L'Union européenne et le fédéralisme économique", Paris, June 21, 2013.

[56] Commission Proposal for a Council Decision on the system of own resources of the European Union (June 29, 2011) COM(2011) 510 final.

[57] Commission Proposal for a Council Directive on a common system of FTT (November 28, 2011) COM(2011) 594 final.

[58] See J. Weiler, "The Transformations of Europe" (1991) 100 Yale L.J. 2423.

[59] S. Plasschaert, "Towards an Own Resource for the European Union? Why? How? And When?" (2004) *European Taxation* 470, 476.

[60] Plasschaert, "Towards an Own Resource for the European Union?" (2004) *European Taxation* 470, 476.

[61] See A. Seely, "The Tobin Tax: Recent Developments", House of Commons Library, SN6184 (September 11, 2013).

Fund (IMF) discussed the option of an FTT in a 2010 report,[62] and the theme was raised by Member States of the Group of 20 (G20) the following year.[63] While the debate at the international level did not lead to any concrete step towards the introduction of a global FTT, a number of EU Member States unilaterally decided to enact FTT at the national level.[64] It is in this context that in September 2011 the Commission tabled a proposal for a Council directive on a common system of FTT to be applied throughout the European Union.[65] The Commission proposal was based on art.113 TFEU and, bearing in mind the increasing number of unco-ordinated national tax measures being put in place, sought the harmonisation of FTT across the European Union with the aim to avoid fragmentation in the internal market for financial services.[66]

The Commission proposal, however, was the object of prolonged discussion in the Council and met the fierce opposition by several Member States wary of introducing legislation which would affect their flourishing financial markets.[67] Eventually, in June 2012 the European Council had to acknowledge that the differences between the Member States were unbridgeable and that "the proposal for a FTT will not be adopted by the Council within a reasonable time".[68] Given the impossibility of reaching a consensus in the Council on the introduction of an FTT, in September 2012 11 Member States—Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia and Slovakia—requested to make use of the enhanced co-operation procedure to introduce an FTT among themselves.[69] The enhanced co-operation procedure is a tool, originally introduced by the Amsterdam Treaty and subsequently revised by the Lisbon Treaty, which allows a vanguard group of at least nine Member States to embark upon a project of differentiated integration in fields which are not yet ripe for common action by all EU Member States.[70] Pursuant to the EU treaties, the activation of an enhanced co-operation requires a number of procedural steps which involve all the main EU institutions. In October 2012, the Commission proposed a Council decision authorising enhanced co-operation.[71] The European Parliament consented to this in December 2012,[72] and the Council authorised the co-operation by QMV in January 2013.[73]

On the basis of this, in February 2012 the Commission published a proposal for a Council directive implementing enhanced co-operation in the area of FTT.[74] The February 2012 Commission proposal for the introduction of an FTT largely mirrors the original proposal of September 2011 and, according to the Explanatory Memorandum, would lead to expected revenues of roughly €31 billion annually for the 11

[62] IMF, *A Fair and Substantial Contribution by the Financial Sector: Interim Report for the G20* (April 2010).

[63] G20, *Cannes Summit Final Declaration* (November 4, 2011), para.82.

[64] See e.g. France: art.5, Loi n° 2012-354, J.O.R.F. n° 64 du 15 mars 2012, 4690. See now also Italy: art.1(491), Legge n. 228 del 24 dicembre 2012, G.U.R.I. n. 302 del 29 dicembre 2012.

[65] Commission Proposal for a Council Directive on a Common System of FTT (November 28, 2011) COM(2011) 594 final.

[66] Commission Proposal for a Council Directive on a Common System of FTT (November 28, 2011) COM(2011) 594 final.

[67] See "Europe's Financial Transaction Tax: Oops", *The Economist*, April 27, 2013.

[68] *European Council Conclusions* (June 28, 2012), EUCO 76/12, p.13.

[69] See also B. van Vooren, "The Proposed Financial Transaction Tax Directive: The Quest to Create Momentum at the G20 Through Internal Legislation" in B. van Vooren et al. (eds), *The EU's Role in Global Governance: the Legal Dimension* (Oxford: Oxford University Press, 2013), p.272 (explaining how the division between the Member States reduced the capacity of the European Union to push for the introduction of an FTT on a global scale).

[70] See also D. Thym, "The Political Character of Supranational Differentiation" (2006) 31 E.L. Rev. 781.

[71] Commission Proposal for a Council Decision authorizing enhanced cooperation in the area of FTT (October 25, 2012) COM(2012)631 final/2.

[72] European Parliament Legislative Resolution on the Proposal for a Council Decision authorizing enhanced cooperation in the area of the creation of a FTT (December 12, 2012), P7_TA(2012)0498.

[73] Council Decision 2013/52 [2013] OJ L22/11.

[74] Commission Proposal for a Council Directive implementing enhanced cooperation in the area of a FTT 14 (February 14, 2013) COM(2013) 71 final.

