

Tax harmonization in the Community

European File

“The Common Market has been in existence now for more than twenty years but each time we cross national frontiers we are still faced with customs officials asking if we have anything to declare: tobacco? alcohol?”... This thought crosses the minds of many travellers, but how many Europeans know that the continued existence of customs checks is due in large measure to disparities between national systems of VAT and excise duties levied on consumption in Community countries? If there were no checks at national frontiers, it would be too easy to buy goods in the country which taxes them least and resell them in the country where the taxes are highest. The consequences of this on tax revenue and on competition are not difficult to imagine. The issue can only be resolved by aligning the levels of taxation within the wider framework of European tax harmonization. The latter is all the more complicated since the taxation systems of Community countries diverge in so many other respects.

Disparities between national tax systems

The total volume of tax varies from one country to another as does its distribution between the different types of tax:

- overall burden of taxation*: total receipts from taxes and social security payments increased in all Community countries between 1973 and 1977 – the latest year for which detailed, comparable statistics are available – but the differences between countries have scarcely changed. In 1977, the total amounted to 34% of gross domestic product in Italy against 49% in Luxembourg. Between these two extremes lie

The structure of taxation and social charges in Community countries (1977)
(as a percentages of total receipts from taxes and social contributions)

	Personal taxation	Company tax	Wealth tax	VAT	Excise	Other	Social charges
Belgium	33.05	6.15	0.80	16.54	5.71	7.07	30.68
Germany	28.29	4.13	2.95	13.13	7.22	10.21	34.07
Denmark	50.72	3.08	5.04	18.95	9.13	11.84	1.24
France	12.15	5.40	0.43	21.17	5.41	13.52	41.92
Ireland	27.63	4.11	6.70	16.99	21.20	10.44	12.93
Italy	23.39	2.57	0.18	15.30	10.66	8.87	39.03
Luxembourg	22.31	13.41	1.23	9.29	6.41	16.46	30.89
Netherlands	25.86	6.65	1.89	15.68	4.73	7.03	38.16
United Kingdom	34.21	5.58	12.13	8.22	12.70	7.76	19.40

Source : *Bulletin of the European Communities*, Supplement 1/80 : Report on the scope for convergence of tax systems in the Community.

Ireland with 35%, the United Kingdom with 37%, France with 39%, the Federal Republic of Germany with 40%, Denmark with 43%, Belgium with 44% and finally the Netherlands with 47%.

- *personal income-tax* (including deductions at source and local taxes): in 1977, these taxes accounted for 12% of total receipts from taxes and social contributions in France but 51% in Denmark. It represented 5% of France's GNP and 22% of Denmark's (compared to 3% and 22% respectively in 1973; the gap has therefore been slightly reduced). Between these two extremes lie Italy with 8%, Ireland with 10%, Luxembourg and the Federal Republic of Germany with 11%, the Netherlands with 12%, the United Kingdom with 13% and Belgium with 15%. Denmark is the only country where the proportion of tax has slightly fallen since 1973. The greatest increases have been experienced in Belgium (+4%), Italy and Luxembourg (+3%).
- *value-added tax*: VAT accounts for 8% of total tax revenue in the United Kingdom compared with 21% in France. It represents about 3% of GNP in the United Kingdom, 5% in Germany, Italy and Luxembourg, 6% in Ireland, 7% in Belgium and the Netherlands, 8% in Denmark and in France.
- *excises*: these duties which are levied on a certain number of specific goods such as alcohol and tobacco, account for 5% of total tax revenue in the Netherlands but 21% in Ireland. As percentages of gross domestic product, these differences are smaller: 2.1% in France, 2.2% in the Netherlands, 2.5% in Belgium, 2.9% in the Federal Republic of Germany, 3.2% in Luxembourg, 3.7% in Italy, 3.8% in Denmark, 4.7% in the United Kingdom and 7.5% in Ireland.
- *corporation tax*: this tax accounts for 3% of total tax revenue in Italy but more than 13% in Luxembourg. As a percentage of gross domestic product, we have the following figures: 1% in Italy, 1.3% in Denmark, 1.4% in Ireland, 1.6% in the Federal Republic of Germany, 2.1% in France and the United Kingdom, 2.7% in Belgium, 3.1% in the Netherlands and 6.7% in Luxembourg.

