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A COMPARATIVE ANALYSIS OF TWO "FEDERAL" TAX SYSTEMS

-regarding the structures of the tax systems in the European union and the United States of America

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ABBREVIATIONS

AGI	Adjusted Gross Income
DC	Directive of Circulation, Council Directive 92/12/EEC
ETR	Europarättslig tidskrift (Journal on EC law)
ECJ	European Court of Justice
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
IRC	Internal Revenue Code
IRS	Internal Revenue Service
ISG	Intracommunity Supplies of Goods
MFN	Most-Favoured Nation
ML	Mervärdesskattelagen (The Swedish VAT Law)
Prop	Proposition (Peremptory work, the Sitting Governments Commentary to a Proposed Legal act.)
SN	Skattenytt (Tax News)
SOU	Statens Offentliga Utredningar (The Official Reports from "Riksdagen")
SvSkT	Svensk Skattetidning (Swedish Journal on Taxes)
TRIPS	Agreement on Trade-Related Aspects of Intellectual Property Rights
VAT	Value Added Tax
WTO	World Trade Organanization

1 INTRODUCTION

1.1 Background

The world of today is psychologically getting smaller and smaller due to the globalisation of trade and the ever-growing Internet. It does not take a large ship and a journey of roughly six months to get to the other side of the globe. This new climate does not however benefit the small states of the world. To get the advantages, which the new age brings upon the economy, it is necessary to form alliances with former competitors. This is true both for corporations as well as for states. For the states this has taken the form of either free trade areas or customs unions to make it easier to sell their products on other markets. The European union has risen as a counterweight to the United States and Japan on the world market. In order to make world trade flow without friction the WTO and the GATT have been enacted.

With the perspective, that the globalisation process has led to the need for stronger entities to safeguard the survival of the actors of this market and to make them more competitive, the European union must be regarded. It is a fairly young organisation compared to the United States. The EU, therefore, has a lot to learn from the USA in all areas, despite the fact that the USA is a federation and the EU is a confederation, from the start. Over time the functions of the Union have increased into more and more areas. The one main objective of the Union is to accomplish a single market without any restriction in the flow of goods between the states. As a result of this there has been a need to lessen the impact of the taxes on intracommunity trade. So far, it is in the fields of the *indirect taxes*, *VAT and excise taxes* on alcohol, tobacco and mineral oils, and the *Customs duties* that harmonisation between the Member States has taken the most significant steps. In the case of Customs there has been a total unification of legislation at the Community level. Concerning VAT and excise duties, it is only the time of taxation that has been established through directives from the central union body. However the EC law has an *indirect effect* on national internal tax legislation of the states. This means that when designing the national tax systems the states must take into account the general principles of EC law. Regarding the direct taxes some progression has been made when it comes to the corporate income tax. Directives have been issued in order to lessen the impact of taxation obstacles in the way of international co-operation between companies within the EU both when it comes to transfers of dividends between parent companies and subsidiaries and the *merger directive* to make it easier to merge companies from different Member States.

In the United States the development has had more time to establish which taxes should be levied at the central federal level. The US also has the Customs law under the central level but in addition there is a federal income tax both regarding individuals and corporations and a federal gift and an estate tax as well. Instead of VAT the United States has chosen a construction with Use and Sales taxes but just as in the case of the EU it is only the time when the tax is chargeable that is the same in all states. The rate is however decided by the individual state.

1.2 Purpose and Objectives

The purpose of the paper is to make a *comparative analysis of the overall structure of the tax systems in the European union and in the United States of America, their organisation on a general level and what can be learned for the future development of the European project*. The European tax system is not yet established to any greater extent, therefore by examining how the United States has solved the problems connected with taxing a large entity some hints of the future development of the tax system of the Union can be seen.

The objective is to show how the USA has chosen to organise its tax system and point out what can be transferred and used in the European union. Both the EU and the USA can be said to have supra national parts that display federal structures. The United States has a long history as a pronounced federation, while the European union can be described as a potential federation in its initial stage. It can thereby be of great interest to compare differences and similarities.

1.3 Scope and Limitations

The objective of the paper is to make a structural comparison of the tax systems in the European union and in the United States. In order to do so, a presentation of the individual taxes must first be made before the larger picture can be painted. To make it possible to see the overall structure one must first see the individual entities.

Of the federal taxes in the USA the description will include the corporate income tax, the individual income tax and the gift and excise taxes. I have left out the federal employment (or payroll) tax since it is so intimately connected with the corporate and individual income taxes. One leads to the other. The sales and use tax is included despite the fact that it is not a federal tax, but since the European union has harmonised the indirect taxes, it therefore has been included. The customs duties are included because they can be compared to a sort of tax.

When it comes to the European union the indirect taxes, the VAT and excise taxes regarding alcohol, tobacco and mineral oils, are presented because of the harmonisation that has taken place. The customs duties are under the central union competence and belong, therefore, in the presentation. The rest of the taxes, the direct taxes, do not fall under the power of the Union but its indirect impact is pointed out and the merger- and parent/subsidiaries- directive are described.

1.4 Overview of the Paper

The paper can be characterised as divided into four parts. It starts with a chapter with some definitions that I feel are important for the understanding of the rest of the paper. After this the tax system of the European union is presented and in the fourth chapter the same thing is done with the tax system in the United States. Each individual tax is described in a rather detailed manner. In the following chapter the structures of the tax systems are compared and analysed. The analysis is done with the larger perspective in mind. I feel, however, that it is necessary to first describe the details before the big picture can be seen.

2 A FEW DEFINITIONS

2.1 Introduction

Prior to the presentation of the tax systems of the European union and the United States there are some definitions which need to be established and that are of interest to the paper at hand. The definitions will contribute to the understanding of the description below and the two entities tax systems. The first is the distinction between a federation and a confederation. This is perhaps more of a constitutional issue but it is important to point it out. After that the difference between a direct and an indirect tax is presented. Both the distinctions are important to bare in mind when reading the rest of the paper.

2.2 Federation and Confederation

With a federation means a federal state. A federal state is a unification of states where it was not possible to find political unity in building a single state. Distinguishing features for a federal state are the division of the political powers between on the one hand a number of participating states and on the other hand a central body of power. The division of power is regulated in detail, usually in a constitution, in order to avoid abuse of power. Tasks of mutual interest for the states, for example defence and foreign policy, shall be placed on the federal level. The states are in principle self-governing when it comes to remaining issues. After the foundation of a federation it assumes the Member State’s voice towards other independent states. The participating states have consequently transitioned into being parts of a new larger sovereign state. The United States of America is a good example of a federal state.[1]

The European union is considered to be a confederation but it exhibits areas which are supra national. It can perhaps be said to be partly federal or mostly confederate. A confederation means a union of sovereign states where each is free to act independently. In a federation the individual states are subordinate to the central government. The states have, in a confederation, joined together to create a strong single political unit.[2]

2.3 The Difference Between Direct and Indirect Taxes

In the legal area which makes out the tax law the taxes are generally divided into a number of different categories depending on what kind of tax it concerns. The two most important groups are the *direct taxes* and the *indirect taxes.* In the case of the direct taxes the one liable for the tax is in fact the one who actually pays the tax. Examples on direct taxes are income tax, taxation of capital and gift tax. In the case of the indirect taxes the tax burden is passed on to another legal person. In the end it is consequently not the one liable for the tax that pays it.[3] The VAT and excises are examples of indirect taxes and when it is the consumer who pays the tax they are usually labelled as consumption taxes. VAT is a general consumption tax since it is levied on the sales of most merchandise; in opposite to excises which only are levied on specific products, like tobacco and alcohol. An income tax can be designed so that it is progressive, this means that the tax rates are higher at higher incomes. The indirect taxes can not be constructed in this way. Instead they are proportional. The tax rates are in other words the same irrespective of the price of the object consumed.[4]

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[1] See *Nationalencycklopedin* p.167-168. See also Shaw, J, *European Community Law,* p. 10, where a closer presentation of the effects the establishment of a federation has for the individual state.
[2] See Encarta 96 Encyclopaedia [confederation].
[3] See Påhlsson, R, *Inledning till skatterätten*, p. 11-12.
[4] See Mattson, N & Melz, P, *Mervärdesskatt - en introduktion*, p. 11-13.

3 THE TAX SYSTEM OF THE EUROPEAN UNION

3.1 Introduction

I have chosen to describe, what best can be called, the tax system of the European union from a Swedish perspective, in order to point out how a membership in the Union effects the Member States. The fields that are under the competence of the union are the indirect taxes and the so-called customs law. Customs duties can perhaps not, per definition, be characterised as a tax but their effects are equivalent and that is the reason why they are included in the descriptive part concerning the tax system of the European union.

Prior to the presentation of the tax system of the European union it is necessary to make a perspicuous description of, for the question at issue, important aspects of EC law.

3.2 Background

The basic structure of the European union is usually characterised as a three-pillar co-operation. It is a co-operation in three very different areas. Pillar number one displays significant supranational elements and in this pillar it is possible to detect several federal features. In pillar two, common security and foreign policy, and three, co-operation on home and justice affairs, the interchange is in the normal interstate form.[5] What is called the European Community is situated in the first pillar and its foundation is to be found in the European Coal and Steel Community (ECSC-treaty) from 1952, European Atom Energy Community (Euratom-treaty) from 1958 and the European Economic Community (EC-treaty) also from 1958. The European union was created with the Treaty of Maastricht (the EU-treaty) in 1992. The union is wider than the European community. With the Treaty of Amsterdam (1997) the co-operation in the second and third pillars was deepened, for example a co-operation among the different police forces and in the field of criminal law. Immigration to the Union has been co-ordinated as well. [6]

In figure 1 the structure of the European community and the European union is made clear.

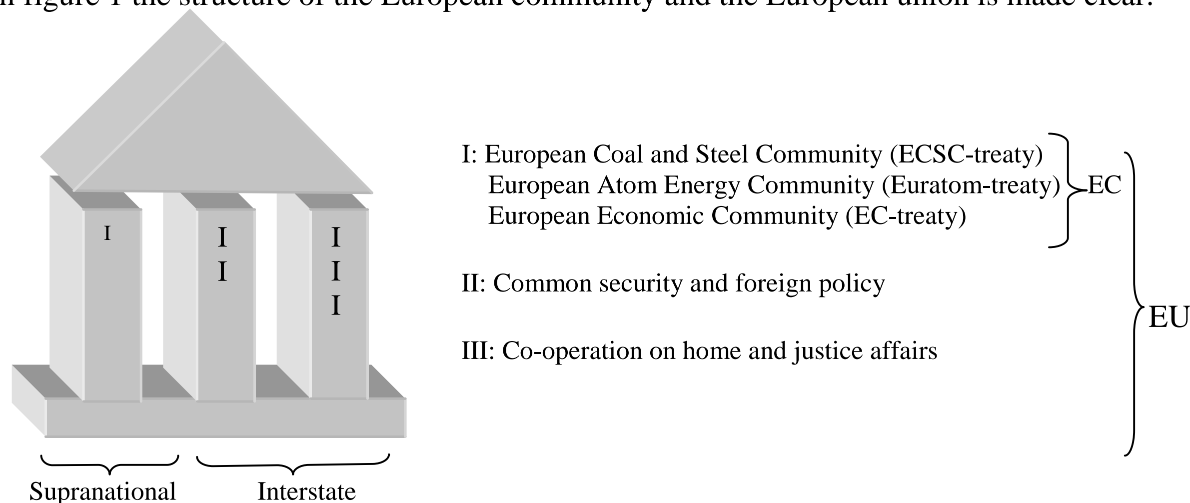

Figure 1. The structure of the European Community and the European union.[7]

[5] See Melin, M & Schäder, G, *EU:s konstitution: Maktfördelningen mellan den europeiska unionen, medlemsstaterna och medborgarna,* p. 11-13.

[6] See Pålsson, S & Quitzow,. C M, *EG-rätten, ny rättskälla i Sverige*, p. 26. Weatherill, S & Beumont, P, *EC law,* p. 1-13. For a closer presentation of the Treaty of Amsterdam see Nergelius, J, *Amsterdamfördraget och EU:s institutionella maktbalans*, p. 129-148 and Piris, J-C & Maganza, G, *The Amsterdam Treaty: overview and institutional aspects*, Fordham International Law Journal 1999 especially p. S32-S41. The borders of the Union were co-ordinated by the Schengen Treaty with a common border towards third countries.

[7] See Shaw, J, *European Community Law*, p. 3-8. The abbreviations of the treaties are made in accordance with the ECJ recommendations in the Official Journal of the European Communities 1999/C 246/01.

3.3 Legal Acts in the European Union

The treaties in the European union make out an important part of what is commonly referred to as *primary legislation*. Primary legislation is generally held and can best be described as a general agreement. In order to give the treaties, which make out the primary legislation, a meaningful content they have to be supplemented with *secondary legislation*. With secondary legislation is meant legal acts drawn up by the Union's institutions with authorisation from the treaties.[8] The legal acts can be of three different kinds.[9] The most extensive are the *regulations,* which are binding in their entire wording and are directly applicable in all the member states. The member states can only pass implementing measures that clarify the meaning of the regulations, these must in turn, of course, be consistent with the community laws.[10] A *directive,* on the other hand, is only binding regarding the final goal. It has been left to the discretion of the member states to implement it as they choose. A *decision* is only binding upon those to whom it is addressed. *Recommendations* and *opinions* do not have a binding force. EC-rules can have *direct effect*, which means that individuals can refer to them in a court and other official authorities. In order for a rule to have direct effect it must be clear and sufficiently precise, in other words that a verdict can be based on it. In addition a rule must be unconditional and not dependent on someone's own discretion. The last and final requirement is that the rule may not be dependent on that any additional steps must be taken. These requirements concern all EC legislation. For a directive the time to implement it has to have expired as well.[11]

3.4 The Competence of the European Union

The fundamental feature of the European union is that the member states have relinquished power in certain areas, transferring this competence to the union, and by this renouncing the right to decide in these fields. One part of the agreement, when giving the union power, is that the states may be bound by a decision contrary to their own conviction.[12] The Union has only power to the extent that the member states have chosen. The powers of the Union can be either *exclusive* or *concurrent*. Exclusive power means that decisions only can be taken on the community level, the member states possibility to regulate nationally have in principle been excluded.[13] In the fields where the powers are concurrent between the Union and the Member States the states can take steps only to the extent that the Union has not made use of the power. If there is a necessity to regulate the issue on community level the Member States right and possibility to decide in that area, locally and independently, disappears.[14]

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[8] Pålsson, S & Quitzow, C M, p. 26 and Melin & Schäder, p. 63-65. See also Shaw, J, p. 98-115.
[9] See Art 249 EC, (former Art 189 of the EC-treaty).
[10] According to the so-called *Variola*-rule which was established in Case 34/73, (*Variola...*), [1973] ECR 981. For more on the rule see Weatherill, S & Beumont, P, p. 296.
[11] Melin & Schäder p. 64. The first time the Court decided that a provision in a treaty can have direct effect was in Case 27/62, (*Van Gend en Loos…),* [1963] ECR 1 CMLR 193. If the Member State have not met its obligations it may be liable to pay compensation, Case C-9/90, (*Francovich*…), [1992] IRLR 84, the individual shall be put in the same situation as it had been implemented. In Case C-106/89, (*Marleasing…)*, [1990] ECR I-4135, the Court concluded that the national should be interpreted in the light of non-directly effective provisions of directives. The EC-law has in this way indirect effect. See Weatherill, S & Beumont, P, p. 304-306 and Shaw, J, p. 158-164.
[12] Melin & Schäder p. 18-28.
[13] What falls inside the scope of the exclusive power is far from exact, but at least the areas of common policy can be said to fall under this category. The areas of common policy are situated in Art 3 EC and among others are foreign trade, fishing and transportation.
[14] Melin & Schäder p. 28-38.

3.5 The Principle of Subsidiarity

3.5.1 In General

The principle of subsidiarity is one of the fundamental principles in the European union. It determines on what level a task shall be performed. It was this principle which made it necessary to implement the Customs law of the Union in the form of regulations, directives were not sufficient. In the case of VAT and excise duties directives were enough. The principle will be of great importance in the future. For this reason a closer presentation of it will be made.

Although the European union is not technically what can be called a federation, in the normal sense, it is possible to detect structures that posses federal features. One is the so-called *principle of subsidiarity*. The principle of subsidiarity in the EC law requires that action to accomplish an objective should be taken at the lowest level of government possible. The higher levels of decision are only to support the lower and intervene only in those cases that it is obvious that the lower levels are not capable of solving the question at hand. According to this the higher levels should only intervene if the lower levels can not solve the problem sufficiently. The principle of subsidiarity is the guideline for the internal division of power between the institutions of the European union and between the institutions and the member states.[15]

The principle of subsidiarity is situated in Art 5 EC (former Art 3b of the EC-treaty), and it states:

> "The Community shall act within the limits of the powers conferred upon it by this Treaty and of the objectives assigned to it therein.
> In areas which do not fall within its exclusive competence, the Community shall take action, in accordance with the *principle of subsidiarity* (my kurs.), only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale and the effects of the proposed action, be better achieved by the Community.
> Any action by the Community shall not go beyond what is necessary to achieve the objectives of this Treaty."

The first part of the article is the so-called *principle of legality*, which means that the Community's institutions can act only if they have explicitly been given competence to do so in a treaty provision. The principle of subsidiarity is found in the second paragraph and in its third the *principle of proportionality*. The principle of proportionality requires briefly that the means to achieve a goal must be no more than is appropriate and necessary to achieve this goal. There must in other words be a correlation between the goal and the means to achieve it.[16]

It must be stressed that the principle of subsidiarity does not in any way distribute power. The division of power between the Union and the Member States is dealt with in the form of treaties. Instead the principle of subsidiarity deals with the issue of whether or not distributed power shall be made use of. Hence the principle can be described as a form of indirect division of power. In the long run the principle of subsidiarity can have the effect that the national competence in a specific area is retained or even in some cases is extended, despite the fact that it would have been possible to solve a problem by means of Community

[15] Fischer, T C, *"Federalism" in the European Community and the United States: a rose by any other name...,* Fordham International Law Journal 1994 p. 423-428.

[16] For a closer presentation of the implications of the principle of proportionality see Melin & Schäder, p. 99-100. A famous case in which the principle was invoked was Case 70/11, (*Internationale Handelsgesellshaft*), [1970] ECR 1125, [1972] CMLR 255, see Steiner, J, *EEC law,* p. 58-59.

legislation. In addition it has been determined that the principle does not have direct effect and therefore individuals can not invoke the principle in order to assert their rights.[17]

Furthermore the principle of subsidiarity cannot be characterised as a pronounced principle with the goal to accomplish decentralisation. Certainly its signification is that the decision making is allocated at the lowest level that the question allows. An other aspect of this question, one that is often forgotten, is that if a problem cannot be dealt in a satisfactory manner on the lower level, the higher levels have an obligation to intervene. The principle of subsidiarity, in other words, provides a sort of safety net for the lower levels, if these cannot solve the problem the level above steps in and unties the knot.[18]

3.5.2 History

The principle of subsidiarity has old traditions within the legal history among the countries of Europe and is in no way a new phenomenon. The roots of the principle can be traced back to the Canon law and was launched in 1891 by Pope Leo XIII as a part of the Roman Catholic churche's social doctrine. The principle dealt with the delimitation between the private and the public sphere and emphasised the right to private property.[19] When the principle was introduced in the sphere of the European Community it was in the form of a method to regulate the division of power between the Union's central organs and the governing bodies of the Member States. The principle is first mentioned, though not by name, in a report from the Commission in 1975.[20] The report recommended an increase in the Community's power only in those cases that the Member States can not effectively administrate the desired task themselves. The starting point in the report was that actions taken by the Member States and actions taken by the Community should complement rather than compete with each other.[21] In 1984 the European Parliament[22] adopted the *Draft Treaty on the European Union* as a proposal for a reform of the Community. In the Draft Treaty the principle of subsidiarity is for the first time expressly mentioned as a general constitutional rule. In all cases falling in the scope of concurrent competence, between the future Union and the Member States, the Union should, according to the Draft Treaty, only intervene if the task could be performed more efficiently together than if the member states acted individually. The Member States could not, however, accept the far-reaching federal features of the Draft Treaty so instead a compromise was reached in 1987, the so-called *Single European Act (SEA)*.[23] The principle of subsidiarity could be found only in the environmental field.[24] In the 1992 Treaty of Maastricht the principle was established as a general constitutional rule[25]. The Treaty of Amsterdam in

[17] Melin, M, & Schäder, G, p. 57-59.
[18] Melin, M, & Schäder, G, p. 59.
[19] The principle of subsidiarity was launched in 1891 in the so-called "Rerum Novarum" (New Things). The right to private property was said to be a gift from God. The next pope, Pius XI, published in 1931 the "Quadragesimo Anno" (On the fortieth year) and the principle has a more central role. For more see Bergman, T, *Subsidiaritetsprincipen*, Tidskrift för folks rättigheter 1994 nr 4 p. 3-7.
[20] 5/75, Bull. EC, Supp.
[21] See Cass, D Z, *The word that saves Maastricht? The principle of subsidiarity and the divisin of powers within the European Community*, Common Market Law Review, 1992 p. 1110-1120, for a closer description of the development of the principle of subsidiarity.
[22] The European Parliament, which is described in article 189 EC (former Art 137 of the EC-Treaty), "…shall consist of representatives of the peoples of the States brought together in the Community…". Those elected to the Parliament primarily represent the people of Europe rather than the interests of each individual state.
[23] Bermann, G, *Taking Subsidiarity Seriously: Ferderalism in the European Community and the United States*, 94 Columbia Law Review p. 344-346 (1992).
[24] In the *Single European Act* Art 130r (4) it is stated that: "The Community shall take action relating to the environment to the extent which the objectives can be attained better at Community level .
[25] See Treaty of Maastricht Art A 2nd section "…decisions are taken as closely as possible to the citizen." and Art last section were it is stated that the principle of subsidiarity is to be respected when pursuing the treaty's abjectives.