Member States that are party to enhanced co-operation.[75] As the first Recital to the draft directive makes clear, the proposal for the introduction of an FTT springs from the ongoing debate,

> "at all levels on additional taxation of the financial sector. It … originates from the desire to ensure that the financial sector fairly and substantially contributes to the costs of the crisis and that it is taxed in a fair way vis-à-vis other sectors for the future, to dis-incentivise excessively risky activities by financial institutions, to complement regulatory measures aimed at avoiding future crises and to generate additional revenue for general budgets or specific policy purposes."

Pursuant to art.2(2) of the proposal, a financial transaction is to be intended as any purchase and sale of a financial instrument before netting or settlement; transfer between entities of a group of the right to dispose of a financial instrument as owner and any equivalent operation implying the transfer of the risk associated with the financial instrument; conclusion of derivatives contracts before netting or settlement; exchange of financial instruments; repurchase agreement, reverse repurchase agreement, securities lending and borrowing agreement. The institutions subject to the payment of the FTT include, according to art.2(8) of the Commission proposal, investment firms, regulated markets, credit institutions, insurance undertakings, pension funds, alternative investment funds, securitisation vehicles and special purpose vehicles. Moreover, the tax applies to any undertaking, institution, body or person trading with respect to any financial instrument, acquiring holdings in undertakings and participating or issuing financial instruments, provided the average value of the financial transactions constitutes more than 50 per cent of its overall average net annual turnover.

Articles 3 and 4 constitute the central provisions of the Commission proposal, outlining the scope of application of the directive. According to art.3(1):

> "This Directive shall apply to all financial transactions, on the condition that at least one party to the transaction is established in the territory of a participating Member State and that a financial institution established in the territory of a participating Member State is party to the transaction, acting either for its own account or for the account of another person, or is acting in the name of a party to the transaction."

With the aim of preventing the FTT from negatively affecting "the refinancing possibilities of financial institutions and states, []or monetary policies in general or public debt management",[76] art.3(4) excludes from the scope of the directive transactions on the primary market, with the ECB or the central banks of the Member States, with the European Union, the EFSF, the ESM, the EIB, and other international organisations and bodies. Pursuant to art.4,

> "a financial institution shall be deemed to be established in the territory of a participating Member State where any of the following conditions is fulfilled: (a) it has been authorised by the authorities of that Member State to act as such, in respect of transactions covered by that authorisation; (b) it is authorised or otherwise entitled to operate, from abroad, as financial institution in regard to the territory of that Member State …; (c) it has its registered seat within that Member State; (d) its permanent address or … its usual residence is located in that Member State; (e) it has a branch within that Member State…; (f) it is party, acting either for its own account or for the account of another person, or is acting in the name of a party to the transaction, to a financial transaction with another financial institution established in that Member State pursuant to points (a), (b), (c), (d) or (e) …; (g)

[75] Commission Proposal for a Council Directive implementing enhanced cooperation in the area of a FTT (February 14, 2013) COM(2013) 71 final, p.14.

[76] Commission Proposal for a Council Directive implementing enhanced cooperation in the area of a FTT (February 14, 2013) COM(2013) 71 final, p.9.

> it is party … to a financial transaction in a structured product … issued within the territory of that Member State … ."

As indicated in art.5, "[t]he FTT shall become chargeable for each financial transaction at the moment it occurs". The Commission proposal, instead, differentiates the FTT rates to be applied in the case of transactions related to derivative contracts (art.7) and transactions other than those related to derivative contracts (art.6): according to art.9(2), the rates shall be no lower than "0.1% in respect of the financial transactions referred to in Article 6; [and] 0.01% in respect of financial transactions referred to in Article 7". Member States remain free to enact tax rates higher than the EU minima. Pursuant to art.15, however, "[t]he participating Member States shall not maintain or introduce taxes on financial transactions other than the FTT object of this Directive". The Commission proposal then includes a set of provisions aimed at minimising tax evasion, avoidance and abuse. As indicated in art.10(1), the "FTT shall be payable to the tax authorities of the participating Member State in the territory of which the financial institution is deemed to be established". Article 11(5) then prescribes that the FTT shall be paid to the participating Member State "at the moment when the tax becomes chargeable in case the transaction is carried out electronically; [and] within three working days from the moment the tax becomes chargeable in all other cases". Articles 12 and 13 call on the States to adopt measures to prevent tax fraud or arrangements that defeat "the object, spirit and purpose" of the FTT. Article 19, finally, introduces a review clause asking the Commission to examine in three years "the impact of the FTT on the proper functioning of the internal market, the financial markets and the real economy".

While art.20 of the Commission proposal ambitiously planned the entry into force of the FTT from January 2014 for the 11 states participating to the enhanced co-operation, it is unlikely this target will be reached. In July 2013, the Commission proposal received the endorsement of the EU Parliament—which, however, has only a consultative role in the procedure.[77] Yet, as mentioned, in April 2013 the United Kingdom brought legal proceedings in front of the CJEU against the decision of the Council to authorise the use of enhanced co-operation for the introduction of an FTT.[78] Moreover, in September 2013, the Legal Service of the Council of the European Union leaked a confidential opinion questioning the legality of the scope of application of the Commission proposal.[79] Both these events raise important questions about the use of enhanced co-operation for the adoption of an FTT, which need now to be addressed.

