EUROPEAN PARLIAMENT

Directorate-General for Research

WORKING PAPER

Tax co-ordination

in the European Union

Economic Affairs Series
ECON 125 EN

This publication is available in

EN (original)
FR
DE.

At the end of this document you will find a full list of recent Economic Affairs Series Publications.

PUBLISHER: European Parliament
L-2929 Luxembourg

AUTHORS: Ben Patterson and Dr. Alicia Martinez Serrano (University of Murcia)

EDITOR: Ben Patterson
Directorate General for Research
Economic, Monetary and Budgetary Affairs Division
Tel.: (00352)4300-24114
Fax: (00352)4300-27721
e-mail: gpatterson@europarl.eu.int

Manuscript completed in December 2000.

EUROPEAN PARLIAMENT

Directorate-General for Research

WORKING PAPER

Tax co-ordination

in the European Union

Economic Affairs Series
ECON 125 EN
12-2000

Preface

This working document is an updated version of the study originally published in 1998 under the title "*Tax Competition in the European Union*".

This edition consists of three sections.

Part I. The General Introduction covers the recent history of tax policy within the European Union, and examines the current situation in the fields of Corporate Taxation, the Taxation of Savings, the Taxation of Labour and Indirect Taxation (VAT and excise duties).

Part II. Taxes on Labour, on Income from Capital and on Corporations in the European Union: a comparative analysis provides a detailed survey of how direct taxes – personal and corporate – are levied within the European Union.

Part III. Competition or Co-operation? discusses the main issues in the current debate on the alternative approaches of competition and co-operation in the tax field.

References to all sections are listed at the end.

CONTENTS

TABLES AND GRAPHS

Summary and Conclusions

Part I: General Introduction

Progress in removing barriers to trade within the EU, together with monetary union, have focused attention on aspects of the Single Market which are still incomplete: notably taxation. Several economic developments in the mid-1990s stimulated new initiatives in this field:

- the free movement of capital on both a European and global scale, which has made the taxation of capital increasingly difficult;
- the ability of companies to supply the whole Single Market from a single base, creating competition to attract inward investment through "tax breaks";
- the growing complexity of tax systems (notably VAT);
- high levels of unemployment, which have drawn attention to taxes on labour.

These factors led the Commission to launch, in 1996, the “New Approach” to taxation, and to the creation of a “High Level Group on Taxation in the European Union”. In the following year the "Monti Package" of initiatives was published, eventually linking three measures:

- the Code of Conduct on corporate taxation;
- the draft directive on cross-border interest and royalty payments; and
- the draft directive on the taxation of income from savings (the "withholding tax").

The Code of Conduct

The Code of Conduct represented a new strategy in the field of corporate taxation, after many reports – most recently the Ruding Report – and several attempts by the Commission to introduce legislation, had failed to achieve any progress. The Code took the form of a political agreement under which Member States undertook to end tax practices which might damage fair competition within the Single Market.

Application of the Code led to the creation of the **Primarolo Group**, which reported at the end of 1999. It had examined 271 tax measures, notified to it under the terms of the Code, and identified 66 which affected “in a significant way the location of business activity in the Community”. The Group’s mandate has now been extended to monitor the “roll-back” of these measures, and to ensure that the “standstill” on new measures is maintained.

Interest and royalty payments

The purpose of this draft Directive, which was originally proposed in 1990, is to eliminate taxes paid at source on payments of interest and royalties between associated companies in different Member States. This would end the existing danger of double taxation. Agreement on the text has almost been achieved in Council, with a transitional period for Portugal and Greece.

The “withholding tax” proposal

The first proposed Directive to introduce throughout the Community a uniform withholding tax on interest from bank deposits, etc. was tabled by the Commission in 1989. In principle, such a proposal is not needed: a taxpayer in one Member State who receives interest from an investment in another is required to declare the income on his or her normal tax return. In practice, there is wide scope for tax evasion.

Disagreement in Council on the first proposal, however, led to its withdrawal. It was re-tabled, in a new form, as part of the Monti package. Rather than a withholding tax alone, this new version proposed a “coexistence” model: Member States could either levy a tax, or undertake to inform the tax authorities of other Member States of any interest paid. This version also encountered vigorous opposition, notably from the UK, which objected to the inclusion of the London “eurobond” market, and Luxembourg which wished to preserve banking secrecy.

Protracted discussions led, eventually, to the compromise agreement at Santa Maria de Feira, under which exchange of information between tax authorities, rather than a withholding tax, became the long-term model. A final decision is scheduled for the end of 2002, but is dependent on agreements being reached with tax jurisdictions outside the EU, notably Switzerland and the US.

