Tax harmonization in the Community

European File

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'The Common Market has been in existence now for more than twenty years but when we cross a frontier the customs officials still ask if we have anything to declare: any tobacco? any alcohol?' This complaint is often heard. But how many Europeans know that the continued existence of checks at national frontiers is due in large measure to disparities between national systems of VAT and excise duties in Community countries?

Disparities between national tax systems

The total volume of tax varies from one country to another. So does the relative burden imposed by different types of tax.[1]

- ☐ Overall tax burden: total receipts from taxes and social security payments increased in all Community countries between 1973 and 1981, the last year for which detailed, comparable statistics are available (1980 for Ireland, 1979 for Greece). Disparities between different countries have, however, been slightly narrowed. The tax burden has not increased significantly in the three countries where it was heaviest in 1973: the Netherlands, Denmark and Germany. In 1981, overall mandatory tax demands represented 36% of the gross domestic product in Italy (28% in Greece in 1979) and 46% in the Netherlands, Belgium and Luxembourg. Between these extremes stood Ireland at 37% (in 1980), the United Kingdom at 39%, Germany at 41%, France at 43% and Denmark at 44%.

- ☐ Taxes on family earnings and property (including wealth taxes where they exist): these accounted for 15% of global, mandatory taxes in France (14% in Greece in 1979), but 54% in Denmark. Between these two poles, they accounted for 26% of taxes in Germany and the Netherlands, 28% in Luxembourg, 29% in the United Kingdom, 30% in Italy and 35% in Belgium.

- ☐ Earnings and property taxes for other sectors (notably companies): these represented 10% of mandatory global taxes in Luxembourg and only 3% in Denmark. Between these extremes, they stood at 9% in the United Kingdom, 7% in the Netherlands, 6% in France, and between 5.4% and 3.8% in Belgium, Italy, Germany and Greece. Irish statistics make no distinction between the taxation of family earnings and other sectors.

- ☐ Taxes on capital (including death duties and extraordinary taxes on capital): these account for just under 2% of the total in Greece and less than 1% elsewhere.

- ☐ Value-added and turnover taxes: represent 10% of total receipts in Luxembourg and 22% in Denmark (and Greece in 1979). In between, they represent 13% of the total in the United Kingdom and Ireland, 14% in Italy and the Netherlands, 15% in Germany, 16% in Belgium and 20% in France.

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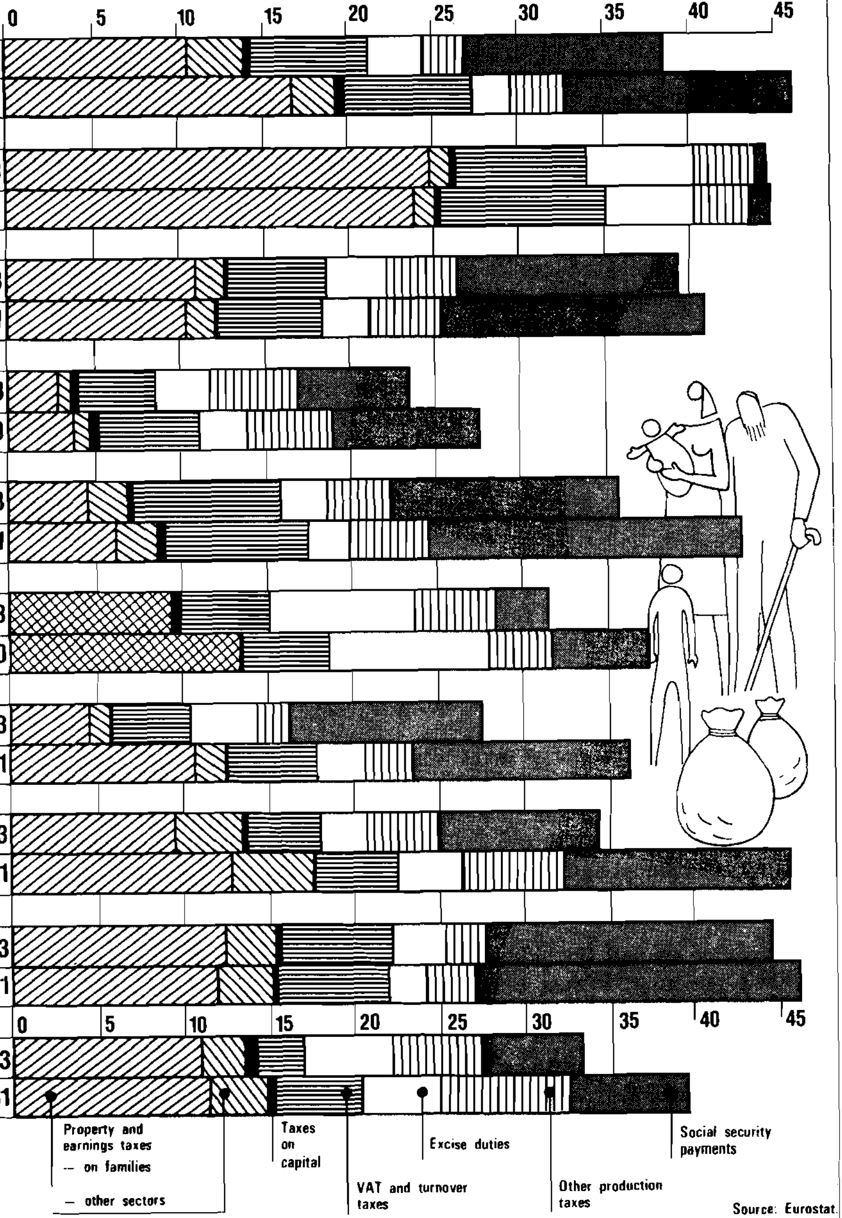
[1] This file updates and replaces our No 7/81.