Legal challenges

The use of enhanced co-operation for the introduction of an FTT raises a number of critical legal questions. Besides setting a plurality of procedural rules, the EU Treaties foresee resort to enhanced co-operation subject to several substantive requirements.[80] Furthermore, in the recent April 2013 Grand Chamber decision in *Spain & Italy v Council of the European Union*,[81] dealing with enhanced co-operation in the field of unitary patents, the CJEU provided new insights to evaluate the legality of the use of enhanced co-operation in the framework of EU law. In what follows, I will focus on the substantive constraints that surround resort to enhanced co-operation and I will suggest that three main tests must be met for a decision

[77] European Parliament Legislative Resolution on the Proposal for a Council Directive implementing enhanced cooperation in the area of FTT (July 3, 2013), P7_TA(2013)0312. See also European Economic and Social Committee Opinion on the Proposal for a Council Directive implementing enhanced cooperation in the area of FTT (September 19, 2013), 2013/0045(CNS) ("welcom[ing] the proposal put forward by the Commission").

[78] *United Kingdom v Council* (C-209/13), Application lodged April 18, 2013.

[79] Council of the European Union, *Opinion of the Legal Service*, JUR 448 (September 6, 2013) (Confidential Document Interinstitutional File: 2013/0045 (CNS)).

[80] Editorial Comments, "Enhanced Cooperation: A Union à taille réduite or à porte tournante? " (2011) 48 C.M.L. Rev. 317.

[81] *Spain & Italy v Council* (C-274/11 and C-295/11) [2013] 3 C.M.L.R. 24.

on enhanced co-operation to pass muster. For labelling purposes, I will call the first the "constitutional test"; the second the "internal market test"; and the third "the non-affectation test". As I will argue, the use of enhanced co-operation for the introduction of the FTT easily meets the first and second tests. At the same time, I will claim that—contrary to the opinion of the United Kingdom and the Council Legal Service—both the Council decision authorising enhanced co-operation and the Commission draft directive implementing enhanced co-operation comply with the third test.

The first substantive test that enhanced co-operation must meet is the "constitutional test". Although the EU Treaties give only a very sketchy explanation of the constitutional function of enhanced co-operation—art.20 TEU stating that enhanced co-operation "shall aim to further the objectives of the Union, protect its interests and reinforce its integration process"—I have argued elsewhere that the history of the introduction of this mechanism in the EU Treaties and a systematic interpretation of the provisions regulating its use suggest that enhanced co-operation aims to create a pathway through which a "vanguard group" of States can move ahead in achieving an "ever closer Union" in new policy areas.[82] Because enhanced co-operation is not simply a tool to ensure flexibility and differentiation in an enlarging European Union, but is actually designed to achieve a specific goal, namely greater *integration* among a group of EU Member States, I suggested that Member States can activate an enhanced co-operation when they disagree *whether* to act jointly at EU level. On the contrary, the procedure cannot be used when Member States agree on the opportunity of expanding integration into a new legal field but disagree on *how* to act at EU level.[83]

In its first decision dealing with the legality of the use of enhanced co-operation, the CJEU embraced a broader understanding of the function of enhanced co-operation. Rejecting the plea raised by Spain and Italy that the use of enhanced co-operation for the introduction of a unitary EU patent constituted misuse of power, the CJEU held that the use of enhanced co-operation was not restricted only to cases where "at least one Member State declares that it is not yet ready to take part in a legislative action of the Union in its entirety".[84] On the contrary, according to the CJEU,

> "the situation that may lawfully lead to enhanced cooperation is that in which 'the objectives of such cooperation cannot be attained within a reasonable period by the Union as a whole'. The impossibility referred to in that provision may be due to various causes, for example, lack of interest on the part of one or more Member States or the inability of the Member States, who have all shown themselves interested in the adoption of an arrangement at Union level, to reach agreement on the content of that arrangement."[85]

With this reasoning the CJEU de facto gave up on its task to scrutinise the reasons why States decide to resort to enhanced co-operation—a conclusion that I have criticised for failing to protect the integrity of the EU legal order and prevent circumvention of EU Treaty rules.[86] Whatever one's view of the appropriateness of the CJEU's approach, however, it seems undisputed that the use of enhanced co-operation in the case of the FTT is compatible with the "constitutional test" that allows Member States to use enhanced co-operation when a "vanguard group" of Member States wants to move forward in the project of EU integration while others consciously decide to step back. The United Kingdom and several other EU Member States had indicated clearly their opposition *tout court* toward the adoption of EU rules in

[82] F. Fabbrini, "Enhanced Cooperation Under Scrutiny: Revisiting the Law and Practice of Multi-Speed Integration in Light of the First Involvement of the EU Judiciary" (2013) 40 *Legal Issues Economic Integration* 197.

[83] Fabbrini, "Enhanced Cooperation Under Scrutiny" (2013) 40 *Legal Issues Economic Integration* 197, 208.

[84] *Spain and Italy v Council* (C-274/11 and C-295/11) [2013] 3 C.M.L.R. 24 at [36].

[85] *Spain and Italy v Council* (C-274/11 and C-295/11) [2013] 3 C.M.L.R. 24 at [36].