There are also other differences. Wealth and inheritance taxes in 1977 represented 12% of the United Kingdom's tax revenue, between 5% and 7% of that in Ireland and Denmark, almost 3% in the Federal Republic of Germany and less than 2% elsewhere. Social security contributions amounted to only 1.2% of total Danish revenue but more than 42% of France's, reflecting the different methods of financing social security.

Harmonization: what and why ?

The extension of social and economic intervention by public authorities since the end of the Second World War has brought with it a considerable increase in taxation in all the developed countries. The role of taxation as an instrument of economic and social policy has also become accepted. Hence, the importance of taxation considerations in the life of the European Community. No thought has, however, been given to developing a truly European taxation policy comparable to the policies pursued in Member States and covering all aspects of taxation. In fact:

- the Community budget is still very modest in relation to the sum of national budgets (about 2.5%), even though it has been financed for several years through its own resources (part of the VAT, customs duties and levies on goods imported from the rest of the world). The budgetary role of taxation can therefore only be of limited significance at Community level.
- the growing economic interdependence of Community countries is one of the striking features of the history of the last twenty years. Increasingly, Community countries jointly set their economic objectives (growth rate, control of inflation, etc.). But economic and social policies and the means of implementing them, especially the use of taxation, are generally left to the member countries' discretion.

In such a situation, the overall aim of Community action in the tax area is to enable it to carry out the tasks assigned to it, in particular:

- the establishment of a common market founded on the free movement of people, goods, services and capital from one Community country to another, and on a system of fair competition;
- the progressive alignment of member countries' economic policies;
- the introduction of a certain number of common policies. Some of these were laid down in the Treaty of Rome, at the inception of the Community (agriculture, transport, external trade). Others have been launched in line with the progress of European integration (regional policy, environment, energy, etc.).

To realize these objectives in full, it will be necessary to do away with certain barriers and distortions which in many cases arise from differences in the tax systems of Member

States. Moreover, Community countries have since 1971 been committed in terms of gradually bringing about economic and monetary union to the following five taxation priorities:

- establishing a uniform basis of assessment for VAT;
- harmonizing the scope, the tax base and the collection procedures of the excise duties;
- harmonizing those kinds of taxation which are likely to have a direct influence on capital movements within the Community;
- the further harmonization of the taxation levied on companies and firms;
- the progressive extension of duty-free concessions granted to private individuals crossing frontiers within the Community.

It will be difficult to achieve even these limited objectives:

- We must not forget that sovereignty in tax matters is one of the vital components of national sovereignty and that the right to vote taxes remains one of the fundamental prerogatives of national parliaments.
- The gradual alignment of Member States' economic policies and the harmonization of their tax systems do not necessarily go hand in hand, and can sometimes conflict. Thus, to combat the current economic crisis, one country may have to lower taxes, whilst another may be obliged to raise them.
- Public opinion is increasingly sensitive to developments in taxation. Certain kinds of tax are relatively well accepted in some countries, much less so in others.
- The structure and even the conception of taxation differ widely from one country to another.
- The complexity of modern tax systems makes it an extremely difficult area to work in.

How far have we got ?

Despite all the difficulties, attempts to harmonize taxation between Community countries have not been in vain. In some areas, success has been achieved. In others, the record is less impressive.

