The Impact of European Union Law on Regional Autonomy in Business and Value Added Taxation

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Abstract: Despite the relevance of the sub-central level of government in the provision public services, its capacity to legislate on tax matters is usually very modest, especially with regards to the value added and corporation taxes. This article analyses the limitations to regional tax autonomy imposed by European Union law and, in this framework, reviews the main options for greater decentralisation taking into account the experience of several federal countries and the economic advantages and risks that such measures could entail. In my opinion, before offering sub-central parliaments the possibility to participate in the regulation of the value added and corporation taxes, it would be advisable to explore other less problematic alternatives, such as the transfer to the regions of normative powers on other taxes with a direct impact on businesses, such as trade or business taxes, taxes on the real property of corporations or taxes on the value added of businesses. This article focuses first on business taxation and, after that, on the value added tax.

Keywords: fiscal decentralisation; tax autonomy; European integration; corporation tax; value added tax.

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1. Introduction

In many countries, sub-central levels of government (regions, *Länder*, cantons, states…) play an important role in the provision of public services, but this autonomy on the expenditure side contrasts with their limited capacity to regulate their sources of revenue. This is particularly clear in relation to the value added tax and the corporation tax, which are usually reserved to national parliaments.

Taking this divergence into account, the purpose of this article is twofold. To begin with, it will analyse the limits that European Union law imposes on the powers of regions to legislate in this area. Once this framework has been clarified, different options for greater decentralisation will be discussed based on the experience of several federal countries and on recommendations from the literature on fiscal federalism.

The analysis of comparative law, which includes a selection of the most relevant experiences of decentralisation in the regulation of the value added and business taxes, will be useful in order to gather ideas which could be applied to other countries. Moreover, some of the cases which are presented are not very well known due to significant reforms in recent years (such as in the case of the United Kingdom) or to the modest attention that academic literature has traditionally paid to local and regional taxes, a gap that this work tries to address.

Even though European Union law imposes a number of constraints on regional tax autonomy, especially in relation to indirect taxation, in most countries there is still room for further decentralisation. However, in this article I argue that before transferring powers concerning the value added tax and the corporation tax, it would be advisable to explore other alternatives with a lower risk of distorting the economy and creating excessive compliance costs. These alternatives could include other taxes with a direct impact on businesses, such as trade or business taxes, taxes on the real property of corporations or taxes on the value added of businesses.

With regard to the structure of the article, the first sections focus on business taxation and analyse the European legal framework, the main international experiences concerning the regulation of the corporation tax by sub-central

authorities, and other examples of decentralisation of regulatory powers in other taxes on businesses. After that, the article concentrates on the value added tax, following a similar approach and taking the most relevant experiences of regional decentralisation into account, especially that of Canada. Finally, the main conclusions are presented.

2. Limitations imposed by European Union law on regional autonomy in business taxation

As a result of the process of European integration, the objectives of which include the establishment of a common market, the member states must respect several limitations deriving from European Union law. These limitations, in turn, also affect the capacity of sub-central parliaments to legislate on tax matters.

Legal literature has already analysed the main limitations imposed by European Union law on regional autonomy in tax matters from a general perspective. Therefore, the next paragraphs will concentrate on those aspects which are particularly significant in the field of corporate taxation and which will be relevant for the analysis of the different ways of distributing regulatory powers over business taxation in countries with several levels of government.

The main conclusion, however, can already be anticipated: European Union law is not incompatible with the decentralisation of business taxes. Certainly, an increasingly heterogeneous regulation across regions would go against the efforts of the European Commission in this field, but it would not necessarily violate European Union law. In fact, the limitations deriving from European Union law which are imposed on sub-central authorities are analogous to those which are faced by the central level of government. Therefore, the internal distribution of taxing powers concerning business taxation in the member states is in principle respected by European Union law.

2.1. Fundamental freedoms

In order to ensure the proper functioning of the internal market, European Union law foresees the free movement of goods, persons, services and capital

(Art. 26 TFEU). The free movement of goods includes, among other aspects, the establishment of a customs union which prohibits customs duties and measures of equivalent effect between member states (Art. 30 TFEU), as well as the prohibition of tax rules which may discriminate against imported products in comparison to those of domestic origin (Art. 110 TFUE). Besides the free movement of persons, which mainly concerns the freedom of movement for workers (Art. 45 TFEU), tax measures can easily collide with the free movement of services (Art. 56 TFEU), including the freedom of establishment (Art. 49 TFEU), and the free movement of capital (Art. 63 TFEU).

The compatibility of national tax legislation with the freedoms foreseen by European Union law has been the object of a large number of judgements of the European Court of Justice. Basically, in its case-law the Court analyses if a certain tax measure restricts any of the aforementioned freedoms and, in that case, if the restriction could be considered as proportionate and justified by reasons such as the prevention of tax evasion.[1]

It should be highlighted that the fundamental freedoms foreseen by the Treaty on the Functioning of the European Union are a basic element of European Union law, which conditions the tax measures that may be adopted by national and regional authorities in a very similar way.[2] In this sense, the European Court of Justice does not seem to apply any particular deference to regional tax measures and in case of collision with the fundamental freedoms they will only be acceptable if they are justified by a legitimate purpose of regional policy and are proportionate from the perspective of the functioning of the internal market.[3]

2.2. Harmonisation in the field of corporate taxaootion

The harmonisation of corporate taxes by European Union law has been very modest compared to the situation of indirect taxation. The most important

1. For a general presentation of this case-law, see, for instance, Traversa, "Is There Still Room", 6-8.

2. Fundamental freedoms do not prevent regional and local authorities from taxing certain economic activities (see Traversa, "Libertés de circulation", 201-202).

3. See Calderón Carrero, "La incidencia del Derecho de la Unión Europea", 341.

initiatives include a set of directives on several specific issues which concern corporate taxation, such as the Parent-Subsidy Directive (Council Directive 2011/96/EU of 30 November 2011), the Mergers Directive (Council Directive 2009/133/EC of 19 October 2009) and the Interests and Royalties Directive (Council Directive 2003/49/EC of 3 June 2003). As Calderón points out, these directives have been drafted assuming that corporate tax is regulated by the central authorities of the different member states, but if a region were granted regulatory powers on this tax it would also have to respect them.[4]

Apart from the previous directives, the European Commission has also tried to improve the functioning of the internal market by approximating the regulation of the corporate tax base through its initiative on a Common Consolidated Corporate Tax Base (CCCTB). Following a long preparation process, in March 2011 the Commission presented an ambitious proposal which included the common rules that would have to be followed in order to compute the tax base (mainly in accordance with the International Financial Reporting Standards), the criteria for the consolidation of the profits and losses obtained in the different member states and the formula for the distribution of the tax base among the different countries in which a company operates.[5] After several years of further discussion, the European Commission has planned to re-launch this project in 2016, focusing on the common tax base, which should become mandatory for multinationals, while postponing the most controversial issues, such as consolidation and the formula for the apportionment of the consolidated tax base. Therefore, it is clear that the regulation of certain elements of the corporate tax base by regional parliaments would not match the efforts which the European Commission is currently undertaking.[6]

2.3. Prohibition of State aids

According to Article 107 TFEU, any aid granted by a member state which could distort competition by favouring certain undertakings or the produc-

4. *Ibid*., 328.