[86] Fabbrini, "Enhanced Cooperation Under Scrutiny" (2013) 40 *Legal Issues Economic Integration* 197, 220.

the area of FTT.[87] Contrary to the case of enhanced co-operation for the establishment of an EU patent—where Italy and Spain did not disagree with the other Member States on the opportunity to introduce a EU patent protection system, but rather disagreed with the other Member States on how do so (namely, what languages to use)—in the case of the FTT, the opposition of the United Kingdom goes to the very heart of the proposal to enact harmonising measures at EU level to introduce a common system of FTT.[88] In this state of affairs, the use of enhanced co-operation by 11 Member States is legitimate.

The second test that the use of enhanced co-operation must meet is the "internal market test". Pursuant to art.326 TFEU, in fact,

> "enhanced cooperation shall comply with the Treaties and Union law. Such cooperation shall not undermine the internal market or economic, social and territorial cohesion. It shall not constitute a barrier to or discrimination in trade between Member States, nor shall it distort competition between them."

In its judgment in *Spain and Italy v Council*, the CJEU did not dwell at length on the meaning of art.327 TFEU, rejecting the plea of the applicant state on the argument that,

> "it cannot validly be maintained that, by having it in view to create a unitary patent applicable in the participating Member States and not in the Union, the contested decision damages the internal market or the economic, social and territorial cohesion of the Union."[89]

However, the matter was addressed in greater depth by A.G. Bot in his Opinion of December 2012.[90] There the Advocate General stated that there was no evidence that the decision authorising the use of enhanced co-operation in the field of unitary patent would undermine the internal market or economic, social and territorial cohesion. In fact, according to the Advocate General, "it would do precisely the opposite".[91] Citing the impact assessment of the Commission, A.G. Bot emphasised how,

> "a mechanism intended to create a unitary patent entailing uniform protection on the territory of several Member States contribute[d] to the harmonious development of the Union as a whole, since it ha[d] the consequence of reducing the existing disparities between those Member States."[92]

The opinion of the Advocate General suggests that the EU judiciary is employing a comparative test to evaluate whether the use of enhanced co-operation violates the provision of art.326 TFEU. Under this test, an enhanced co-operation is regarded as legitimate when it *does not worsen* the (already existing) fragmentation of the internal market. On the contrary, enhanced co-operation would not be authorised if it *worsened* the status quo, e.g. by introducing new obstacles to the functioning of the EU internal market. In the case of the enhanced co-operation for a unitary patent, the Advocate General underlined how, until then, 27 different national patent systems coexisted within the European Union, fragmenting the internal market,[93] and how, instead, enhanced co-operation,

[87] See Council of the EU, PRESSE 23 (January 22, 2013) (indicating that the decision authorising enhanced co-operation for the introduction of a financial transaction tax was adopted by qualified majority, with the abstention of the United Kingdom, the Czech Republic, Luxembourg and Malta, all of which declared their opposition to the adoption of common EU rules in the field).

[88] See also *Hansard*, HC, cols 11–12 WS (October 16, 2012) (UK Chancellor of the Exchequer George Osborne stating in the House of Commons that "the UK would not be joining" enhanced co-operation for an FTT).

[89] *Spain and Italy v Council* (C-274/11 and C-295/11) [2013] 3 C.M.L.R. 24 at [75].

[90] Opinion in *Spain and Italy v Council* (C-274/11 and C-295/11) [2013] 3 C.M.L.R. 24.

[91] *Spain and Italy v Council* (C-274/11 and C-295/11) at [143].

[92] *Spain and Italy v Council* (C-274/11 and C-295/11) at [151].

[93] *Spain and Italy v Council* (C-274/11 and C-295/11) at [144].

> "relating to the creation of a unitary patent producing uniform effects on the territory of … 25 Member States, necessarily help[ed] to improve the functioning of the internal market and to reduce barriers to trade and also the distortion of competition between the Member States."[94]

Applying mutatis mutandis this reasoning to the case of FTT, it appears that also in this context the use of enhanced co-operation meets the "internal market test". As of today, EU Member States are free to adopt national FTT—and some of them have.[95] This has an impact on the functioning of the internal market. By introducing a common system for the Member States that participate in enhanced co-operation, the proposal for an FTT reduces the differences in the regulatory regimes in place across the EU Member States. As such, while the use of enhanced co-operation does not resolve the problem of the fragmentation of the internal market, it certainly does not worsen it either. Rather, it creates a more consistent regulatory framework at least for all those States which are party to the co-operation. Hence, the proposal for an FTT via enhanced co-operation also meets the "internal market test".