Meanwhile, the OECD has also been working on a strategy to tackle "harmful tax competition", which has culminated in an intention to "name and shame" non-co-operating "tax havens", together with possible sanctions against them.

Indirect taxation

In the area of VAT, little progress has been made towards the originally-planned "definitive" system, based on the origin principle. Instead, the latest Commission programme concentrates on certain minimum improvements to the existing "transitional" system. A large number of proposals, approved by Parliament, still await Council decision. Only in the cases of VAT on telecommunications and e-commerce has urgent action been taken.

The sole decision on **VAT rates** remains the setting of a minimum standard rate of 15%, with a number of reduced rates. In the case of excise duties, too, the only agreement has been on low minimum rates, with reforms to the structure of excises still not settled.

Both the transitional VAT system and that for the movement of excisable goods have attracted severe criticism for the scope they give for **fraud**. Successive Commission reports have drawn attention to the inability of national tax authorities to co-operate effectively.

Part II: Taxes on Labour, Income Capital and Corporations: A Comparative Analysis

Taxes on labour

An analysis of **income taxes** in the EU reveals important differences between Member States in matters such as tax allowances, minimum and maximum tax rates and tax schedules.

- Most European countries apply tax allowances instead of tax credits, although some of them apply both types of tax relief. The most generalised method of giving relief is allowances for actual costs of certain work-related expenses.
- The first rate levied by Central Government is at its highest level in Ireland (26%) and the lowest in Greece (5%). The average is 14.2%. Top marginal rates of Personal Income Tax levied by central government range from 38% in Finland to 60% in the Netherlands. The European average of maximum rate is 47.4%.
- In some European countries workers have to pay local state income taxes on top of the central government income tax. This is the case in Belgium, Denmark, Finland and

Sweden. In some of them, these taxes are quite significant, for instance in Sweden and Denmark, rates are around 31%. Local tax rates are not progressive: most countries apply flat rates, which vary from municipality to municipality.

- There are also some temporary supplements to income tax, such as the Austerity Surcharge in Belgium, the German Solidarity Tax and the Unemployment Surcharge in Luxembourg.
- Some national governments also impose a tax on income on behalf of the state church. Austria, Germany, Finland and Denmark all have such a church tax, although rates are in general quite low. The church tax in Sweden was abolished in 2000.

The European average of **effective tax rates**, calculated for an average wage, was 17.2% in 1999. The systems differ so widely that a single person on the average industrial wage may pay tax at rates varying from 2.9% in Greece to 33.5% in Denmark.

The comparative data on **effective tax rates and social security contributions**, expressed on gross earnings, again show Denmark in the lead, though Belgium and Germany are only two percentage points below. The Netherlands, Finland and Sweden also exceed the EU average (29.1%), which is kept down by countries such as Portugal, Greece, Spain, Luxembourg, the United Kingdom and France. Rates in Austria and Italy are approximately at the EU average.

The differences found in effective tax rates calculated for different wage levels and according to family status are also important.

- A comparison between the effective tax rates of a single taxpayer, and the rates applied to a married person with two children, reveals lower rates in all countries except Finland, where they remain at the same level. The most important relative decreases are in Luxembourg and Germany.
- A comparison can also be made between the case of a single income family, and that of a two income family in which one earns the average wage and the other receives 1/3, in six countries. In Austria, Finland, Greece, Italy, the United Kingdom and Sweden, tax rates on the latter are lower than in the case of a single income family, in spite of the fact that family revenues are higher by 33%. In the remaining European countries the tax rates are higher, except in Luxembourg, and in Spain where they are at the same level. The lowest increase in rates is in Portugal. The highest increases are in Spain and Belgium.
- If family revenues grow 33% more than in the previous case, in all the countries tax rates are higher, except in Greece and Spain, where they are the same. Germany continues to be the country with the highest increase of relative variation. Again Denmark is the country with the highest rates. while Luxembourg and Greece are the countries with the lowest levels.

National differences in personal income tax, however, do not appear to cause any major distortions of competition in the labour market, nor in choice of work-place. Only in the case of frontier workers do differentials in social security contributions and personal income taxes between border regions create a discernible incentive to cross-border migrations for work.

The evolution of taxes on labour over the last decade shows a substantial increase in these taxes in most European countries, while the taxation of production factors other than labour has shown an overall decrease. The European Confidence Pact for Employment proposed by the Commission in 1996, highlighted the need to reverse the tendency of taxation systems detrimental to employment.