5. See *Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB)* (COM/2011/121).

6. For a comparison of this issue with the situation in the United States, see Mason, "Common Markets", 612-617. In relation to the harmonisation of the corporation tax in Canada, see Boadway, "International Lessons," 35.

tion of certain goods will be incompatible with the internal market as long as it affects trade between member states. The form of these aids is irrelevant and therefore some tax measures could also qualify as unlawful state aids.

In recent years, the issue of regional legislation in the field of business taxation which could give rise to cases of prohibited state aids has become increasingly relevant and has been the object of several judgements of the Court of Justice.[7] The most significant cases have dealt with the tax regime of the Azores (judgement of 6 September 2006, case C-88/03), the Basque Country (judgement of 11 September 2008, joined cases C-428/06 to C-434/06) and Gibraltar (judgement of 15 November 2011, joined cases C-106/09 P and C-107/09 P). In these judgements, the Court has established a series of criteria in order to determine which regional tax measures would be acceptable.[8]

When analysing the selective nature of a certain tax measure adopted by a regional authority, legal literature has distinguished between territorial and material selectivity. Given that measures adopted by regional parliaments will only be applicable in part of a member state, the problem of regional selectivity would be the most evident, but regional tax measures could also be considered as unlawful as a result of their material selectivity.[9]

With respect to regional selectivity, it is first necessary to differentiate between symmetric situations in which all regions have the same regulatory powers and asymmetric situations in which one or some of the regions have greater powers than the rest. This distinction is very important for the determination of the reference framework which will have to be taken into account.

In a symmetric situation a common reference framework at the national level does not exist and therefore the fiscal pressure in a certain region cannot be compared to any "normal" level. Consequently, in a symmetric situation the

7. In fact, not only regional legislation could be contrary to the European State aids regime, but also regional administrative practices, such as those concerning tax rulings.

8. For a general review of these cases, see, for instance, De Cecco, "State Aid and Self-Government," 221-239; Martín y Pérez de Nanclares and Urrea Corres, "Unión Europea y financiación autonómica," 37-84; and Lyons, "Commission and Spain v Gibraltar," 55-63.

9. In relation to material selectivity and regional tax measures, see, for instance, Martín Jiménez, "Límites al poder tributario," 231-260.

measures taken by a certain sub-central body will never be regionally selective, independently of its degree of autonomy.[10]

In asymmetric cases, it is necessary to determine whether the regional body is sufficiently autonomous from the central government. According to the judgement in the Azores case, a region will be sufficiently autonomous if it enjoys institutional, procedural and economic autonomy. The first requirement of institutional autonomy will be fulfilled if the region has a constitutional, political and administrative status that can be differentiated from that of the central State. Procedural autonomy implies that the central authorities do not have the power to directly affect the content of the new regional tax measures. Finally, a region will be considered to be economically autonomous if it completely bears the consequences of its tax measures, that is, if the lower revenues derived from a lower tax pressure are not compensated by additional transfers from the central level of government. If these conditions are met, the reference framework will be that of the region and, consequently, territorial selectivity will not exist.[11]

2.4. Recommendations on harmful tax competition

The work of the European Union on harmful tax practices is not new, since the Code of conduct for business taxation dates back to 1997. This code was the object of a resolution of the Council and the representatives of the governments of the member states, meeting within the council, on 1 December 1997, and was published in the conclusions of the Economic and Financial Affairs Council (ECOFIN) of 1 December 1997.[12] Despite its legally non-binding nature, it is a clear example of soft law since it was issued with the objective of influencing national legislation on business taxation and a review process was foreseen with the aim of ensuring the effective application of the code.

Basically, the objective of the Code is to prevent states from introducing tax measures aimed at affecting the location of business activity in the European Union. Consequently, the measures which should be avoided include, for

10. For more details, see Carrasco González, "Ayudas de Estado," 194.

11. For a review of these criteria, see, for instance, Traversa, "The Selectivity Test." 119-135.

12. Official Journal of the European Communities of 6 January 1998, C 2/1.

instance, tax advantages which are aimed only at non-residents, those which are ring-fenced from the domestic market, those which are granted despite the absence of any substantial economic activity, those which depart from the OECD standards on the determination of profits by the units integrating multinational enterprises, and those which lack transparency. In this sense, it is irrelevant whether such measures are adopted by the national parliaments or by other levels of government with certain regulatory powers in the field of business taxation.

Among the vast number of measures which were identified as harmful in the different member states, some of them had been introduced by regional authorities. This was the case, for instance, of the co-ordination centres in the Basque Country and Navarra.[13]

3. The decentralisation of normative powers over the corporate tax in countries with several levels of government

The corporate tax is usually regulated by the central level of government in most countries of the European Union, including federal countries such as Belgium. This option is not problematic from the perspective of European Union law and is indeed considered as the most convenient option by economic literature on fiscal federalism.[14] The reason is that the corporate tax base is highly mobile and regional disparities in the tax rates would distort the location of investments. Moreover, if the tax base is not defined in the same way by all regions, this could entail relevant administrative difficulties and increase compliance costs.[15] Decentralisation, in turn, could also have certain advantages, such as increasing the fiscal accountability of sub-central levels of government and offering more autonomy in areas which may be of more interest for some regions. For instance, sub-central parliaments may

13. For more details, see the Report of the Code of Conduct Group (Business Taxation), known as Primarolo Report, of 29 November 1999, pp. 34-35.

14. For an introduction to the main issues concerning taxation in federal systems, see Oates, *Fiscal Federalism*, 119-153.

15. See, for example, Musgrave, "Who should Tax," 10-13; Dahlby, "Taxing Choices," 95-97; and McLure, "Assignment of Corporate Income Taxes," 101-124.

wish to use this tax as a tool to provide incentives which could take the specificities of the economic structure of the region into account and which could therefore be particularly suitable for the promotion of its economic growth. A situation of extreme decentralisation, despite probably having more disadvantages than advantages from an economic perspective, would not necessarily violate European Union law.

Between these two extreme situations, in several countries it is possible to observe the partial decentralisation of the regulation of the corporate tax. In this section, the most relevant experiences within the European Union have been selected, which include the cases of Germany, Spain, the United Kingdom and Portugal. Moreover, the situation in Canada, Switzerland and the United States, which are federal states with a long tradition, is also discussed. In relation to each of these countries, particular attention is paid to issues such as the scope of the powers which are decentralised, the coordination between the central and sub-central levels of government and the historical and political considerations that explain the current situation. A brief presentation of the regulation of this issue in these countries will be useful in order to draw several lessons.