The third core substantive test that the use of enhanced co-operation must pass is then the "non-affectation test". Pursuant to art.327 TFEU "enhanced cooperation shall respect the competences, rights and obligations of those Member States which do not participate in it". Surprisingly, the "non-affectation test" seems to be at the heart of the proceedings brought by the United Kingdom before the CJEU with regard to the legality of the Council decision authorising enhanced co-operation in the area of FTT.[96] Nevertheless, the question whether enhanced co-operation affects in an impermissible manner the competences, rights and obligations of those Member States which do not participate in it hardly arises in the decision of the Council, which *simply* authorises enhanced co-operation. Rather, the question will only arise once the Member States which are party to enhanced co-operation exercise their power within this framework: it is in fact the legal act adopted by the EU Member States participating in enhanced co-operation that might adversely affect non-participating Member States. This point emerges plainly from the judgment of *Spain and Italy v Council*, where the CJEU, following in A.G. Bot's footsteps, discarded as inadmissible at that stage the plea raised by the applicant States which concerned the substance of the future measures to be adopted in the framework of enhanced co-operation.[97]

In light of the above, it would seem inevitable to conclude that the UK challenge before the CJEU is bound to meet with an inadmissibility decision, because it concerns a question that has nothing to do with the Council decision *authorising* enhanced co-operation in the area of the FTT, but rather concerns the substance of the Commission proposal for a Council directive *implementing* enhanced co-operation in the area of the FTT. However, because the question whether the FTT designed by the Commission is liable to infringe the "non-affectation test" was at the core of the leaked opinion of the Council Legal Service, it is appropriate to consider here already whether the worries raised by the United Kingdom and the legal experts of the Council have any foundation. In its leaked document, the Legal Service of the Council took issue especially with art.4(1)(f) of the Commission proposal, which introduces a so-called "counter-party" principle which makes subject to the FTT also financial institutions established outside the FTT zone which transact with financial institutions established within the FTT zone.[98] As was mentioned in the previous section, art.4(1) of the Commission proposal sets out a number of connecting factors to regulate

[94] *Spain and Italy v Council* (C-274/11 and C-295/11) [2013] 3 C.M.L.R. 24 at [149].

[95] See fn.64.

[96] Council of the EU, *Information Note of the Legal Service*, JUR 264 (May 24, 2013), para.2 (Council Legal Service reporting that the grounds of the challenge of the United Kingdom before the CJEU are that "the Authorizing Decision is unlawful because it authorises the adoption of a [FTT] with extraterritorial effects which is contrary to Article 327 TFEU ….").

[97] *Spain and Italy v Council* (C-274/11 and C-295/11) [2013] 3 C.M.L.R. 24 at [76].

[98] Council of the European Union, *Opinion of the Legal Service*, JUR 448 (September 6, 2013) (Confidential Document Interinstitutional File: 2013/0045 (CNS)).

the scope of application of the FTT: the FTT is chargeable to any financial institution which is either resident in the FTT zone (residence principle: art.4(1)(a)–(d)), or is party to a financial transaction in structured products issued within the FTT zone (issuance principle: art.4(1)(g)), or to transactions with an institution of the FTT zone (art.4(1)(f)).

According to the Council Legal Service, by deeming established within the FTT zone a financial institution resident outside the Member States party to the co-operation when it interacts with a financial institution resident within the Member States of the co-operation, art.4(1)(f) of the Commission draft violates a number of legal tenets—which ultimately concern the "non-affectation test". In the Legal Service's view: first, art.4(1)(f) raises issues of "extraterritorial exercise of jurisdiction",[99] since it would impose tax obligations "over entities located outside the geographical area concerned by the legislation adopted under the enhanced cooperation".[100] Secondly, it threatens different treatment of resident and non-resident financial institutions as to the connecting factors applied, by discriminating against financial institutions that are not resident in the participating state.[101] Thirdly, it infringes the right of the non-participating Member States by limiting their capacity "to maintain or adopt their own tax system".[102] Fourthly, it distorts competition between the Member States.[103] And fifthly, it would hinder free movement of capital, by producing "an effect equivalent to that of a duty imposed in return of the possibility to enter into a transaction with an institution located in a participating Member State".[104]

The criticisms of the Council Legal Service do not appear convincing. First, the concern that the "counter-party" principle results in an extra-territorial application of tax jurisdiction fails to notice that art.4(1)(f) of the Commission proposal valorises a clear connecting factor: once a financial institution resident outside the FTT zone transacts with a financial institution resident within the FTT zone, *it shall pay the FTT*. This customarily occurs in tax legislation. To use an example: if a British citizen purchases wine from an Italian producer, he/she will be subject to Italian VAT—regardless of where he is resident, of course. Why would rules have to be different where a transaction involved financial institutions and concern financial instruments? The nature of the economic operation is diverse, but the underlying logic is the same: once someone does business with the FTT zone, it can be taxed by it. Secondly, the Council Legal Service argues that art.4(1)(f) has a discriminatory effect between transactions involving financial institutions which are resident in the FTT zone, and institutions which are not. In fact, however, the very opposite is true. The end result of the rule designed in the Commission proposal is that *every financial institution transacting within the FTT will be taxed*. Discrimination would instead emerge if the Commission were to exempt from the FTT financial institutions resident outside the FTT zone, but transacting within it—as the Council Legal Service suggests. In this case, institutions established outside the FTT could do business within the FTT without having to bear the tax costs that apply to institutions resident within the FTT. Thirdly, the Council Legal Service contends that art.4(1)(f) interferes with the tax jurisdiction of non-participating Member States. This is untrue: financial institutions established outside the FTT zone and which do not do business with the FTT zone are not subject to the FTT. Non-participating Member States are free to regulate and tax operations occurring outside the FTT zone as they see fit, and it is only the autonomous choice of economic actors outside the FTT zone to transact with financial institutions within the FTT zone that brings them under the scope of application of the FTT. Which leads us to the last points raised by the Council Legal Service: namely, that art.4(1)(f) distorts competition and hinders free movement of capital. However, bluntly put: this argument is not a legal one. Chicago School economists