Taxes on income from capital

These, particularly interest income from savings, form the most mobile of tax bases, creating a strong possibility that differences in taxation will result in distortions of capital allocation.

There is no **withholding tax on interest income** in Denmark, Luxembourg and the Netherlands. Income from interest is included in the taxable income of the resident individual investor, and tax is calculated in accordance with the progressive income tax rates. Interest withholding tax is not final in Germany, Spain and the United Kingdom, but treated as a prepayment of income tax liability. The tax withheld on the interest is credited against the resident investor's final income tax liability. The withholding tax is the final income tax for resident individuals in most countries.

The very different ways of treating **dividend income** provide varying degrees of relief from double taxation. The Netherlands operates a classical corporate tax system, under which profits distributed in the form of dividends are fully taxed twice, once at the corporate level, and again at the shareholder level. The other countries provide varying degrees of relief. Ireland, Spain and the United Kingdom apply partial imputation systems, allowing part of the corporate tax paid on distributed profits to be credited against the resident investor's personal income tax liability. The imputation system that operates in Finland and Germany, eliminates the double taxation of dividends in full. France and Italy are quite close to full imputation.

The tax treatment of **dividend income from foreign sources** depends on the system applied in the investor's country. If the investor lives in a country with a classical system there is in principle no discrimination between domestic and foreign source dividend income. If the investor lives in a country with an imputation system, when a domestic company distributes foreign source income to domestic shareholders, it is usually fully taxed, because there is no imputation tax credit for foreign corporation taxes paid. This results in discrimination against investment in foreign companies.

Corporate taxes

Corporation tax can be considered an essential adjunct to personal income tax. It enables taxation to be levied on retained profits, which can accrue to shareholders in the form of capital appreciation, and would not be taxed (if at all) until the appreciation was realised.

It taxes pure profits or rents, defined as the difference between the accrued revenue of a firm and the full imputed cost of producing that revenue. Corporate tax can be used as an instrument of economic policy to influence the allocation of capital within the private sector.

There are many differences in the corporate tax systems operated by each Member State, including considerable variations in the tax rates and tax base.

- All European countries levy corporation taxes at the central government level. The **rates** vary in European countries between 28% (Finland and Sweden) to 37% (Italy). In Belgium, Ireland, Netherlands and United Kingdom, rates are progressive, the maximum rate being 45% in Germany, and the minimum rate 21% in United Kingdom. Germany distinguishes between retained income (the rate is 45%), distributed income (30%), and non-residents companies (40%), and Greece applies a rate of 35% for resident companies, and 40% for non-resident companies. Germany, Austria, Italy, Luxembourg and Portugal levy a tax at the local level, and in most of these countries the rates at the local level vary from region to region.
- **Taxable income** is calculated in similar ways under the different tax regimes. Income arising from all sources, including non-business income as well as business or trading

income, is normally included in the base. Taxable income is computed on the basis of the ordinary principles of sound commercial accounting practice, and is generally based on the profits shown in the company accounts. In order to arrive at the profit for tax purposes, some adjustments are often required by statute. The general rule is that expenses incurred in earning taxable income, and in maintaining the assets used in the company’s activities, are deductible.

- In all Member States there are some measures that have the effect of **correcting for inflation**. This may be relevant to three aspects of the measurement of the tax base: the depreciation system, capital gains taxation and the treatment of stocks. In order to achieve the objective of taxing real income, capital gains in most countries are partly exempt. Depreciation rules and rates may be favourable (accelerated depreciation). As regards the treatment of stocks, the use of the LIFO method in some countries provides some adjustment for the impact of inflation on the cost of stock replacement.
- **Interest payments** are deductible in all Member States if incurred for business purposes, and if the capital amount is used for generating taxable income. Belgium and Portugal provide for some restriction on the amount of interest that may be deducted.
- All countries allow a company to carry the amount of **trading losses** forward, and some allow a carry back of trading losses. The number of years over which trading losses can be carried forward ranges between five years and indefinitely.
- An allowance for the **depreciation of assets** is given in all countries. A variety of systems are used in different countries, the most frequent being straight-line depreciation and declining balance. Machinery is generally depreciated through the declining balance method and for buildings the straight-line method is the more common way of depreciation.
- There are a variety of methods to **value stock** for tax purpose. Inventories can be valued according to the FIFO method in all European countries. The LIFO method is allowed in most of them although in some cases severe restrictions on the use of this method are imposed.
- The rules for the treatment of **provisions for contingencies** vary considerably from one country to another. Germany, the Netherlands, and Luxembourg could be considered liberal, while other countries, such as Italy, Belgium and France are rather restrictive. According to some estimates, the percentage of the tax-free provisions as a proportion of balance sheet value is 27% in Germany and only 6% in Italy and Belgium.
- In most countries there are special incentives in the **expenditures on research and development,** which are deductible in the year in which they are incurred.