3.1. Germany: participation of the Länder in the legislative process at the central level

Even in the cases in which the corporate tax remains, strictly speaking, beyond the powers of regional parliaments, it may be possible to establish mechanisms in order to facilitate their participation in the regulation of this issue at the central level, usually through an upper house or senate. This can be exemplified by the situation in Germany. According to the German constitution (*Grundgesetz*, GG), the regulation of the corporate tax is a concurrent power of the federation (Art. 105(2) GG). This means that, following Art. 72 GG, if the federation has already regulated this issue, the *Länder* will not be able to adopt their own legislation. However, the regulation of the corporate tax will require the consent of the *Bundesrat*, which is an organ of territorial representation. The government of each *Land* appoints its representatives in the *Bundesrat*, which range in number from three to six, according to the size of the *Land* (Art. 51 GG).

According to Art. 105(3) GG, this consent is necessary for all federal laws dealing with taxes, the revenue of which accrues wholly or in part to the *Länder*, which clearly includes the corporate tax since it accrues jointly to the federation and the *Länder* (Art. 106(3) GG). The key role of the *Bundesrat* can be observed in the failure of the Treaty between Switzerland and Germany for cooperation in the fields of taxation and financial markets, which was signed on 21 September 2011. This treaty, which had important tax implications, was finally rejected by the *Bundesrat* in 2013, since the representatives of the *Länder* considered that it was not an adequate tool to fight against tax evasion.

This mechanism offers the *Länder* the possibility of having an influence on the regulation of the corporate tax, while maintaining a uniform regulation. Therefore, tax competition is avoided and no taxpayer can claim being discriminated against in comparison to others.[16]

3.2. Spain: the particular tax regime of the Basque Country and Navarre

The corporate tax approved by the Spanish parliament is applicable to the whole country with the exception of two regions (*comunidades autónomas*): the Basque Country and Navarre. In particular, for historical, constitutional and political reasons, the three historical territories which make up the Basque Country (the provinces of Álava, Guipúzcoa and Vizcaya) and Navarre can regulate their own tax systems, even though they are subject to important harmonising limits.

Therefore, a single corporate tax will be applicable to each taxpayer, in some cases the one established by the state and, in others, the ones regulated by the historical territories. In this context it is important to pay attention to three aspects: the level of harmonisation which is applied to ensure that the system is workable, the criteria which are followed to determine the regulation which is applicable to each taxpayer, and the impact that European integration has had on this system.

16. Soler Roch considers that the approach followed in Germany would be advisable for other countries such as Spain (Soler Roch, "Prólogo", 18).

With respect to the degree of harmonisation which is applied to these corporate taxes, besides the coordination that affects the rules of the three historical territories which make up the Basque Country, we will concentrate on the harmonisation between the corporate tax approved by the state and the other corporate taxes which are applied in the Basque Country and Navarre. In particular, the case of the Basque Country will be used to exemplify this situation, since the situation in Navarre is very similar.[17]

The Statute of Autonomy of the Basque Country foresees several harmonising principles in its Article 42. The most important are the need to take into account the general tax structure of the state, the need to follow the harmonising rules contained in the Economic Agreement between the State and the Basque Country (Art. 41(2)(a)), and the obligation of applying the exceptional or provisional tax rules that the State may decide to apply in the common territory (Art. 41(2)(c)).

The Economic Agreement (*Concierto Económico*) with the Autonomous Community of the Basque Country is regulated by Law 12/2001, of 23 May 2002, which suffered several modifications in 2007 and 2014. The principle of fiscal harmonisation is developed in Article 3 of the Economic Agreement and the most important rules are the need to maintain the same overall effective fiscal pressure as in the rest of the state (Art. 3(a)) and the obligation of respecting the freedom of movement and establishment of persons and the free movement of goods, capital and services throughout the territory of Spain, without giving rise to discrimination or a restriction of the possibility of commercial competition or distortion in the allocation of resources (Art. 3(c)).

It can be observed that the previous provisions are rather general. The requirement of an equivalent overall effective fiscal pressure has normally been interpreted by the courts in the sense that it does not refer to any particular tax, but to the whole tax system. Therefore, it is difficult to justify that a particular tax advantage is contrary to this principle, since it could be compensated by other measures which affect other taxes. Similarly, the obligation to respect the unity of the Spanish national market does not automatically forbid all the measures which may have an impact on its functioning. It is

17. For a general presentation of this issue, see, for example, Martínez Bárbara, "Armonización fiscal," 59-70; and De la Hucha Celador, "Las haciendas forales," 367-392.

understood that it is necessary to strike a balance between this principle and the respect for autonomy on tax matters which is granted to the historical territories. This implies that the measures which will not be acceptable are those which intentionally constitute an obstacle for the functioning of the national market, something which is frequently controversial and which will have to be decided on a case-by-case basis.[18]

The criteria for the determination of the legislation which is applicable to each case are included in Article 14 of the Economic Agreement. Corporations with their fiscal domicile in the Basque Country will follow the Basque regulation unless during the previous year their turnover exceeded 7 million euro and 75% or more of their operations took place in the rest of Spain. It is also foreseen that taxpayers with their fiscal domicile in the rest of Spain will apply the Basque norms if during the previous year their turnover exceeded 7 million euro and all their operations took place in the Basque Country.

It can be observed, therefore, that the Basque regulation will be applied to all corporations with a fiscal domicile in the Basque country and a turnover below or equal to 7 million euro, regardless of the place where they carry out their operations. This shows that regional corporate taxes can be particularly suitable for small and medium-sized companies, while in the case of large corporations operating throughout the country it is more reasonable to apply national legislation.

The simultaneous existence of a corporate tax regulated by the national parliament and regional taxes in the Basque Country and Navarre has been controversial from the perspective of European Union law on several occasions. One of the most important legal issues concerned the consideration of certain fiscal benefits applicable in the Basque Country as prohibited state aids. However, taking into account the criteria established by the European Court of Justice in its judgement of 11 September 2008, it could be concluded that the Basque Country has the sufficient institutional, procedural and economic autonomy so as to consider that the measures which had been adopted were not of a selective nature.

18. For more details on the interpretation of these principles by the case-law, see Martínez Bárbara, "Armonización fiscal," 62-66.

The regulation of the corporate tax in the Basque Country and Navarre also raised some concerns from the perspective of the Code of Conduct for Business Taxation, as mentioned previously. Moreover, the project of a common consolidated corporate tax base shows a clear trend towards greater coordination and harmonisation, and, consequently, a heterogeneous regulation by the regional authorities would go against the aspirations of the European Commission.

The case of the Basque Country and Navarre shows that an asymmetric distribution of the power to regulate the corporate tax can be consistent with European Union law. However, in practice a high degree of harmonisation is applied in order to facilitate the coexistence of the different taxes.

