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Does Commission Proposed Financial Transaction Tax Comply With European Union Law?

1. The proposal

On 14 February 2013, the European Commission adopted the proposal[*1] for a Council Directive implementing enhanced co-operation in the area of financial transaction tax. It's not clear how the tax on financial transactions will be implemented as many stakeholders have acknowledged its detrimental impact. Thus, it remains to be seen by whom and how exactly it will be done. However, since 11 Member States have joined the cooperation and consequently indicated interest in proceeding with discussions on issues of application of the tax, it is most appropriate to analyse whether there are legal consequences to this initiative. After all there are less than half Member States participating in it. And there is widespread negative feedback from interested parties.

Most certainly this is largely a political matter that clearly has economic impact[*2] as well. Whether planned or otherwise remains to be seen. However, the legal issues associated with the Proposal are fascinating as well. Intriguingly enough, the Proposal is based on enhanced co-operation of a sort that has been applied only a few times. Also its aim is to harmonise legislation pertaining to indirect taxation in order to ensure proper functioning of the market, while only part of the internal market supports it. This most certainly raises the question of whether the aims of the Proposal, including avoiding distortion of competition while at the same time creating a level playing field with other sectors from a taxation point of view, can indeed be reached. These legal concerns cannot be ignored.

1 See the European Commission proposal for a Council Directive implementing enhanced co-operation in the area of financial transaction tax (COM/2013/71) (hereinafter 'Proposal'). Available at http://ec.europa.eu/taxation_customs/resources/documents/taxation/com_2013_71_en.pdf (most recently accessed on 14.4.2013).

2 Impact assessment accompanying the document 'Proposal for a Council Directive Implementing Enhanced Cooperation in the Area of Financial Transaction Tax': Analysis of policy options and impacts' (SWD/2013/28). Available at http://ec.europa.eu/taxation_customs/resources/documents/taxation/swd_2013_28_en.pdf (most recently accessed on 14.4.2013).

2. The legal basis

According to the Proposal, the legal basis for the proposed Council Directive is Article 113 of the Treaty on the Functioning of the European Union[*3] (TFEU). Said article gives the Council the right to adopt provisions for the harmonisation of legislation on turnover taxes, excise duties, and other forms of indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and functioning of the internal market and to avoid distortion of competition.

It is evident that, for one to rely on Article 113 of the TFEU for adoption of provisions for harmonisation, a number of requirements must be met. Firstly, it seems that this article can be relied on for harmonisation only. Secondly, any action undertaken has to apply to indirect taxation such as tax on turnover; a common tax of this nature in the European Union is the value added tax.[*4] Thirdly, it has to ensure establishment and functioning of the market. Fourthly, it must not distort competition. If those requirements are not met, reliance on Article 113 of the TFEU as the basis for the Proposal becomes highly questionable. Without this basis, this Proposal for a directive can hardly exist.

2.1. Harmonisation

Harmonisation is, in essence, a measure to unify practice in a particular part of the internal market. Notwithstanding whether the intention is total or only partial unification, it still means fundamentally that the whole market is or should be affected by it. Otherwise, it would not be possible to talk about unifying anything. However, enhanced co-operation, by definition, also can affect only participating Member States. Otherwise, it would simply not make sense to proceed with enhanced co-operation in the stead of some other legislative procedure. This means that enhanced co-operation is not intended for unification. Thus actions taken under the enhanced co-operation can hardly be regarded as attempts at harmonisation, by its very nature.

Even if this were an actual attempt at harmonisation, it would be easy to argue that it is nevertheless built on incorrect assumptions. The TFEU directly states that measures need to bear the aim of harmonising of legislation. Therefore, there has to exist something that is to be harmonised in the first place. However, according to the impact assessment[*5] in this case, not all Member States have imposed a tax on financial transactions similar to that in the Proposal. Therefore, it is impossible to refer to any kind of harmonisation of legislation. At least in part—i.e., with reference to those Member States that do not have anything similar already enacted—it would just be drafting of new legislation.

Another issue with harmonisation is that Article 113 of the TFEU only pertains to the field of indirect taxation. The impact assessment, on the other hand, leads one to believe that the measures already imposed by Member States are not necessarily examples of indirect taxation. Rather, they—with exceptions, of course—often resemble more of a levy or a state fee. Therefore, the harmonisation could not cover all of those so-called taxes. This means that a European-Commission-proposed financial transaction tax would not actually harmonise existing legislation in that sense either, because those monetary obligations that differ in nature from the proposed financial transaction tax would still remain effective.