Part III: Competition or Co-operation?

Some – but not all – tax competition can be harmful; and some – but not ubiquitous – co-operation may be beneficial. Put formally, tax co-ordination is desirable if the welfare gains from eliminating "*the inefficiency of non-co-operative behaviour*" exceed "*Leviathan's tendency to waste*".

These broad conclusions follow from an analysis of tax statistics for the last few decades.

- Tax competition has not had the effect of *reducing* tax bases, either within the EU or the OECD. Rather, the percentage of GDP taken in tax has shown a steady tendency to rise. However, the increase in overall taxation over the last ten years has only been marginal compared to that in the previous ten or twenty, and certain EU countries have experienced a fall since 1996. This allows the possible conclusion that tax competition has effectively "capped" the tendency for taxes to rise in relatively high-tax countries, and produced a convergence within the EU.

- The figures do not show any recent tendency for direct taxes or social security contributions to rise more markedly than taxes overall. Over the period 1985-94 there was, however, a shift to taxes on labour from taxes on other production factors, though this was by no means so in all Member States. Falling rates of corporate taxes tend to confirm an average shift of the tax burden from the "mobile" to the "immobile" tax base.
- On the other hand, differing tax structures make for sharp variations in these effects. For example, countries like Denmark and the UK rely relatively less on direct social charges than countries like France. Factors such as this may well explain why tax competition classified as "harmful" by one Member State is not considered to be so by another.

Parliament's own resolution of 18 June 1998 reflected this analysis, and gave general support to the approach of the Commission embodied in the "Monti package". Increasing competition between national tax systems, it pointed out, was likely "*as a result of the greater transparency achieved by the introduction of the single currency*"; and it welcomed

> "*beneficial tax competition among Member States as a tool to increase the competitiveness of the European economy confronted with the challenges of globalization*".

Co-ordination was, however, justified when the degree of competition resulted in

> *"a potential failure to harvest the full benefits which the single market can provide in terms of growth and employment, given the increased tax burden put on labour compared with the more mobile capital".*

A broad measure of agreement exists on the elimination of "unfair competition" which arises from the **complexity of tax systems**. The more complex a tax system, the more scope it creates for (illegal) tax evasion, and the more incentive for companies, in particular, to devote resources to (legal) tax avoidance. Parliament's report criticised the dropping from the final Monti package of "*the measures designed to eliminate significant distortions in the area of indirect taxation*".

There is less agreement on the **rates of tax**. In the field of VAT, a 15% minimum rate was eventually set in 1992; but not the original Commission proposal for a 20% upper limit as well. A Commission proposal in 1995 to set a 25% upper limit was rejected by both Parliament and Council, in spite of the fact that no Member State in fact exceeds this level.

It would appear that, as far as *maximum* tax rates are concerned, there is a general inclination to leave this to competition and market forces. A natural upper limit in any case exists at the point when any *increase in rates* results in *falling aggregate revenue* from the tax concerned. There is reason to believe that this position may already have been reached in the case of some Member States' very high levels of excise duty on alcohol and tobacco (though governments may choose to maintain them at this level in pursuit of public health or social policy objectives).

On even minimum rates, however, there are widely differing views. There has been no agreement on any minimum rate of corporation tax, despite the recommendations of the Ruding and other reports.

Finally, renewed discussions are now taking place on **the procedures to be used in taking decisions on tax matters**. Hitherto the only firm legal base in the Treaty concerns indirect taxes only: Article 93 (formerly Article 99); and this requires unanimity in Council, with the European Parliament being only "consulted". The Commission has now once again proposed that qualified majority voting (QMV) should be used on tax matters where this is "necessary to keep the single market going[1]".

There is general agreement that unanimity in Council will be retained during the foreseeable future for *tax rates*. The position is less clear, however, in the case of those features of a tax system which are *equivalent* to tax rates: for example, the complexities of corporate taxation which result in *effective* rates of tax being considerably lower than nominal headline rates. Past experience suggests that finance ministers will resist any changes that might threaten their revenues.