3.3. United Kingdom: devolution to Northern Ireland and Scotland

In the United Kingdom, the devolution of the corporate tax has been the object of intense debate in recent years. This possibility has finally been accepted in Northern Ireland, but not in Scotland or other parts of the country, which has given rise to an asymmetrical distribution of taxing powers. In Northern Ireland, the recently approved Corporation Tax (Northern Ireland) Act 2015 opens the door to the devolution of the rate of corporation tax. The Assembly of Northern Ireland will be able to set a lower rate compared to the rest of the United Kingdom, which could become applicable starting in 2017. This asymmetric situation can be explained by the particularities of Northern Ireland. This region has a land border with the Republic of Ireland, a country with a very low corporate tax rate, and given the weakness of its economy compared to the rest of the United Kingdom it seems advisable to introduce reforms which could stimulate economic growth.

Nevertheless, it is not yet clear whether a lower tax rate will be finally adopted. From a political perspective, this possibility is conditioned upon the implementation of the Stormont House Agreement of December 2014, which would require the adoption of welfare and budgetary reforms. Moreover, given that according to the European regime of State aids any reduction of revenues caused by a lower tax rate could not be compensated by financial transfers from the central government, there is the fear that lowering the

tax pressure could require, at least in the short term, a reduction of public spending. If, however, a lower tax rate is finally set, the Corporation Tax (Northern Ireland) Act 2015 foresees a series of rules in order to determine which companies would benefit from the lower tax rate. In the case of small and medium-sized enterprises (as defined by European Union law) they will only apply the regional tax rate if 75% or more of the working time and expenses of their employees in the United Kingdom correspond to Northern Ireland. On the contrary, large corporations will have to distinguish between the part of the profits corresponding to Northern Ireland and the one corresponding to the rest of the United Kingdom, following an approach similar to the international transfer pricing principles which are used for the attribution of profits to the entities which are part of multinational corporations operating in different states.

In the case of Scotland, the possibility of devolving the rate of corporation tax was already discussed during the preparation of the *Scotland Act 2012*. In the view of the Scottish Government and the representatives of the Scottish National Party, the power to set corporation tax was necessary in order to increase the competitiveness of Scotland, attract business and create new jobs, since there was the perception that a uniform corporate tax for the whole United Kingdom tended to favour the concentration of businesses in the conurbation of London. However, during the debates it was pointed out that the devolution of this tax could generate a process of tax competition which ultimately would erode the revenue collected in the whole United Kingdom and, therefore, the regulation of this tax did not only concern Scotland. Taking into account that the European Union regime on state aids has been interpreted by the European Court of Justice in the sense that regions which reduce their tax pressure cannot be compensated by the central state, Scotland would have to bear the risk of any shortfall in tax revenues. Moreover, from a practical perspective it was also noted that given that many companies did business simultaneously in Scotland and in the rest of the United Kingdom, developing an assignment system would be difficult and costly.[19]

19. For more details on the arguments for and against the devolution of the rate of corporate tax which were expressed during the discussion of the *Scotland Act 2012*, see Seely, *Devolution of tax powers*, 8-10, 15-18 and 20-22.

From the recent debates and reforms which have taken place in the United Kingdom it is possible to draw several lessons. On the one hand, the devolution of the corporate tax is seen as very exceptional. The European regime on state aids, which prevents the central state from compensating the loss of revenue, reduces the attractiveness of this type of measures. Moreover, devolution of this tax also has to face technical barriers, which probably explains why discussions were always limited to devolution of the power to set the tax rate, leaving aside all other aspects of the regulation of the tax, such as the tax base or the possibility of introducing tax benefits. The situation in Northern Ireland also shows that the need to apportion the profits of large corporations operating simultaneously in Northern Ireland and Great Britain can increase compliance costs. On the other hand, the British case also makes clear that, despite the technical disadvantages and risks, political considerations deriving from historical and economic reasons could justify an asymmetric decentralisation of this tax. In fact, the institutional architecture of the United Kingdom is rather particular, since Members of Parliament from England, Wales and Scotland would not be able to decide on the tax rate applicable in Northern Ireland, but those from Northern Ireland would continue to have the right to vote on the regulation of the corporate tax applicable in the rest of the United Kingdom (including the tax rate).

3.4. Portugal: local surcharges on the corporate income tax

In the European Union it is not common to find member states in which central, regional or local corporate taxes coexist or, at least, in which the regional or local authorities have the possibility of introducing surcharges on this tax. As an exception, the case of Portugal can be mentioned, which foresees the possibility of introducing local surcharges on its corporate tax (*Imposto sobre o Rendimento das Pessoas Coletivas*). The law regulating the financial regime of local entities (*Lei n.º 73/2013, de 3 de setembro*) foresees in its Article 18 that municipalities can levy a surcharge of up to 1.5% of the taxable profit generated in its geographical area. In the case of those companies with permanent establishments in different municipalities and a tax base higher than € 50,000, the general rule for the apportionment of the profits is based

on the proportion of wage expenses that corresponds to each permanent establishment located in Portugal.

3.5. Beyond the European Union: Canada, Switzerland and the United States

Outside the European Union there are several examples of federal countries in which corporate taxes introduced by the central and sub-central levels of government coexist. This is the case of countries with a solid federal tradition, such as Canada, Switzerland and the United States.

In Canada, the federal corporation tax coexists with the corporation taxes regulated by the provinces and territories. In this country, the rules are relatively homogeneous given that the provinces and the territories (with the exception of Quebec and Alberta) have delegated the collection of these taxes to the Canada Revenue Agency and have agreed to define the tax base in the same way as in the federal legislation. However, the provinces and territories can introduce certain tax incentives. In the cases of Quebec and Alberta, despite having more freedom to regulate their own corporate taxes, the regulation of the tax base follows the federal definitions to a large extent.

In Switzerland, the Confederation and the cantons have historically had the power to regulate their own taxes, that is, all of them can be considered to have fiscal sovereignty. Moreover, the municipalities also have relatively broad taxing powers which depend on the legislation of each canton. Consequently, the total fiscal pressure on business profits will depend on the taxes established by these three political levels.

However, the Federal Constitution includes several measures in order to ensure the coherence and feasibility of the tax system. For instance, it states that the Confederation may levy a direct tax of a maximum of 8.5 % of the net profit of legal entities and that, in fixing the tax rates, it is necessary to take into account the tax burden imposed by the cantons and communes (Art. 128). Furthermore, Article 129 grants the Confederation the power to harmonise the direct taxes imposed by the Confederation, the cantons and the communes, including aspects such as tax liability, the object of the tax and the tax period, but excluding tax rates and tax allowances. In this sense,

it is important to cite the Federal Law on the harmonisation of direct taxes of the cantons and the municipalities of 14 December 1990, which, for instance, defines the elements which are subject to the tax on profits (Art. 24). In practice, the result is that, despite the similarities in federal and cantonal legislation dealing with business taxation, the differences in the tax rates produce very significant disparities in the tax pressure from canton to canton and from municipality to municipality.