1997 has strengthened the role of the principle of subsidiarity as a general constitutional rule.[26] The principle can be found in article 5 EC (former article 3b of the EC-treaty).[27]

3.5.3 Positive Aspects with the Principle of Subsidiarity

The principle of subsidiarity states, as pointed out above, that the governing should be carried out at the lowest possible level without renouncing the goals stated from central levels of government. The advantages with a local government are perhaps clear, but I will below point out the aspects of this that I have found to be the most apparent.

3.5.3.1 Self-determination and Accountability

Giving the individuals an effective representation, in the assemblies where rules concerning private persons are made, leads to a greater influence over the material contents of the rules when they are originally drawn up. The possibility in participating in the decisionmaking makes it more probable that the laws reflect the interests of the public. In addition participation leads to the citizens feeling autonomous towards a central government, and gives them a sense of pride. The individuals in the community feel that they are self-determinate and will, in the long run, favour the essential democratic values. Beside the fact that the local influence is big in the creation of the rules, the local participation continues to make itself apparent when the decisions are to be carried out. If the elected do not act as the electorate think that they should the constituents can show there discontent by not re-electing them. In this way the elected can be said to be held accountable for their actions. The fact that the elected are in the local society when they govern, makes it a lot easier for the citizens to see what each one has done and accomplished.[28]

3.5.3.2 Political Liberty

A second positive aspect with the principle of subsidiarity is that with it comes the possibility of political freedom. By diverting the power away from a central European body of decision-making the risk of political tyranny and oppression occurring is lessened. There is no compulsion that the local government must have the same "political colour" as the central body of governance. The political liberty also has repercussions in the way that it increases the freedom of the individual. It is possible for the individual to conduct their own line of politics on the local level despite the fact that the individual does not share the central opinion, providing of course that it is possible to find enough people who share the same opinion.[29]

3.5.3.3 Flexibility

A third advantage that the principle of subsidiarity brings about is the flexibility to act quickly and adapt effectively to changes both economic and social or other events, which happen within the local community. Because the leadership is so deeply rooted in the local society the correct responses, adapted for the specific situation, can be put to use. Measures that have been successful and functional in other places are not automatically transferable to the change that has happened in the specific case. With the local knowledge it is possible to adapt an existing model for solving a problem so that it fits for the local divergences and in this way optimising its effectiveness. Another side of the adaptability of the laws and rules to the population that they serve, brought by the principle of subsidiarity, is that it increases the confidence for the laws and the constitutional decision-making process. In the long run this

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[26] For the consequences of the Treaty of Amsterdam on the principle of subsidiarity see Timmermans, C, *Subsidiarity and transparency*, Fordham International Law Journal 1999 p. S113-S115.

[27] See above in section 3.5.

[28] See Bermann, G, 94 Columbia Law Review p. 340. See also the European Council meeting in Edinburgh in 1992 were it is emphasised the principle of subsidiarity brings the decision-making as closely as possible to the citizen, *Conclusions of the Presidency*, Bulletin of the European Communities, Commission, 1992/12 p. 12-13.

[29] Vause, G, *The subsidiarity principle in European Union law—American federalism compared*, Case Western Reserve Journal of International Law, Winter95, Vol. 27, Issue 1, p. 60-61.

flexibility in addition to giving the society a good government, leads to advances for democracy as a social order.[30]

3.5.3.4 Preservation of Identities

A result of organising power so that it promotes self-determination and local responsibility is that it leads to the local population finding it easier to recognise their own identity and in this way conserve their feeling of social togetherness and cultural inheritance. The laws and rules are of course not the only thing or even the thing that is conclusive when determining ones identity, but they can be important factors of symbolic value over a society's common set of values.[31]

3.5.3.5 Diversity

The effect of preservation of identities, which the principle of subsidiarity has, also leads to a more diversified political landscape, viewed from a larger political perspective. There is an intrinsic value in the fact that the political field is diversified in the sense that it makes room for new creations and innovations. If an idea works on a small scale perhaps the option to try it on a larger scale is one that has to be thought through thoroughly. The same applies of course *visa versa*, if an idea is found to be not working it is merely to reject it which at the same time limits the damages.[32]

3.5.3.6 Respect for Internal Divisions of Component States

One of the most significant aspects of the principle of subsidiarity is that it tends to place the power of the states own territory with the Member States themselves. The transfer of normative power to the Union will inevitably alter the pre-established balance of power within an individual state. Limiting the Union's intervention in the individual state to an absolute minimum, with the principle of subsidiarity, leads to a slowing down of the erosion of power within the State's own components of power.[33]

The fear of centralisation is of great importance to the members of the European union. This fear has played a big role in the development of the principle of subsidiarity. The principle is a guiding star whose significance has risen more and more with the progress of co-operation within the European union. Its effect will, with all probability, also remain and be a central feature in the future advances of the European project. The fact that it has sprung from the fear of centralisation can be said to be a principle that has decentralising aspects.[34]

3.5.4 Negative Aspects with the Principle of Subsidiarity

The negative aspects of decentralisation, that the principle of subsidiarity in fact means, are apparent. By distributing the implementation of regulations to the lower levels of government this can have the effect that the different countries choose to perform the task in very varying ways. This can make it confusing for a person travelling between the different nations. If regulations had been implemented from the central body of government there would have been a uniform set of rules instead of having to get on top of every single state's local deviancies. Further there is always the risk that all states have not had time or been able to implement the changes in time and that thereby this creates be a discrepancy in the set of rules

[30] See Bermann, G, Columbia Law Review p. 341. See also SOU 1995:123 p. 38-41, where the democratic aspects of the principle of subsidiarity are discussed, among others it is emphasised that the interpretation of the law and its practise through this principle will be placed on the local level.

[31] See Bermann, G, Columbia Law Review p. 341. Compare the European Council meeting in Edinburgh in 1992 where they asserted that subsidiarity contributes to the respect for the national identities of the Member States, *Conclusions of the Presidency*, Bulletin of the European Communities, Commission, 1992/12 p. 13.

[32] See Bermann, G, Columbia Law Review p. 342. The Supreme Court in the United States has pointed this out as well. In *New State Ice Co. v. Liebman*, 285 U.S 262 (1932), the Court stated that a single state may serve as a laboratory in trying out new social and economic experiments without risking the rest of the federation.

[33] See Bermann, G, Columbia Law Review p. 342-343.

[34] See Steiner, J, p. 3-6.

that were supposed to be uniform to all states. In addition to this it is considerably faster to accomplish changes if all it takes is a single decision on a central level.

3.6 The Direct Taxes

A large portion of the development of the community law within the European union has been put under the jurisdiction of the European Court of Justice (ECJ).[35] When the Treaty of the European Community is vague in its wording, because it has not been possible to agree upon a clearer formulation, it is up to the ECJ in its practice of the Community law to carry out the goals stated therein. This is the reason why it is of great importance to show how the ECJ has decided in a number of cases in order to point out how the rules have developed. In some cases the rules have even been altered and in this way have gained a different meaning than what the drafters of the treaty first intended or even could foresee.

3.6.1 In General

When it comes to the area of the direct taxes the competence does not, at the moment, fall under the jurisdiction of the European union.[36] Despite the lack of competence the EC-law has had some impact through directives in the field of corporate income taxation. It is of great importance, according to Art 56 EC (former article 73b of the EC-Treaty) for the EU to abolish any obstacles that hinder free flow of capital between Member States. Tax rules are one such blockade that can curb the free flow. In order to meet the objectives in Art 56 EC two directives have been adopted by the Council, a *merger directive*[37] and a *parent-/subsidiaries directive*[38]. The first directive consists of rules of taxation in order to eliminate obstacles for border-crossing fusions and fission. The second directive includes rules regarding dividends from a company in a Member State to a subsidiary in another Member State to be exempt from any taxation.

The states in the European union have different tax rates regarding the corporate income tax. As a result problems with harmful tax competition have been recognised as a crucial factor for the future growth and job creation in Europe. Because of this the European Union's Finance Council agreed, in 1997, on a paper to counter harmful tax competition. The paper consists of three parts: a proposal for a directive to ensure a minimum level of taxation of cross-boarder interest on savings, a code of conduct for business taxation and a proposal for a directive to eliminate withholding taxes on interest and royalty payments between associated companies.[39]

The effects on the areas of direct taxation is limited to the above stated. It has not yet been possible to adopt any additional legislation in the field.

The fact that the Union does not have competence in the field of the direct taxes does however not mean that the EC-law does not effect the area. It in no way hinders the European Court of Justice to decide whether or not the internal tax rules in a member state are in accordance with the applicable Community law. The member states have an obligation to assure that their internal tax regulation does not impede the goals of the treaties, among which the most

[35] Compare Pålsson, S & Quitzow, C M, p. 19 who says that the Community law is in large portions judge made, by the ECJ.
[36] The indirect taxes, such as the Value Added Tax and excise taxes, are on the other hand part of the power sphere of the European union according to article 93 EC (former Art 99 of the EC-Treaty).
[37] Council Directive of 23 July on the common system of taxation applicable to mergers, divisions, transfer of assets and exchange of shares concerning companies of different Member States (90/434/EEC).
[38] Council Directive of 23 July on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (90/435/EEC).
[39] Alber, S, *European Community Tax law and its development in the light of the recent case law of the European Court of Justice*, Fordham International Law Journal 1999 p. 770-771.

important can be said to be the creation of a common single market. A general purpose with the European project is to accomplish a single market without unequal treatment on the grounds of nationality and without restrictions that hinder the four freedoms to flow in a single market[40]. This purpose has been the starting point in the ECJ's determination if the national direct taxes are in harmony with the Community laws or not. In addition according to the so-called *principle of loyalty* in Art 10 EC (former Art 5 of the EC-Treaty) there follows a prohibition against member states having a tax law system that has the effect of a restriction on the free market.[41]

3.6.2 Prohibition of Discrimination

In order to prevent unequal treatment on the ground of nationality there is, in article 12 EC (former Art 6 of the EC-Treaty), a principle of non-discrimination on stated grounds, which moreover has direct effect and therefore, consequently, can be referred to by an individual towards authorities.[42] Art 12 EC is however only to be applied secondarily if it is not possible to build a case by support of the specific provisions regarding non-discrimination. In a case involving taxes it is usually the prohibitions of discrimination regarding the four freedoms, which are found in articles 39, 43, 49 or 56 EC (former articles 48, 52, 59 and 73b of the EC-Treaty), that are to be applied. The prohibition on discrimination in article 12 EC has not yet been appealed in the field of taxation of incomes, the ECJ has been able to use one of the primary articles instead. The discrimination can be of two sorts, either direct or indirect. *Direct discrimination* means that someone or something is overtly discriminated on the grounds that they have another origin of nationality. *Indirect discrimination* is at hand if seemingly equally treating rules factually discriminate foreign subjects. It is insignificant if this effect was intended or not when the Member State designed their rules.[43] Indirect discrimination is not per se necessarily incompatible with the Treaty, in contrary to direct discrimination that never can be acceptable. The cases that are acceptable are if the *effect* on the common market is *non-existent* or if the discrimination, of one or the other reason, can be said to be *objectively justifiable*.[44]

All differences in the treatment, regarding tax benefits and direct taxation, between those who have residence in a state and those who are residing in other member states is not automatically regarded as a forbidden discrimination. There are, for natural reasons, normally differences between residents and non-residents. If they cannot be said to be in a comparable situation it is not a prohibited discrimination at hand. These individuals do not find themselves, in the normal case, in comparable situations since the foreign taxpayer usually only receive parts of their income from this state.[45] The question was brought in front of the ECJ in the *Schumacker*[46]-case. In the case the ECJ determined that if the case was that the foreign taxpayer had his entire or almost his entire outcome from the state where he worked a

[40] The four freedoms are the free movement of *goods* Art 28 EC (former Art 30 of the EC-Treaty), free movement of *persons* Art 39 EC (former Art 48 of the EC-Treaty), free movement of *services* Art 49 EC (former Art 59 of the EC-Treaty) and the free movement of *capital* Art 56 EC (former Art 73b of the EC-Treaty).

[41] See Bergström, S, *Något om EG-domstolens tolkningsprinciper, med särskild inriktning på inkomstskatterätten,* SN 1998 p. 482-484 and Lenz, C O; *The jurisprudence of the European Court of Justice in tax matters*, Fordham International Law Journal 1997 p. 638-639.

[42] Compare *Frågor och svar,* SN nr 7-8 1997.

[43] See Bergström, S, *Något om EG-domstolens tolkningsprinciper, med särskild inriktning på inkomstskatterätten,* SN 1998 p. 485 and compare with Pålsson, S & Quitzow, C M, p. 39-41 who has a somewhat different vocabulary, instead of *direct* and *indirect* discrimination he talks about *open* and *hidden* discrimination but means the same thing. See also Alber, S, *European Community Tax law and its development in the light of the recent case law of the European Court of Justice*, Fordham International Law Journal 1999 p. 777-781.

[44] See Persson, R, *EG-rättens indirekta verkan på svenska skatteregler*, SN 1995 p. 11.

[45] See Bergström, S, *Restriction of Free Movement and the principle of Non-Discrimination in the EC Law and their Implications for Income Taxation*, p. 56-57.

[46] Case C-279/93, (*Schumacker*), [1995] ECR I-225.

comparable situation is at hand and hence a negative difference in the treatment would in that case be in violation with the prohibition of discrimination of Community law. This conclusion was followed up and defined in more detail in the cases of *Wielockx*[47] and *Asscher*[48].[49] This principle is a stringent natural extension of an employee paying his taxes and in this way contributing to the well being of a country, which he is then able to benefit from. By earning the entire or almost the entire income in a country the individual shall be treated in the same way as the country's own citizens. In addition it is possible to find support for the *Schumacker*- verdict in Art 24 of the OECD:s model treaty which allows that taxpayers are treated differently depending on where they reside.[50]

3.6.3 Prohibition of Restriction

An additional fundamental principle within the EC law, which to its scope of application is far wider than the non-discrimination principle, is the so-called prohibition of restriction. A restriction is at hand in those cases where something hinders the free movement in the inner market. In the *Dassonville*-case it was determined that a restriction is at hand if something is capable of hindering, directly or indirectly, actually or potentially, intracommunity trade.[51] The prohibition of restriction can be said to include the principle of non-discrimination. If one chooses to use the *Dassonville*-definition as a starting point when determining if a restriction is at hand, the conclusion is that a restriction is, in principle, everything that effects the single common market. It does not have to be an actual obstacle, when it is in fact enough that it is a potential obstacle. The most significant difference between, on the one hand the prohibition of discrimination and on the other hand the prohibition of restriction, is that the former is only effective against citizens from other community countries, in the case of the prohibition of restriction it is also applicable in cases involving the State's own residents. This leads to, with the help of the prohibition of restriction, that it is possible to attack and correct such limitations that are unfavourable for the inhabitants of a member state. If a discriminating or restriction provision is at hand in a concrete case, but this can be justified with objective arguments that the court can accept, then it is permissible.[52]

In the case of discrimination it is up to anyone who is of the opinion that discrimination has taken place to prove that that is in fact the case. In particular this will be accentuated when it comes to the field of indirect discrimination because it is not probable that a state has rules that expressly treat individuals unfairly on the ground that they originate from other member states. If rules with this signification would occur it would, in practice mean, that the state had lost in advance since the field when open direct discrimination is accepted is very narrow.[53]

[47] Case C-80/94, *(Wielockx...),* [1995] ECR I-2493.

[48] Case C-107/94, *(Asscher...)*, [1996] ECR I-3089. For the meaning of and a close analysis of the *Asscher*-case see Williams, D, *Asscher: the European Court and the power to destroy*, EC Tax Review 1997/1 p. 4-10.

[49] Lenz, C O, *The jurisprudence of the European Court of Justice in tax matters*, EC Tax Rewiew 1997/2 p. 82-85. Compare Persson, R, *Rättsfallskommentar. EG-domstolens dom i målet Schumacker* C-179/93., SN 1995 p. 264-267 where he gives his view of the case.

[50] See Ståhl, K, *EG-domstolen och den internationella skatterätten*, SN 1997 p. 762-763. For a closer analysis of the implications of Art 24 of the model treaty of OECD on the Community law see van Raad, K, *The Impact of the EC Treaty's Fundamental Freedoms Provisions on the EU Member States' Taxation in Bordercrossing Situations – Current State of Affairs*, EC Tax Review 1995/4 p. 190-201.

[51] See Pålsson, S & Quitzow, C M, p. 155. In *Dassonville* (8/74 [1974] ECR 837) the issue was the free movement of goods, Art 30 of the EC-Treaty (now Art 28 EC), but guidance can be taken to the application in the areas of the other four freedoms. For further reading on the so-called *Dasonville*-rule see Steiner, J *EC Law* p. 373-375 where an extensive presentation of the rules effect on the intracommunity trade. The *Dassonvill*e-rule is found in section 5 of the case.

[52] See Bergström, S, *Något om EG-domstolens tolkningsprinciper, med särskild inriktning på inkomstskatterätten,* SN 1998 p. 486-48786. The European Court of Justice has according to Bergström interpreted this exception from the main rule in a restrictive manner in the field of income taxation in the same way in which other exceptions are applied in accordance with the general priciple of the European Community law.

[53] The exceptions are situated in Art 30 EC (former article 36 of the EC-Treaty), which is meant to be an exhausted list. The article have later been developed by the ECJ in accordance with the so-called *Cassis*-doctrine, from Case 120/78, (*Cassis de*

That it has been left up to the individual to show that he or she has been discriminated against, in the case of indirect discrimination, follows from the fact that it is a rule that formally does not discriminate against non-residents but in practice its effects de facto predominantly discriminate foreign subjects. For example it can be a demand of residence in the state. This is not in itself a discriminating statue but its effects will discriminate against foreign subjects. Foreign subjects must, in other words, show that they, in fact, have been discriminated against despite it not seeming that way on paper. If it is an indirect discrimination it is up to the state to demonstrate objective justifiable grounds that can justify the unequal treatment. The state does not come into the picture until it has been determined that discrimination has in fact occurred. In the case of a restriction it is on the other hand up to the state to show that a rule does not impose a limitation on free movement and if this fails provide objective justifiable grounds for the design of the regulation. The state is consequently imposed the entire burden of proof. That it falls upon the States to prove that it is in fact not a restriction at hand is an extension of the fact that, according to the *Dassonville*-rule, already a potential restriction is forbidden. It is thus an advantage for the individual if it is a prohibition of restriction and not only a non-discrimination principle. According to Bergström, who bases his statement on Quitzow, the tendency in the jurisprudence of the European Court of Justice is to more and more reason in terms of prohibition of restriction instead of prohibition of discrimination.[54]

Support that enables the ECJ to interpret a prohibition of restriction into articles that according to their wording only have a prohibition of discrimination, see for example the free movement for workers in article 39 EC (former Art 48 of the EC-Treaty), can probably be asserted from article 3 (c) EC. There it is stated that in order to achieve the goals set out in Art 2 EC, inter alia the establishment of a common market, all obstacles in the way of this are to be abolished between the member states. Against this background it is not so surprising that ECJ reasons concerning the prohibition of restriction despite the fact that it at a first glance does not seem to be fitted in the wording of the articles.

The ECJ has more and more interpreted, in addition to only a prohibition of discrimination, a prohibition of restriction in the articles that regulate the areas of the four freedoms. Regarding article 39 EC (former Art 48 of the EC-Treaty), the free movement for workers, it has been established in the *Bosman*-case [55] that is to be interpreted as including a prohibition of restriction and not only a prohibition of discrimination on the grounds of nationality. The Court has further concluded, in *Gebhard* och *Zindler*[56], that Art 43 EC (former Art 52of the EC-Treaty), freedom of establishment and Art 49 EC (former Art 59of the EC-Treaty) free movement of services, are to be interpreted in the same manner.

3.6.4 Objectively Justifiable

In the Treaty of the European Community a number of cases are stated when direct discrimination can be accepted. In the articles concerning the free movement within the union it is stated when unequal treatment can, in exceptional cases, be permitted. Grounds that can be said to be justified are: limitations on grounds of public order, security and health.[57] In the

Dijon...), [1979] ECR 649, which for example includes effective fiscal control and consumer protection. According to the *Cassis*-doctrine a restricting measure can only be accepted if it is justified in order to satisfied mandatory requirements and are proportionate. See Pålsson, S & Quitzow, C M, p. 156-160 and Steiner, J *EC Law* p. 428-463.