[99] *Opinion of the Legal Service*, JUR 448 (2013/0045 (CNS)), para.17.
[100] *Opinion of the Legal Service*, JUR 448 (2013/0045 (CNS)), para.18.
[101] *Opinion of the Legal Service*, JUR 448 (2013/0045 (CNS)), para.26.
[102] *Opinion of the Legal Service*, JUR 448 (2013/0045 (CNS)), para.35.
[103] *Opinion of the Legal Service*, JUR 448 (2013/0045 (CNS)), para.39.
[104] *Opinion of the Legal Service*, JUR 448 (2013/0045 (CNS)), para.40.

have developed economic arguments to claim that taxes are costs that burden the functioning of the financial markets—but no legal principle prevents sovereign States from introducing (even stupid) taxes if they democratically decide so. Every tax may affect the functioning of the market, and the FTT is no exception. However, this does not prohibit States from introducing an FTT, either severally or jointly through the form of enhanced co-operation.

All in all, therefore, it seems that the legal questions raised about the legality of resort to enhanced co-operation for the introduction of an FTT can be set aside. The Council decision authorising the use of enhanced co-operation in the area of FTT, as well as the follow-up draft Commission proposal for a Council directive implementing enhanced co-operation in the area of FTT, meet the "constitutional test", the "internal market test" and the "non-affectation test". In particular, the concerns that animate the legal challenges of the United Kingdom before the CJEU and the leaked opinion of the Council Legal Service do not withstand attentive legal scrutiny. Yet, the legality of enhanced co-operation in the area of FTT tells us nothing about the political challenges that this option faces, owing to the interaction between taxing and spending in the EMU. I shall now turn to this question.

Political challenges

Whereas the use of enhanced co-operation to introduce an FTT withstands legal scrutiny, the adoption of the FTT by a limited number of EU Member States raises several political challenges. These become evident if we return to the starting point of the analysis: namely, the relationship between taxing and spending in the euro zone. Since the beginning, the proposals to endow the EMU with a fiscal capacity and those to introduce authentic EU taxes were linked. As explained above, raising revenues at EU level was seen as the necessary step to establish a real budgetary power in the euro zone and liberate the EMU fiscal policy from the recriminations that these days characterise fiscal transfers between the Member States. As argued by Miguel Maduro, the introduction of EU taxes—be it the FTT, or alternatively, a carbon emission tax or an EU corporate tax—"will not only provide [the EU] with the funds necessary to support [a] budget increase but will contribute to a clearer justification of the project of European integration … It is essential that the Union is seen as redistributing the Union wealth and not the wealth of some states".[105] However, the introduction of an FTT by only *some* States—11 out of the 18 members of the euro zone as of January 1, 2014—makes it politically difficult to direct the revenues levied through the FTT into common spending for *all* the EMU.

This state of affairs is reflected in the changing destination envisioned for the FTT by the Commission. While the original November 2011 Commission proposal for a Council directive on the FTT clearly linked the introduction of the FTT to the creation of "a new own resource to be entered into the budget of the EU",[106] the new February 2013 proposal, taking stock of the fact that only a few Member States will introduce the FTT via enhanced co-operation, proposes less ambitiously that "part of the receipts generated by the FTT shall constitute an own resource", reducing the direct contribution by these Member States.[107] As explained in the Legislative Financial Statement annexed to the proposal, the Commission envisioned that "levying FTT would facilitate efforts of budgetary consolidation in the participating member states".[108] Yet, the FTT could, at best, replace other forms of direct contribution that the Member States currently

[105] Maduro, "A New Governance for the European Union and the Euro", PE 462.484 (2012), p.21.

[106] Commission Proposal for a Council Directive on a common system of FTT (November 28, 2011) COM(2011) 594 final, p.3.

[107] Commission Proposal for a Council Directive implementing enhanced cooperation in the area of a FTT (February 14, 2013) COM(2013) 71 final, p.4.

[108] Commission Proposal for a Council Directive implementing enhanced cooperation in the area of a FTT (February 14, 2013) COM(2013) 71 final, p.33.

make to the EU budget, with "their GNI-based national contributions [being] reduced".[109] Hence, although the European Council had noted in February 2013 the use of enhanced co-operation for the introduction of the FTT and invited the participating Member States to examine if the FTT could become the basis for a new own resource for the EU budget, without impacting on non-participating Member States,[110] the Commission proposal retreated to a position in which the FTT will accrue the Member States' budget and be used, at best, to replace other forms of national contributions to the EU budget.