2.2. A new tax

Since harmonisation in the meaning of Article 113 of the TFEU can only apply to the area of indirect taxation, it is of utmost importance to establish whether the proposed financial transaction tax indeed is an indirect tax. Notwithstanding the object of an indirect tax, an indirect tax is by its very nature a tax that essentially comes about through the consumer of goods or services.[*6] In addition, the tax cannot depend on who the taxpayer is.[*7] Otherwise, it would lack neutrality, another essential element of an indirect tax.[*8]

3 Treaty on the Functioning of the European Union. – OJ C 326, 26.10.2012.

4 Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax. – OJ L 347.

5 See the impact assessment (Note 2), pp. 57–63.

6 L. Lehis. *Maksuõigus* ['Tax Law']. Tallinn: Juura 2004, p. 46 (in Estonian).

7 *Ibid.*, p. 353.

8 *Ibid.*, p. 358.

In the case of the proposed tax, however, that criterion is not met. According to the Proposal, the tax is imposed on certain financial transactions to ensure that financial institutions make a so-called fair and substantial contribution to covering the costs of the crisis. This could not occur in the case of an indirect tax, wherein the burden is essentially born by the consumer. Imposing the financial transaction tax in this manner would ultimately, in one way or the other, only increase the costs for the consumer of services, but it would still not be a tax that is passed on to them as indirect taxes are.

This position is supported by Recital 14 of the Proposal, which states that the taxation should concentrate on the financial sector as such rather than on citizens. This makes the passing of the tax on to citizens highly questionable, whatever means might be chosen for this by financial institutions. On the other hand, passing on the costs that a financial institution bears in those transactions through, for example, fees and commissions to citizens would not ultimately lead to establishment of the proposed tax as an indirect tax that is borne by the consumer of services.

In addition, it cannot be left unnoticed that this proposed tax depends on the nature of the taxpayer. It is levied only on the financial institution specified in Article 1 (8) of the Proposal. Therefore, it is not objective; however, objectivity is, as is stated above, an essential feature of an indirect tax.

On this basis, it is fair to state that the tax is not an indirect tax because it is borne not by the consumer but, rather, by a financial institution. Even if one concedes that financial institutions conclude financial transactions, it cannot be left unnoticed that they are concluded also for and on behalf of their clients, and not just for their own purposes. These clients again are not necessarily financial institutions. Again, transactions of citizens and certain other bodies covered by the Proposal should not be subject to this tax. It becomes even more evident here that the tax is dependent on the taxpayer.

Moreover, the proposed financial transaction tax seems to bear the aim of taxing the profits of the financial sector. This can be concluded on the basis of one of the aims of the Proposal, that of ensuring that financial institutions contribute to covering the costs of the crisis. It is true that, on the other hand, it lacks certain elements that would identify it directly as a tax on income. This is so because in the case of the proposed tax everything received as consideration for the transaction is taxed, not merely the profit.[*9]

Also, the proposed tax cannot be considered some kind of existing indirect tax either. At least there is no analysis to support this view. The impact assessment[*10] itself declares that this tax is not a value added tax or an excise duty. If this is so, it remains utterly unclear what other kind of indirect tax this proposed financial transaction tax could be. Therefore, it seems that the Proposal would create a whole new tax. That too, however, is not within the scope of Article 113 of the TFEU, since imposing a new tax and doing so for a limited number of Member States cannot be considered harmonisation in the meaning of the TFEU.

2.3. Competition

There is more than one way to look at the issue of competition. The fact is that imposing the proposed financial transaction tax in some Member States only would evidently give others an advantage: for example, their tax environment would be less complex, and it would also be easier to attract additional funding. The same applies to financial instruments—and ultimately to the issuers thereof—that are deemed issued in a participating Member State.

In the case of the latter financial instruments, issuers from a participating Member State would have difficulties in competing with issuers of financial instruments who are considered established in a non-participating Member State, because, for example, they, unlike others, would be more expensive to purchase. Therefore, it is evident that the tax provides seeds for distortion of competition and not the opposite—i.e., what should be the aim of measures taken under Article 113 of the TFEU. It also conflicts with Article 326 of the TFEU, which states that enhanced co-operation shall not distort collaboration among Member States.