The development of global, mandatory taxation (including social security payments) 1973 to 1981 (in % of GDP)



Source: Eurostat.

- ☐ Excise duties: these usually apply to selected products, such as alcoholic drinks, tobacco and petrol. Their share of the total tax yield ranges from 25% in Ireland to 5% in Belgium, the Netherlands and France. Elsewhere they account for 12% of taxes in Denmark, 11% in the United Kingdom, 10% in Greece, 8% in Luxembourg and Italy and 7% in Germany.

- ☐ Other taxes, tied to production: represent 19% of total taxes in the United Kingdom and 6% in the Netherlands. Elsewhere, they account for 18% in Greece (1979), 13% in Luxembourg, 11% in France, 10% in Germany and Ireland, 8% in Italy and Denmark and 7% in Belgium.

- ☐ Mandatory social security payments: there are wide disparities in this sector, caused by differing ways of financing social security. In Denmark, which has a high level of publicly-funded social protection, direct payments represent only 1.6% of total taxes. In France they represent 43%. Between these extremes are Ireland with 15% of the total in 1980, the United Kingdom 17%, Luxembourg 29%, Belgium and Greece (1979) 30%, Italy 35%, Germany 38% and the Netherlands 41%.

Harmonization: what and why?

The growth of social and economic intervention by public authorities since the end of the Second World War has led to a substantial increase in taxation in all developed countries. The role of taxation as an instrument of economic and social policy has become widely accepted. Hence, its importance to the functioning of the European Community. But there is no intention of creating a full-scale European taxation system, covering all aspects of taxes, like those of the Member States. In fact:

- ☐ The Community budget is small in comparison to the sum of national budgets (about 2.8%), even though it has been financed for several years through its own resources (a share of VAT, customs duties and levies on goods imported from the rest of the world). The budgetary role of taxation at Community level is therefore limited.

- ☐ The increasing economic interdependence of Community countries has been one of the striking features of the last 25 years. Their economic objectives (growth rates and inflation targets) are more and more often jointly established. But economic and social policies and the means of implementing them, especially the use of taxation, are generally left to the discretion of Member States.

In these circumstances, the overall purpose of Community action in the tax field is to ensure that other aims of the Community are fulfilled, notably:

- ☐ The establishment of a common market, founded on the free movement of people, goods and services between Community countries and fair competition between Community firms. In the face of increased international competition, the European Commission believes it is all the more important to allow Community industries to sharpen their competitive edge by securing the advantages of a continental-scale market, enjoyed by their rivals in the United States and Japan.