In contrast to the situation in Canada and Switzerland, in the United States the degree of harmonisation of corporation taxes at the federal, state and local level is not so high. Federal taxes on income could be introduced without having to apportion the revenue among the states according to their population after the approval of the Sixteenth Amendment to the Constitution in 1913. Currently, the federal corporate tax, which completely accrues to the Federation, is regulated by the Internal Revenue Code.

At the state level, the situation is asymmetric. Even though most states have regulated their own corporate taxes following the example of the federal legislation to a large extent, the rules are not homogeneous and there are also important differences in the tax pressure. For instance, Nevada and Wyoming do not even have a state corporate tax. In the case of corporations operating in several states, income is apportioned according to formulary methods based on the proportion of factors such as sales, property and payroll which correspond to a certain state. These rules are not uniform, which increases the complexity of the system. Some local entities also impose a corporate tax, but there are important disparities not only in the tax rates but also in the regulation of other aspects such as the tax base. It is important to note that state and local taxes are a deductible expense from the perspective of the federal corporate tax and, consequently, the global tax pressure is not the result of the mere addition of the tax rates charged at the federal, state and local levels.

3.6. Lessons from the comparative experience

Taking into account the experience of the countries which have been previously analysed, the following aspects can be highlighted. To begin with, it is clear that the distribution of taxing powers concerning the corporation tax

derives from the historical and political particularities of each country rather than from a rational design of their tax systems. Consequently, the successful experience of a certain country may not necessarily work in others. In federal states in which the constituent units traditionally had taxing powers, such as Switzerland, they have kept some of their original regulatory powers, while a certain degree of coordination has been progressively introduced by the central authorities. On the contrary, other countries which traditionally have been centralised, such as the United Kingdom, are experiencing the opposite process as a response to the political pressure exerted by certain regions interested in higher levels of self-government.

With the exception of countries such as Germany and Portugal, in the rest it is possible to observe disparities in the regulation of the corporation tax in the different sub-central entities which are part of the same State. Sometimes, this is the result of the asymmetric distribution of regulatory powers concerning this tax, such as in the case of Spain. Similarly, in the United Kingdom, the reforms which could affect Northern Ireland have a clear asymmetric nature. These asymmetric regimes should not necessarily be seen as unjustified privileges and can be a reasonable way of addressing the higher interest in self-government or the economic particularities which may exist in certain regions.[20] In other cases, the use of similar taxing powers has led to a very heterogeneous distribution of the tax pressure.

However, in general it is possible to observe a trend towards the harmonisation of the tax base of the corporation taxes which coexist within one country, while regional autonomy is increasingly limited to the capacity to set the tax rate. In the European Union, the harmonisation of the tax base has been one of the objectives of the European Commission in order to improve the functioning of the internal market. In fact, it can be argued that certain aspects of European Union law, such as the prohibition of state aids, are a factor that has tended to limit the introduction of regional disparities, as shown by the experiences of the United Kingdom and Spain.

In any case, this harmonising trend can also be observed beyond the European Union in countries such as Canada, Switzerland and the United States.

20. For a detailed analysis of the issue of fiscal asymmetries, see, for instance, Congleton, "Asymmetric Federalism," 131-153.

The reason is that the harmonisation of the tax base has clear advantages from the perspective of the simplification of the administration of the tax, while the reduction of the autonomy that this harmonisation entails can be easily compensated by having more freedom to set the tax rate or to introduce certain tax incentives.

4. Decentralisation of regulatory powers over other taxes on businesses

In order to increase the accountability of sub-central authorities and their autonomy in the field of business taxation, the decentralisation of the corporation tax is not the only alternative. There are other taxes with a direct impact on businesses which may be more adequately regulated by regional authorities. This is the case, for instance, of taxes on the real property of businesses, which are usually local taxes but which could be instead allocated at the sub-central level. Moreover, taxes on economic activities or on the added value of businesses could also be a relevant source of revenue, which could be complemented by other taxes aimed at addressing specific regional needs, such as those with environmental purposes. In my view, for countries interested in increasing regional autonomy in the field of business taxation, instead of decentralising the corporation tax it would be advisable to explore other alternatives first, such as the ones which are presented here. Sometimes, this will require a redistribution of regulatory powers between the regional and local authorities.

4.1. Taxes on trade or businesses and economic activities

In Germany, one of the most important local taxes is the trade tax or business tax (*Gewerbesteuer*), which is based on the trading profit of a business, as defined by § 7 of the law regulating this tax (*Gewerbesteuergesetz*). Within the limits fixed by the law, the municipalities have the possibility of establishing the rate at which it is levied (Art. 106(6) GG). In the case of the city states, such as Berlin, it works as a tax of the *Länder*. A very similar communal business tax is applied in Luxemburg (*impôt commercial communal*). It is levied on the profits of commercial companies and each municipality can establish its own communal rate, depending on its preferences.

In Spain, the tax on economic activities (*impuesto sobre actividades económicas*) is a local tax which is due based on the mere fact of carrying out business or professional activities, that is, regardless of the profit which is obtained. Even though the tax is regulated by the state (*Texto refundido de la Ley Reguladora de las Haciendas Locales*), the local authorities may modify, within certain limits, some of the coefficients which determine the final amount to be paid. Moreover, the law also foresees several optional tax benefits (aimed at favouring, for instance, the creation of new businesses, the hiring of new employees or the protection of the environment) which each municipality can apply or not, depending on its political priorities. It is important to note that a surcharge can be introduced by the provinces and, in the case of the autonomous communities which are only made up of one province, this surcharge would be a regional rather than a local tax. Moreover, the law regulating the financing of the autonomous communities (*Ley Orgánica 8/1980, de 22 de septiembre, de Financiación de las Comunidades Autónomas, LOFCA*) allows regional parliaments to introduce taxes on the same subject (Art. 6(3) LOFCA), which in practice has not taken place because the law also foresees that in that case local authorities would have to be economically compensated.

4.2. Taxes on the real property of businesses

From an economic perspective, taxes on real property are particularly suitable for the purpose of achieving higher levels of decentralisation since in this case the tax base has a very low inter-jurisdictional mobility.[21] Therefore, taxes on the real property of businesses should be one of the first options which should be explored by countries interested in increasing regional autonomy in the field of business taxation.

In France, the *cotisation foncière des entreprises*, which is part of the *contribution économique territoria*le, the tax which some years ago substituted the *taxe professionnelle*, is a local tax based on the real property of companies or persons which perform an economic activity on a regular basis. It is regulated in Article 1447 – 1478 of the *Code Général des Impôts,* CGI, which offers some autonomy to the local authorities in aspects such as the tax rate (Art. 1636 B *sexies* CGI). In order to compute the tax to be paid, a tax rate established by

21. See Musgrave, "Who should Tax," 10-13.

each municipality is applied to the tax base, which includes the rental value of the immovable property. For the cases in which the rental value is very low, local authorities can also establish a minimum level of taxation which will depend on their turnover. Moreover, local authorities can also introduce certain tax benefits, including a tax allowance in the overseas departments and territories subject to the European State Aids regime (Art. 1466 F CGI).