This seems an inevitable choice, as acknowledged also by the EU Parliament in its legislative resolution of July 2013.[111] Commenting in its consultative role the February 2013 Commission proposal for the implementation of enhanced co-operation in the area of FTT, the Parliament underlined how:

> "The use of FTT revenue as Union own resources is possible under the enhanced cooperation procedure only if national contributions of participating Member States to the Union budget could be reduced by the same amount and would avoid the disproportionate contribution by participating Member States compared to non-participating Member States."[112]

At the same time, the Parliament expressed its wish that things could change in the long-term, holding that:

> "Once FTT is implemented at Union level, all or part of the amount of the own resources originating from FTT should be added to the national contributions of the Member States in order to gather new funding sources for European investment without a reduction of the national contributions of the participating Member States to the Union budget."[113]

Of course, if at least all the Member States of the euro zone were participating in enhanced co-operation, the resources raised with an FTT could be set aside in a special euro zone fund, functioning as the bulk of the fiscal capacity proposed in the high-level policy documents discussed above.[114] However, the refusal to join an enhanced co-operation in the area of FTT did not come only from the United Kingdom, or other Member States outside the euro zone: Cyprus, Finland, Ireland, Latvia, Luxembourg, Malta and the Netherlands—countries within the euro zone which embrace a lighter taxing and regulatory framework toward the banking sector, or simply oppose further EU integration in the fiscal arena—refused to be involved in raising the FTT.[115] It would therefore be politically difficult to justify the use of resources gathered within the FTT zone to address, say, risks of bank failures in Cyprus or high unemployment rates in Ireland (two hypotheses that are far from imaginary). At the same time, while proposals have been made to create a special fund among the 11 Member States of the FTT zone to be used for the common benefits of the members only,[116] it is clear that such a step would require a political agreement—which is

[109] Commission Proposal for a Council Directive implementing enhanced cooperation in the area of a FTT (February 14, 2013) COM(2013) 71 final, p.33.

[110] European Council Conclusions (February 8, 2013), EUCO 37/13, para.115.

[111] European Parliament Legislative Resolution on the Proposal for a Council Directive implementing enhanced cooperation in the area of FTT (July 3, 2013), P7_TA(2013)0312.

[112] European Parliament Legislative Resolution on the Proposal for a Council Directive implementing enhanced cooperation in the area of FTT (July 3, 2013), P7_TA(2013)0312, Amendment 2.

[113] European Parliament Legislative Resolution on the Proposal for a Council Directive implementing enhanced cooperation in the area of FTT (July 3, 2013), P7_TA(2013)0312, Amendment 2.

[114] See text accompanying notes fnn.11–41.

[115] See C. Grant, "Britain Could Reshape Europe, if it Only Tried", *Financial Times*, May 14, 2013 (outlining arguments for opposition to the FTT in several euro zone Member States).

[116] See A. Majocchi, "A European Fund for Growth and Development", *New Federalist*, June 30, 2013.

hardly likely to take place given the eagerness of the participating Member States to use the income of the FTT to fill their depleted coffers.[117]

In conclusion, though the use of enhanced co-operation to adopt an FTT appears legally sound, it makes it politically difficult to establish an EMU fiscal capacity endowed with own resources. Although, as it has been stated, "[t]he political difficulties in the way of a genuine EU tax … could, in principle, be overcome if a substantial number of Member States were to muster the political will to move ahead, conceivably within the 'enhanced cooperation' framework, thus sidestepping the unanimity rule which remains staunchly defended by a few member states",[118] the relationship between taxing and spending undermines the ability of enhanced co-operation in the area of FTT to provide the financial resources needed for a euro zone fiscal capacity. In fact, it is precisely with the aim of facilitating progress in the area of fiscal policy that, more than 10 years ago, the *European Convention Working Group VI on Economic Governance* had recommended "some changes [to] be made to the existing decision-making procedures".[119] In particular, the use of QMV would allow the introduction of new European taxes by overcoming the collective action problems produced by unanimity vote. While the prospect of achieving QMV at the level of the European Union may be unlikely, opportunities might open to this end in the framework of the euro zone as a result of the pressures brought to bear by the euro crisis.[120]

As has been increasingly emphasised from both an academic and a political perspective, the degree of interdependences attained in the euro zone may soon demand the elaboration of a new institutional framework in which the Member States are able to manage adequately the challenges posed by a currency Union.[121] According to Jean-Claude Piris, given the unfeasibility of a general Treaty reform for all 28 Member States of the European Union, those States that are part of the euro area should institutionalise their closer co-operation—in his view, through an additional treaty—and set up a more effective decision-making system.[122] In its final report, *Towards a Genuine EMU*, the European Council President traced the need for constitutional reform in the euro zone,[123] and—although the integrity of the single market remains dear to all members of the European Council[124]—as much has been recognised by British Prime Minister Cameron in his January 2013 speech when he stated that "we all need the Eurozone to have the right governance and structures to secure a successful currency for the long term".[125] In the context of an increasingly likely overhaul of EMU, the introduction of QMV for the adoption of tax legislation should be regarded as a key reform to ensure the ability of the euro zone to endow itself with the financial resources needed to support an autonomous fiscal capacity.

At the same time, a reformed euro zone constitutional architecture with the possibility of enacting taxes by QMV ought to be compensated by greater parliamentary legitimacy. Since the early stages of constitutionalism, legislative bodies, as the direct representatives of the people, have conditioned the

[117] See D. Pesole, "Ora Roma teme riflessi sul debito", *Il Sole 24 Ore*, February 14, 2013 (explaining that the Italian Government has already committed the income of the FTT to its domestic budget).