- VAT*: this is where we have obtained the most encouraging results. Two European directives, adopted in 1967, abolished the 'cascade' tax systems where they still existed. Applicable to each stage in the production or distribution of a product, cascade taxes were detrimental to economic activity and also to the free movement of

goods in the Community. A second step towards the harmonization and economic neutrality of national taxation systems was taken in 1977 with the establishment of a uniform basis of assessment for VAT. This was necessary to implement the Community's own-resources mechanism to the extent that it is based on this tax (maximum levy of 1% of the uniform basis of assessment). In 1979, a new directive was passed to harmonize the rules for reimbursing VAT to non-resident taxable persons. The European Commission has also introduced a proposal setting out the arrangements to be applied to works of art, used goods, furniture, etc. It will shortly present an action programme to simplify the procedures and formalities at member countries' frontiers.

- *Excise duties*: the results in this sector are fairly disappointing. In 1972, the European Commission presented the Council of Ministers with a harmonization programme and with various proposals for directives to abolish the duties levied on certain products, to harmonize the structure and basis of taxation of the excise duties that were being retained (tobacco, beer, alcohol, wine and mineral oils) and to prevent Member States from introducing new ones. The Commission has in addition taken action in the European Court of Justice — and has been upheld — in several infringement proceedings against Member States who use these duties to promote the consumption of national products (especially alcoholic drinks) to the detriment of their partners' products. But the only common rules to have been adopted so far are those concerning cigarettes.
- *Duty-free allowances*: the Community has met with more success in its policy of granting tax exemptions for private individuals who travel between member countries. First introduced in 1969, these exemptions have been gradually extended, though at a slower rate than the European Commission would have wished. The Commission has also introduced proposals covering the temporary importation of certain means of transport and the importation of the personal property of individuals who move home, get married or receive an inheritance.
- *Personal income tax*: in 1979 the European Commission sent the Council of Ministers a proposal to end the tax disadvantages suffered by persons working in a member country other than their country of residence. This aspect of personal income taxation was chosen because of its impact on the free movement of persons and especially frontier workers in the Community. Apart from this, the Commission does not intend to work on the harmonization of personal income taxes since they are regarded as instruments of national economic policy.
- *Taxes on capital and on companies*: there are in force three Community directives to harmonize taxes on the raising of capital where this takes the form of contributions of assets to companies. But further action must be taken to secure greater equality of competition between European companies and to facilitate the free movement of capital, which is one of the basic operating principles of any common market. The maximum of tax neutrality is needed if capital movements are to be determined by economic factors and not by the tax considerations relating to particular Member States. It was with this in mind, and also for reasons of fair competition, that the

European Commission presented in 1975 an important draft directive on the adoption of a common system for company taxation and the harmonization of systems withholding taxes on dividends: rates of cooperation that are set within the range 45-55%; partial relief from double taxation of corporate income (first as companies profits and then as shareholders' dividends) is granted through the introduction of a tax credit, etc. In further moves to facilitate industrial coöperation and to enable European companies to adapt their operations to the new dimensions of international competition, the Commission put forward two proposals way back in 1969 defining the tax systems applicable to companies which merge across frontiers or those which have subsidiaries in other member countries.

- The battle against tax avoidance and evasion:* in 1977 and 1979 the Community adopted two directives providing for mutual assistance by the relevant authorities in Member States in the fields of direct taxation and VAT. Such cooperation will strengthen anti-fraud action at the national level. It also helps to make competition fairer between all European enterprises.

Outlook for the future

The European Commission is setting two priority objectives for the next few years:

- in the field of indirect taxation, the abolition of tax frontiers and the creation of a single market with characteristics similar to those of a country's domestic market. This means creating the conditions which would enable us to dispense with taxation and remission of tax in inter-Community trade and with checks at frontiers;
- in the field of direct taxation, the close alignment of companies' tax burdens, so that production costs, investment location and the return on invested capital are not unduly influenced by the taxation in a given country.