Another way to look at the issue of competition is that expressed by the Supreme Court of Estonia.[*11] According to the judgement in question, the value added tax is a tax on value that has been added. The essential feature of such a tax is the right to deduct input VAT, which assures that VAT does not accumulate.

9 See L. Lehis (Note 6), pp. 44–47.

10 See the impact assessment (Note 2), p. 54.

11 Supreme Court of Estonia 28.05.2002, 3-3-1-21-02, *AS Balti Investeeringute Grupp v. Tartu Linna Maksuamet*, para. 18. Available at http://www.nc.ee/?id=11&tekst=RK/3-3-1-21-02 (in Estonian).

Therefore, as long as goods and services are provided to business, tax will, in essence, not be collected. Proceeds will be generated only if the buyer is a person who does not have the right to deduct VAT. Any deviation from that principle is not allowed, because it would distort competition and prevent free movement of goods and services through increase in production costs.

This reasoning stated by the Court should, overall, be applicable to the proposed financial transaction tax as well. If this indeed is a tax on turnover or any other form of indirect taxation, as can be assumed from the legal basis, it must follow the principle laid down in connection with the above argument; i.e., it may not be accumulating and most certainly is not to be imposed on business, which it nevertheless is. Otherwise, certain service providers would have an unfair advantage over others in essentially the same market—i.e., within the European Union. If one holds that the proposed tax actually is not a form of indirect taxation, thus not raising the issue of competition, the issue of the legal basis of the Proposal still must be resolved.

Yet another way would be to state that in relations between participating and non-participating Member States, the implementation of FTT legislation and recovery of taxes due are facilitated by the obligations of non-participating Member States *vis-à-vis* participating Member States pursuant to primary and secondary Union legislation. The same facilities do not exist for the implementation of FTT *vis-à-vis* financial institutions established in third countries. This may result in distortions of competition and of capital movement between financial institutions established in non-participating Member States and financial institutions in third countries.[*12]

3. The effect of the tax

Article 326 of the TFEU states that enhanced co-operation should not, among other things, undermine the internal market or economic cohesion. It should also not distort competition between Member States. Therefore, the admissibility of enhanced co-operation depends on its effects. Although that is partly more of an economic issue, it determines whether enhanced co-operation is admissible at all. Therefore, this cannot be ignored and certainly should be considered.

The response of the Swedish National Debt Office[*13] indicates that the proposed tax would have a serious effect on the functioning of the Swedish financial market, especially on government securities markets, where basic conditions for secondary trading would disappear, and, in turn, that it would diminish the possibilities for financing the central government debt at a reasonable cost. It would also have similar effects on the market for mortgage bonds, which would, in turn, increase the cost of borrowing and thereby the cost of mortgages.

The impact assessment[*14] addresses these concerns only partly and even where doing so is based on unfounded assumptions as to, for example, mitigating effects. This leaves the Proposal very poorly motivated and leads one to believe that the proposed tax would actually undermine the internal market and economic cohesion. Moreover, if negative effects were to arise only in the case of Sweden, which does not seem to be likely, the Proposal would still distort competition between Member States. That again is not admissible.

Further proof that the proposed tax would distort competition between Member States is that a similar tax was imposed in Sweden in the 1980s and considerably decreased trading in Sweden, a decline caused first and foremost by wishes to avoid the tax.[*15] Therefore, even if efficient and legitimate anti-relocation measures are applied, the tax would distort competition between those Member States that are in the financial transaction tax zone and those that are not.

12 Opinion of the legal service. Proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax (FTT). Legality of the counterparty-based deemed establishment of financial institutions (Article 4 (1) f) of the Proposal) (JUR 448/FISC 163/ECOFIN 771), p. 13.

13 Response: European Commission Proposal for a Directive on a Common System of Taxation on Financial Transactions, pp. 1–9. Available at https://www.riksgalden.se/PageFiles/11583/European%20Commission%20proposal%20for%20a%20directive%20on%20a%20common%20system%20of%20taxation%20on%20financial%20transactions.pdf (most recently accessed on 14.4.2013).

14 See the impact assessment (Note 2), pp. 25–26.

15 S.R. Umlauf. Transaction taxes and the behavior of the Swedish stock market. – *Journal of Financial Economics* 1993 (33), p. 228.