In the case of the United Kingdom, National Non-Domestic Rates (NNDR), generally known as "business rates" are a local tax charged on non-domestic properties, such as factories, warehouses, offices and shops. In order to compute the amount payable, the tax rate is applied on the estimated annual rent which would be paid for the property. Despite being a local tax, each municipality cannot decide on the fiscal pressure. However, the tax pressure and other administrative aspects are different in England, Wales, Scotland and Northern Ireland.

Even though the Assembly of Wales already had the power to regulate business rates (according to the Government of Wales Act 2006, the Assembly can legislate on local finance,Heading 12 in Part 1 of Schedule 7), since 2015 this is the first tax which has been completely devolved. This means that for the first time the revenue obtained will have a direct impact on the level of funding of the Welsh Government, which should increase its accountability and constitute an incentive to promote business activities. In the case of Scotland, the Scotland Act 1998 already foresaw that local taxes to fund local authority expenditure (including non-domestic rates) were not part of the reserved matters which could only be centrally regulated (Head A1 in Part 2 of Schedule 5). In Northern Ireland, the tax includes a regional and a district rate. The first one is decided by the Northern Ireland Assembly and the second, by each district council. Therefore, in this case, the tax combines a local and regional nature.

In Belgium there are several taxes which concern the real property of businesses. The first one is the property tax on material and tools (*précompte immobilier sur matériel et outillages*), a regional tax which has been recently reintroduced in Wallonia. The tax affects machines and other facilities which are used by businesses, such as industrial companies, and it is computed according to the average revenue which could be obtained from those goods during a year (Art. 471 and 483-485 *Code des impôts sur les revenus*). Another Belgian tax which affects real property and business activities is the local tax

on offices, currently in force for instance in the city of Brussels (*taxe sur les surfaces de bureau*). The tax, which has to be paid by the owner of the office, is computed according to its surface (currently, it amounts to 8.90 € per m^2 and year).

Other countries have similar taxes on real property used by businesses, such as Denmark, which charges a financial levy on commercial premises (*Dækningsafgift af forretningsejendomme*) which affects offices, shops, hotels, factories, workshops and other properties used with similar purposes. The revenue obtained accrues to the local authorities, which also set the tax rate. Other aspects, such as the tax base and the existence of tax reliefs, are regulated by the central authorities.

4.3. Taxes on the added value of businesses

As we will see later, the value added tax is an indirect tax on consumption which cannot be easily decentralised. However, several countries have introduced local or regional taxes on the value added of businesses, which actually have more common aspects with direct taxes on income obtained by corporations.

In France, the tax on the added value of companies (*cotisation sur la valeur ajoutée des entreprises*) is a local tax which, together with the *cotisation foncière des entreprises* constitutes the *contribution économique territoriale*. The revenue obtained thanks to this tax accrues to the local and regional levels of government (municipalities, departments and regions). Even though the tax is centrally regulated (Art. 1586 *ter* – 1586 *nonies* CGI), this is a relatively uncommon tax that shows that sub-central levels of government can also benefit from the taxation of businesses. In particular, this tax amounts to a fraction of the added value produced by a company, which is explicitly defined by the law as the difference between the turnover (subject to a number of adjustments) and several other variables such as stocks of raw materials. The revenue is allocated to the local authority in which the company has its facilities or employees and, in case of operating in more than one municipality the revenue is apportioned according to a formula which takes into account the value of the real property and the number of employees in each place.

In 1997 Italy introduced a regional tax on productive activities (*imposta regionale sulle attività produttive, IRAP*) the revenue of which finances regional expenses, such as health services. It is regulated by the central state (*decreto legislativo 15 dicembre 1997 n.446*), but the regions may modify the tax rate within certain limits foreseen by the law (Art. 16(3) D.Lgs. 446/97). With respect to the main characteristics of the tax, it is payable by companies doing economic activities (production of goods or provision of services) and the tax base includes the added value, which is computed, basically, as the difference between revenue and production costs.[22]

The introduction of this tax gave rise to a judgement of the European Court of Justice in which it analysed if the IRAP could be considered as a turnover tax which would be incompatible with the value added tax established by European Union law (Judgment of the Court of 3 October 2006, Banca popolare di Cremona Soc. coop. arl v Agenzia Entrate Ufficio Cremona, Case C-475/03). According to the Court, the IRAP could not be identified as a turnover tax in the sense of Article 33 of Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the member states relating to turnover taxes, since its functioning is very different from that of VAT. For instance, VAT is levied on individual transactions while IRAP is charged on the net value generated by a business during a certain period of time, the tax base is also computed in a different way, and in the case of the IRAP, it is not necessarily borne by the final consumer. However, some authors have criticised the view of the Court for considering that it places form over substance and that value added taxes can be administered by either a credit invoice or subtraction method with only certain differences in the tax base, which will depend on the treatment of exports and imports and on the existence of non-taxable items.[23]

Besides France and Italy, a similar local tax paid by corporations on value added also exists in Hungary (*Helyi iparűzési adó,* HIPA). The compatibility of this tax with the VAT was analysed by the Judgement of the Court of 11 October 2007, Cases C-283/06 and C-312/06, and the conclusion reached was the same as in the case of the Italian IRAP. The Court also considered that HIPA significantly differed from VAT, since for instance HIPA cannot

22. For more details on this tax, see Bordignon *et al.*, "Reforming Business Taxation," 195-197.
23. See Neubig *et al.*, "Non-VAT Taxes," 657.

be regarded as proportional to the price of the goods or services. Moreover, the possibility of deducting the VAT paid during the preceding stages of the production and distribution process is not comparable to the functioning of the HIPA.

4.4. Taxes on certain types of businesses

In states with several levels of government it is relatively common to observe the existence of regional or local environmental taxes which affect business activities. For instance, in Belgium, the regions of Wallonia and Flanders have established taxes on industrial waste (*taxe sur les déchets industriels*). In Spain, many of the taxes introduced by the regional parliaments have an environmental purpose. This is the case, for instance, of the taxes on water and air pollution which exist in most of the autonomous communities, and the taxes which affect nuclear power stations and large commercial establishments in Catalonia.

Besides the previous taxes with a clear environmental purpose, some regional and local taxes focus on certain production forms or business sectors. This is the case of the tax on motive force (*taxe sur la force motrice*), which is charged by many municipalities and some of the provinces of Belgium and has a direct impact on businesses which use motors for the development of their activities. Each local authority has its own regulation, but the tax is normally proportionate to the power of the motors. The importance of European Union law is also visible in relation to this local tax. The regulation of this tax by the municipal council of Seraing and the provincial council of Liège, which included an exemption which was applicable to motors used in natural gas stations, but not to motors used for other industrial gases, gave rise to a preliminary ruling before the European Court of Justice in order to determine whether that situation could be regarded as state aid, a possibility which was admitted by the Court in its judgment of 15 June 2006 (joint cases C-393/04 and C-41/05).