Table 1. Competition v. Co-operation: the arguments

Arguments for co-ordination/against competition	**Arguments for competition/against co-ordination**
With the disappearance of risks based on currency fluctuations, the differences in tax systems have become clearer, and have a greater impact on capital flows. Capital allocation will be distorted if it takes place solely for reasons of tax efficiency.	Competition takes place, not between tax systems in isolation, but between revenue/expenditure systems as a whole. Countries with relatively high taxation – for example in Scandinavia – remain competitive by offering attractive social and other factors.
Tax competition will result in a "race to the bottom", eroding Member States' tax bases.	Tax competition has not, in fact, resulted in a fall in the proportion of GDP taken in tax: rather the opposite.
There is an imbalance between the lack of co-ordination on tax on the one hand; and, on the other, the centralisation of monetary policy within the € area, together with tightly constrained budgetary policy.	Since national governments within the € area have lost the ability to change interest rates, exchange rates or monetary aggregates, the only instrument left to them for stabilisation policies is freedom to vary taxes.
Welfare maximisation through competition only works when both capital and labour can move between competing jurisdictions. Where one factor (capital) is mobile, but another (labour) is not, the tax system will be distorted. Tax competition is increasing the tax burden on labour, which increases the rate of unemployment.	The gains from co-operation are not necessarily shared equally between participants. Lower taxes are one of the mechanisms through which relatively poor and/or small economies can compete in attracting investment (e.g. Ireland). Tax co-operation may therefore be merely an attempt by richer/larger economies to protect their revenues.
Tax competition makes it extremely difficult to pursue social and environmental objectives through the tax system: for example, income redistribution, the taxation of pollution, etc. Only co-ordination will prevent "free-loading".	The desired mix of taxation/public expenditure may not be the same in all economies. Devolved decisions on tax are therefore more likely to correspond to citizens' preferences. Tax competition is in accordance with the principles both of subsidiarity and democracy.
Business has to deal with fifteen different tax systems and fifteen different tax authorities within the EU, causing considerable costs and distortions.	"*There is no art which one nation more swiftly learns of another than that of draining money from the pockets of the people*". (Adam Smith)

[1] Commission President Romano Prodi, writing in the *Financial Times* of 16 November, 2000.

SOME DEFINITIONS

Brief definitions of some terms used in this study may be useful.

HARMONISATION**:** Convergence of systems as a result of legislative action at Community level. We can distinguish between *Full Harmonisation*, which produces identical tax bases, rates, systems, etc.; and *Partial Harmonisation* or *Approximation*, which involves something less: for example, minimum or maximum tax rates, the elimination of double taxation, etc.

CO-ORDINATION: Measures to bring the tax practices of the EU Member States closer together, generally through non-legislative mechanisms like conventions, recommendations, guidelines, codes of conduct, etc.

COMPETITION BETWEEN SYSTEMS: A process by which convergence of tax systems is secured through the operation of market forces, without deliberate harmonisation or co-ordination.

CONVERGENCE: A process whereby Member States´ tax bases, rates, systems, revenue yields, etc., grow closer together, irrespective of whether this happens as a result of EU action or the interplay of market forces.

ECOFIN**:** The EU Council of Economic and Finance Ministers.

SUBSIDIARITY**:** The principle that, in areas where the Community does not have exclusive competence, it should only act when, and to the extent that, the objectives cannot be achieved to a sufficient extent by the Member States. Complementary with the principle of subsidiarity is that of *proportionality:* no Community measure should exceed what is necessary to achieve the desired objective.

HIFO ("highest input, first output")
FIFO ("first input, first output")
LIFO ("lowest input, first output"): Alternative methods of evaluating inventories.

PART I: GENERAL INTRODUCTION

Historical Background

Tax and the Single Market

The European Union's internal market is defined in Treaty Article 14 as

> *"an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured."*

Progress in achieving this objective has been substantial, if intermittent. The coming of the Single Market at the beginning of 1993 removed most of the "technical barriers to trade" – differences in industrial standards, health and safety regulations, professional qualifications, etc. – which had been targeted in Commissioner Lord Cockfield's White Paper of 1985. Economic and Monetary Union is now eliminating transaction and exchange costs, and helping to remove the last barriers to the free movement of capital.

The very fact of this progress, however, has focused attention on a number of areas in which the Single Market is still incomplete. Of these, one of the most important is taxation.

The immediate requirement within the Single Market programme had been an end to tax and customs checks at internal Community frontiers. This meant changes to both the Value Added Tax and excise duty systems. Fortunately, a firm legal base existed for legislation in Article 99 (now renumbered 93) of the Treaty.