- ☐ The gradual alignment of the economic policies of Member States.

- ☐ The creation of common policies. Some, such as agriculture, trade and transport policy, were foreseen by the Treaty of Rome which launched the Community. Others have been established as the Community has developed, such as regional, energy and environment policies.

To realize these objectives fully, it will be necessary to abolish certain barriers and distortions, many of which arise from differences between the tax systems of Member States. Beyond this, Community countries agreed in 1971 to move towards economic and monetary union, partly through action in five priority tax fields:

- ☐ By establishing a uniform basis of assessment for VAT;

- ☐ By harmonizing the scope, tax base and collection procedures for excise duties;

- ☐ By harmonizing certain taxes likely to have a direct influence on capital movements within the Community;

- ☐ By further harmonization of taxes on companies;

- ☐ By gradually increasing the tax-free allowances for private travellers crossing frontiers within the Community.

Although comparatively modest, even these objectives will be difficult to achieve:

- ☐ It must not be forgotten that fiscal sovereignty is a vital component of national sovereignty and that the right to vote taxes is 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. To combat the recession, for instance, one country may have to reduce taxes and another to increase them;

- ☐ Public opinion is increasingly sensitive to developments in taxation. Some taxes are relatively well accepted in some countries, less so in others;

- ☐ The structure and even the conception of taxation differ widely from one country to another;

- The complexity of modern taxation systems makes them difficult to tamper with.

How far have we got?

Despite these difficulties, efforts to harmonize taxation in the Community have not been entirely fruitless. In some areas, success has been achieved. In others the record is less impressive.

- VAT: most success has been achieved in this field. Two Community directives, adopted in 1967, abolished the remaining 'cascade' systems of tax. By taxing each stage in the manufacture or distribution of a product, these systems hampered economic activity and the free movement of goods. A further step towards the harmonization and economic neutrality of national tax systems was taken in 1977 when a uniform basis of VAT assessment was established. This was necessary to allow the introduction of the Community's own resources system, partly based on this tax (a levy of a maximum 1% VAT rate on the common base, but shortly to be increased). In 1979 a directive was agreed to harmonize the rules for reimbursing VAT to non-resident taxable persons. The Commission has also proposed VAT arrangements for works of art, second-hand goods and furniture. At the same time, the Commission is attempting to simplify checks and formalities at frontiers between Member States. It has already been decided that, from 1985, spot checks will replace systematic controls. A single document is to be introduced for shippers and transporters and the Commission has proposed that VAT payments on imports should be deferred so that the tax no longer has to be handed over at the frontier itself.

- Excise duties: results in this sector are rather disappointing. In 1972 the European Commission presented a harmonization programme to the Council of Ministers. This contained various draft directives on the abolition of duties on some products and the harmonization of the structure and basis of taxation of others (tobacco, beer, spirits, wine and fuel oils). Member States were also to be forbidden to introduce new excise duties. At the same time, the Commission has taken – and won – actions against Member States in the European Court for using these duties to favour the consumption of domestic products (principally alcoholic drinks) and discourage consumption of similar products from other Community countries. But the only common rules to have been adopted so far have been for cigarettes.

- Tax-free allowances: the Community has had more success in encouraging tax-free allowances for private travellers between Member States. Since their introduction in 1969, these allowances have been gradually increased, albeit more slowly than the European Commission would have liked. They have just been extended to the temporary importation of certain means of transport and the permanent importation of personal property, as a result of emigration, marriage or inheritance.

- ☐ Personal income tax: in 1979 the European Commission proposed to the Council of Ministers that tax disadvantages suffered by people working in another Community country should be abolished. This will be of particular benefit to frontier workers. Otherwise, the Commission has no plans for harmonizing personal income taxes which are regarded as instruments of national economic policy.