[54] See Bergström, S, *Något om EG-domstolens tolkningsprinciper, med särskild inriktning på inkomstskatterätten*, SN 1998 p. 487 and Bergström, S, *Restriction of Free Movement and the principle of Non-Discrimination in the EC Law and their Implications for Income Taxation*, p. 52-55.

[55] Case C-415/93, (*Bosman*...), [1995] ECR I-4291.

[56] Case C-275/92, *(Zindler..)*, [1994] ECR 1039 och Case C-55/94, (*Gebhard*..), [1995] ECR 4165.

[57] See article 39 EC (former Art 48 of the EC-Treaty), the free movement for workers, article 43 EC (former Art 52 of the EC-Treaty), freedom of establishment and article 49 EC (former Art 59 of the EC-Treaty) free movement of services.

case of indirect discrimination the ECJ has, in its jurisprudence, developed the articles so that also other grounds, in addition to the ones explicitly mentioned in the Treaty, are acceptable. In order to establish whether or not unequal treatment, that constitutes an indirect discrimination, can be said to be acceptable a test developed by the ECJ is used, the so-called *"rule of reason"*. The test was first applied in the *Cassis de Dijon*-case[58]. The case dealt with the permissibility of a rule that impeded the free circulation of goods. The test has over the years been applied, in order to establish if unequal treatment which hinders free movement could be accepted, likewise in the fields of the other freedoms. A negative unequal treatment, which in principle qualifies as an indirect discrimination, can in accordance with the "rule of reason" -test be justified if it is necessary in order to satisfy mandatory requirements. In addition the measure must be in proportion to this requirement. In order to make the "rule of reason" clearer it is, in other words, a test in two parts. First of all there must be demonstrated a mandatory requirement and secondly point out that the steps taken by the state in question are proportionate.[59] The ECJ is however restrictive in accepting an unequal treatment with reference to the "rule of reason"- doctrine. In the field of taxes the court has in the *Bachmann*-case[60] accepted the cohesion of the tax system in accordance with the "rule of reason"-doctrine. It is not however possible to make any far-reaching conclusions, when a negative treatment is acceptable, with reference to what the court has pronounced in previous cases. The same reasons, in order to justify, as in the *Bachmann*-case, where used in the *Wielockx*-case[61]. In the latter case the ECJ did not find them permissible. The circumstances in the individual case determine if the court finds them acceptable or not. If the court has rejected the arguments in previous cases this does not in any way mean that they will never accept them.[62]

3.6.5 The Jurisprudence of the European Court of Justice Regarding the Direct Taxes

As mentioned above the jurisprudence of the ECJ is of utter foremost importance in the evolution of the Community law. Therefore it is of great value to be aware of the considerations the court has made and in this way pushed the progression forward. Below follows therefore a presentation of a selection of important decisions from the ECJ concerning the domain of the law of taxation. With these I have tried to show how the European Court of Justice has brought the legal development, in the areas concerning the direct taxes, forward despite the fact that they are not formally within the competence of the European Union.

The first case concerning income taxation, which was put in front of the ECJ, was the so-called *Avoir fiscal*-case[63]. In other words it took until 1986 before the court made its first ruling on the issue whether the member states internal income tax regulations were consistent with the Community law. The case was about the applicability of Art 52 of the EC-Treaty (now article 43 EC). A tax credit, so-called *avior fiscal*, was available to French companies. This opportunity was not however permitted for foreign companies. The ECJ found that this was a discrimination against the foreign companies and put a limit on the possibility of foreign companies' establishment in France. The regulation therefore consisted in discrimination according to Art 52 of the EC-Treaty. In the court's view it was generally in order to treat foreign and resident subjects in different ways for the purpose of taxation, but in this case it was not objectively justifiable. This case is the only one in the jurisprudence of the ECJ, concerning direct taxes, where direct discrimination on the grounds of nationality is so

[58] Case 120/78, (*Cassis de Dijon...*), [1979] ECR 649.
[59] For more about the *Cassis de Dijon*-case and the "rule of reason"-test see Steiner, J *EC Law* p. 428-463.
[60] Case C-204/90, (*Bachmann...*), [1992] ECR 1-249, more about the case bellow.
[61] Case C-80/94, *(Wielockx...)*, [1995] ECR I-2429.
[62] See Ståhl, K, *Aktiebeskattning och fria kapitalrörelser* p. 194-198.
[63] Case C-270/83, (*Commission v. France)*, [1986] ECR 273.

apparent.[64] The important aspect of the *Avoir fiscal*-case is that the ECJ clarifies that the principle of non-discrimination can be applied on discriminating national tax law in the field of the direct taxes dispite the fact that they do not fall within the scope of the Union's competence.

In the *Biehl*-judgement[65] the European Court of Justice determined that discrimination does not have to be direct instead so-called indirect discrimination also falls in the field of application. Indirect discrimination means, as stated above, that foreign subjects actually are discriminated against by the national tax rules regardless whether or not this was intended. In the case a German citizen in Luxembourg who was refused a tax refund of the overpaid tax owed to him on the grounds that he was not a resident in Luxembourg under the entire tax year. The court concluded that the rule in itself does not expressly discriminate against foreign citizens but indirect it has these effects when it is more likely that this category of persons move in and out of Luxembourg. In addition there was nothing to objectively justify the rule. The rule therefore was contrary to Art 48 of the EC-Treaty (now article 39 EC) by indirectly discriminating against citizens who resided in other states.[66]

In the *Bachmann*-case[67] it was a German citizen who was employed and resident in Belgium. He was refused a deduction for contributions to a German insurance company. The denial of the deduction was made with reference to a rule providing that deductions for insurance premiums in foreign companies, are not allowed expenditure. The court found that the rule was contrary to both Art 48 of the EC-Treaty (now article 39 EC) and to Art 59 of the EC-Treaty (now article 49 EC). Since the regulation effected both domestic and foreign nationals equally it is to be regarded as a restriction and not a discrimination. The ECJ however went one step further in its line of reasoning and stated that the restriction might be justified, despite the fact that a restriction was at hand. The restriction could be objectively justifiable with regard to the need to safeguard the cohesion of the Belgium tax system. The right to deduct insurance premiums only exists under the condition that the amount that subsequently falls out is taxed in Belgium.[68] The importance of the case is that the concept of fiscal cohesion within the national tax system was accepted as a ground of objective justification despite the fact that there was a restriction contrary to both Art 48 and Art 59 of the EC-Treaty.

A case with a Swedish connection is the *Safir*-case.[69] The case was about endowment assurances taken in companies resident in other countries. The Swedish rules treated assurances taken in Swedish companies and those signed in foreign companies differently. The ECJ came to the conclusion that the design is a restriction which is hindered by Art 59 of the EC-Treaty (now article 49 EC). The rules impaired the free movement of services and therefore were contrary to the treaty. The court further concluded that direct taxes do not at the moment fall under the competence of the Community, but that the Member States still have an obligation to respect the EC law when designing their national tax systems.[70]

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[64] See Bergstöm, S, *Restriction on Free Movement and the Principle of Non-Discrimination in the EC Law and their Implications for Income Taxation,* Festskrift till Leif Mutén, p. 53.

[65] Case C-175/88, (*Biehl ...)*, [1990] ECR I-1779.

[66] See Lenz, C O; *The jurisprudence of the European Court of Justice in tax matters*, Fordham International Law Journal 1997 p. 641.

[67] Case C-204/90, (*Bachmann ..),* [1992] ECR 1-249.

[68] See Bergström, S, *Restriction on Free Movement...* p. 56. The case has, according to Bergström, been criticised. Compare Ståhls dissertation p. 196-197. According to Ståhl is the most common objection towards the verdict, that in the field of international taxation there do not exist any principle which says that the right to deduct is dependent on whether or not the same state also has the right to tax the equivalent income.

[69] Case C-118/96, (*Safir...*), [1998] (ECR nr saknas)

[70] See section 21 in the *Safir*–case. See Ståhl, K, *Skattenytt Internationellt,* SN 1998 p. 525-527, for a more extensive summary of the case, compare Bergström, S, *Något om EG-domstolens tolkningsprinciper, med särskild inriktning på inkomstskatterätten*, SN 1998 p. 482-483.

3.7 The Customs Law of the European Union

One of the most apparent federal features, which is possible to obtain within the European union, can be found in the domains of the customs. Below follows a description of the Customs law of the European union. I have chosen to describe it from a Swedish perspective in order to make it easier to give an overview of how the Customs law works in practice in the EU, regarding both rules the union have taken centrally and the effects this has had concretely for Sweden.

3.7.1 In General

Customs duties are only of interest when trade passes another state's borders. Customs duties are designed on a relationship of giving and taking. If a state wants to sell its merchandise on another state's market it must also be ready to let the other state in on its own market, or in some other way give compensation. This is done in the form of international treaties that regulate the degree that fees, in the form of customs duties, which are put on goods at the crossing of a border. Within the area of Customs legislation changes are often made on account of changes in the international political scene. It is a field of law in which there is a lot of prestige and where everyone wants to come out as a winner. The conflicts, which erupt from time to time, give repercussions to large portions of the world population. The purpose of the customs duties is otherwise, just like other taxes and fees, to contribute to the financing of the public sector. It is furthermore possible to detect a side of protectionism with customs duties that is to protect domestic goods from the competition of foreign products.[71] In the European union the revenue from customs duties is almost a fifth of its total income. By this it is easy to understand that the significance of customs duties shall not be underestimated. Of the revenue originated from customs duties, from the individual states, 90% of these go to the mutual budget of the EU. The remaining ten percent goes to financing the customs administration in the Member States. The EU must get help from the individual states for the processing of cases concerning customs duties since the Union does not have an administration for customs at its disposal. In Sweden it is "*Tullverket*"[72] who has the responsibility for guarding the passage of merchandise over the union's extensive external borders situated in Sweden. For the Swedish part there is a large section of external border to the west adjacent to Norway, since it is not a member of the Union.[73]

3.7.2 International Agreements

On the international arena the creation of the World Trade Organization (WTO) [74] in 1994 is the most significant and far reacting multilateral agreement in the field of the customs. The WTO is an umbrella organisation that includes a number of different treaties concerning international border crossing trade. The most important is the GATT (the General Agreement on Tariffs and Trade) from 1994 where trade and commerce with goods was regulated. The trade in services is regulated in the GATS (the General Agreement on Trade in Services) and intellectual property in the TRIPS (The Agreement on Trade-Related Aspects of Intellectual Property Rights).[75]

Because the GATT is of such great significance, to both the European union and to the United States, I intend to point out and make a short presentation of some of its most important

[71] See Lasok, D, *The Customs Law of the European Economic Community*, p. 1-27.
[72] For a closer presentation of the Swedish authority's responsibility in the area of customs duties see SOU 1998:18.
[73] See Moëll, C, *EG:s tullrätt ur ett svenskt perspektiv*, SvSkT 1998 p. 187-188.
[74] When the final agreement on the WTO, accepted by 104 states, entered into force on 1 January 1995 for 81 members, it represented 90 percent of the international trade. See Malanczuk, P, *Akehurst´s modern introduction to international law,* p. 231
[75] See Malanczuk, P, *Akehurst´s modern introduction to international law,* p. 231-235.

principles. The central principle in the GATT is the principle that can be found in *the most-favoured nation*-clause (MFN)[76]. According to this all members of the GATT shall treat every nation the same way as they treat the most favoured. The exception regarding the MFN is that it does not apply if members of GATT form a customs union. It is also forbidden, once a product has passed customs, to discriminate on the grounds of the product’s nation of origin. “Like” products are to be treated equally, which means that if a product is imported it is to be treated in the same way as a “like” product with origin from within the country.[77] There can, of course, arise problems in determining, in a specific case, whether or not two products can be said to be “like” but that is a different issue.[78]

In addition to the WTO there is a model convention, the HS-convention (Harmonized Commodity Description and Coding System), that regulates a system for harmonised description of products. The participating states in the convention pledge to draw up their customs tariffs in accordance with it. In this way an international nomenclature for products has been created and has been implemented in the legal systems, inter alia in the EU and in the USA. HS-convention is the foundation for the *customs tariff*, which is an important part of the external common tariff barrier, of the EU.[79]

3.7.3 The Customs Law of the European Union

When it comes to customs they, according to article 133 EC (former Art 113 of the EC-Treaty), fall under the Community’s exclusive powers. This means that the Member States ability to legislate in this field has in large portions been limited and even in some cases totally excluded. In addition the Community has competence, within the frame of the common commercial policy in article 133 EC, to conclude international treaties. These powers are exclusive, which means that the member states can not venture into international agreements in the field.[80] According to article 307 EC (former Art 234 of the EC-Treaty) international agreements are still valid if they are consistent with the EC law. At Sweden’s admittance in the union in 1995 this led to, since the commercial policy is community exclusive, all free trade agreements, which Sweden had entered with other states, ceased to be valid, but instead became part in all the free trade agreements which the community had with third countries.[81]

According to article 23 EC (former Art 9 of the EC-Treaty) the community is a *customs union*[82]. Characteristic for a customs union is that all customs and boundaries have been totally abolished between the states so that goods can move freely within the component units, moreover there is a common external tariff towards third countries. The customs union was established in 1968.[83] A customs union differs from a *free trade area* in the way that in the latter case the states participating still are free to apply customs duties towards non-participating states, in other words no common external tariff. Within a customs union goods from third countries are given the same status as goods produced in a member state. In a free

[76] See article I GATT.
[77] See article III GATT.
[78] See Malanczuk, P, p. 229.
[79] See Moëll, C, *EG:s tullrätt ur ett svenskt perspektiv*, SvSkT 1998 p. 191. Compare SOU 1994:89 p. 155. The convention can be compared to the model treaty of the OECD.
[80] See SOU 1994:89 s125f. According to article 281 EC (former Art 210 of the EC-Treaty) the Community is a legal personality and according to article 300 EC (former Art 228 of the EC-Treaty) it is the Commission that, after authorisation from the Council, with third countries. Article 310 EC (former Art 238 of the EC-Treaty) regulates the possibility to enter into association agreements.
[81] See SOU 1994:89 p. 126-129. The ECJ has decided, in Case 104/81 [*Kupferberg I...*] ECR 3641, that provisions in free trade agreements can have direct effect provided that they are sufficiently clear and unconditional.
[82] The definition of a customs union is found in the GATT Art 24.
[83] See Weatherill, S & Beumont, P, *EC law,* p. 16.

trade area only goods that originate from within the area, not goods from a third country, are allowed to move freely.[84] Since there are no internal borders within the EU the customs law only deals with trade with third countries, that is trade that passes over the common external border. In the field of the customs law the most important legal acts are the *customs code*, *the implementation code* and *the customs tariff*.[85] The legislation has all been enacted in the form of regulations and is therefore, according to article 249 EC (former Art 189 of the EC-Treaty), directly applicable in all member states.[86] The customs code, which has originated with the support of article 23 EC (former Art 9 of the EC-Treaty), is the foundation of the customs law within the European union and it is based on the HS-convention. In the customs tariff one can find out, product for product, if there are any anti-dumping duties, if the union has entered into free trade agreements with a certain country and all other customs quotas, among others. This consequently makes the customs tariff very extensive. In chapters 1-24 agricultural products are regulated and the rest, chapters 25-97, deal with industrial products. The law of the customs procedure, that is how it actually works when importing products, is regulated in the customs code and the very extensive rules of implementation to it which is situated in the implementation code.[87]

3.7.4 Import

Import means when it comes to Community law that a product is transported into the Union from a third country. In order to determine if customs duties are to be levied because merchandise is brought over the external border into the EU it is of importance that it can be *classified*, *valued* and its *origin* determined. No duties are levied if the transactions only are made within the boundaries of the Union. Products that are manufactured in the Union are of course of origin in the Union; the same is valid when it comes to raw material. If on the other hand the products are assembled in the union there is a demand that there has been "*sufficient processing*" in order for them to be of origin from within the union. Sufficient processing can be of three kinds. The first is the so-called *tariff method*, which means that the components are processed in a way that they get different classification in the customs tariff. The second method is the *value method* where there instead is made an examination if there has been a large increase of the value of the product through the work. Third and last is the so-called *processing method* which means that the origin is determined regarding which process technique has been put to use on the goods. The rules of origin can be found in the customs code Art 22-26 and in the implementation code Art 35-65. If nothing has been added to the product, if it for example has only been assembled, it is not considered as of origin from the European union.[88] The classification of a product is usually no problem, it is done in accordance with the customs tariff. The valuation of an item is of greatest importance since the customs duties are usually levied as a percentage of a sum taxable based on the value of a product. The principles of valuation, within the customs law of the European union, are found inter alia in Art 28-36 of the customs code[89]. These are based on the principles of valuation in

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[84] See Pålsson, S & Quitzow, C M, p. 30-31 and Lasok, D, *The Customs Law of the European Economic Community,* p. 1-3.

[85] Council regulation 2913/92 (the Community Customs Code), Council regulation 2454/93 (implementation code) and Council regulation 2658/87 (the Common Customs Tariff).

[86] See Weatherill, S & Beumont, P, *EC law,* p. 295-296. In Case 34/73, (*Variola*…), [1973] ECR 101, it was established that regulations can not be converted into national laws. Member states can only pass clarifying implementing measures or if needed complementing criminal legislation, see Quitzow, C M, p. 49-51. In Sweden "*Tullagen*" (1994:1550) regulates how the customs authorities are to be organised. As a main rule can control by custom authorities only be done at the passage of an external border, but with "*privatinförsellagen*" (1994:1615) can control be made when entering Sweden from another member states.

[87] See Vogel, H-H, *Tullrätten i EG*, SN 1995 p. 59.

[88] Compare SOU 1994:89 p. 156-159, the terms are of my translation. For more about the definition of origin see also Lasok, D, *The Customs Law of the European Economic Community*, p. 217-229.

[89] The principles of valuation can also be found in articles 141-181a of the implementation code and in the supplements 23-29 of the implementation code.

Art VII GATT. For the purpose of income taxation valuation there are specific rules in the OECD. In other words there are two sets of rules that are used on the same transaction. In the field of income taxation the taxpayers want the value to be as high as possible in order to lower the sum taxable, lower the profits, for customs purposes as low value as possible is strived to be attained in order to cut down the customs duties. It is not a good system to have two different ways of valuation and it has been criticised. In the USA they have therefore chosen a transition to valuation according to one uniform system.[90]

As always when fees are concerned there will always be attempts to get around them or at least cut the costs. One way is to import products in pieces, which are levied with lower customs duties, and assemble them within the European union. This possibility has, as shown above, been stopped but there will always come new ways of attempting to get round the duties. As a last resort there is always the option to smuggle the product without paying any duties at all. At the moment every Member State has its own customs authorities which control the importation of goods from third countries. This is, in many ways, an awkward system. Of course these different entities should be able to co-operate but the best would probably be if the customs authorities were put under a central Union body. A system like this would be good partly since the larger portion of the customs revenue goes to the budget of the European union and partly because it would this way be easier to distribute the resources in a more efficient way. To put the controlling functions of the customs authorities under a central EU flag is an infringement in the states sovereignty. Therefore it is probably not realistic to believe that it would be possible to implement such a system despite the fact that everyone would benefit from such a centralised system.

Above, from my point of view, makes it possible to take as a justification for step in a federal development. That the customs law is an obvious supranational sign, a federal feature within the union, is beyond all doubt. As said in section 2.1 is the foreign policy, to where the customs law must belong, an area that usually is on the federal level.

[90] See Moëll, C, p. 192-193.

3.8 The Value Added Tax

3.8.1 In General

In the vast field of taxes it is foremost concerning the indirect taxes the interest to harmonize centrally, within the European union, has been concentrated. VAT is part of the group of indirect taxes, which according to article 93 EC (former Art 99 of the EC-Treaty), fall under the community powers to harmonize if necessary to establish a functioning inner market. In the EU a number of directives, with this purpose, have been adopted concerning the value added tax. The most important step towards a harmonization, of VAT legislation in the member states, is the so-called *Sixth EU VAT Directive*[91]. The directive contains detailed regulations of how the tax-base, the tax liability, shall be designed within the EU. The purpose of the directive is the creation of a free inner market where there is neutrality when it comes to competition between the Member States. The tax shall not effect and be determent in the choice of country one chooses to order goods or services from. There is further a necessity to harmonize the tax base since the budget of the EU is in large portions based on a share of the member states value added tax-base.[92] When harmonization is accomplished by means of directives there is a demand on the member states to implement them in their national systems of law. The directive has been implemented in Swedish law through "Mervärdesskattelagen"[93] (ML), the VAT-law. Since the law has a directive as a base it must be interpreted in the light of the directive, in its application. If there is a conflict, between Swedish law and the directive, the latter will prevail in accordance with the principle of *Supremacy of Community law*.[94] The directive can, under certain circumstances, have direct effect if it has not been implemented in the correct manner.[95] In the case of VAT the taxation is done either in accordance with the *country of destination principle* or with the *country of origin principle*. The country of destination principle means that the product is taxed in the country where it is consumed, released for consumption and that the taxes go to the land of consumption. The country of origin principle means that the taxation of a product is done at the source, either in the state where the product was manufactured or where it was imported into the European union. This in turn leads to that the selling state gets the tax revenue. In the field of VAT the country of destination principle is the one prevailing at the moment but the goal is a transition to an adoption of the country of origin principle.[96] The final goal in the VAT arena for the European union is to create a uniform, common VAT, where the taxation is done in accordance with the principle of origin. At the moment it has yet not been possible to complete such an arrangement. The reasons are inter alia that the tax rates in the member states deviates to a great extent and because it has not been possible to construct a way to compensate the reduction in tax revenue in the land of consumption. It is only in the domain of the private consumption that the principle of origin has been implemented. In commercial trade the principle of destination is applied for now.[97]

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[91] Sixth Council Directive of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment (77/388/EEC), with amendments until Council Directive 95/96 EEC.