4. Issuance and residence principles

The proposed directive foresees certain measures to avoid relocation of financial transactions. Accordingly, a financial instrument is considered issued in the participating Member State if an entity has a registered seat in the said participating Member State that issues it.*16 This means that, no matter where financial instruments are actually issued, they are always considered to be issued in the participating Member State.

In addition to that, the tax is imposed on transactions if at least one party is established in the territory of a participating Member State.*17 The fact of establishment, however, is not determined solely by the location of the domicile of the financial institution. The financial institution is deemed to have been established in the territory of the participating Member State if, for example, it has been authorised by authorities of that Member State to act in that capacity, in respect of transactions covered by that authorisation.*18

That raises questions of free movement of capital and freedom of establishment. It is obvious that these rules certainly limit issuing of financial instruments by a party from a participating Member States in non-participating Member States, because transactions with those instruments would clearly have a disadvantage in that market, as they would be subject to taxation with the proposed tax, in clear contrast to transactions to which the tax does not apply.

It is clear from *Sandoz**19 that building a barrier to investment in other Member States is a restriction on free movement of capital. Through imposition of a tax on transactions concluded in another Member State, residents of a Member State are deprived of the possibility of benefiting from the absence of taxation, which may be obtained outside the territory of that Member State. This is likely to deter concerned parties from issuing financial instruments in the non-participating Member State. Article 63 (1) of the TFEU clearly states that all restrictions on the movement of capital between Member States are prohibited.

Even though direct taxation lies within the competence of Member States, discrimination on grounds of nationality is, according to *Baars**20, not allowed. There can be no argument about this not applying to legal entities as well. Also, it is evident from *Royal Bank of Scotland**21 that principles of European Union law apply fundamentally to individuals and entities.

It is true that Article 65 (1) of the TFEU states that Member States have the right to apply relevant provisions of their tax law that distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to where their capital is invested. Such a situation could arise also in the case of the proposed financial transaction tax. However, Article 65 (3) of the TFEU specifies that these measures cannot constitute a means of arbitrary discrimination or disguised restriction on free movement of capital.

According to *Verkoojen**22, in order for the restriction to be admissible, it has to be objectively justifiable through overriding reason in the general interest. Purely economic reasons, however, cannot constitute overriding reason in the general interest such as to justify restriction of a fundamental freedom.*23 Therefore, it seems that the restriction imposed by the proposed directive is not justified. It would be if justified on grounds of public policy or security and to prevent infringements of national law and regulations, but it still is not to constitute a means of arbitrary discrimination or disguised restriction on free movement of capital.

In speaking about preventing infringements of national law and regulations, it is clear that this refers to effective administration and enforcement of the tax system but not matters of economic policy.*24 And, on the other hand, public policy and security are interpreted narrowly and in accordance with other freedoms.*25

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16 See Proposal, Article 2.1 (11).

17 Proposal, Article 3.1.

18 Proposal, Article 4.1 (b).

19 Case C-439/97, *Sandoz GmbH v. Finanzlandesdirektion für Wien, Niederösterreich und Burgenland*, para. 19. – ECR 1999, p. I-7041.

20 Case C-251/98, *Baars v. Inspecteur der Belastingen Particulieren/Ondernemingen Gorinchem*, para. 17. – ECR 2000, p. I-2787.

21 Case C-311/97, *Royal Bank of Scotland v. Greece*, para. 23. – ECR 1999, p. I-2651.

22 Case C-35/98, *Staatssecretaris van Financien v. Verkoojen*, para. 46. – ECR 2000, p. I-4071.

23 Case C-311/97, *Royal Bank of Scotland v. Greece*, para. 48.

24 P. Craig, C. de Burca. *EU Law: Text, Cases, and Materials*. Third edition. Oxford: Oxford University Press 2003, p. 683.

25 See Case C-311/97, *Royal Bank of Scotland v. Greece*, p. 684.

In addition to restriction on free movement of capital, the measures foreseen with the Proposal could also constitute restriction on freedom of establishment. Namely, Article 49 of the TFEU states that restrictions on freedom of establishment are prohibited. This means also that restrictions on moving one's business to another Member State are prohibited. That also applies to setting up agencies, branches, or subsidiaries, including setting up and managing undertakings. According to the *Factortame*[*26] judgement, the concept of establishment refers to actual pursuit of economic activity through a fixed establishment in another Member State for an indefinite period.