- ☐ Taxes on capital and companies: three European directives harmonize taxes on capital formation. But more must be done to secure increased equality of competition between Community firms and to promote the free movement of capital, one of the fundamental operating principles of any common market. Maximum fiscal neutrality is needed to ensure that capital movements are influenced by economic criteria and not by taxation differences between Member States. It was with this in mind, and also to protect fair competition, that the European Commission put forward an important draft directive in 1975 on the adoption of a common system for company taxation and the harmonization of systems for taxation of dividends at source. Its provisions included rates of cooperation within a 45 to 55% range and partial relief from double taxation of corporate income (first as company profit and then as shareholders' dividends) through the introduction of a tax credit. The Commission is pressing for speedy approval of 1969 proposals designed to encourage industrial cooperation between companies in different Community countries and make better use of the potential for international competitiveness and growth inherent in the economic integration of Europe. These proposals concern tax arrangements for companies involved in mergers across Community frontiers or which have subsidiaries in more than one Community country. The Commission is also pressing for rapid agreement on its 1976 plans for the elimination of certain forms of double taxation. It has called for national action, including fiscal measures, to encourage productive investment by favouring capital formation and strengthening the internal liquidity of companies (through the reduction of taxes not linked to profits and a better system for writing off and carrying over losses).

- ☐ The battle against tax avoidance and evasion: in 1977 and 1979 the Community adopted two directives which provide for reciprocal assistance between the authorities in Member States in both direct taxation and VAT. Such cooperation will strengthen anti-fraud activities at national level. It will also help to make competition fairer between Community companies.

Outlook for the future

The European Commission believes that two priorities should be pursued in the coming years:

- ☐ In the field of indirect taxation, the abolition of tax frontiers and the creation of a single market where conditions would be comparable to those of a country's domestic market. This means taking steps to dispense with taxation and the remission of tax in all intra-Community trade and the suppression of frontier formalities.

☐ In the field of direct taxation, the close alignment of companies' tax burdens so that production costs, the location of investments and the return on capital are not influenced unduly by the tax systems of different countries.

A great many difficulties stand in the way of these objectives, especially in the case of VAT, excise duties and corporation tax.

☐ VAT is of course now applied in almost all Community countries (in Greece not until 1986). This is a significant advance. The uniform basis of assessment must, however, be fully established before we start considering the question of tax rates. This raises some delicate questions:

- The different Member States have between one and eight VAT rates, according to products. The simplest solution would be to fix a single rate. This would be, economically, the most neutral answer. But the multiplicity of rates often reflects social priorities, which must be taken into account one way or another.

- These different rates apply to lists of products which themselves differ from country to country. Food is often given preferential treatment but, for other products, there is great diversity in the approach of Member States and frequent changes of classification. Once harmonization is completed, such reclassification could only be carried out on a Community-wide basis.

- Finally, the most ambitious objective of all, the closer alignment of tax rates, could lead either to a rise in the cost of living or a drop in government tax revenue. For this reason, harmonization should be gradual and compensatory measures should be considered where necessary. The problems should not be underestimated. The upheaval would be comparable in scale to that which resulted from the introduction of VAT in the first place.

☐ Excise duties: there are three obstacles to the harmonization of these duties. Progress must be gradual, with lengthy periods of transition:

- Social priorities: it would be difficult to envisage a sudden imposition of duties on products which have traditionally been exempted in some countries (for instance wine in Italy and Germany);

- Consumption patterns: if the duties charged in a particular country were altered too quickly, it could transform patterns of consumption and cause great problems for traditional products;

- Tax revenues: here also harmonization will cause problems and restrict the finance ministers' room for manœuvre.

☐ Corporation tax: harmonization of national systems for company taxation presupposes agreement on:

- The same basic system. It is therefore important that the 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, is different from one country to another. They should perhaps be given the opportunity in all countries of opting for taxation as a company or as individuals;

- The same rates or at least similar ones, and identical rules on tax credits;

- A common basis of assessment. Even if confined to taxation proper, the task is daunting, given the vast area to be covered and the differences between national legislations. National measures to stimulate investment take account of a great variety of factors and need not be harmonized. But they should at least be coordinated on the basis of common criteria to ensure that Member States do not discriminate against or outbid one another.

△

The tax systems of Community countries remain disparate and sudden upheavals would be unacceptable nationally. Tax harmonization in the Community must therefore be pursued carefully and gradually. But this makes it all the more necessary to have a clear political will, an overall framework and precise objectives. When Member States introduce – as they frequently do – major changes in their tax systems, it would be helpful if they consulted beforehand, with the Commission and one another, so that these reforms, far from widening the existing gaps, help gradually to close them ■

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