[92] See Forssén, B, *Mervärdesskatten och EU*, Ny Juridik 1:95 p. 25-27.

[93] Mervärdesskattelag (1994:200).

[94] The principle of Supremacy of EC law can not be found in the EC-Treaty. Instead it has been established through the case law of the European Court of Justice. The principle was first determined in Case 6/64 (*Costa v. ENEL*), [1964] ECR 585. That a national court should not apply a national law which was contrary to the EC law was established in Case 249/85, (*Alko v. Balm*), [1987] ECR 2345, 2360. For more on the principle see Weatherill, S & Beumont, P, p. 315-317.

[95] See more about the interpretation of the Swedish VAT law in Westberg, B, *Mervärdesskatt- en kommentar,* p. 24-26.

[96] See Jonsson, G, *Mervärdesakttefrågor inom EG - Problem och förenklingar*, SvSkT 6-6/95 p. 403-404 and Steenstrup, B, *De harmoniserade punktskatterna – en överblick,* SN 1995 p. 52 and Fantozzi, A, *Editorial*, EC Tax Review 1996/1.

[97] See Rabe, G, *Mervärdesskatt- ett arbetsprogram från EU-kommissionen,* SN 1996 p. 609-610 and Fantozzi, A, *Editorial*, *The Italian Government shall devote its best efforts to promote the completion of the "common European house*", EC Tax Review 1996/1.

In its character the VAT is what is usually referred to as a *multi-stage tax*. Every level in a chain of production or trading is responsible for the increase in value that they have added to a product. This is accomplished by letting the companies from the VAT, on their own turnover sales, deduct the tax from the sales. The tax liability is in this way postponed until the final consumer is reached.[98] The VAT can thereby be said to have no distortionary effects on business decisions and put all traders on an equal footing as well.[99] The EU has, as pointed out, passed a vast number of directives concerning the VAT. Since they are almost impossible to overview I have chosen to describe the Swedish VAT law instead. It is based on the directives and therefore is supposed to be of the same contents. The harmonization of the VAT is only with regard to when the tax liability occurs. The tax rates have been left much up to the states. The EU have just set a minimum rate of fifteen percent with no maximum limit, the Commission has suggested a band spanning between 15 to 25 percent for the VAT.[100]

Tax liability in the case of VAT can occur on three occasions, namely: *sales within the state*, *intracommunity supplies of goods* (ISG) and *import from a third state*.[101] Both physical and juristic persons can be subjects of VAT taxation if the qualifications in ML are fulfilled.[102]

3.8.2 The Swedish VAT Law-- Mervärdesskattelagen

3.8.2.1 Sales Within the State

The first case when VAT is to be paid, according to ML 1:1, is at tax liable *sales within the state*, of *products and services*, which is done in *a professional occupation*[103]. Sales mean the transfer of a product with compensation or if a product is taken from a business without the payment of due compensation.[104] The definition of professional occupation is coherent with the definition in the Swedish income taxation law (KL)[105]. Consequently it is the same definition that is used in both income taxation and VAT. That there is a correspondence between the definition in the two laws benefits the foreseeability in the application of the law. It is further an advantage for the legal security and for, when it comes to taxes so essential, that the principle of legality is upheld. Taxes can not be levied without the support of law. Therefore it is to the advantage to anyone liable to pay tax that they correspond. When it comes to products and services the starting point is that if sold or imported they are liable for tax unless the opposite is stated.[106] If there is any questions to whether or not tax is to be paid take a starting point in the main rule, all sales are liable for tax, see in the third chapter ML if this case is exempted from taxes. Whether or not a product or service is to be considered sold within the state is evident in the 5 chapter. For the tax liability the most important thing is to establish if a product is sold within the state or not, if the professional occupation is carried on in or out of the state is of no significance. If a product is sold within the state there is also tax liability.[107]

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[98] The consumer can be either an individual or a company whose business does not trigger an obligation to pay taxes and no right to reimbursement of VAT. See RSV:s handledning för mervärdeskatt 1997 p. 49.

[99] See Owens, J, *The move to VAT*; Intertax 1996/2 p. 43.

[100] See Alber, S, *European Community Tax law and its development in the light of the recent case law of the European Court of Justice*, Fordham International Law Journal 1999 p. 772.

[101] See 1:1 ML, there is an exhaustive enumeration of when VAT is to be paid to the Swedish government. Of this follows é contrario that the principle of origin is to be used on private consumption.

[102] The tax rate at the application of the ML can be found in the 7 Chapter ML. The main rule in Sweden is a 25% VAT. ML 1:2 provides who is liable for the tax. As mentioned above the tax rates vary in the member states and are not determined on the central level.

[103] Professional occupation ("yrkesmässig verksamhet") is defined in the 4 Chapter ML.

[104] Sales ("omsättning") are defined in the 2 Chapter ML.

[105] In 4:1 ML there is a reference to 21§ KL.

[106] See 3:1 ML, liable for tax unless otherwise stated in the 3 Chapter ML.

[107] See Forssén, B, p. 36-37.

3.8.2.2 *Intracommunity Supplies of Goods*

Special rules apply when trade is done amongst states that are members of the European union. Intracommunity supplies of goods mean trade with merchandises originating from the EU or have been imported there and via customs obtained access to the inner single market. If an intracommunity supply of goods is at hand, as a part of commercial trade, the taxation shall be done in accordance with the principle of destination. Intracommuntiy supplies of goods are, as a main rule, when there is dealing between two tradesmen in the EU.[108] If a Swedish supplier sells a product to a VAT registered buyer and if the merchandise is transported over the Swedish boarder no VAT is to be paid on the goods in Sweden.[109] The taxation of the goods will instead be done in accordance with the receiving states internal VAT rules, that is taxation in accordance with the country of destination principle. It is, however, up to the seller to provide proof of the buyer's VAT number; otherwise the seller will be forced to pay the tax according to the Swedish rules.[110] If the relationship is the opposite, a Swedish businessman acquires goods from a seller in another EU State and it is transported here, in accordance with the principle of destination the taxation shall be made in Sweden in accordance with 1:1 2p ML. It must be assumed that the supplier's country has the equivalent regulations as in 3:30a ML and that the transaction is exempt from taxes. Since the Swedish VAT law (ML) is based on a central EU directive, which should be implemented in all member states, this is a safe assumption.

When it comes to private individuals it is only if they acquire a new means of transportation in another EU State that it be an intracommunity supply of goods.[111] According to 1:1 ML an ISG is taxable here. In other cases when private individuals buy goods in another EU-state taxation is made according to that state's internal VAT rules, which means that the country of origin principle shall be applied.

3.8.2.3 *Trade with a Third State*

The ground rules, when it comes to trade with a state that is not a member of the European union, are the same as when trading within the union. Export is defined in ML 1:10 as sale outside of the EC and import means, according to ML 2:1a ML, that a product is taken into Sweden from a place outside of the EC. All imports are, according to 3:1 ML, tax liable sales. At import the tax liability occurs, according to 1:5 ML, when the goods are reported to customs. The tax is payable when the product is brought into the country and the Swedish tax is levied at the crossing. The taxation value, when calculating the import VAT, is the same as the value of the goods in customs.[112] The fact that the import tax is levied at the crossing of the boarder means that there is a significant difference at import, in comparison to ISG. It is not until later persons liable for tax gets a refund by the right to deduct. Imported goods are in this way at a disadvantage compared to products that originate in the Union. Thus it is a disadvantage to import goods to the Union.[113]

When a Swedish businessman sells and distributes goods to a state outside of the EU the principle of destination is fully applied and with that the Swedish VAT is lifted at the boarder. The consumption can be done abroad and it is up to the land of consumption to tax if it wishes to do so. At export it is thereby the same procedure as in ISG.[114]

[108] What is meant with intracommunity supplies of goods is distinguished in the 2a Chapter ML.
[109] Despite the fact that the transaction fulfils requirements of 1:1 ML and VAT ought to be paid. According to 3:30a ML however the case is an exception from tax liability.
[110] See Mattsson, N, & Melz, P, *Mervärdeskatt*, p. 59-60, compare Forssén, B, p. 38-40. See also Vandendriessche, P, *Proof of Intracommunity Supply of Goods: Achilles' Heel of the VAT Transitory Regime*, EC Tax Review 1996/1 p. 33.
[111] See 2a:3 1p ML,
[112] The taxable value at import is stated in 7:8 ML and starts out from the customs value in the Customs Code.
[113] Compare Forssén, B, p. 38.
[114] Mattson, N & Melz, P, p. 63.

By the usage of the principle of destination at export, with lifted VAT at the boarder, it makes it possible for Swedish export products, and of course from the other member states, to compete at foreign markets on the same terms as the domestic actors. The Swedish produced products do in other words not have a disadvantage of the high Swedish level of taxes. However some states apply a system where an indirect tax is levied on the product when passing the boarder. This way of taxation is thus equivalent to the Swedish import tax. Once the goods have crossed a boarder they are not likely to be mistreated on the grounds of origin since most states of the world have signed the GATT-treaty and in its Art III there is a non-discrimination principle.[115]

3.8.2.4 Services

Regarding services Swedish VAT is levied if the service can be considered sold ("omsatts") in Sweden and is done as a part of a professional occupation.[116] The delimitation between service and goods is determined according to the normal civil rules. It is of no importance in what state the one performing the service has his professional occupation, the determining issue is whether or not the service can be conceived as sold ("omsatt") in Sweden or not.[117] Since it is not possible to grasp a service the legislators have chosen the permanent place of business of the entrepreneur ("företagarens fasta driftställe") as a starting point in the determination if the service is sold in Sweden or not. In the trade of services in the EU a service is considered sold abroad, according to 5:7 3 section 1p ML, if the service is supplied a buyer who is a tradesman in that particular EU state. If on the other hand the buyer, of a service in another EU state, is not a businessman the service is considered sold in Sweden.[118]. If the service is provided a buyer in a state outside of the European union EU it is to be considered sold abroad without taking into consideration if the purchaser is a tradesman or not.[119]

3.8.3 The VAT and the Internet[120]

In an ever more digital world where more and more is done electronically, on the so-called Internet, it must be presented in some way. It is not possible to disregard the Internet and its implications, in a presentation of the VAT. I have chosen to point of some of the greater problems with this new medium. Although new the Internet seems to be here to stay.

The problems arising when it comes to VAT in the electronic commerce originate in large portions in the demand of localising a permanent place of business ("fast driftställe"), in a specific state, for the one offering services. Through the Internet a global market without any boarders has been created where there are great difficulties in indicating the location of a state the seller and buyer. If it is not possible to prove a sufficiently strong connection to a certain state it will be hard for that state to claim the right to tax which in the long run erodes the base of taxation. The company can in this way escape the consumption taxes. The VAT is levied either in accordance with the principle of origin or the principle of destination both conditions that the country of origin and consumption can be established. If what is provided via the net are services then there it is a necessity to determine in what state a seller has his permanent place of sales ("fasta driftställe"). Through the Internet the seller does not have to have a place of sales in the state where the purchase takes place. This however in no way impedes his

[115] See Mattson, N & Melz, P, p. 58-59. About the GATT see Malanczuk, P, p. 229.
[116] See 1:1 ML.
[117] Whether or not a good or service is to be considered sold ("omsatt") in Sweden can be concluded in 5 Chapter ML.
[118] That this is the case follows from 5:8 ML which provides that other cases than those in 7§ the service shall be considered sold ("omsatt") in Sweden.
[119] See Forssén, B, p. 42-43.
[120] I presume that the reader knows what the Internet implies and how digital-shopping works. The technical details are of minor importance for the presentation. The discussion is on a general level and in no way claim to be exhaustive.

opportunity to provide the service.[121]

3.8.3.1 A Service or Goods?

At VAT different rules apply depending on if the transaction concern is a service or goods. Therefore it is essential as a first step to determine if it is a purchase of goods or a service. If a consumer chooses to download a book or a record, from a company that provides this against payment, the transaction is done in the form of zeros and ones.[122] Is it a service or goods that have been bought? I mean that one can see the down loading of for example a book or a record as the purchase of an item.[123] In the end it is the contents of a book or a record one is after, the packaging should be of subordinate importance. A book ought to be a book just as well in a digital form as in a bound form. If it is the same book it is the same contents and if it is a good in one case it should also be so in the other.

3.8.3.2 Mail-order Sales

If the Internet is used to order clothes, food, books etc. and get the goods delivered to the home it should stand without a doubt that it is mail-order sales of goods that have taken place. At mail-order sales the goods are considered as sold in Sweden, according to 5:2 ML and therefore Swedish VAT shall be paid according to 1:1 ML. The easiest would be if these rules could be applied in the case of downloading via the net. Everything that can be bought in a physical form, as a good, ought to remain in this status despite the fact that it is transformed into a digital form. The big problem will be how the taxation is to be performed. Perhaps the responsibility of the tax payment could be put on the seller. Difficulties arise when the sellers are located in other states. But if they want to be serious actors on the Swedish market they will probably follow the rules, provided that there are sanctions connected to them.

There have been suggestions on taxation of every sent unit of information instead of levying VAT, a so-called ”bit-tax”. However it will probably not be a reality, partly because it taxes all information that is downloaded from free servers and ordinary E-mail, and partly because there will not be tax neutrality between digital goods and physical ones.[124]

In my presentation above I have tried to point out that it should be possible to apply the normal rules of VAT in e-commerce. Goods would keep their status as goods despite the transition to a digital form. It will be difficult to control that the taxes are paid in due order with the ever-increasing globalisation of the trade over the net. Finally it will need a multilateral treaty where taxation of digital trade is determined. No single state can solve this problem since commerce does not recognise any national boundaries.

It is a vast and slow process to pass new laws after the changes in the society. It is usually preferable to try to apply the old laws to the new situations. The problem is however that if the laws are written so vaguely that they fit all situations the foreseeability is at risk and by this in the extension also the security of law. If possible use the old laws, perhaps with modifications, but the new legislation may not renounce the security of law.

[121] See Landgren,C, *Internet och dess betydelse för mervärdesskatten – en internationell studie,* SN 1998 p. 460-461 and Hinnekens, L, *The Challenges of Applying VAT and Income Tax Territoriality Concepts and Rules to International Electronic Commerce*, Intertax 1998/2 p. 55-56.

[122] I assume that it is sold from whoever has the right to do so and consequently it is done in a legal manner without infringement of the copyright.

[123] The issue is far from clear. It is possible to view it as a service because at the actual purchase the physical good does not exist. See Landgren, C, SN 1998 p. 461.

[124] See Landgren,C, SN 1998 p. 466-467, compare Mutén, L, *Mera om IT-skatten,* SN 1998 p. 605. See also Staiman, A, *Shielding the Internet from Undesirable Content: The Advantages of a PICS based Rating System,* Fordham International Law Journal 1997 p. 882 about a PICS based rating system.

3.9 The Excise Taxes

3.9.1 In General

The excise taxes belong to the group of indirect taxes and thereby fall under the powers of the community, according to article 93 EC (former Art 99 of the EC-Treaty). The powers have only been used in the areas of alcohol, tobacco and mineral oils, the so-called *harmonised excise taxes*.[125] In Sweden the excise taxes are located in a number of different laws.[126] The easiest is to describe the directive, which is the basis for the national legislation, in other words the opposite to what was the case with the VAT.

3.9.2 Council Directive 92/12/EEC - The Directive of Circulation

As a part of the creation of the single market the Council has adopted the so-called *directive of circulation*[127]. The directive is implemented in the Swedish legislation through a number of laws.[128] Since the laws are based on a directive they have to be interpreted in the light of it. This is what is referred to as the *indirect effect* of the EC law[129]. The directive can of course also have *direct effect* if it is not implemented or wrongly implemented.[130] The objective of the directive is in the long run to abolish regulations concerning excises, which need controls at the boarder-crossings, and in this way stand in the way of realizing the single market. An important aspect of this market, where goods are supposed to be able to circulate freely, is that the liability to pay excise taxes occurs at the same point of time in all the member states.[131] Bellow follows a presentation of the main features of the directive of circulation. The scope of application for the directive is limited, according to Art 3.1, to mineral oils, alcohol and alcoholic beverages and tobacco. Goods within the scope of application of the directive are subject to excise duties at the instance they are produced in the union or at the time of their importation into that territory.[132] However the excise taxes are not chargeable until the products are released for consumption.[133] The starting-point in the directive is that goods subject to excise duties shall be able to circulate freely and that the taxation does not occur until they reach the consumer. The taxation will be in the state of consumption, in accordance with the country of destination principle. This is the so-called *order of suspension*.[134] The fact that there is cohesion in the time of when the tax is charged does not in any way mean that the states have the same tax rates. Just as in the case of the VAT it has been left to the states discretion to decide the level at which they prefer to have the excise duties.

3.9.2.1 Order of Suspension[135]

The intention of the order of suspension is to make it possible to produce, process, hold, and move intracommunity, of products liable for tax, without any consequences regarding taxation. As long as the goods are within the order of suspension there is consequently a latent

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[125] See RSV:s *Handledning för punktskatter* 1997, p. 54.

[126] Lag (1984:151) om punktskatter och prisregleringsavgifter, LPP, states which excise taxes there are in Sweden. However only the taxes on tobacco, alcohol and mineral oils which are based on EU directives.

[127] Council Directive (92/12/EEC) of 25 February 1992 on the general arrangements for products subject to excise duty and on the holding, movement and monitoring of such products. In Swedish "cirkulationsdirektivet" my translation to "the directive of circulation".

[128] The Directive has been implemented in the in Swedish law by lag (1994:1563) om tobaksskatt, lag (1994:1564) om alkoholskatt och lag (1994:1776) om skatt på energi.

[129] In Case C-106/89, (*Marleasing…*), [1990] ECR I-4135, the ECJ insisted that the national courts should interpret national laws in the light of relevant directives, whether the law in question predates or post-dates the directive. See Weatherill, S & Beumont, P, p. 305.

[130] See Pålsson, S & Quitzow, C M, p. 139-147.

[131] See Directive 92/12/EEC preamble 1 and 4.

[132] See directive of circulation (DC) Art 5. The territory of the Community is defined in Art 2 DC.

[133] See Art 6 DC.

[134] My translation of the Swedish "suspensionsordningen". See Art 4 DC and 6. See also Prop 1997/98:100 p. 46.

[135] See supra note 129 about the translation.

tax debt. The liability to pay excises first occurs when the product has left the order of suspension at this time it is released for consumption. For products that are outside of the order of suspension the tax is to be paid at the time of production or when the product is imported. A product included in the order of suspension can be transported without this leading to that the tax is chargeable. If a product is to be transported within a state the professional trade must guarantee the payment of the tax in accordance with the state's rules. At a transport between two member states the guarantee is of the payment in accordance with the state of destination and the goods must be accompanied by a special document drawn up by the consignor. The purpose of the document is to simplify the control of the taxes between the states. The document shall be drawn up in quadruplicate, the consignor keeps one, and the rest goes with the goods. After the arrival of the transport the consignee holds on to one copy, sends one back and one is for the relevant authorities of the Member State of destination (in Sweden the tax authority in Dalarna)[136]. If there is a departure from the rules regarding the order of suspension leads to that the product is considered released for consumption. The effect is that the tax is instantly chargeable. The taxes shall be paid, by the one that has put up the guarantee, in accordance with the rules that apply in the state where the violation took place. If the state of violation can not be determined then it is viewed as if it was where the infringement was detected. If a product subject to excise duties of some reason should not reach its intended destination and it can not be ascertained what has happened to it the excise is charged in the state from where it was sent.[137]

3.9.2.2 Entry for Private Use

For private individuals the main rule, taxation in accordance with the principle of destination, does not apply. Instead it is the principle of origin that shall to be used. If private individuals acquire products for their own use, and transport them themselves, the excise duties shall be charged in the state where they were acquired. This follows, according to Art 8 DC, from the principle governing the internal market. For guidance, in determining whether or not goods can be regarded as being for private use and not intended for commercial purposes, can be taken in Art 9 DC where it is stated quantitative levels below which can not be if it shall be regarded as being for commercial purposes. Sweden has, however, just like Denmark and Finland, an excemption from these when it comes to entry for private use.[138]

3.9.2.3 Distance Selling

Distance selling means sales where the buyer and seller are situated in different member states. Is the buyer neither authorised warehousekeeper, nor trader with or without excise-registration and the seller directly or indirectly transports the product, or it is transported on the behalf of the vendor, the taxation shall be in accordance with the Member State of destination. Formally the tax is chargeable to the vendor at the time of delivery. It is however sufficient if the seller puts up at a guaranty for the payment of the tax, prior to the shipment of the product. The article applies particularly to mail-order sales towards private individuals. In that case the order of suspension is not in use. The vendor must put up a guaranty and this is not refunded until the tax is paid in the state of destination.[139]

In the case of entry for private use the main aspect is to attend the transport without any

[136] The demand of a guaranty at transportation see Art 15-17 DC, the documentation is regulated in Art 18-19 DC. See also 1997/98:100 p. 51.
[137] See Art 6-7 DC. About the order of suspension, the need for documents and violation of the order of suspension see Prop 1997/98:100 p. 46-51.
[138] See Art 26 DC. The levels, which are legal when it comes to private entry to Sweden, are stated in "Lag (1994:1565) om beskattning av privatinförsel alkoholdrycker och tobaksvaror från land som är medlem i Europeiska unionen". That Sweden is included in Art 26 DC is evident from Council directive 96/99/EC, where the time limitation of the article is prolonged as well.
[139] See Art 10 DC, compare Prop. 1997/98:100 p. 48.

involvement at all from the vendor’s part in order to be sure that the tax is not chargeable in accordance with the state of destination.