[118] Plasschaert, "Towards an Own Resource for the European Union?" (2004) *European Taxation* 470, 479.

[119] European Convention, *Working Group VI on Economic Governance*, Final Report (October 21, 2002), CONV 357/02, WG VI 17, p.6.

[120] See on the implications of the euro crisis on the governance framework of the European Union and the EMU, K. Armstrong, "The New Governance of EU Fiscal Discipline" (2013) 38 E.L. Rev. 601.

[121] See e.g. the joint statement by France and Germany, "Together for a Stronger Europe of Stability and Growth" (May 29, 2013) (calling for strengthened euro zone governance); and the report of the Glienicker Group, A. von Bogdandy et al., *Towards a Euro Union* (October 17, 2013) (same).

[122] J.-C. Piris, *The Future of Europe: Towards a Two-Speed EU?* (Cambridge: Cambridge University Press, 2012), pp.121ff.

[123] See President of the European Council, Final Report, *Towards a Genuine EMU* (December 5, 2012), p.12 (suggesting even the establishment of a Treasury for the euro zone with the ability to borrow money on the markets).

[124] *European Council Conclusions* (October 25, 2013), EUCO 169/13, p.13.

[125] D. Cameron, Prime Minister of the United Kingdom, "EU Speech" (January 23, 2013).

adoption of taxes to their approval.[126] As is well known, however, the EU Parliament currently exercises only a consultative role in tax matters. In its resolution authorising the use of enhanced co-operation for the introduction of the FTT, the Parliament complained of this state of affairs and called the Council to enhance the role of the Parliament in decision-making related to taxation through the use of the "*passerelle* clause". As the Parliament emphasised, on the basis of art.333(2) TFEU:

> "Where a provision of the Treaties which may be applied in the context of enhanced cooperation stipulates that the Council shall adopt acts under a special legislative procedure, the Council, acting unanimously … may adopt a decision stipulating that it will act under the ordinary legislative procedure."

Hence, the Parliament,

> "call[ed] on the Council to adopt a decision pursuant to Article 333(2) TFEU, stipulating that when it comes to the proposal for a Council Directive implementing enhanced cooperation in the area of FTT pursuant to Article 113 TFEU, it will act under the ordinary legislative procedure."[127]

Yet, resort to the "*passerelle* clause" depends on a political decision of the Member States in the Council.[128] The future decision-making framework for the adoption of taxation in the context of the euro zone should therefore foresee the full involvement of the EU Parliament as co-legislator, removing from the Member States the discretion whether to involve the EU Parliament and restoring at the European level the principle of "no taxation without representation".[129]

Conclusion

The article examined the recent proposals to endow the euro zone with a fiscal capacity and explained how this requires raising new EU own resources. It analysed the draft legislation on the FTT and discussed its introduction by 11 euro zone countries through the use of enhanced co-operation because of the lack of consensus among all the EU Member States. Resort to enhanced co-operation in the area of FTT has been the object of legal challenges, but this article set them aside. Enhanced co-operation for the introduction of the FTT is compatible with the constitutional function of this instrument, does not unlawfully interfere with the functioning of the internal market and leaves the rights and privileges of the non-participating Member States unaffected—so it is legal. However, the article highlighted that resort to enhanced co-operation for the adoption of the FTT complicates the possibility of using the revenues of the FTT for common EMU spending. Because taxing and spending are two sides of the same coin, levying the FTT in 11 States of the euro zone undermines the possibility of appropriating the FTT revenues for the benefit of a common euro zone budget. The proposals to create a fiscal capacity outlined in the report of the European Council President and in the blueprint of the Commission are part of a broader road-map of reforms of the EMU. In the end, this article suggests that a fiscal capacity—a much-needed improvement to manage the interdependences that exist in the euro zone—cannot be severed from an enhanced EMU governance framework in fiscal affairs. Common spending requires the capacity to levy taxes, but also QMV and the principle of "no taxation without representation". Ultimately fiscal union demands political

[126] See also B. Ackerman, "Taxation and the Constitution" (1999) 99 Columbia L. Rev. 1.

[127] European Parliament Legislative Resolution on the Proposal for a Council Decision Authorizing Enhanced Cooperation in the Area of the Creation of a FTT (December 12, 2012), P7_TA(2012)0498, para.2.

[128] On the "*passerelle* clause" see G. Amato, "Future Prospects for a European Constitution" in G. Amato et al. (eds), *Genesis and Destiny of the European Constitution* (Brussels: Bruylant, 2007), pp.1271, 1272.

[129] See also President of the European Council, Final Report, *Towards a Genuine EMU* (December 5, 2012), p.16 (arguing in favour of "the involvement of the European Parliament as regards accountability for decisions taken at the European level").

union. While, so far, resort to enhanced co-operation to adopt an FTT is wholly acceptable from a legal point of view, further institutional reforms are needed in political terms to reunite taxing and spending at the supranational level and establish a deeper and more genuine EMU.