Even so, it was only after prolonged negotiations that the necessary unanimity was found for even a "transitional" VAT regime, and the establishment of low minimum excise duties. The VAT legislation required the adoption, in due course, of a "definitive" system; and the Commission eventually published *A Common System of VAT: a programme for the Single Market* (1996) which outlined a timetable, running to mid-1999, during which the new system would be introduced. However, the programme soon fell badly behind schedule, and has now effectively been put into cold storage. Instead, a much more modest programme[2] concentrates on improvements to the existing “transitional” regime.

Several studies by the Commission or specially-appointed groups of experts[3] had also, over the years, examined the need and scope for Community action in the field of both personal direct and corporate taxation.

Little by way of a legal base for such action is to be found in the Treaties, however; and it has generally been the assumption in all Member States that direct, as opposed to indirect, tax should remain the preserve of national fiscal sovereignty. The pre-1993 attempt to introduce a minimum withholding tax on interest paid by banks to depositors from another Member State failed to get the necessary unanimity in Council, and the same fate befell even the limited proposals to prevent the double taxation of corporate royalty and interest payments.

Nevertheless, a number of economic developments stimulated new Community initiatives during the mid-1990s.

[2] A Strategy to Improve the Operation of the VAT System within the Context of the Internal Market, COM(2000)348, 7 June 2000.

[3] Notably, the Neumark Report of 1962; the Van den Tempel Report of 1970; and the Ruding Report of 1992.

- The **free movement of capital** has always been a fundamental aim of the European Community. It was not practically achieved, however, until 1994, by when it formed only one element of a general **globalisation**. New telecommunications technologies have made possible the creation of 24-hour financial markets, within which funds can move between national tax jurisdictions in nanoseconds. The taxation of capital and of the income from financial assets has become increasingly difficult[4].
- The removal of legal and technical barriers to trade has made **companies and their production bases more mobile**: in theory (and subject to the constraints created by language and cultural differences), the whole Single Market can be supplied from one Member State. Tax has therefore become an important factor in location decisions, particularly for companies based outside the EU (e.g. the US computer companies which are established in Ireland). This, in turn, has encouraged national, regional and local authorities to compete in **attracting firms to their areas through various "tax breaks" –** often in near-breach of Community competition rules.
- The **complexity of tax systems** and **high tax rates** have encouraged **tax avoidance** (legal) and **tax evasion** (illegal). The growing intricacy of Value Added Tax both at European Community and at national level, for example, has prompted companies to devote resources to "VAT planning"[5]. Likewise, the higher the levels of VAT and direct charges on labour, the greater the incentive for firms and labour to move into **the "black" economy**[6]. Finally, as a result of globalisation, major companies have often found themselves subject to a multiplicity of tax jurisdictions, providing both the incentive and opportunity to minimise overall tax through **"transfer pricing"** and other devices.
- Finally, and most significantly, **unemployment levels** rose in most EU economies during the mid-1990s. This, in turn, drew attention to the rising cost of employing labour within the European Union, and in particular to the **"non-wage costs"** created by taxes and social security charges. The increasing difficulty of taxing capital was seen to have resulted in a steady change in the structure of tax systems: an increasing proportion of total taxation was falling on the relatively immobile factor, labour[7]. It became the stated policy of the Community to reverse this trend by shifting the tax burden from employment to, for example, the direct taxation of CO^2 emissions or energy[8].

The New Approach

These factors led to a Council report on tax competition in 1992, and in 1996 to a new Commission initiative on taxation. A "reflection document", *Taxation in the European Union* (1996), was approved by the Council of Economic and Finance Ministers (ECOFIN) at its

[4] For a full study of this issue, see *Globalization and the Future of Social Protection* (2000) by Vito Tanzi, International Monetary Fund, January 2000.

[5] This has been one explanation for the failure of VAT revenues to keep pace with GDP growth in a number of countries.

[6] Increasing discrepancies between the size of Member State economies as measured by GDP figures, and the size as measured by VAT receipts, was the principal reason for adding the GDP element to the Community's "own resources" under the Edinburgh agreement of 1992.

[7] The Commission repeatedly pointed out that between 1980 and 1994 tax rates on labour rose by about 6%, while those on other production factors - notably capital - fell by 9%.