3.9.3 Avoiding Excise Duties

In the European union there has been a harmonisation of the time when the excise tax, in the scope of the directive of circulation, is chargeable. This, in no way at all, means that there are equivalent tax rates in the states concerning these products. The Member States have chosen only to set a minimum level, which the tax shall not fall under.[140] As a result there is a great diversification between the member states regarding the level on which they have chosen to put their tax rates. Unfortunately when there are differences in the tax rates between states it leads to that there is money to earn in trying to avoid the own states taxes. The ways to cheat are many but they all have in common, in contrary to the applicable law, an aim to get the products taxed in the state that provides the lowest taxes. An example of the art of cheating is to send back a fake return copy of the document, which accompanies the product during transportation, and thus give an deceptive appearance that the tax has been paid in the state of destination. This in turn leads to that there is no tax paid at all. As an alternative the products can be sent to a state with higher tax rate without the returning of a copy of the document. The effect of this is that the tax is paid in accordance with the tax rate in the sending state.[141] Furthermore the products can be exported to a third state in order to escape taxes. In the case of export the tax is lifted at the external boarder of the union. After that it is “only” to smuggle the merchandise back across the boarder.[142]

3.9.3.1 ”The Man in Black”

An elaborate tax-planing scheme was at hand in the so-called *”The Man in Black”*- case[143]. The facts in the case were in short the following. A British company had two subsidiary companies situated in Luxembourg. The managements in the two companies were different. The British company offered retail of cigarettes, the taxation was supposed to be in accordance with the rules in Luxembourg, and act as an intermediary with one of the subsidiary companies in Luxembourg. This in turn obtained the cigarettes while the other subsidiary, via an agreement between the two, was in charge of the transport to Britain. The question was if it was to be regarded as entry for private use, according to Art 8 DC, and thereby charge the taxes in the state of origin, that is Luxembourg. An alternative interpretation was if it should be regarded as distance sales, according to Art 10 DC, and thereby being taxed in accordance with British law. The European Court of Justice determined that Art 8 DC is not meant to be applied if an agent does the transport of products liable to excise duties.[144] The opinion of the court was that the transaction should be viewed as a distance sale in the sense intended in Art 10 DC and the taxes thereby levied in the state of destination, that is Great Britain.

[140] See Steenstrup, B, *De harmoniserade punktskatterna – en överblick*, SN 1995 p. 52.
[141] See Moëll, C, *Fusk med punktskatter*, SN 1997 p. 683-684. Regarding the cheating when it comes to cigarettes in Sweden see Persson, L G W, m fl, ”Obeskattad konsumtion av cigaretter” Chapter 6.
[142] Through, Lag (1998:506) om punktskattekontroll av transporter m.m. av alkoholvaror, tobaksvaror och mineraloljeprodukter, the customs authorities have been given a far greater possibility to control that transports of products liable for excises are done in a correct manner. Sanctions such as taken charge of the goods, forfeit and fines if the transport is not done in accordance with the order of suspension. If for instance a transport not accompanied by the correct document will be fined.
[143] Case C-295/95, (*The Man in Black...*), [1998] ECR I-1605.
[144] See *the Man in Black-case* at 37.

4 THE FEDERAL TAX SYSTEM OF THE UNITED STATES

4.1 The living Constitution

4.1.1 History

The constitution of the United States is an old document, originally drawn up in 1787, but the Supreme Court has, with its interpretation of it, made it a legal paper that has evolved with the changes of society.[145] The wording of the Constitution is, like the treaty of the European Community, somewhat of a general framework whose contents have been deciphered through the interpretation of the court. A big responsibility when it comes to the development of the law has, in this way, been put on the Supreme Court. The positive aspects of this arrangement are, as has been pointed out, that the constitution evolves and adapts to the various changes in the community. This is what generally is meant when the Constitution is referred to as a living document. The original text consisted of only seven articles, the first three regulate the division of power following Montesquieu's tripartite scheme, with a legislative, an executive and a judicial branch of government. To the original text there has, under its 200 year history, been added only 26 amendments[146].[147]

The power to tax is an inherent characteristic of state authority. In other words the states have a right to levy taxes within their territory as long as they have not transferred that privilege to the central, federal, government.[148] Bellow follows a description of the taxing powers divided between the different levels of government in the American society.

4.1.2 The Tenth Amendment

After the American Revolution in 1776 the various states had independent sovereignty. The states could act individually as far as they had not transferred power voluntarily to a central power of government. The divided power between the states and the federal body is usually described as two separate spheres of dual sovereignty. Each sphere makes its own decisions within the area where the decisionmaking is exclusive. In some areas the powers are concurrent, which means that both can regulate.[149]

The Constitution established a strong central government that at the same time reserved power to the level of the individual states. A regulation of great importance, concerning the division of power between the Federal government and the States, is the Tenth Amendment. The Tenth Amendment provides:

> "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or the people."[150]

[145] The doctrine of *stare decisis* states that all like cases should be decided alike. The important statement in a judicial case, the so called *ratio decidendi,* the remainder of the case is referred to as mere *dicta* and carries less weight as a legal argument. As a rule lower courts are bound to follow the findings of higher courts. The Supreme court can choose not to follow previous decision, the American judiciary does not follow the doctrine of stare *decisis* rigidly. The doctrine makes it easier to predict what the courts will decide. For an analysis of the doctrine of *stare decisis* see, Clark, D S, Tugrul, A, *Introduction to the Law of the United States,* p. 35ff.

[146] Ten of these amendments are the most well known, the so called "Bill of Rights", was amended in 1791, see Clark, D S, Tugrul, A, p. 51

[147] On the role of the Supreme court as a interpreter of the Constitution see Clark/Tugrul, p. 53-58.

[148] Gelfand, D & Salsich, P, JR, *State and Local Taxation and Finance*, p. 5-6.

[149] Vause, W. Gary, *The subsidiarity principle in European Union law—American federalism compared*, Case Western Reserve Journal of International Law, Winter95, Vol. 27, p. 62.

[150] The 10th amendment to the Constitution of the United States.

The Supreme Court has on numerous occasions had to answer questions regarding the Tenth Amendment. The early decisions gave the central government a strong role. In modern day the court has given a somewhat modified interpretation to the issue. The modern approach was first stated in the case of *United States v. Darby*[151]. In the case the court held that the federal government only has as much power as it has been given. All that has not been surrendered is retained.[152] The main aspect of the *Darby*-decision is that, if the federal government wished to exercise the use of delegated or implied powers, the states couldn't hinder this by referring to the Tenth Amendment. In the Tenth Amendment the word "expressly" has been left out. This is, according to Vouse, very important because it shows that the object of the Amendment was not to make it possible for the states to interfere or restrict any of the powers that the federal government has been given in the Constitution, expressly or not.[153] The view of federal supremacy, put forward in the *Darby*-case, was later modified in the case of *National League of cities V. Usery*[154]. The court prevented federal regulations of functions essential to separate and independent state existence.[155] The *Usery*-decision lasted until the *Garcia*-case[156] overruled it by concluding that it was impossible to distinguish between traditional governmental functions, that are protected under the Tenth Amendment according to *Usery*, and non-traditional functions which are not.[157]

4.1.3 The Fourteenth Amendment

The part of the Fourteenth Amendment, that is interesting in the field of taxes, is in section one, it provides:

> "…nor shall any State deprive any person of life, liberty, or property, without due process of law;…"

Questions regarding taxes with reference to the Fourteenth Amendment, the so-called *Due Process Clause*[158], have on numerous occasions been raised in front of the Supreme Court. The questions raised concern States' power to impose taxes. The Supreme Court has only accepted the use of the Fourteenth Amendment in cases were it has been shown that the state has used its taxing power to get around powers that have been forbidden by the Constitution. The state has in other words used taxes as an excuse to obtain the real, hidden objective.[159]

Bellow follows a selection of cases decided by the Supreme Court where taxes have been the issue with regard to the Fourteenth Amendment.

In case *Magnano Co. v. Hamilton*[160] the issue was if an excise tax on butter was consistent with the Due Process Clause, in the Fourteenth Amendment. The Court found that this was the case. The Court held that only on extraordinary occasions could the taxing power of a state be limited with reference to the Due Process Clause. This is, according to the Supreme Court, because the power to tax is an inherent *attribute of sovereignty*.[161] The Court further

[151] *United States v. Darby*, 312 U.S 100 (1940).
[152] *Darby*, 312 U.S, at 124.
[153] Vause, W. Gary, p. 63.
[154] *National League of cities V. Usery*, 426 U.S 833 (1976).
[155] *National League of cities*, 426, at 845.
[156] *Garcia v. San Antonio Metropolitan Transit Authority*, 469 U.S 528 (1985).
[157] *Garcia*, 469, at 540-541.
[158] The due process clause in the Fourteenth Amendment applies to the State. There is a similar due process clause in the Fifth amendment that applies to Congress.
[159] Gelfand, D & Salsich, P, JR, *State and Local Taxation and Finance*, p. 10-11.
[160] *Magnano Co. v. Hamilton*, 292 U.S 40 (1934)
[161] *Magnano Co. v. Hamilton*, 292 U.S at p. 44.

held that the due process clause only could be used, regarding tax rules, if the state had been doing something prohibited, such as confiscating property by disguising it as a tax.[162]

In *City of Pittsburgh v. Alco Parking Corp.*[163], the question was if a 20 % tax on income from a parking could be regarded as so high that it could be considered as being contrary to the Due Process Clause. The Court pointed out that the size of a tax and what its impact is on business is a matter for the legislation and nothing the Court can decide on, if it is not a covert attempt to exercise a forbidden power.

In *Commonwealth Edison Co. v. Montana*[164] the company claimed that it paid more taxes than the benefits it received in return from the community. The Court ruled that the fact that there is not correspondence, between paid tax and value of services provided to that taxpayer from the society, does not entitle to a test under the Due Process Clause. Further the Court concluded that the only advantage a taxpayer is entitled to by the Constitution comes from the privileges that derives with living in a civilised society, established and safeguarded by the devotion of taxes to public purposes.

In *Container Corporation of America v. Franchise Tax Bd.,*[165] the Court came to the conclusion that the Due Process Clause does not automatically give the states the right to tax incomes, that origins from interstate trading. To tax this sort of income there must be a minimal connection, or nexus, between the interstate business and the state that wants to tax. According to the Court an additional detail is that there must as well be a rational relationship between the income attributed to the state and the intrastate values of the enterprise.

[162] *Magnano Co. v. Hamilton*, 292 U.S at p. 46.
[163] *City of Pittsburgh v. Alco Parking Corp.,* 417 U.S. 369 (1974)
[164] *Commonwealth Edison Co. v. Montana,* 453 U.S 609 (1981).
[165] *Container Corporation of America v. Franchise Tax Bd,* U.S 159 (1983).

4.2 Constitutional Sources of Federal Taxing Power

4.2.1 In General

As said above, and as stated in the *United States v. Darby*-case, the individual states have only given to the central government as much power as stated in the Constitution. The rest of the power to tax remains as an *inherent power* to the State. Therefore, it is of great concern to examine what taxing power the federal government is given by the Constitution. Below follows both a summary of the provisions described above and the rest of the statutes in the Constitution concerning taxes as well. The basis of the taxing power is easy. It can be said that a main rule is that the Congress has the right to levy taxes. To this rule there has been added a number of exceptions to when the power to tax can not be used by the congress. In other words the states have first declared that Congress has the right to tax but not in these certain cases.

Taxes are mentioned already in the first article of the Constitution. The general provision to tax is given to Congress in article I, section 8, cl. 1, it provides:

> "The Congress shall have Power To lay and collect Taxes, Duties, Imposts, and Excises to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts, and Excises shall be uniform throughout the United States;…"[166]

The general provision of the first phrase has its first limitation in the last part of it. Today it seems perhaps to be an obvious limitation that taxes must be equally distributed among the population and that no one shall pay taxes differently due to where in the United States they reside. The drafters of the Constitution probably wanted to safeguard the future existents of the federation and therefor felt compelled to clarify this to avoid disputes. With a distorted taxation there would have been an imminent risk that the federation would have fallen apart.[167]

The first article of the Constution restrains the congressional tax power additionally in section 9, cl. 5 by providing:

> "No Tax or Duty shall be laid on Articles exported from any State."[168]

This provision is a direct and express constraint on the Federal taxing power. In addition to this the courts have, in the principles of federalism, found an implied doctrine of immunity from federal taxation for the States. The scope of this doctrine has been narrowed from its original broad field of application. The doctrine of State immunity from Federal taxation today only applies in cases of Federal taxes that directly effect a traditional State or governmental function.[169]

In order to derive revenue a tax bill must be passed with a majority vote, by the House of Representatives and then transferred to the Senate for the formal and final approval, either as

[166] Article I, Section 8, clause 1, of the United States Constitution.
[167] The provision that it has to be uniformity concerning excise taxes and other indirect taxes is a geographical limitation. This means that a subject must be taxed at the same rate wherever found. The limitation does not apply when it comes to progressive rates or classifications that are of nongeographic kind. See Committee Print, *Overview of the Federal Tax System*, p. 1.
[168] Article I, Section 9, clause 5, of the United States Constitution.
[169] See Committee Print, p. 3. About the doctrine of State immunity from federal taxation see *Graves v. New York ex rel. O´Keefe*, 306 U.S 466 (1939) and *Ohio v. Helvering*, 292 U.S 360 (1934), among others.

it is or with additional alterations. This order of legislation is stated in Article I, Section 7, clause 1 of the Constitution the so-called *Origination Clause*[170] and it provides:

> "All bills for raising revenue shall originate in the House of Representatives, but the Senate may propose or concur with amendments as with other bills."

4.2.2 The Sixteenth Amendment

Through the Sixteenth Amendment to the Constitution the Congress has been given the right to impose a Federal income tax. The Sixteenth Amendment provides:

> "The Congress shall have the power to lay and collect taxes on incomes, from whatever source derived, without appointment among the several States, and without regard to any census or enumeration."[171]

Prior to the Sixteenth Amendment it was not politically possible to levy an individual tax on income. The hinder lay in Article I, Section 9, clause 4, of the United States Constitution. Section 9, cl. 4 provides:

> "No Capitation, or other direct Tax, shall be laid, unless in Proportion to the Census of Enumeration herein before directed to be taken."[172]

According to the cited article there could only be imposed a direct tax in proportion to the consensus of the states in the federations. This was highly impractical so therefore the Sixteenth amendment was added to the Constitution in 1913.[173]

4.2.3 The Commerce Clause

The Commerce Clause is the greatest limitation on the states' power to tax that can be found in the Constitution of the United States. The Clause provides:

> "The Congress shall have the power…To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes;…" [174]

The Commerce Clause has been interpreted by the Supreme Court as both granting power to the Congress as well as being a limitation on the States' powers. Initially the Clause was interpreted extensively and thereby rendering the states without any possibility to tax services and goods when it came to interstate commerce. This led to the effect that interstate commerce was immune state taxation despite the effect it might have on facilities and institutions of a specific state. In a few cases the Court came to the conclusion that it was alright to tax interstate commerce as long as the tax was non-discriminatory. The main point of view however was still that a state direct tax on interstate commerce was unconstitutional.[175] An underlying philosophy to the doctrine has been that interstate commerce should enjoy a kind of "free trade" immunity from state taxation.[176] The tax immunity rule was finally abandoned by the Supreme Court in *Complete Auto Transit Inc. v. Brady*[177].

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[170] See Committee Print, p. 5.
[171] The Sixteenth Amendment to the constitution of the United States.
[172] Article I, Section 9, clause 4, of the United States Constitution.
[173] Committee Print, *Overview of the Federal Tax System, p. 2.*
[174] The Commerce Clause can be found in article I, §8, cl. 3, in the Constitution of the United States.
[175] See Gelfand, D & Salsich, P, JR, *State and Local Taxation and Finance*, p. 14 –16.
[176] The "free trade" view was summarised in *Freeman v. Hewit*, 329 U.S 249 (1946). The court concludes, in the case, that the commerce clause is a limitation of the power of the State even if Congress has not implemented any legislation. The court continues by saying that a state is precluded to do anything that may have effect on the free flow of trade between the States, see *Freeman v. Hewit*, 329 U.S p. 252.
[177] *Complete Auto Transit. Inc. v. Brady*, 430 U.S 274 (1977)

4.2.3.1 The Complete Auto Transit-test

In *Complete Auto Transit Inc. v. Brady* the question was whether or not a sales tax was contrary to the Commerce Clause. The State of Mississippi had levied the tax on a corporation that transported cars, manufactured outside the state, to dealers within. The Court came to the decision that "interstate commerce may be made to pay its way"[178] and as a result of this, a tax that effects interstate commerce, is not unconstitutional *per se*. The court deviated from the previous doctrine of immunity from Federal taxation on interstate commerce. The rule was abandoned in favour of a test in four points, the so-called *Complete Auto Transit*-test, which emphasised on the practical effect of a tax rule. With the test state taxation of interstate commerce is not prohibited by the Commerce Clause under the condition that:

I) the tax is applied to an activity with a *substantial nexus* with the taxing State,
II) is *fairly apportioned*,
III) *does not discriminate* against interstate commerce, and
IV) is fairly *related to the services provided* by the State.[179]

The first part of the *Complete Auto Transit*-test has not rendered any problems when applying the test. An activity with a *substantial nexus* is, in principal, every activity within a state, that can be said to be not only minor. *Fair apportionment* refers to the degree a business, that is interstate in its character, can be taxed, by a state, on its income. The formula used to determine the extent of taxation, uses the proportion of payroll, property and sales from the company for its in-state operations and compares those three factors with the total business activities worldwide. If, for example, by using the formula it turns out that the company does one percent of its business within the state, then one percent of its entire income can be used in calculating state corporate income tax. The *non-discrimination* requirement simply means that interstate commerce shall not have inferior conditions compared to other commerce within the state.[180]

The last point in the *Complete Auto Transit*-test regards the relation between the paid tax and *services provided* by the state. A tax is fairly related to services provided by the state, if the tax is reasonably related to the contact the taxpayer has with the state. There is not any requirement that the actual amount of paid tax is compared to the benefit that the company has gained from the state. The mere fact that the state has provided protection and opportunities has, in several cases, been enough for the court. In other words the benefits deriving from doing business in a functional civilised society is in most instances, sufficient for fulfilling the last point in the test.[181] The test is the standard for testing state and local taxation under the commerce clause.[182] [183]

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[178] *Complete Auto Transit*, 430 U.S p. 281.

[179] *Complete Auto Transit*, 430 U.S p. 279. The decision was welcome by the doctrine that had long argued that a tax which was non-discriminatory and apportioned to commerce done within a state shouldn't be regarded as an intrusion on interstate commerce since it would fall both interstate commerce and commerce carried on within the state. The ruling made it possible to establish a frame for a more sensible approach to an intricate problem of federalism. See Gelfand, D & Salsich, P, JR, p. 17.

[180] See Gelfand, D & Salsich, P, JR, *State and Local Taxation and Finance*, p. 20-24.

[181] Compare *Commonwealth Edison Co. v. Montana,* 453 U.S 609 (1981) in section 4.1.3 above.

[182] See Gelfand, D & Salsich, P, JR, p. 18-19.

[183] For the development of the *Complete Auto Transit*-test see Commonwealth Edison Co. v. Montana, 453 U.S 609 (1981), regarding if a tax is fairly *related to the services provided* by the State and when a tax *discriminates* against interstate commerce. The question whether a tax is *fairly apportioned, see Mobil Oil Corp. V. Commissioner of Taxes of Vermont,* 455 U.S 425 (1980).