When discussing a financial institution deemed to have been established in the territory of a participating Member State, Article 6 (3) of Directive 2004/39 states that any valid authorisation allowing an investment firm to provide investment services is valid throughout the European Union, either through establishment of a branch or via the free provision of services. Additionally, Article 31 (1) of said directive states that an investment firm authorised in another Member State may freely perform investment services or perform other activities within any of the Member States and that no additional requirements may be imposed.

A situation wherein a financial institution of a Member State is considered to be established in another Member State purely on the basis of the fact that it has authorisation to pursue economic activity there—i.e., that it is authorised to do so—could therefore be regarded as restriction to the freedom of establishment. The restriction in question is the actual barrier on moving to another Member State. It simply renders relocating to another Member State pointless. On the other hand, this, in effect, deems every financial institution to be established in the participating Member State, which most certainly conflicts with the requirement that enhanced co-operation not be binding on other than participating Member States.

5. Double taxation

The impact analysis[*27] states that part of the nature of a process of enhanced co-operation in the field of taxation is that it cannot succeed in avoiding all occurrences of double taxation within the European Union, as long as not all Member States participate in the co-operation. This means that double taxation can be eliminated and avoided only if there is only a single system of taxing financial transactions—i.e., if all Member States participate in the enhanced co-operation.

In fact, even then double taxation would, in theory, not be avoided, because the Proposal imposes the tax on certain financial transactions only, leaving others outside its scope or, on account of their nature (i.e., monetary obligations other than tax), not including them at all. This would create a situation wherein either even participating Member States could impose a tax on another type of financial transaction or taxable transactions would be taxed with the tax as adopted in line with the Proposal and, in addition, for example, a levy beyond the scope of the Proposal.

Although the impact analysis claims otherwise, double-taxation agreements would not constitute a possible solution for avoidance of double taxation. These agreements apply to taxes on income and capital only, while the Proposal itself is built on the assumption that the tax on financial transactions is a means of indirect taxation and therefore not a tax on income or capital—even though the latter may be the actual intent. Since treaties on double taxation do not cover indirect taxes, double taxation remains an issue.

Even if one were to consider the tax on financial transactions to be a tax to which treaties on double taxation somehow would apply, the problem remains. According to the OECD model tax convention[*28], the taxes covered can be regarded as taxes on total income, on total capital, or on elements of income or capital. However, the taxable amount according to Article 6 of the proposed directive is everything that constitutes consideration paid or owed in return for the transfer. Thus it becomes clear that the tax is not levied on income or capital.

Additionally, it cannot be ignored that this proposed tax is not covered by any of the current double-taxation agreements. Although the list of taxes to which agreements apply is not exhaustive, it is, according to the model convention, nevertheless a complete list of taxes imposed and covered and only a similar subsequent tax will be included.[*29] The proposed tax is not, however, that kind of tax.

[26] Case C-221/89, *R. v. Secretary of State for Transport, ex p. Factortame*, para. 20. – ECR 1991, p. I-3905.

[27] See the impact assessment (Note 2), p. 15.

[28] Model tax convention on income and on capital, condensed version, 15 July 2005. OECD Committee on Fiscal Affairs.

[29] *Ibid.*, pp. 70–71.

6. Avoidance

There is no doubt that the financial transaction tax would induce relocation of activity. The Commission has even gone as far as to state that it was clear from the beginning that taxing financial transactions could only be meaningful if internationally co-ordinated.*[30] The reason for this is that global mobility of financial transactions is very high. Naturally, this would pose a risk of tax-induced relocation of financial activities and services. As a means to avoid this, participating Member States have to adopt measures preventing tax fraud and evasion.*[31] Naturally, the question arises of what fraud and evasion mean in this context.

To address this issue, Article 13 of the Proposal introduces a number of measures that must be introduced if circumvention is to be avoided. Among other arrangements, participating Member States need to make sure that artificial arrangements—i.e., those without economic substance, put in place essentially for the purpose of avoiding tax—are not honoured. This includes transactions that would ordinarily not be employed in what is expected to be reasonable business conduct. However, it would be surprising if expected reasonable business conduct would not entail tax planning.

