Comparative Fiscal Federalism

What Can the U.S. Supreme Court and the European Court of Justice Learn from Each Other’s Tax Jurisprudence?

By Reuven S. Avi-Yonah

In October 2005, a group of distinguished tax experts from the United States and the European Union gathered in Ann Arbor, Michigan, to debate the question of comparative fiscal federalism. The conference was sponsored by the U-M Law School, U-M’s European Union Center, and Harvard Law School’s First of its kind, was a series of ECJ decisions the ECJ interpreted the EU’s approach to be discriminatory in direct tax matters as a whole (since the multinational typically enjoys favorable treatment in foreign jurisdictions). The lesson for the ECJ is thus not to abandon its domestic loss offset rules than by giving up on the unani

The reason the Court adopted this approach was design: incentives are decisions can be changed by Congress through simple legislation, since the Constitution does not assign the power to regulate commerce among the states, but Congress is powerless to override decisions under the Due Process Clause. The Court thus expected Congress to intervene and set rules under which states can force remote vendors to collect sales taxes.

Fourteen years have passed, and Congress has not acted. The lesson is simple: the states are not represented in Congress, so Congress cares more about corporate barries to trade than about state tax revenues. In the meantime, the Internet has sprung to existence, generating $100 billion per year, and state sales tax revenues are rapidly shrinking.

Further, the advantage of the Court’s approach is clear: Commerce Clause decisions can be made by the state legislature. The states are not, after all, sovereign countries, and taxation is an inherent state power. Thus, the Court accepted the argument that the Internet was a medium of business, not a physical presence, and has shown a willingness to consider state tax liens based on Internet transactions.

However, the Court’s approach is not without limitations. The Commerce Clause’s requirement of a physical presence test still applies, but only in the case of high tax states like New York or California that can afford to be a bit harsher without trampling on the dormant commerce clause. In the meantime, the Internet has sprung to existence, generating $100 billion per year, and state sales tax revenues are rapidly shrinking.

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The lesson for the EU is thus not to decide cases in the expectation that the political branches will act. Many Member States are vehemently opposed to direct tax harmonization. The U.K., for example, is more likely to react to losing Marks and Spencer by abolishing its domestic loss offset rules than by giving up on the unani

As a rule, the Court intervenes only when the tax measures in question appear to be discriminatory or to infringe international agreements. In the U.S., federalism means that the Supreme Court has the ultimate word on the constitutionality of state taxes under the U.S. Constitution. If the Supreme Court is willing to find the state tax to be discriminatory, it will strike it down.

Moreover, the authority of the ECJ to strike down Member State direct taxes is more limited. The ECJ can only strike down measures that it views as incompatible with the Constitution. As Justice Oliver Wendell Holmes observed, the state tax on remote sales would be more generous in most cases. Moreover, the ECJ has always maintained a deferential approach to state taxation, even if it resulted in some level of discrimination against out-of-state retailers. The EU Commission; Servaas van Thiel, chief tax doctor at the University of Michigan, Ann Arbor, Michigan, USA