A great many difficulties stand in the way of these objectives, in the specific instances of VAT, excise duties and corporation tax:

- VAT is of course now applied in all Community countries: this represents definite progress. The uniform basis of assessment must, however, be fully established before we start considering the problem of tax rates. This raises some delicate questions:
 - there are currently between one and eight different VAT rates in force depending on the country and product. The simplest solution would be to fix a single rate inasmuch as this is more neutral from an economic point of view. But the multiplicity of rates is often a reflection of social requirements which have to be taken into account in one way or another;
 - these different rates apply to lists of products which themselves differ from country to country. Food products are often given preferential treatment, but others are

subject to great diversity and governments frequently reclassify goods and services. Once harmonization is completed, such reclassification could only be made on a Community-wide basis;

- finally, when it comes to our most ambitious objective, closer alignment of the levels of rates can lead in one country to a rise in the cost of living and in another to a fall in its tax revenue. This means that harmonization should be gradual and that in certain cases offsetting measures should be considered. The difficulty should however be magnified, since such changes would be broadly comparable in scale to those resulting from the introduction of VAT;
- Excise duties: in harmonizing these duties, we have to reckon with three sorts of problems, thus strengthening the case for a gradual approach involving lengthy transition periods:
- social priorities: it is difficult, for example, to introduce suddenly duties on products which have traditionally been exempt in certain countries (e.g. wine in the Federal Republic of Germany and Italy);
 - consumption patterns: if the duties levied in a particular country are altered too quickly, this could lead to sudden changes in consumption patterns and create problems for certain traditional products;
 - tax revenues: in this area as well, harmonization will give rise to changes and will at the same time restrict the Finance Ministers' room for manoeuvre.
- Corporation tax: harmonization of national company taxation systems presupposes that agreement is reached on:
- the same basic system. It is therefore important that the Community's Council of Ministers should adopt the 1975 draft directive introducing, as mentioned above, a common tax credit system;
 - the same scope. The treatment of partnerships, for instance, varies from one country to another. They should perhaps be given the possibility in every country of opting for taxation as a company or as individual members of the partnership;
 - the same rates or at least similar ones, and identical rules as regards tax credits;
 - a common basis of assessment. Even if this is confined solely to tax measures, the task is still daunting, given the vast area to be covered and the differences in national legislation. National measures to stimulate investment respond to a great

variety of different situations and so do not require to be harmonized. On the other hand, they ought to be coordinated on the basis of common criteria so as to avoid Member States outbidding or discriminating against each other.

△

The tax systems in the countries making up the Community are still very different and sudden upheavals at national level would in many cases be unacceptable. Hence, European tax harmonization must be pursued carefully and at a gradual pace. It thus becomes all the more necessary to have a clearly defined political resolve, an overall framework and precise objectives. And when Member States introduce — as they frequently do — major changes to their tax systems, it would be desirable for them to get together beforehand at Community level, with each other and the Commission, so that any such reforms, instead of widening the existing gaps, gradually close them ■



The contents of this publication do not necessarily reflect the official views of the institutions of the Community.

Commission of the European Communities

Information offices (countries fully or partially English speaking*)

- Ireland** 39 Molesworth Street, Dublin 2 — Tel. 71 22 44
- United Kingdom** 20 Kensington Palace Gardens, London W8 4QQ — Tel. 727 80 90
— 4 Cathedral Road, Cardiff CF1 9SG — Tel. 37 16 31
— 7 Alva Street, Edinburgh EH2 4PH — Tel. 225 20 58
— Windsor House, 9/15 Bedford Street,
Belfast BT2 7 EG — Tel. 40 708
- Australia** Capitol Centre, Franklin Street, P.O. Box 609,
Manuka 2603, Canberra A.C.T. — Tel. 95-50 00
- Canada** Association House (suite 1110), 350 Sparks Street,
Ottawa Ont. K1R 7S8 — Tel. 238 64 64
- USA** 2100 M. Street, N.W. Suite 707,
Washington D.C 20037-USA — Tel. 202-862-9500
— 245 East 47th Street, 1 Dag Hammarskjöld Plaza,
New York, N.Y. 10017 - U.S.A. — Tel. 212-371-3804

3

* Offices also exist in other countries including all Member States.