4.2.4 The Supremacy Clause

The Supremacy Clause is situated in article VI, cl. 2 of the Constitution. It provides:

> "This Constitution and the Laws of the United States which shall be made in Pursuance thereof…shall be the supreme Law and of the land…any Thing in the Constitution or Laws of any State to the Contrary notwithstanding."[184]

The Clause is applied in cases regarding claims of state and local regulations conflicting with federal tax regulations, particularly acts past by Congress in accordance with the Commerce Clause or the Taxing and Spending Clause. When judicial conflict, between state and federal government is at hand, the supremacy clause states that the supreme federal law shall prevail. In addition the supremacy clause shields the federal government from being taxed by the States. The federal government is immune from State taxation if the levy falls on the United States itself, or a body so closely related to it, that the two cannot in tax matters be viewed as two separate entities. [185]

4.2.5 The Committee on Ways and Means

Congressional tax legislation has to be initiated in the House of Representatives.[186] In the House of Representatives legislation in tax matters originates from the Committee on Ways and Means.[187] To its help the committee has a number of subcommittees. One of these is the Subcommittee on Oversight, which is an investigative, non-legislative arm of the Committee on Ways and Means. As its responsibility the Subcommittee shall review and oversee if the current laws are effective, adequate and if they are applied as it was meant. Furthermore it falls on the Subcommittee to determine if these laws and regulations are interpreted properly and that the Federal agencies responsible for administrating the task do it in a fair and efficient manner. In short *the Subcommittee on Oversight* is responsible to evaluate the impact of the laws and rules that are in effect at present day within the committee's jurisdiction.[188]

4.2.6 The Department of the Treasury

The Department of the Treasury is in charge of overseeing the financial interests of the United States. The Department in this capacity gives the President advice in matters regarding all the fiscal policy, from proposing tax legislation to being a fiscal agent for the Government.[189]

4.2.6.1 The Internal Revenue Service

A subdivision of the Department of the Treasury is the Internal Revenue Service (IRS). The IRS administrates the majority of the Federal tax laws of the United States and is divided into three levels, national, regional and district. From the national headquarters the over all policy is issued, in form of regulations and other guidance to the tax laws. The lower levels are to effectuate and implement the finding from the national headquarters.[190]

4.2.7 The Process of Making Tax Legislation

On the basis of the Constitution of the United States the tax laws are passed. It is the Congress that enacts these tax laws; some detailed but a large portion of them are vague, presenting a broad framework that has to be filled. In order to ensure that the tax laws are applied uniformly, fairly and effectively in all the varieties of situations, concerning taxes, which can occur in the Federation's fifty states, the framework is filled in with rules, regulations and

[184] Article VI, cl. 2, of the Constitution of the United States.
[185] See Gelfand, D & Salsich, P, JR, p. 27-28.
[186] McNulty, J K, *Federal income taxation of individuals*, p. 7.
[187] See Committee Print, p. 9.
[188] Committee Print, *Overview of the Federal Tax System*, p. 15.
[189] Committee Print, p. 17.
[190] Committee Print, p. 18-19.

interpretations. These rules and regulations are issued by the Secretary of the Treasury.[191] Regulations are official explanations and interpretations of the Code's provisions and the proposed regulations are published in the Federal Register and are binding neither for the public nor for the Government. The codified and final versions of the regulations can be found in the 26th title of *the Code of Federal Regulations*, commonly called the IRS regulations. The regulations do not have the same status as law but are followed by the court if they can be said to be consistent with the reasonable interpretation of the underlying laws. The IRS cannot contest the decision made by a court, it is bound to it.[192]

Revenue Rulings are interpretations of the Code made by the national headquarters of the IRS and are published in the Internal Revenue Bulletin. The rulings are made out of hypothetical cases to demonstrate the application of the Code, regulations and other rulings. One part of this is to exemplify and show the taxpayers how the Code works in actual situations, another part is to control if there is a coherency in the system, and no conflict between the rules.[193]

In the case that the individual taxpayer is not satisfied with the tax liability issued by the IRS he or she can pursue the case, within 90 days, to a Federal Tax Court.[194]

[191] According to Section 7805 of the *Internal Revenue Code (IRC)* the Secretary has the general authority to issue rules and regulation which may be needed for the administration of the laws.
[192] Committee Print, p. 20-21. After the law is passed by the Senate it is sent to the President for his action., see McNulty, J K, *Federal income taxation of individuals*, p. 7
[193] Committee Print, p. 21-22. In addition to Regulations and Rulings, the IRS publishes, Revenue Procedures which are internal practices o the IRS. The IRS gives Private Letter Ruling on a specific situation requested by an individual taxpayer and is binding on the IRS. For more details on these and other IRS publications see Committee Print, p. 22-23.
[194] Committee Print, p. 25. According to the Code section 6212-6213 the taxpayer has 90 days to dispute a tax liability from the IRS. The IRS can not collect a tax until the period has expired.

4.3 The Federal Individual Income Tax

4.3.1 History

The first time an income tax was introduced in the United States was through the Revenue Act of 1862 in order to raise funds during the Civil War. The tax was used between 1862-1871 and when the urgent need for money disappeared after the war, the tax went away as well. A new income tax was re-enacted in 1894 but in 1895 the Supreme Court declared it unconstitutional. The Court found in *Pollock v. Farmer's Loan and Trust Company*[195] the individual income tax was a violation of Article I, cl. 4, section 9 of the Constitution[196], which prohibited direct taxes if they were not apportioned among the States. With this ruling it was clear that the Congress did not have the power to levy an individual income tax, without a constitutional amendment.[197]

In 1913 the 16th Amendment was ratified. With the 16th Amendment the Congress has the power to accumulate taxes "on incomes, from whatever source derived, without apportionment or any census or enumeration". The first Federal Income tax enacted under this new amendment was as part of the Revenue Act of 1913. Over the turning of time the federal income tax has been altered many times, but the present day federal income tax is a direct descendent of the one passed in 1913. Today the individual income tax is the single most significant source of revenue in the United States.[198]

4.3.2 Overview

There are two basic general principles that build up the ground structure of the federal individual income taxation, namely the principle of *efficiency* and the principle of *equity*. The objective is that the two shall be able to coexist without conflicting with one another. This goal, of course, is a utopia that can not fully be achieved. Measures made to increase efficiency may result in a decrease in the equity. The object of the principle of efficiency is to design a tax so it interferes as little as possible when it comes to choices in the individuals' economic transactions. In other words a tax shall not be the determining reason whether or not a person makes a transaction or chooses to refrain from doing so. The optimal tax would be one that taxed all income and transactions in the exact same manner, without interfering in the economic transactions. The individual income tax is not designed in this way, mainly because Congress has wanted to encourage certain activities or to level out injustices by lowering tax rates.[199]

The principle of equity can be divided into either *horizontal equity* or *vertical equity*. Horizontal equity means that individuals in similar situations are to be taxed alike. Under the principle of vertical equity persons with a higher income are to pay more taxes than those with lower incomes. This is accomplished by using the principle of progressivity, those with higher income pay a higher percentage on their income than those with a lower income. Progressivity is commonly justified by the theory that as an individual's income increases each additional dollar is less important to that person's well being.[200] In the income tax

[195] *Pollock v. Farmer's Loan and Trust Company*, 158 U.S 601 (1895)
[196] See section 4.3.2 above.
[197] See McNulty, J K, *Federal income taxation of individuals*, p. 5-6.For a more in-depth analysis of the historical background of the Federal income tax see Davies, D G, *United States taxes and tax policy*, p. 21-34.
[198] Committee Print, *Overview of the Federal Tax System,* p. 39. In 1989 the federal income tax raised 45 percent of all the Federal income. For a closer introduction of the 16th Amendment see section 4.3.1 above.
[199] Committee Print, p. 40.
[200] See Abrams, H E & Doernberg, R L, *Essentials of United States Taxation,* Part I p. 7. This is what is referred to, in microeconomic terms, as *diminishing marginal utility,* see Varian, H R; *Intermediate Microeconomics – A modern approach,* p. 65-70.

system of the United States vertical equity is accomplished in three ways. First of all the marginal tax rate is higher as a taxpayer's income rises. Secondly incomes below certain levels are excluded from taxation altogether through provisions of exemptions and deductions. Lastly there are tax credits available to reduce the tax liability of low-income taxpayers, in some cases the income becomes negative, after deducting tax-credits, and the Federal government refunds the sum.[201]

4.3.3 A General Presentation

In order to compute the individual income tax the first thing that must be calculated is the "*taxable income*". The tax is levied on the taxable income. Taxable income is the equivalent of the taxpayers total income, minus exclusions, exemptions and deductions. After reaching the taxable income the appropriate tax rates are applied to it. The tax may be reduced if the taxpayer can use taxcredits against otherwise owed tax liability. If the income is very low, tax credits may reduce the tax liability below zero and as a result the household is entitled to a refund. Tax liability is the amount of Federal income tax the taxpayer owes to the Government.[202]

4.3.3.1 Taxable Income

One of the basic terms in the income tax law is *Gross income*. Gross income is defined in the IRC § 61 (a) as *"all income from what ever source derived..."*. In the statue there is a non-exhaustive list of fifteen items that are included, for example compensations for services, gains derived from dealings in property, interest and dividends. In short, all incomes unless exempt or excluded in the IRC are included in the taxpayers gross income.[203] *Adjusted gross income* (AGI) is defined in the IRC § 62 as the gross income less, trade and business deductions of employees, long term capital-gains deductions, losses from sale or exchange of property, to name a few.[204] The deductions available from the gross income can be divided into two different groups, those which contribute to the production of income and those which do not contribute to the production of income but which are deemed by Congress to promote a socially desirable goal. In the first group are ordinary and necessary expenses when producing business income, such as employee's wages and interest on loans.[205] The second group is called "*itemized deductions*". These deductions are those which can be made from the AGI. AGI deductions are allowed for expenditure, to which income taxation has been deemed to be inappropriate or inadmissible, some medical expenses and home mortgage interests and contribution to charity are examples of deductions that can be made on the *Adjusted gross income.*[206] What is left, after the AGI has been modified, is the *Taxable income*.

4.3.3.2 Tax Amount

In order to calculate the tax payable the taxpayer can either use the Taxable income by tax rates found in IRC § 1, or if the income does not exceed certain levels the tax is instead, according to IRC § 3, calculated by using tax tables. There is in other words both "taxable

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[201] Committee Print, *Overview of the Federal Tax System*, p. 40.

[202] Committee Print, p. 64-65.

[203] In the Code statutory exclusions are made in IRC §§ 101-134; inclusions and exclusions can also be found in IRC §§ 71-89. What falls under the definition of gross income has been a big source of litigation, cases, regulations and rulings, see Amico, J C, *Introduktion to the US Income Tax System*, p. 14-27.

[204] See McNulty, J K, *Federal income taxation of individuals*, p. 10-11 for a closer presentation of the problems connected with Gross income and Adjusted Gross income.

[205] See IRC §§ 162-168.

[206] For further information on the calculation of the Adjusted Gross Income see Amico, J C, *Introduktion to the US Income Tax System*, p. 27-49. The exemptions on the Adjusted Gross income can be found in IRC § 151, regarding personal exemptions and in IRC § 63 (c) for a standard deduction, if the individual does not individualise each deduction post. "Itemized deductions" can be found in §163(h) mortgage interests, §164 property taxes on a personal residence, §170 charitable contributions, §213 extraordinary medical expenses, §165 losses due to casualties and §§151 and 152 deductions for each child and other dependants. For more on the various deductions see, Abrams, H E & Doernberg, R L, Part I p. 29-40.

income” and “tax-table income”.[207] This tax-sum is what is referred to as *gross tax*. This *Gross tax* can be reduced by a sort of “negative tax”, a *tax credit*. Tax credits are available to all taxpayers and it is not determined by if any deductions have been made. Examples of credits are those for the elderly and the disabled, the earned income tax credit, the credit for extra expenses for childen and foreign tax credit. After subtracting tax credits, what is left is the individual’s *tax liability* and is the individual’s Federal tax bill for the tax year. From the tax liability estimated tax payments and tax withholdings shall be subtracted. The amount remaining has to be paid. If a taxpayer’s tax liability is negative that means that the government in some cases will refund the surplus tax.[208]

The tax rates used to tax individuals are progressive, i.e. the tax rate on the last dollar is higher than on the first. The nominal tax rates vary from 15% to 39.6%. The factual effect on the individual taxpayer depends very much on what deductions he or she is able to make. The taxes are, in other words, paid, not after income but rather after one’s ability to file for deductions. The U.S Federal tax system benefits those with the knowledge of the deductions and has the time to file for them.[209]

The description of the Federal income tax in the United States above has in Figure 2 been summarised schematically.

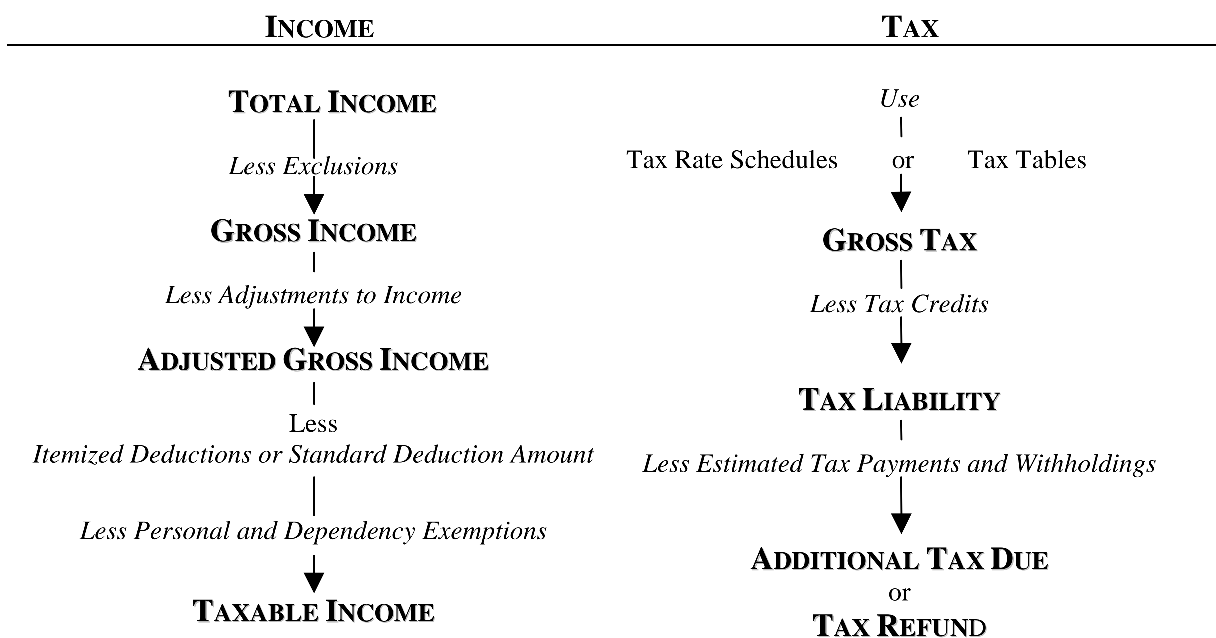

Figure 2. A schematic presentation of the Structure of the Federal Individual Income Tax.[210]

In addition to the Federal income tax the majority of States levy some sort of personal income tax.[211]

[207] See McNulty, J K, *Federal income taxation of individuals*, p. 12.
[208] Committee Print, *Overview of the Federal Tax System,* p. 64-65.
[209] Abrams, H E & Doernberg, R L, *Essentials of United States Taxation*, Part I p.7-9.
[210] Committee Print, p. 66.
[211] See Gelfand, D M, p. 40-43.

4.4 The Corporate Income Tax

4.4.1 History

In addition to individual income tax, the United States, like most countries, has a corporate income tax. The history of the corporate income tax is longer than that of the individual income tax. The United States has had a corporate income tax since 1909. Before the enactment of the 16th Amendment, which came 1913, the Supreme Court declared that the corporate income tax of 1909 was a valid excise tax on the privilege of operating in a corporate form.[212] After the 16th Amendment the corporate income tax has a firm foundation whether it is labelled as an excise tax or as an income tax.[213]

4.4.2 Overview

The structure of the corporate income tax is much the same as for the individual income tax. Firstly the taxable income is calculated and then the amount that shall be paid in tax. Below follows a presentation of the main characteristics of the corporate income tax.

The first thing that has to be clarified is what entity will be taxed as a corporation? According to the IRC § 7701 (a) (3) corporate taxpayers are corporations, associations, joint-stock companies and insurance companies. This is the main rule but there are other entities, for example trusts and partnerships, that may be taxed in accordance with the corporate income tax rules and vice versa. A corporation can be taxed as a partnership even though it legally is a corporation. In order to determine if an entity can be taxed, as a corporation there is a test in four steps. To be taxed as a corporation at least three of the criteria must be met. If only two or less it will not be taxed as a corporation. The following test is used in the tax classification:

a) *continuity* of life,
b) *centralised* management,
c) *free transferability* of shares or interests,
d) *limited liability* of shareholders.

Continuity of life means that the entity can survive even if the shareholders do not take care of it any more, for example if they die or have declared bankruptcy. Central management simply means that there is a body, such as a board of directors, that independent from the shareholders tend for the companies business. Shareholders can be on this board but not as a de facto shareholder. Free transferability means that the shares can be transferred without the prior approval from the other shareholders. Limited liability is when the liability, for the companies debts, only goes as far as the amount of contributed capital. Usually a shareholder only looses what he has paid for the shares.[214]

4.4.3 A General Presentation

In order to reach a taxable income the same method as for the individual income tax is used. The first thing that has to be established is the gross income. The gross income is defined as all income from whatever source.[215] In order to calculate the corporate taxable income a number of deductions can be made from the gross income.[216] Only deductions specifically referred to in the IRC can be made, for example, trade or business expenses, interests, royalties, service fees, taxes, losses and bad debts, just to mention a few. [217]

[212] See *Flint v. Stone Tracy Co*., 220 U.S. 107 (1911).
[213] Abrams, H E, & Doernberg, R L, *Essentials of United States Taxation,* Part II p. 1
[214] Amico, J C, *Introduction to the US Income Tax System*, p. 87-89.
[215] IRC § 61(a).
[216] According to IRC § 63(a), taxable income equals gross income minus allowable deductions.
[217] IRC §§ 162-166. For a more detailed description of the deductions legally available see Amico, J C, p. 106-134.

When a taxable income has been computed the tax is levied in a number of steps. The tax varies between 15 per cent to 35 per cent, see table 1 bellow.

Taxable income	**Tax rate**
First $50'	15 percent
Next $25'	25 percent
Above $75'	34 percent
Above $10''	35 percent
For companies with an income exceeding $18,333.333 there is a flat rate of 35 percent.	

Table 1. Show the rates on the taxable corporate income.[218]

4.4.4 The Corporate Double Tax

Corporation shall be separate from the shareholders. One of the most distinct aspects of this is the so-called corporate double taxation of the corporate profits. The first part of the tax is imposed on the corporate level on their profits. The second part of the double taxation is when the shareholders dividends are taxed on the individual level. In addition the corporation that pays out the dividend is not entitled to a deduction for the amount distributed. The final effect of this is that the profits are taxed two times, once on corporate level and a second on the shareholder level.[219]

Just as in the case of the individual income tax the majority of states impose an additional corporate income tax.[220]

[218] This is just an overview of the most important taxes there are additional specific taxes as well but for a closer description of the corporate taxes rates, see Abrams, H E & Doernberg, R L, Part II p. 45. The corporate tax rates are to be found in the IRC § 11.

[219] Abrams, H E & Doernberg, R L, Part II p.1.

[220] See Gelfand, D M, p. 40-43.

4.5 The Sales and Use Taxes

4.5.1 Introduction and History

In the United States there does not exist any federal taxes equivalent to the VAT system in the European union. Instead taxation on the production, use and consumption of goods and services, more or less, has historically in those fields been left up to the individual states. The most common tax is the *sales tax* but there is also, the *use tax* and the *gross receipts tax*.[221] The states can, in principle, design the sales and use taxes as they wish but due respect must be taken to constitutional restraints and the interpretation thereof made by the Supreme Court. If the states have given up an area of taxation to the Federal government it is only natural that the States can not regulate in opposition to this.