As long as the legal substance of the transaction matches the economic reality, tax planning should be considered legitimate.*[32] Therefore, it should not be construed as avoidance. It's as simple as that. If, on the other hand, the taxpayer chooses a form that is inconsistent with the legal substance, it is impossible to consider the behaviour to be fraud, because the taxpayer has not submitted incorrect information or in any way concealed the transaction.*[33] And so it becomes difficult to establish what exactly constitutes fraud. It is even more difficult to say what constitutes illegal tax planning.*[34] When one considers the differences that must be honoured between national legal systems in determination of this, the problems are multiplied.

Leaving the issue of fraud and returning to tax evasion, we find that the Supreme Court of Estonia*[35] has stated that the taxpayer is entitled to conclude transactions in consideration of tax implications as well and that no-one is obliged to structure business in the manner that imposes the greatest tax burden. There is no obligation to maximise the tax revenues of the state. To establish that a transaction is concluded with the aim of avoiding tax because of inconsistency of the transaction with the legal substance, it has to be clear that the main aim is to gain advantage and that there is no commercial substance.*[36] So it seems that business planning cannot be considered to be avoiding tax.

In order to state that a transaction is concluded to avoid tax, one must establish that said transaction is inconsistent with the legal substance.*[37] In the opinion of the European Court of Justice in *Kefalas**[38], Community law cannot be relied on for abusive or fraudulent ends. According to *Halifax**[39], this means that the Community legislation cannot be extended to cover abusive practices—i.e., to transactions carried out not in the context of normal commercial operations but solely for the purpose of wrongfully obtaining advantages provided by Community law. Then again, it is hard to imagine how issuing financial instruments in another Member State or relocating one's business would be inconsistent with the legal substance.

In *Halifax*, the European Court of Justice went even further, saying that it is clear that the choice between exempt transactions and taxable transactions may be based on a range of factors, including tax considerations related to tax systems, and where a taxable person chooses one of two transactions, there is no requirement to choose the one that involves paying higher taxes. Quite to the contrary, taxpayers may choose to structure their business so as to limit their tax liability.*[40] With that in mind, one clearly cannot see moving actual business activities to another Member State solely for tax purposes as avoiding tax.

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30 See the impact assessment (Note 2), p. 7.

31 See 'Proposal' (Note 1), Article 12.

32 See L. Lehis (Note 6), p. 189.

33 T. Grauberg. Õiguse kuritarvitamise doktriin maksuõigussuhte tõlgendamisel ja maksude vältimise tõkestamisel ['The doctrine of abuse of rights in the interpretation of taxation law relationships and in the prevention of tax evasion']. – *Juridica* 2008/10, p. 664 (in Estonian).

34 *Ibid.*, p. 665.

35 Supreme Court of Estonia 4.11.2009, 3-3-1-59-09, *Ilvest v. Maksu- ja Tolliameti Põhja maksu- ja tollikeskus*, para. 13. Available at http://www.nc.ee/?id=11&tekst=RK/3-3-1-59-09 (in Estonian).

36 *Ibid.*, para. 18.

37 *Ibid.*, para. 19.

38 Case C-367/96, *Kefalas and Others v. Greece*, para. 20. – ECR 1998, p. I-02843.

39 Case C-255/02, Halifax plc, *Leeds Permanent Development Services Ltd and County Wide Property Investments Ltd v. Commissioners of Customs & Excise*, para. 69. – ECR 2006, p. I-01609.

40 *Ibid.*, para. 73.

For one to establish that an abusive practice exists, the transaction must result in a tax advantage the granting of which is contrary to the purpose of national and Community legislation and it must be apparent from a number of objective factors that the fundamental aim of the relevant transaction is to obtain a tax advantage.[*41] However, the purpose of the national legislation cannot be the elimination of more tax-advantageous transactions. According to *Centros*[*42], a taxpayer choosing to carry on its business in a location that allows evading the application of more restrictive rules is not in itself an abusive practice. In the case of the proposed financial transaction tax, avoidance will never be the only aim, so the essence of the abuse would not be established under the *Cadbury Schweppes*[*43] ruling. Therefore, it most likely would not be an abusive practice.

7. Liability

It has to be borne in mind that this proposed tax, should it have negative economic effects on non-participating Member States, may also prompt actions related to damages and monetary claims. This is because of Article 340 of the TFEU, which states that in cases of non-contractual liability the European Union will, in accordance with general principles common to the laws of the Member States, make good the damages caused by its institutions.