Moreover, some economic sectors may be the object of regional or local taxes. For instance, in France, the *Code Général des Impôts* foresees a local tax on network companies, such as those which produce and distribute electricity and gas companies (Art. 1519 D - 1519 HA CGI). Another example is that of

the tourist industry, affected by the taxes on overnight stays at hotels. These taxes usually have a local nature, such as the hotel taxes introduced by cities such as Brussels, but in certain cases they are also regulated by the regional authorities, such as the Catalan tax on stays in tourist establishments.

5. Limitations imposed by European Union law on regional autonomy on the value added tax

Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax is currently the legal source which harmonises this tax in the European Union. In the framework of this harmonisation, which includes fundamental aspects such as the regulation of the tax base, the member states may legislate on certain aspects, such as the tax rate, within the limits set by the Directive.

However, the possibility that regional parliaments could also participate in the regulation of this tax has not been considered. In other words, it is assumed that the transposition of the Directive into national law will always be carried out by the central authorities and that there will not be regional disparities. As an exception, the Directive foresees certain particularities applicable to some regions or territories, which can be explained mainly by geographical reasons.

For instance, in the case of Portugal, Article 105 of the Directive allows the possibility of applying a lower tax rate in the autonomous regions of the Azores and Madeira compared to the rest of the country. This rate is not set by the central authorities, but by the regional ones, which is a rather exceptional case of regional autonomy in the field of the value added tax. In several other countries there are territories to which the VAT Directive is not applicable, such as the Canary Islands in Spain, but this does not necessarily mean that these regions have the autonomy to regulate their own value added taxes. For instance, the General Indirect Tax which is applicable in the Canary Islands is regulated by the central state.

Consequently, leaving aside the previous asymmetric situations which are justified by geographic and economic considerations, the European regulation of the value added tax excludes regional autonomy in this field. In particular,

the European Commission interprets the VAT Directive in the sense that the standard and reduced rates which can be set by each member state have to be the same for the whole country (this aspect is currently regulated in Articles 96 to 101 of Council Directive 2006/112/EC of 28 November 2006). Possible exceptions to this can be included in the Directive or in the accession treaties, but they are usually of a temporary nature and require the unanimity of all the member states. Moreover, different regional tax rates would go against the conception of the VAT as a general tax, could be a barrier for the free movement of goods, and could distort competition and the functioning of the internal market.[24]

However, it is important to remember that in Germany, the *Länder* can indirectly influence the regulation of the value added tax in the same way as in the case of the corporate tax, an aspect which was mentioned before. The legislation is uniformly drafted at the federal level, but given that the revenue is shared by the Federation and the *Länder*, the approval of the *Bundesrat*, in which the *Länder* are represented, is necessary.

6. The decentralised regulation of the value added tax in countries with several levels of government

The regulation of the value added tax by regional authorities is extremely uncommon since the coordination and enforcement of multiple value added taxes could become very problematic. However, there have been several academic proposals in order to increase decentralisation in this area and the example of Canada shows that this is not completely impossible.

6.1. The sub-central regulation of the value added tax: technical considerations

From a technical perspective, the possibility that certain aspects of the regulation of the value added tax, such as the tax rate, could be set by sub-central parliaments has generally been considered as highly problematic. The value

24. For an analysis of the position of the European Commission, see Lasarte Álvarez and Adame Martínez, "Cesión del IVA," 150-159.

added tax, as it is currently in force in the European Union, is charged at each stage of the production process but also enables the deduction of the tax paid at the preceding stage. Independently of the number of transactions, the tax is finally borne by the final consumer.

In the context of the European Union, the intra-Community acquisition of goods is taxed according to the destination principle, that is, by the country where consumption takes place. Given that some aspects of the regulation, such as the tax rate, are not homogeneous in all the member states, an adjustment in such cross-border transactions is necessary. If regional parliaments could also set the tax rate applicable in their territory it would also be necessary to introduce a similar system of adjustments and, consequently, the administration of the tax would become much more complex and costly. Therefore, economic literature considers that value added taxes are less suitable for decentralisation than other taxes, such as those on personal income, since the improvement in the accountability of sub-central entities that would be achieved would not compensate for the higher administrative costs.[25]

As a result, the sub-central regulation of certain aspects of the value added tax is very exceptional, not only in the European Union but also in other federal countries with a long tradition of fiscal decentralisation. For instance, in Switzerland, the value added tax is the most relevant example of centralised tax, since the federal level, instead of the cantons, is responsible not only for its regulation but also for its administration and, furthermore, the revenue accrues to the federal budget. The Swiss Constitution, in its Article 134, explicitly prevents the cantons and the municipalities from introducing taxes similar to the federal value added tax.

Even though the regional regulation of the value added tax is not currently possible under the present European Union legal framework, nor is it in many states with a federal nature, such as Switzerland or Australia,[26] this does not necessarily mean that it is not feasible for sub-central levels of governments to participate in the regulation of value added taxes. Several theoretical al-

25. See, for instance, Dahlby, "Taxing Choices," 94-98.

26. In the case of Australia, even though the revenue from the Goods and Services Tax (GST) is distributed to the States and Territories, it is centrally regulated by the Federal Parliament. For a presentation of the criteria used for the distribution of the GST revenues, see Collins, *The States and the GST*.

ternatives have been proposed in the literature and the practical experience of some countries such as Brazil, India and, especially, Canada shows that this is possible.

6.2. The decentralisation of the VAT in Canada

The analysis of the experience of Canada is justified by the fact that it is the most relevant example of a federal country in which the value added tax is partly regulated by sub-central levels of government. The current situation is the result of the historical and political particularities of Canada and it can be characterised by two main aspects: the coexistence of different taxes and the asymmetric nature of the system.

In 1991, Canada introduced a federal value added tax called the goods and services tax (GST) which coexists with the provincial and sales taxes (PST). These provincial taxes are cascading taxes, with the exception of the Quebec sales tax (QST), which is a value added tax. In some provinces, the goods and services tax and provincial sales taxes have been combined into the harmonised sales tax (HST), which is also a value added tax.

The situation throughout the country is clearly asymmetric. Some provinces charge the harmonised sales tax, such as Ontario; some of them charge the goods and services tax and their provincial sales tax, such as British Columbia; a minority only charges the goods and services tax and no provincial sales tax, such as Alberta; and in Quebec the goods and services tax coexists with the Quebec sales tax. The characteristics of provincial sales taxes are not homogeneous and the tax rate of the harmonised sales tax also changes from province to province. Moreover, the goods and services tax is administered by the Canada Revenue Agency in the whole country with the exception of Quebec, where it is administered by *Revenu Québec*, together with the Quebec sales tax.