The *sales tax* and the *gross receipts tax* were first introduced during the depression in the 30’s because state revenues from other taxes had dropped dramatically at the same time as expenditure was rising. The tax rates were modest at first but after World War II the cost for the states rose. One reason was the demand for education. The other tax sources could not accommodate the higher costs, a rise in the income tax was not a popular alternative among the electorate. In 1983 forty-six of the federation’s fifty states had a sales tax.[222]

Special sales taxes, also known as excise taxes, have a much longer history. The special sales taxes can be dated back to the late seventeenth century Europe and the philosopher Hobbes. In the 1790’s the first excise tax was imposed in the United States in the form of a whiskey tax.[223]

The hardening atmosphere the politicians are facing in society today with louder and louder demands on lowering income and property taxes have made sales taxes more popular. At the same time as there are calls for lower taxes the public does not want a decrease in the services provided by the state. Consumption taxes have an underlying principle of taxation based on the benefit received. This makes them an alternative to the income and property taxes, as a source of revenue for the states, partly because with them there is a possibility for taxing individuals not residing in the state, and partly because with the consumption taxes, the taxpayers feel that they have greater control over when taxation occurs. This has made the sales and use taxes the biggest alternative to income and property taxes.[224]

4.5.2 The General Sales Tax

The general sales tax is a tax levied on all retailers for the privilege of being engaged in the business of selling tangible personal property at retail or offering services that are taxable within the State’s taxing jurisdiction. The tax is not due to be paid until the final stages of the process of production and distribution. In other words, it is imposed when the consumer buys the products or services. Because the sales tax is imposed on items used or consumed by the public it is usually referred to as consumption taxes.[225]

The general rules concerning the sales tax are the same in all of the states. The meaning of the phrases “tangible personal property”, “sale at retail” and “taxable services “ may on the other hand differ from state to state. These terms can generally be said to include consumer goods,

[221] Abrams, H E & Doernberg, R L, *Essentials of United States Taxation*, Part I p. 6.
[222] Davies, D G, *United States taxes and tax policy*, p. 217-219.
[223] See Gelfand, D M, *State and Local Taxation and Finance,* p. 43-44. For a closer description of the contemporary history of the sales tax see Brownlee, W E, *Federal Taxation in America*, especially p. 130-155.
[224] See Gelfand, D M, p. 44-45.
[225] See Gelfand, D M, p. 46-47. See also section 2.3 above. The general sales tax is an indirect tax.

entrance charges for entertainment, hotel and restaurant bills, telephone costs, transportation and rental fees. The term "sale" includes sales made on credit and exchanges of property. "Sale at retail", simplified, means that someone who does business, transfers the ownership to a buyer and the purchaser will not directly resell the tangible property, i.e. for the purchasers own consumption or use.[226]

4.5.2.1 The Special Sales Tax - Excises

Special sales taxes or *excises* differ from the general sales tax by the fact that they are used to target certain specific commodities. Excises are an instrument when trying to change behaviour in the society. Usually excises are used when it comes to the public health or in environmental conservation. By imposing higher taxes on goods the government wants to divert the consumers away from what is harmful and towards a better alternative. There are a number of Federal excises in the United States for example on diesel fuels, alcoholic beverages and cigarettes.[227]

Both when it comes to the general sales tax and any eventual excises they are levied on the seller but the economic burden is instantaneously passed on to the consumer as a specific percentage of the taxed good or service.[228]

In a number of states there are sales taxes imposed from both state and local government. The burden to collect the tax is placed on the seller. Although the tax is passed on to the consumer it is still the seller that in the end is responsible for the payment of the tax. That the administrative responsibility is placed on a state government agency does not change the fact that the seller is the primary collector of the sales tax. The sellers have, usually quarterly, to send in the collected tax amount. Some states allow the seller to keep a part of the tax as payment for the trouble of administrating the tax but it is not a constitutional obligation.[229]

4.5.3 The Use Tax

As a complement and supplement to the sales tax the states have imposed the use tax. The use tax is a tax on the privilege of using, storing, or consuming tangible personal property within the limits of the state or local government and can be characterised as an excise tax upon personal property brought into the jurisdiction of the state by the purchaser. The purpose of the tax is to protect the base of the sales tax by discouraging attempts to buy outside the jurisdiction and in this way pay a lower sales tax in the other state. The use tax also compensates for revenue that would otherwise risk being lost because of Commerce Clause limitations on the taxation of sales of goods bought outside the state but used within. The same rates that are used when imposing the sales tax is usually used when it comes to the use tax, the tax being a percentage of the retail sales price. The liability for the use tax is levied on the individual consuming, storing or using the property, but the seller is responsible for collecting the tax even if the seller is located outside the State's limit.[230]

4.5.4 The Gross Receipts Tax

A tax related to the sales tax is the gross receipts tax. The tax is, just like, the sales tax levied by the States. The gross receipts tax is a tax that is imposed on the total incomes of a business and is paid on an annual or other periodic basis. The tax is taken as a percentage of a company's total gross revenue during a period. As an example of the tax can be mentioned

[226] Some transfers of property are not generally regarded as sale at retail, for example if there is a transfer of property when a corporation reorganises, contribution of capital to corporations, distributions, dividends and return of capital, and business liquidations. See Gelfand, D M, *State and Local Taxation and Finance,* p. 47-48.

[227] See Abrams, H E & Doernberg, R L, Part I p. 3. See also Ernst & Young, *Doing Business in the United States*, p. 1.

[228] See Gelfand, D M*, p. 45.*

[229] For a closer description of the administrative side of the sales tax see Gelfand, D M, p. 49-53.

[230] See Gelfand, D M, p. 57-61.

the occupational license tax which is imposed on domestic or foreign corporations for the privilege to do business in the state. What differentiates the gross receipts tax from the corporate income tax is that in the latter case the tax is only levied on the profits and in the former it is the entire revenue accumulated through the business. The gross receipts tax is, of course, restricted by the same constitutional restraints and regulation as the other taxes. The question of whether or not a gross receipts tax is in accordance with the Commerce Clause has on a number of cases been discussed.[231]

[231] See Gelfand, D M, p. 66-67. About the Commerce Clause see section 4.3.2 above.

4.6 The Federal Estate and Gift Taxation

4.6.1 Introduction

In the United States and in most other countries, transfer of property, either by death or as a gift, is subject to taxation. In the case of the European union this has been left to the discretion of the individual Member States. In the United States Federal taxes on the transfer of property, both private and real property, has been imposed from a central co-ordinated point of view.

When it comes to transfer of property in the case of a death, taxes can be of two different kinds. Either in the form of an *estate tax* or as an *inheritance tax*, in both cases it is a form of an excise tax. In the case of the estate tax it is the privilege of giving property at death that is taxed. The size of the estate tax is, as a main rule, determined as a percentage of the estate. An inheritance tax is the direct opposite of the estate tax. Instead of taxing the privilege of giving, the privilege of receiving is taxed. In the case of an inheritance, the size of the entire estate is uninteresting, the tax is instead determined by the value of the property received by a certain taker. The Federal estate tax is of course an estate tax, many of the States death taxes are on the other hand constructed as an inheritance tax.[232]

The gift tax was imposed so it would not be possible to get around the death taxes by giving the property prior to the time of death. The gift tax is, as the name implies, in other words a tax imposed on the transfer of property from one living individual to another.[233]

The Federal gift and estate taxes are regarded as direct taxes. If this had been the case the taxes would have had to be apportioned among the states in accordance with Article I, Section 9, clause 4, of the United States Constitution. The only Federal direct tax that has been possible to be imposed is the Federal income tax, through the 16th Amendment to the Constitution.[234] Technically the federal estate and gift taxes are viewed as excise taxes. That which distinguishes them from the direct taxes is that the excise taxes are imposed on an event or a transaction, for example in the event of buying liquor or cigarettes or because someone dies. The direct taxes are imposed directly on a person or property. This is the argument as to why the federal estate and gift taxes fall outside the requirement of apportionment.[235]

4.6.2 History

The first time a federal tax on transfer at death was imposed, was in 1862 in the form of an inheritance tax, with low rates. The revenue was needed for the funding of the Civil War. After the war the tax was abolished. In 1916 a Federal estate tax was imposed partly under the demand to raise revenue and partly because there was a political pressure to redistribute concentrations of wealth and concentrations of wealth through inheritance. In 1921 the Supreme Court declared that the tax was an indirect tax and therefore not unconstitutional.[236] Many states had on their own implemented estate or inheritance taxes with a wide range of tax rates. These disparities in the rates encouraged the wealthy to tax plan and change

[232] See McNulty, J K, *Federal estate and gift taxation*, p. 1.
[233] See Abrams, H E, Doernberg, R L, Part IV p. 272.
[234] See more about Article I, Section 9, clause 4 and the 16th Amendment to the Constitution in section 4.3.1.
[235] See McNulty, J K, *Federal estate and gift taxation*, p. 2. I fell that it can be questioned the status of the federal estate and gift taxes. To call them excise taxes and by this way saying that they are not direct taxes can seem strange. By augmenting this way a income tax could be an excise as well, it is levied on an event namely the event of having done a days work. To call the estate and gift taxes for an excise tax could be interpreted as a way to get round the constitutional requirement of apportionment on direct taxes.
[236] *New York Trust Co. v. Eisner*, 256 U.S 345 (1921).

domicile for tax reasons. Because of this, the Congress, in 1924, legislated a tax credit against the federal tax for paid stately death transfer taxes. This made almost all States enact rates so that full tax credit against the Federal tax was possible, and thereby there had become uniformity in the field of estate taxes. In order to prevent tax planing, by skipping estate taxes, by giving the property away when still living the federal government levied the Federal gift tax in 1924, progressive and accumulative over the donor's lifetime. With a few minor modifications the taxes have stayed the same to today's date.[237]

4.6.3 The Federal Estate Tax

The federal estate tax from 1986, a direct descendant of the legislation from 1916, is situated in the IRC and begins with IRC §2001, were the tax rates are to be found.[238] The starting point for determining the size of the estate tax lies in the *gross estate*, or tax base.[239] The gross estate includes the value of all property owned by the deceased at the time of death. In addition to this the gross estate may include life insurance and some property given away prior to death but is legally treated as still owned, by the diseased until death and then passed on. After the determination of the gross estate deductions can be made. The deductions include marital deductions, orphans deductions, charitable deduction, deductions for certain debts and expenses.[240] What remains of the estate after deductions have been made to the gross estate is the *taxable estate.* To the taxable estate the tax rates in IRC § 2001 are applied, from this sum eventual credits for taxes paid in lifetime can be subtracted.[241] What is left after credits have been deducted from the taxable estate is the *tax payable*.[242]

Below, in figure 3, follows a schematic presentation of the structure of the federal estate tax as described above.

THE STRUCTURE OF THE FEDERAL ESTATE TAX

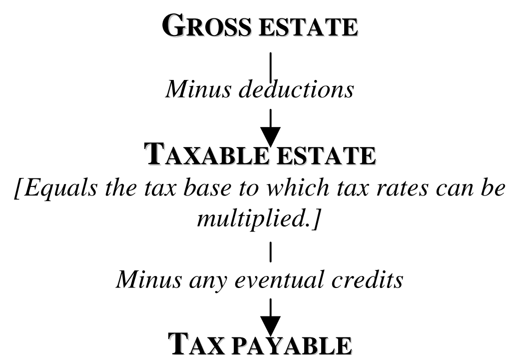

Figure 3. A schematic presentation of the Structure of the Federal Estate Tax.[243]

[237] See McNulty, J K, *Federal estate and gift taxation*, p. 3-13.
[238] The tax is levied in accordance to certain brackets. Up to $10' 18%, 10'-20' 20%, 20'-40' 22%, etc up to 3,5''-4'' 63% and above 4'' 65%. There are however different rules depending on when the death/gift occurred. See IRC §2001
[239] The gross estate is, according to ICR § 2031, "the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated." In ICR § 2032 there is an alternative valuation date, six months after the death occurred. In ICR § 2034 the gross estate is specified as including all property without any deduction in favour of the surviving spouse.
[240] The deductions are found in IRC §§2051-2057 and included funeral arrangements and unpaid mortgages IRC §2053, marital deduction IRC §2056 among others.
[241] The credits are stated in IRC §§2010-15. There is a general credit to the estate of every descendant against the tax imposed in IRC §2001. In 1998 it was $625' and in 1999 $650'. In IRC §2011 there is a credit for state death tax, in §2012 on for gift tax and in §2014 a credit for foreign death taxes.
[242] About the computation of the estate tax see McNulty, J K, *Federal estate and gift taxation*, p. 41-51 and Abrams, H E & Doernberg, R L, Part IV p. 265-272.
[243] See McNulty, J K, *Federal estate and gift taxation*, p. 14-16.

4.6.4 The Federal Gift Tax

The gift tax is imposed on all transfers of property by gift made by an individual, during a calendar year, and it does not matter whether or not it is made by a resident or non resident.[244] The word gift means that a transfer has been made without consideration or that an equivalent value has not been given in return. This is regardless of the intent of the transaction. The money's worth, difference in value, will be taxable. A gift is to be valued at the date of the gift.[245] According to IRC §2502 the same rates that are used in the estate tax, IRC §2001 are to be used. The tax rate is applied to the total amount of gifts made during one year.[246] The rates are however not merely progressive on the year's gifts but accumulative over the gifts made during the donor's entire lifetime. In order to calculate the tax on a certain gift this is determined by adding the value of taxable gifts from prior years and in this way imposing a marginal rate on the specific gift. Each donor has an annual exclusion of $10,000 to every person that he or she decides to give a gift. When the exclusion is used up, the rest of the gift's value is tax liable. A gift to a charity is deductible, as well as gifts between people who are married.[247] From the taxable gifts there is also to some extent the possibility of subtracting eventual tax credits.[248] It is the donor that is liable for the payment of the tax, the donee is however secondarily liable.[249] [250]

Below, in figure 4, follows a schematic presentation of the structure of the federal gift tax.

THE STRUCTURE OF THE FEDERAL GIFT TAX

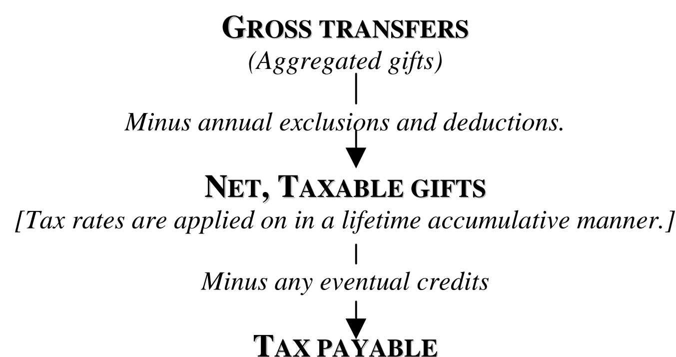

Figure 4. A schematic presentation of the Structure of the Federal Gift Tax.[251]

4.6.5 The Roles of the Transfer Taxes

The amounts raised by the estate and gift taxes are of marginal importance to the Federal budget. In 1992 the revenue was only one percent of the budget, or $11.5 billion. It is only a small portion of the population that is subject to transfer taxes. Those who do fall under the category that pay these taxes only pay small amounts, due to low rates and the possibilities to make exemptions are extended. Instead of raising revenue the main purposes of the estate and gift taxes are, to prevent accumulation of wealth and then transferring them from generation to generation, the taxes also make a contribution to the entire tax systems progressivity.[252]

[244] IRC §§ 2501 and 2511.
[245] IRC § 2512.
[246] IRC § 2503.
[247] IRC §§ 2522 and 2523(a).
[248] IRC § 2505.
[249] See McNulty, J K, *Federal estate and gift taxation,* p. 111 and Abrams, H E & Doernberg, R L, Part IV p. 272. The donor has to file for a gift tax return in the event that a gift is tax liable, see McNulty, J K, *Federal estate and gift taxation*, p. 27.
[250] See McNulty, J K, *Federal estate and gift taxation,* 50-55 for a closer description of the gift tax.
[251] See McNulty, J K, *Federal estate and gift taxation,* p. 18-19.
[252] See McNulty, J K, p. 13-14.

4.7 The Customs Law of the United States

4.7.1 Introduction

As stated above in the presentation of the rules regarding customs in the European union most of the regulations are based on international treaties. The United States has in the same way as the EU entered into these agreements, such as the Organisation for Economic Co-operation and Development (OECD), the GATT and the HS-convention.[253] Due to this the same basic principles are applicable when it concerns the USA and the EU for example the GATT most favoured nation clause and the non-discrimination due to origin provision. Section 3.7.2 above regarding international agreements also applies in the customs law of the United States.

In 1992, the same year as the creation of the single market in the EU, the United States, Canada and Mexico entered into an agreement that formed the *North American Free Trade Area* (NAFTA). It is a free trade area that is a counterweight to the European union and Japan.[254]

4.7.2 The Customs Service

The collection of duties on imported goods and the overall responsibility of the enforcement of the Customs law lie with the *Customs Service*, a sub-division of the Department of the Treasury. The Secretary of the Treasury has the authorisation to issue rules and regulations in order to enforce the customs laws. Accordingly the Customs Service has issued a number of regulations in order to administrate and enforce the customs laws, these can be found in 19 Code of Federal Regulations.[255]

In the Harmonized Tariff Schedule of the United States (HTSUS), which is based on the HS-convention, information can be obtained if a merchandise imported to the United States is subject to duty or exempt thereof. Most duties are determined by a percentage of the value of the imported goods.[256] The duties are to be paid when merchandise is imported, as a main rule when taken into the United States from a place abroad. At the arrival within the limits of the United States the importation is complete and the duties shall be paid. Unless otherwise provided it is the importer that is liable for the payment of the duties which comes from the import.[257]

After crossing the boundaries of the United States and eventual payment of Customs Duties, a merchandise is free to circulate within the United States which since it is a federation, no further duties need to be paid when passing the individual states' limits. In other words the same rules that apply in the European union. The European union is a customs union and therefore has no boundaries. The United States is in a way much similar to the European union. After entering the federation a merchandise can circulate in all of the fifty states, not because it is a customs union, all though the effects are much the same, but because it is a single entity, a single state.

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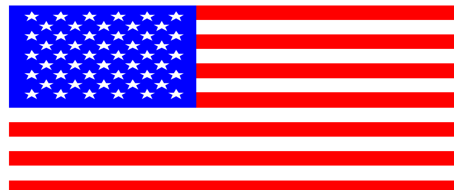
[253] See Malanczuk, P, *Akehurst´s modern introduction to international law,* p. 224-232.
[254] See Malanczuk, P, p. 225 and 300.
[255] See Sturm, R E, *Commentary Customs Law & Administration*, p. 57-68 for a closer presentation of the role of the Customs Service.
[256] See Sturm, R E, p. 1-2. The Harmonized Tariff Schedule of the United States (HTSUS) is found in 19 USC 1202.
[257] See Sturm, R E, p. 20-23.

5 ANALYSIS

5.1 Introduction

As an initial reflection it can be established that both the United States and the European union have the five-pointed star in common, see figure 5. It is present both in the flag that symbols the United States of America and in the flag of the European union. In both cases each star represents a state that is participating in the Federation, in the case of the USA, and in the Union, in the case of the EU.[258]

The flag of the European union.



The flag of the United States of America.

Figure 5. The flags of the European union and the United States of America.

Through the passing of time, the exchange of experiences between the New World and the Old, has been an extensive one. This is true both when it comes to the area of culture and when it comes to constitutional issues regarding the organisation of government. In the area of government the young federation, the United States, chose the model that the French statesman and philosopher Montesquieu had drawn up in 1748.[259] Tocqueville went over to America in the early nineteenth century and observed how the federation and the American society worked in reality.[260]

Today, films from Hollywood flood the cultural area in Europe and most artists, in Sweden at least, sing in English in order to make a name for themselves in the world and especially in the USA. It is therefore, not surprising if inspiration can be taken in other fields as well as in an interchange of experience. In the case of taxes the result may very well be that the young European union glimpse at what has happened in the United States. They have, after all, had a tax system for almost two hundred years more than the Europeans. It is therefore not surprising if the American model of taxation works in a smoother and more efficient way than in the European union.

The following analysis below is will, in many ways, show the advantages of the United States tax system.

[258] Compare the flag of the Peoples Republic of China.

[259] Montesquieau's tripartite division of power was first presented in his work *L'Esprit des lois* [1748]. For more on Montesquieau see Strömberg, T, *Rättsfilosofins historia i huvuddrag,* p. 33.

[260] See de Tocqueville, A, *Democracy in America*, Volume I [1835] and II [1840]. It is regarded to be for liberalism what *Das Kapital*, by Karl Marx, is for communism.

5.2 The Powers of the Central Body of Government

5.2.1 General Reflections

Initially, the differences between the European union and the United States, regarding the structure of power and the constitutional base, can appear to be vast. One is a federation with a strong presidency as head of state and the other a body for trade co-operation between independent sovereign states. They are, in addition to this, situated on different continents with the great Atlantic Ocean as a large moat keeping the two at a safe distance from each other. In the international arena the US has only one representative in the United Nations while the EU, in turn, has fifteen, one for each state.

A closer look at the various distinctive features in the two entities reveals however that the differences are perhaps not as great as it initially seemed. For instance, when it comes to the power sphere, that sets the boundaries in which the two can operate, similarities can be seen. Despite the fact that one is a federation and the other a confederation *the base of the power structure*, in the two, shows a remarkable *resemblance* to each other. Both the union and the federation cannot perform any tasks outside of the competence which they have been given through the transferral of power from the “agreement” which the individual states have entered into. Of course it is not an easy task to interpret the extent of the given powers. In the end there comes a point when it is up to the Supreme Court respectively the European Court of Justice to declare whether or not the central body of power has overstepped its limit of competence. If the task needs to be performed at the central level it is up to the participating states to decide if they wish to transfer more power.

When it comes to the power to tax is viewed in both the European union and the United States many similarities can be discovered. In both cases the power to tax is seen as an inherent attribute of sovereignty. The states are free to tax as they wish if the power has not been transferred to the central level. The right tax is an important part of the independent state. It is one thing for foreign policy and defence to be handled centrally and a totally different issue when it comes to the power to tax.

5.2.2 Dangers with Transferring Power

In the European union the principle of subsidiarity is the guiding principle in the field of the extent to which the power shall be placed at the central level. If the task cannot be executed effectively on a lower level, it is up to the central body to intervene. This can lead to something that Vause characterises as “creeping federalism”. This means that the central government has a more and more pervasive control on local affairs. The limits of the principle of subsidiarity are not clear, and therefore, there is a risk of the central government obtaining more power, whilst at the same time the powers of the individual states are eroded, if a reaction from the participating states does not take place. According to Vause it is up to the European Court of Justice to determining the extent to which the principle of subsidiarity is applicable. Just like the Supreme Court has done in the United States, regarding boundaries of the Commerce Clause, the ECJ must be observant of the risk of “creeping federalism” and stop it in time. If it is meant that the centre of gravity, regarding power, should shift in any direction, is up to the Member States to decide and not let it be something that “just happens”.[261] Once powers have been exerted it is very difficult to reverse the process.