[8] A CO^2 tax was proposed by the Commission in 1992 (COM(92)0226), with a revised proposal, (COM(95)0172) appearing in 1995. Proposals for the "restructuring" of energy taxation effectively replaced the CO^2 proposals in 1997 (see COM(97)0030).

meeting in Verona in April 1996. At the same time, the Council formally established a "High Level Group on Taxation in the European Union", consisting of Personal Representatives of the Finance Ministers, and chaired by the then taxation and Single Market Commissioner, Mario Monti.

Following a request from the Florence Council in June of that year for a

> *"report on the development of tax systems within the Union, taking account of the need to create a tax environment that stimulates enterprise and the creation of jobs and promote a more efficient environment policy"*,

the Commission published, in October 1996, *Taxation in the European Union: report on the development of tax systems* (1996), which summarised the views up to that point of the High Level Group. The approach of the report was cautious, echoing a much earlier Commission paper, *The Scope for Convergence of Tax Systems in the Community* (1980), which had noted that:

> *"tax sovereignty is one of the fundamental components of national sovereignty"*,

and pointed to widely differing ideas about the functions of taxation.

The High Level Group report accordingly observed that

> *"any proposal for Community action in taxation must take full account of the principles of subsidiarity and proportionality",*

and recommended that action should result in "co-ordination" rather than "harmonisation".

The "Monti Package" and the Code of Conduct

The package of measures which the Commission put forward in a new document – *Towards Tax Co-ordination in the European Union: a package to handle harmful tax competition* (1997) – was nevertheless quite wide in scope. It took up a number of "blocked dossiers" in the fields of both direct and indirect taxation, formal proposals on which had already been, or were in due course, published.

The initial package, however, proved too extensive, and was eventually reduced to three concrete measures in a revised proposal: *A package to tackle harmful tax competition in the European Union* (1997).

These were:

- a code of conduct for business taxation;
- the elimination of distortions to the taxation of capital income (the minimum withholding tax on bank interest proposal); and
- measures to eliminate withholding taxes on cross-border interest and royalty payments between companies.

The indirect tax elements – increasing the powers of the VAT Committee; the taxation of investment gold, of passenger transport and of energy products; and the FISCALIS anti-fraud programme – were no longer included (although the Commission continued to pursue them in the normal way). The Commission also accepted that action on fiscal state aids would need to accompany the code of conduct.

Corporate Taxation

The first proposals in the field of corporate tax harmonisation were contained in a report prepared in 1962 by the Neumark Committee, which recommended that corporation tax systems be harmonised along the lines of a split-rate system, with a lower rate of tax on dividend distributions than on retained profits.

In 1969, proposals for directives on parent-subsidiaries[9] and mergers[10] were tabled. This was followed by the Van den Tempel Report of 1970, which advocated a classical corporation tax system throughout the Community. A subsequent resolution by the Council in 1971, concerning economic and monetary union, called for the harmonisation of corporation tax systems, and of those types of taxes likely to have a direct influence on the movement of capital within the Community, namely withholding taxes on dividends and interest.

In 1975 the European Commission tabled a proposal on the harmonisation of systems of company taxation and withholding tax on dividends[11]. Its aim was to eliminate economic double taxation on dividends through the concept of a centralised harmonisation of tax systems. In the draft directive, the Commission proposed a common partial imputation system of company taxation, with statutory rates within a band of 45-55%, and a tax credit, also within a band of 45 to 55% for dividend recipients, irrespective of the Member States in which they resided. At the same time, it was also proposed that all Member States should levy a 25% withholding tax on dividends distributed by their resident companies.

This draft directive was criticised because it made little sense to harmonise corporation tax systems and statutory tax rates as long as differences continued to exist among Member States in the rules for computing the tax base (see Part II of this study). The importance of a common tax base was subsequently acknowledged by the Commission in its 1980 *Report on the scope for convergence of tax systems in the Community.*

In the late eighties a new concept of economic integration was defined. Priority was now given to co-ordination and mutual approximation of the Member States tax systems rather than a systematic harmonisation imposed at the European Union level. This new concept was developed under the principle of subsidiarity. Accordingly, the 1975 proposal was withdrawn by the Commission in April 1990.

In 1988 the Commission began to draft a proposal to harmonise the rules for the determination of the corporate taxable base. The initial draft contained guidelines about depreciation allowances, capital gains, inventory valuation, reserve provisions, valuation adjustments, and overhead costs. The basic purpose was to establish a more uniform and transparent tax treatment of corporate income, which would pave the way to a harmonisation effort along the lines of the 1975 proposed directive. The draft proposal would have limited the scope for indirect subsidisation through the tax base, and tax incentives would have had to be provided in the form of cash grants, investment tax credits, or preferential statutory tax

[9] Draft Directive Concerning the Common System of Taxation Applicable in the Case of Parent and Subsidiaries of Different Member States, COM (69) 6 final.