According to *Dubois*[*44], Community liability in the case of a legislative measure can be incurred only if there is breach of a rule of law with greater precedence for the protection of individuals. From the above it is evident that restrictions on the movement of capital between Member States are prohibited. This applies to restrictions on the freedom of establishment as well. The TFEU is undisputedly a higher-ranking rule than the proposed directive. Therefore, it seems that, should damage occur because of the enhanced co-operation, a Member State would be eligible to claim damages.

It is clear from the *Van Gend en Loos*[*45] case that a levy too can be illegal. If a levy imposed by a Member State can be considered illegal, a levy imposed by European Union law most certainly can be considered illegal. In addition, as is stated in the *Wollast*[*46] judgement, the European Union can apply restitutionary principles in a situation wherein an individual has been unjustly enriched on account of the European Union. Therefore, the same principle should apply if the European Union unjustly enriched, e.g. on the account of a Member State. If this illegal levy is received by a Member State, then in principle it should be recoverable from that Member State. As can be seen from *Sofrimport*[*47], the damages need not be limited to the amount of the illegal levy alone. Accordingly, it is all the more possible that claims against the European Union will be submitted and perhaps even claims against participating Member States.

Of course, causality needs to be established. According to *Sucres*[*48], the European Union cannot be held responsible if damage is incurred through an autonomous act by the Member State in question. On the one hand, this Proposal does not involve an autonomous act of a Member State. Rather it is sanctioned by the European Union. On the other, it seems that, for this reason, a Member State that has decided to engage in the enhanced co-operation should not be entitled to claim for damages as it is the participating Member State that will incur damage to itself. According to the *Adams*[*49] decision, nor is a Member State that has failed to act to prevent the Proposal from being adopted by at least indicating the possible inconsistencies, since that could perhaps be considered negligence. However, at least those openly opposed to the tax should be entitled to claim damages.

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41 *Ibid.*, para. 86.

42 Case C-212/97, *Centros Ltd v. Erhvervs- og Selskabsstyrelsen*, para. 27. – ECR 1999, p. I-01459.

43 Case C-196/04, *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*, para. 75. – ECR 2006, p. I-07995.

44 Case T-113/96, *Edouard Dubois et Fils v. Council & Commission*, para. 59. – ECR 1998, p. II-125.

45 Case 26/62, *NV Algemene Transpoerten Expeditie Onderneming van Gend en Loos v. Nederlandse Administratie der Belastingen*. – ECR 1963, p. I.

46 Case 18/63, *Mrs Estelle Wollast (née Schmitz) v. European Economic Community*. – ECR 1964, p. 85.

47 Case C-152/88, *Sofrimport Sarl v. Commission*, para. 1. – ECR 1990, p. I-2477.

48 Case 132/77, *Societe pour l'Exportation des Sucres SA v. Commission*, para. 27. – ECR 1978, p. 1061.

49 Case 145/83, *Adams v. Commission*, para. 53. – ECR 1985, p. 3539.

8. Conclusions

This piece has only scratched the surface as to the legal issues associated with the proposed financial transaction tax. Then again, they still illustrate eloquently that not all effects of the tax are addressed with the attention they deserve, and far-reaching implications may arise here. One of them is that the tax is based on the wrong legal foundation. Another involves the possible effect of the tax: in the name of protecting the tax base, the system may breach underlying rules of the European Union. This could lead to harm being incurred by those Member States that do not participate in the enhanced co-operation and a situation wherein one may be able to claim for that damage.

Already the Council has through its legal service expressed concerns that the proposed tax perhaps may be in conflict with norms of international customary law as they are understood by the Union, since the tax does not have a relevant link between the State that exercises jurisdiction and the person or situation over which jurisdiction is exercised. It also infringes the taxing competences of non-participating Member States and is thus incompatible with Article 327 of the TFEU as the latter requires that any enhanced cooperation has to respect competences, rights and obligations of non-participating Member States. Plus, the legal service of the Council has pointed out that this proposed tax is discriminatory and likely to lead to distortion of competition to the detriment of non-participating Member States.[*50] And that is an opinion on just one single criterion of the proposed tax.

50 See Opinion of the legal service. Proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax (FTT). Legality of the counterparty-based deemed establishment of financial institutions (Note 12), p. 14.