[261] See Vause, G, *The subsidiarity principle in European Union law—American federalism compared*, Case Western Reserve Journal of International Law, Winter95/1, Vol. 27, p. 70-71.

5.2.3 The Addressee of the Legislation

A big and clear difference between a federation and a confederation lies in who the addressee of the legal acts is. In the United States the federal government enacts laws which are directed to the individual person living in the states. The legislation gets an immediate impact, in the same wording, throughout all of the states. In the federal model it is the individual who is the addressee of the legislation. In the case of the European union the legislation is not addressed to the individual. Instead it is the Member States which are directly effected. Despite the fact that the EU regulations are directly applicable, and thereby, should have an immediate effect in the states, they are still written with the state in mind. Directives must be converted, and transformed, into national legislation before the full impact of them is seen. [262]

A negative aspect of having the Member States as the addressee in the EU could be that the citizens in the states do not feel, as if they are part of an entity. The Member States on the other hand can always blame the Union for the laws that have to be implemented. So instead of building a strong and united Europe the effect could be the opposite. The people living in the individual state have found a common "enemy" that in the long run, could result in, the end of the entire European project. It would be better for future development if the addressee of the central legislation was the individual person instead of the states. It would perhaps be better to embark on the path of the federal model of legislation.

5.2.4 The Powers of the Supreme Court and the European Court of Justice

The roles of the two highest actors in the field of legal application and interpretation, the Supreme Court and the ECJ, are very different. The ECJ can be characterised as being dynamic in the domains of judicial progression. The legal system of the EU is a fairly young one compared to the one in the USA and is in the act of establishing its outer boundaries. The ECJ can in many ways be said to be where the Supreme Court was in the days of the evolving federation. After having had a dynamic role[263] the function of the Supreme Court seems to have shifted into a more static one. The Supreme Court only makes a verdict and interprets it if legislation is in accordance with the Constitution.[264] The European Court of Justice on the other hand has a freer role in the development of the law in the Union. In its jurisprudence the ECJ have gone beyond the treaties which can be regarded as making out the "constitution" of the Union, and by stating general principles, that have to be obeyed and that are, to their scope of application, very far reaching. This is something that the Supreme Court could never have done. The function of the Supreme Court is to interpret the Constitution and is thereby bound by its limits. The principle of the supremacy of the EC-law[265] and the doctrine of direct and indirect effect[266] are examples of principles that the ECJ has launched in its practice of the EC law. In the field of direct taxes, which do not fall under the competence of the Union, the doctrine of indirect effect has had a great impact in the Member States. The ECJ has concluded that despite the fact that the Member States have not transferred power in the field regarding the direct taxes they still have to take the general principles of the EC law into consideration in designing their internal national tax systems.[267]

The powers of the ECJ must, viewed in the light of what I have stated above, be considered as more far-reaching than the powers of the Supreme Court. The Union does not, on the other hand, have the equivalence to the Constitution of the United States. The treaties, on which

[262] Compare Hallström, P, Är EU ett statsförbund, ERT 1998 p. 91.
[263] See for example about the *Commerce Clause* above in section 4.2.3.
[264] See Clark, D S. & Tugrul, A., *Introduction to the Law of the United States,* p. 52 regarding the function of the Supreme Court as the interpeter of the Constitution, and p. 53-60 about the principles involved in the constitutional review.
[265] See Weatherill, S & Beumont, P, p. 315-327.
[266] See section 3.3 above.
[267] About the direct taxes see section 3.6 in general and especially section 3.6.5 above.

both the union and the single market are based, must be viewed as political documents that, in their wording, have been kept rather inexplicit because it was not possible to agree on an exact wording. It is up to the ECJ to make a functioning legal system of it. When the legal history of the Union is longer, the role of the ECJ will probably be a more static one just as the Supreme Court of today. It is at this point however necessary for the ECJ to be a strong force in the development of the EC-law. There would otherwise be a risk for decisions made at central level not being implemented in the Member States if the control of the implementation does not exist or functions poorly. The ECJ in this way stands as a guarantee for the function and establishment of a legal system in the European union.

5.3 The Customs law

5.3.1 In General

The legal area that exhibits the most similar features in the EU and in the US is the Customs law. Both are participants in international agreements, such as the WTO, the GATT and the OECD. This has lead to the general principles at use, for instance the most favoured nation clause and the principle of non-discrimination, being mutual in both of the entities.[268] International agreements benefit the international trade in the way that actors on this market know what rules are applied, without having to do research. Theoretically all it takes is a look in the mutual agreement since the parties have agreed to implement the rules therein, in their national legislation.

The resemblance between the United States and the European union, regarding the Customs law, does not stop at the above stated. In the Union the legislation in this area has taken the form of regulations. With the use of the principle of subsidiarity the EU came to the conclusion that the task could not be achieved satisfactory and efficiently at a lower level. Regulations can be regarded as the closest thing to federal legislation that exists in the European union at the moment. The regulations are directly applicable in the Member States and can only be complemented with rules regarding the application.[269] In theory this means that the effects of such legislation is the same as the federal legislation in the United States.

5.3.2 The Big Difference Compared to the U.S Homogenous Federal System

In the European union the competence to make decisions in the field of Customs law has indeed been transferred to a central body of power. Unfortunately the lack of a central body of implementation means that it has been left up to the individual Member States to do this. It is certainly the same regulation that shall be applied, which theoretically implies that the same material rules. Central regulations are, however, translated into the different official languages of the Member States, which are supposed to be on equal footing and of the same importance.[270] Even given that they are of the same magnitude, the laws are applied in countries with different legal traditions, this in turn leaves a mark when they are put into practice. In addition the various languages differ when it comes to nuances. The English and French languages have far more varieties of expression than for instance Swedish. During translation there is always the risk that the equivalent expression does not exist. Furthermore the wording of the law is always interpreted in accordance with the linguistic rules of the language in question.

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[268] See section 3.7.2 and 4.7 above.

[269] See section 3.3 above.

[270] There is however a saying, regarding the process of legislation in the EU, which goes something like this: *French is used when writing a rule, it is commented in German and English is used in the coffee room.* The truth of this can of course be questioned but it points to the problem at hand. Even if it is not accepted officially the languages are divided into an A- and a B- league.

The only thing that can be stated as hard facts is, that there is a common external boarder towards third states. Despite the fact that, on the paper, same material rules appear to be applied there is a risk that the differences in the states legal and linguistic traditions, regarding the Customs authorities structures, leads to a discrepancy when applied in the field. In view of the above stated it is not surprising if implementation in certain cases differs from state to state. The regulations can seem to be a very exact tool of implementation but is in reality a rather blunt one.

A co-ordination of the Customs authorities, in accordance with the American centralised model, would lead to a more efficient use of the of the Union’s resources. Partly in the way that a central Customs authority would be able to put the resources to use where best needed, and partly by freeing resources. Instead of fifteen different authorities, each acting separately, resources could be concentrated centrally. In the end this would benefit the effectiveness.

5.4 The Use and Sales Tax versus the VAT

There are great differences between the Use and Sales tax of the United States and the VAT levied in the European union. The first is a *single stage tax,* which means that the tax is only levied on the product when it is consumed, and the latter is a *multi-stage tax,* which means that the tax is levied on each level of production. The biggest difference is that the purchaser can not reclaim a single stage tax, as is the case in the multi-stage tax, which is reclaimed at the next link, until the final consumer is reached. The world is divided into two categories on this issue but a large number of the countries in the world have chosen VAT.[271] After scratching on the surface more resemblance between the two can be discovered, than it first seemed.

In both the United States and the European union this category of taxes has been left much to the individual states to decide the levels of the tax rates. In the EU it is however compulsory to levy a VAT since the member fee is a percentage of the tax base of the VAT.[272] In the USA it is totally optional to levy the Use and Sales tax. In both the USA and the EU the tax liability for the consumption tax is applicable at the same time in all the states. But this is where “centralisation” stops. This tax can be said to display the largest level of likeness between the two entities, seen from a larger perspective. Different rates of tax are levied in all the states without harmonisation from the central body of power.[273]

The problems mentioned regarding the difficulties with VAT and the Internet of course apply just as well on the American form of taxation. It will take a global agreement to establish how the control of the payment of taxes and taxation itself should be arranged.

5.5 The Excise Taxes

The excise taxes or special sales taxes, which they are referred to in the USA, exist in the Union and the Federation for the same reasons, to target the behaviour of the citizens and divert it to other areas. In the United States the federal excise tax can be compared to the taxes which are in the scope of the directive of circulation. The big and important difference is that the American model is constructed so that the tax rates regarding excises are the same in all of the states and not as is the case in the Union where it is up to the Member States to decide. As has been stated above the differentiation of the tariff leads to it being worth while to smuggle

[271] Owens, J, *The move to VAT*; Intertax 1996/2 p. 45-47.
[272] See section 3.8 above.
[273] There is in the EU a minimum tax rate of 15% but it is at the states own discretion if they want to put it at a higher level. See section 3.8 above.

none taxed products, or to have them taxed where the tax is low.[274] This has lead to a control problem which is immense. One way of solving this problem is to harmonise the tax levels in all the member states of the EU and levy the same tax thereby taking away the incitement for smuggling. The taxes do not however have to be totally harmonised, it is sufficient that it is no economic benefit in smuggling. If the profits do not exceed the risk and the costs of the business the incitement to do so is taken away.[275] A decision to harmonise the tax rates is not easy to implement on the account of the cultural aspect of the excise taxes. In Sweden, for instance, the tax on alcohol has traditionally been high in order to discourage the drinking of alcohol and thereby preventing alcohol-related injuries.[276] In the southern part of Europe the states have a different approach to alcohol than the northern states, where excise taxes are set to divert from the drinking. The tax on tobacco is another example of this use of taxation as an instrument to discourage from a bad behaviour. This will make the transition towards a central union tax, in accordance with the American model, difficult, if not impossible, to accomplish.

5.6 The Individual and the Corporate Income Tax

5.6.1 The Individual Income Tax

The differences in income tax rates are probably not a great incitement for private individuals to change their place of domicile. Human beings could be said to be slow movers who need familiar surroundings, moving is a big and difficult step for many. In the United States the move is easier than in the European union since there is a common language it is not such a big step for the individual. It is one thing to change ones city of residence a totally different to change country and language. The tax competition in the area of the individual income taxation, if my assumption is correct, would not create a large problem in the EU. There is not for this reason a need to implement a central individual income tax in the European union. On the other hand it could be argued that it could increase the feeling of belonging to a bigger entity if a tax, in accordance with the American model, was enacted. By paying the tax directly to the Union instead of paying it indirectly via the Member States membership fees. As it is today, the tax funds are collected by the state and then later passed on to the Union. This can have the effect that the individual does not feel as if he belongs with the rest of Europe. It looks as if the union takes the money from the state as some kind of a punishment.

5.6.2 The Corporate Income Tax

Economic entities on the other hand have a far greater mobility than people. If a state offers either a discount or low taxation on profits there is a great incitement for the company to change its place for location in order to lower their costs. Some companies, however, are not able to take advantage of this possibility, on account of the need for a certain locality due to the nature of their business. This is true in the case of the production of paper which is dependent on both the source of the raw material and on the access to running water. Large co-operations that have invested a lot of resources on establishing a plant in a certain area are not inclined to move either. New investments on the other hand are not probable to end up in a state with a high tax rate since the companies are often multi-national and can thereby choose the country with the lowest taxes to invest in not having to consider on where it is situated.

[274] See section 3.9.3 above.
[275] See Mattson, N & Meltz, P, *Mervärdesskatt*, p. 64-67.
[276] The tax on one litre alcohol is 1999 464 sek in Sweden and 432 sek in Finland. The same amount in Spain is 59 sek and in Italy 56 sek , the minimum tax from the EU is 47 sek. The statistics comes from Gustafsson, O, *Sverige har den högsta skatten på sprit i EU*, p.1 *metro* 16/12 1999, who referred to *Skattestatistik årsbok* as the source.

The new generation of companies dealing with computers and information that have appeared on the field of business in the last decade, are not at all as dependent on the location for their business. Give them a computer, a telephone and a nice room and they can operate from any place on the globe. The necessity to be close to the consumer has disappeared in the ever-growing web that constitutes the Internet. These are the kind of companies that are most receptive to tax competition. If a neighbouring state offers better conditions it is only to “plug-in” in that state, regarded of course that the employees want to and are able to move too. Tax competition between states can, in the long-run, lead to, if not a total unification, that the tax rate close in to a mutual level. A central minimum level is needed. In addition a central tax, in accordance with the American model, where the tax payment goes directly to the union would, apart from stopping tax competition, lead to that everyone active in the area of the single market would contribute to and could feel associated with the European project.

To sum it up; a central tax is mostly needed in the field of the corporate taxation in order to prevent the states from competing with each other for the establishment of a company within their territory. A central individual income tax is not needed since it seems that people are reluctant to move. However a federal tax could make the peoples of Europe feel more associate with each other, this is an effect that the corporate tax perhaps also might have.

The proposal from the Council to avoid harmful competition can be viewed as a first step of intervention from the Union’s side in the field of harmonising the corporate income tax in the EU. Even if the proposition does not go through, the problems connected with competition between the Member States have been lifted into the light and solutions can thereby be discussed. That the states are aware of the problem can in itself lead to that the states refrain from the harmful tax competition. No state wants to be accused of being the “bad state”.[277]

5.7 The Gift and Estate Tax

In the United States English is spoken throughout the federation. The language barrier which the EU has to cope with does not exist. It is therefore not a large step for people to take, to move to another state in the US. The need for a common gift and estate tax, in accordance with the American model, is not overwhelming within the Union at the moment. In the United States the gift and estate taxes were enacted on the federal level in order to prevent that the states competing with each other over the people who moved to the place that had the lowest tax.[278]

In the European union a number of different languages are spoken, French, German, Greek and Danish just to name a few. Despite the fact that Sweden and Denmark can be said to have similar languages there is not, to any greater extent, much migration between the neighbouring countries. The cultural differences are too big.

There have been voices raised for the harmonization of the inheritance, estate and gift taxes in the European union but not on the grounds of social reasons or because people moved to a state for the reason that it has the lowest taxes. The reason for the calls for harmonization is instead, that the various states use different criteria and concepts in levying inheritance, estate and gift taxes. This leads to double and even multiple taxation occurring. In the future there must be an agreement for a mutual understanding in the European inheritance, estate and gift

[277] See about the Council proposal in section 3.6.1 above.
[278] See section 4.6.2 above.

taxes and not on the union level in order to solve the problems connected with the double taxation.[279]

5.8 Advantages with the American model

The big advantage with the Federal tax system in the United States is that legislation is carried out with the individual as the addressee who is directly effected by the laws enacted. The individual is given the feeling of being part of a larger entity, the federation called the United States. The American democratic system does not, in theory, have the democratic deficit that the European union has. The American population can in elections decide directly the course, which they think the U.S. should take. This puts the electorate closer to the democratic system and thereby strengthens the individuals’ possibility to make a difference. In the European union the decisions are made further away, if not by physical distance so by psychological distance. The governments in the Member States decide on the policy of the Union and the populations of these states can only indirectly effect the outcome in the elections to their national parliaments. There is a European parliament but its powers are up to now only minor.

The American structure with a centralised tax organisation has many positive aspects. The IRS for instance is an organisation with ramifications from a central national headquarters all the way down to the local level. This gives a greater efficiency in the application of the tax rules. The rules are, in addition, applied in the same manner in all of the 50 states. If changes are needed in the material rules these can have an immediate and total impact, without the need for further implementation measures that is the case in the European union.

The problems of delay at the implementation of legislation which the European union has, mostly in the use of directives, but also to some extent when it come to regulations, would be abolished if the tax legislation and authorities were centralised under the wings of the European union. The union must in that case undergo a fundamental transition to meet the new demands. The change would however benefit all.

Control of the Customs duties could also be put under the centralised tax authorities hereby gaining the advantages that I pointed out above with the American model.

5.9 Views on the Future Development of the European Union

5.9.1 History

Is a federation a plausible development for the future? Is it a natural next step? In order to try to predict what the future holds for the European union, from a fiscal point of view, I will start with a recapitulation of the Union’s development up to the present. From the creation of a *customs union* in 1968 the next important step was the *harmonisation of the indirect taxes*. For VAT and the excise taxes it mostly effected the time of when the tax is charged. Still it was a big step to take in order to create a single market in 1993. In 1999 the introduction of *a single currency* with the EURO and the EMU was an important step in trying to establish a single market without trade barriers. If all states have the same currency it is much cheaper and easier to buy from sellers in other Member States. For example, comparison of prices is simplified when there is no longer a need to convert the amount into the currency of each Member State with a loss on the cost at the exchange rates. Of importance for the fiscal development are also the *verdicts from the European Court of Justice* regarding the need for the internal *national tax* rules to be *in accordance with the Community law*. The ECJ’s interpretation that the articles with the four freedoms include a prohibition of restriction and

[279] See Sonneveldt, F, & Zuiderwijk, J, *Harmonization of Inheritance, Estate and Gift Taxes within the EU?,* EC Tax Review 1995/2 p. 95-96.

not only a prohibition of discrimination was one of the reasons for the need to harmonise the indirect taxes. Taxes can always be regarded as a restriction. In view of this, it is not a surprise that the indirect taxes were the first to be the subject of harmonisation. There has been suggested from the Commission that a ceiling is to be determined on the span on the VAT.[280] If this is implemented a logical next step is to narrow the tunnel, in which the Member State's VAT rates can deviate. Once there is a correspondence in the VAT rates then it might as well be placed under central control with taxation in accordance with the country of origin principle.

5.9.2 What would be the advantages with a federation?

In order to create a single market, where the four freedoms can move freely without any interference, the federal model would be the ultimate one. To found a federation, let us call it the United States of Europe, with a strong central government with direct control over the individual is the utopia. With centralisation also comes legislation that is passed directly with the individual as the addressee instead of the system applied at the moment where the addressee is the Member State, in other words a system of indirect legislation where the legislation takes a detour via the states. In the long run, the federal model of legislation can contribute to strengthen the feeling of belonging between the different nationalities in Europe.

In a federal structure in the European union there is much to gain by co-ordinating the tax and customs authorities under central umbrella organisations, in accordance with the American model, with branches all the way down to the local level. This leads to the creation of a strong order where effectiveness is radically improved with the application of the same rules, in the same language, in all the territories. National boarders do not bind the authorities, instead they can act in the entire Union without restriction of the national limits. The resources can be put to use in the optimal way. The problems with avoiding with excise taxes could be abolished.

From a strict fiscal point of view the creation of the federal United States of Europe would be a good thing to do.

[280] See section 3.8.1 above.

6 CONCLUSIVE REMARKS

I have, in the descriptive part of the paper, presented the tax systems of the United States and that of the European union. Each one of the taxes has been described. It can perhaps be regarded as somewhat an overkill to do it in this way when the objective at hand is to compare the structures of the taxes and not the taxes regarding the details as such. I feel however that it is necessary to first get familiar with the individual tax before a structural analysis can be made.

At first the European union can appear to be far from ever becoming a federation. After some thought and taking into account that one of the objectives is to create a single market where the movement of goods can flow freely without any disturbances, a federation somehow does not seem so remote any more. From a fiscal point of view my analysis shows that there would be much to gain in a federation. The control of the Customs duties at the external boarder and the simplification of VAT are only a few examples.

The greatest obstacle in the creation of a "single market" with all that it implies, can very well be the differentiation in the tax rates between the states. This includes all taxes and not just VAT and excises but income and corporate taxes as well. The differentiated tax rates can, in the light of the *Dassonville*- definition, be regarded as a restriction. It is enough that it potentially hinders free movement. However, there are a couple of aspects which are often overseen in the discussion of what the future holds for the European project. On the drawing board it all looks so simple. Take away the Customs barriers between the states, co-ordinate the tax base, harmonise the tax rates and put all that regards the taxes in one central authority which distributes the revenue. Is it that easy? Is it a viable future alternative? I do not think so! The linguistic barriers and the cultural differences are just as important. These can be what in the end determine the possibility to establish a federation in Europe. In the USA, or rather what was going to become the USA, had more or less the same culture and did not have to deal with a language problem. In addition to this there was a mutual enemy, the old colonial power in the form of the British Empire, which could be united against. Instead of disputing among themselves in order to maximise their own individual profits the states united in order to accomplish something that could last and bring prosperity to all.

In my analyses I have pointed out that from a strict fiscal point of view much stands to be gained by adopting some of the structures from the United States tax system. I am afraid that this, however, could just be a dream. Even if it was possible to agree on the establishment of a federation the cultural and linguistic barriers still remain. The United States of Europe might look good on paper but would, despite this, not work in reality. I have pointed out that there are other things to consider as well, not only the economic and trade aspects. If one uses a larger overall perspective and includes society with its cultural and linguistic differences the picture it is not so simple. It will not be an easy thing if the goal is to create a federation in Europe after the American model, despite all the advantages that would stand to be gained from a fiscal point of view.

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