Taking into account the complexity of the Canadian system, the question that arises is: how can this system be workable and, furthermore, a successful experience? In this sense, from the thorough analysis presented by Bird it is possible to highlight two different aspects. On the one hand, the regulation has simplified some of the most controversial aspects, such as the criteria for

the allocation of the revenue among the different provinces. However, this simplification means that the application of the destination principle is not so accurate. On the other hand, the administration of these taxes has been relatively successful thanks to the close cooperation and the exchange of information between the Canada Revenue Agency and *Revenu Québec*, and to the fact that the existence of a federal value added tax provides information which is also useful for the administration of provincial taxes.[27]

It would be difficult, however, to apply the Canadian experience in the European Union. Deviations from the destination principle, for instance, may be very difficult to accept by all the member states. Moreover, following the Canadian model in the European Union would actually require the introduction of a homogenous value added for the whole Union which would have to coexist with the value added taxes of the different member states and, furthermore, with those of the regions which are granted a certain degree of autonomy in this field. Consequently, the resulting situation would be much more difficult to administer.

6.3. Other theoretical alternatives

Even though value added taxes exist in almost all federal countries, with the notable exception of the United States, the decentralisation of regulatory powers has only taken place in a few countries. Besides the experience of Canada, which has been characterised as a dual VAT due to the coexistence of federal and sub-central value added taxes,[28] only countries such as Brazil and India have partially decentralised this tax,[29] but their results are not so successful. However, from a theoretical perspective, in the academic literature it is possible to find other forms of decentralisation of value added taxes.

One possibility is the "compensating VAT" (CVAT), proposed by McLure. In this system, sales between sub-central entities would be subject both to the central VAT and a central CVAT, while operations taking place within one

27. For more details, see Bird, *VATs in Federations*, 15-30; and Bird, *The GST/HST*.

28. For more details concerning this model, see Bird and Gendron, "Dual VATs," 429-442.

29. With respect to the situation in Brazil and India, see Bird and Gendron, "VATs in Federal Countries," 303-308.

region would be subject both to the central VAT and regional VAT. The tax rate of the CVAT would have to be set by the central level of government taking into account the tax rates of regional VATs, for instance, computing a weighted average. This system would simplify the administration of operations between different sub-central entities and would reduce the potential for tax fraud. Given that the CVAT would be fully creditable, the final result would be a destination sub-national VAT.[30]

Another approach with several similarities is the "viable integrated VAT" (VIVAT) developed by Keen and Smith. In this case, a uniform VIVAT rate is charged to sales to registered traders both in transactions between different sub-central entities or within a single one. The VIVAT would also be fully creditable, but since instead of a central VAT (such as in the case of the CVAT) the VIVAT would be credited against sub-central VATs, which would have different tax rates applicable to sales to final consumers and unregistered traders, a clearing mechanism would be necessary to reconcile the credits on imports and exports among regions.[31]

In relation to the case of Spain, Durán Cabré has presented several proposals in order to increase the power of the autonomous communities to regulate the value added tax, regardless of the current limitations imposed by European Union law.[32] The first possibility would be the application of a regional tax rate at the retail trade stage. This would require a precise definition of operations at the retail stage and the determination of the place where the chargeable event would occur. Later, the revenue would be distributed according to the volume of operations at retail stage corresponding to each region and to the tax rate in each one. A second alternative would be a regional surcharge on sales at the retail stage, which would also require a precise definition of this stage and which would be directly allocated to the region which had charged it. A third alternative is a dual tax, following the example of Quebec in Canada.

30. See McLure, "Implementing Subnational Value Added Taxes," 723-740.

31. This approach has actually been conceived in order to improve the functioning of the VAT within the European Union rather than in order to facilitate a further decentralisation within the different member States. See Keen and Smith, "The Future of the Value Added Tax," 373-420.

32. Durán Cabré, *La descentralització de l'IVA*, 41-52.

7. Conclusions

The impact of European Union law on regional autonomy in business and value added taxation has been very different. Indirect taxation is highly harmonised and sub-central levels of government are prevented from regulating any aspect of the value added tax. On the contrary, in the field of direct taxation on businesses, the limitations deriving from European Union law are not an insurmountable barrier for the decentralisation of these taxes. The most important constraints are intended to ensure the functioning of the internal market, such as the fundamental freedoms and the prohibition of state aids, and are applicable to central, regional and local authorities in a similar way.

Taking these limitations imposed by European Union law into account, what options exist for countries interested in increasing regional autonomy in this area? Which are more reasonable from an economic perspective? Which practices of some countries could be followed by others?

Decentralising the value added tax in the European Union would require a legal reform that is currently difficult to imagine, since such a change would have to be adopted unanimously by all the member states and this is clearly not one the priorities of European institutions. Moreover, from a technical perspective, a decentralised value added tax could be problematic, since it would be much more difficult to administer and enforce. This should be, consequently, one of the least preferred alternatives for increasing regional autonomy on tax matters. However, this does not mean that the decentralisation of the value added tax is completely impossible. Several theoretical options have been presented in the literature and the case of Canada shows that decentralisation can also be relatively successful in this area.

In the field of business taxation, partial regulation of the corporation tax by sub-central parliaments would be less problematic from the point of view of European Union law, but economically it could have important disadvantages. A heterogeneous regulation of the tax base could increase compliance costs significantly and disparities in regional tax rates could lead to harmful tax competition dynamics. Therefore, it is not surprising that the experiences of the countries with different levels of government which have been analysed show a trend towards the harmonisation of corporation taxes.

For countries interested in increasing regional autonomy in the field of business taxation, I consider that the first option which should be explored is the possibility of offering the regions the power to regulate other taxes which also have an impact on firms. Taxes on the real property of businesses are very common and their decentralisation does not create serious economic distortions given the low mobility of their tax base. Moreover, in countries such as Germany, Luxemburg and Spain, taxes on trade or businesses and economic activities have traditionally existed at the local level. Another alternative is that of taxes on the value added of businesses, which have recently been introduced at the local and regional levels in France and Italy. For those regions interested in using taxation in order to address particular needs, such as pollution or other negative externalities deriving from certain economic sectors, it may be convenient to increase their capacity to legislate in these cases.

Any reform in this direction should follow a holistic approach, that is, it should not focus on a single tax but rather on the previous set of taxes and, especially, on coordination and cooperation between the central, regional and local levels of government. Furthermore, regional autonomy should not be seen as an end in itself, since although it may have advantages, such as increasing the accountability of sub-central authorities, it can also entail excessive compliance costs for taxpayers, distort the decisions of economic agents and create inefficiencies. Besides these technical considerations, the historical and political constraints of each country also have to be taken into account. Asymmetric regimes could be a reasonable way of accommodating these particularities.

It is true that European Union law imposes certain limitations on regional tax autonomy, especially in the field of indirect taxation. On the contrary, in the area of business taxation there is still plenty of room for further decentralisation. However, all the measures which are legally feasible may not be economically reasonable and, in this field, it seems that instead of decentralising the regulation of the corporation tax, it may be more advisable to explore other alternatives, such as the transfer of regulatory powers on other taxes which also have a direct impact on businesses.

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