[10] Draft Directive Concerning the Common System of Taxation Applicable in the Case of Mergers, Divisions and Contributions of Assets Taking Place Between Corporations of Different Member States. COM (69) 5 final.

[11] Draft Directive Concerning the Harmonization of Systems of Company Taxation and of Withholding Tax on Dividends, COM (75) 392 final.

rates, rather than through accelerated depreciation or other adjustments of the tax base. In 1991 the earlier proposal was withdrawn.

In 1990 three proposals concerning company taxation were adopted:

- The Parent-Subsidiary Directive[12] dealing with the tax treatment of cross-border dividend payments between parent companies and subsidiaries and the taxation of parents on income received from subsidiaries.
- The Merger Directive[13] aimed at the deferral of capital gains taxation in case of certain cross-border transactions related to the restructuring of groups of companies.
- The Convention on the elimination of double taxation with the adjustment of profits of associated enterprises[14].

The European Commission also published a draft Directive on the set-off of losses sustained by branches and subsidiaries (COM (84) 404 final) and a draft Directive on the abolition of withholding taxes on interest and royalty payments between parent companies and subsidiaries (COM (90) 571 final).

In addition to tax treaties, mutual assistance can currently be based on the Directive for mutual assistance in direct tax matters[15]. This Directive provides for the exchange of information, response to inquiries, and the presence of an agent of one Member State on the territory of another Member State with a view to monitor the activities of multinational corporations.

The Ruding Report

In March 1992 a Committee of experts chaired by Mr. Ruding[16] published a report of conclusions and recommendations on company taxation within the European Union, deemed necessary to assure the proper functioning of the internal market after 1992. It advocated that action should concentrate on the following **priorities**:

- removing discriminatory and distortionary features of countries´ tax arrangements that impeded cross-border business investment and shareholding;
- setting a minimum level for statutory corporation tax rates and also common rules for a minimum tax base, so as to limit excessive tax competition between Member States intended to attract mobile investment or taxable profits of multinational firms, either of which tend to erode the tax base in the Community as a whole; and

---

[12] Council Directive of 23 July 1990 on the Common System of Taxation Applicable to Parent Companies and Their Subsidiaries of Different Member States. 90/435/EEC, OJ L 225, 20.8.1990.

[13] Council Directive of 23 July 1990 on the Common System of Taxation Applicable to Mergers, Divisions, Transfers of Assets and Exchanges of Shares Concerning Companies of Different Member States. 90/434/EEC, OJ L 225, 20.8.1990.

[14] Convention on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises of Different Member States. 90/436/EEC, OJ L 225, 20.8.1990.

[15] Directive 77/799/EEC Concerning Mutual Assistance by the Competent Authorities of the Member States in the Field of Direct Taxation and Value-Added Tax.

[16] Report of the Committee of Independent Experts on Company Taxation, Commission of the European Communities, Brussels, 1992.

- encouraging maximum transparency of any tax incentives granted by Member States to promote investment, with a preference for incentives, if any, of a non-fiscal character.

To ensure the elimination of **withholding taxes** levied by source countries on dividends paid by subsidiaries to parent companies, the Committee also recommended:

- that the scope of the parent-subsidiary Directive be extended to cover all enterprises subject to corporate income tax irrespective of their legal form; and that
- a substantial reduction should be made in the participation threshold prescribed in the parent-subsidiary Directive.

To combat **tax evasion,** the Committee recommended:

- that the Commission should propose a uniform withholding tax of 30% on dividend distributions by resident European companies, subject to waiver where appropriate tax identification was provided.

To eliminate **double taxation**, levied by source countries on payments between enterprises in different Member States, the Committee recommended:

- that the proposed interest and royalties Directive be adopted and that the scope of the Directive be extended to encompass all such payments between enterprises, together with accompanying measures to ensure that the corresponding income was effectively taxed within the Community in the hands of the beneficiary.

To eliminate **double taxation arising from transfer-pricing disputes**, the Committee recommended:

- that the Commission urge all Member States to ratify the Arbitration Convention; and
- that the Commission take action, together with the Member States, to establish appropriate procedures concerning transfer-pricing adjustments by Member States.

To reduce **impediments to cross-border investments** likely to generate losses in early years, the recommendations were:

- that Member States adopt the draft directive dealing with losses of permanent establishments and subsidiaries in other Member States;
- that all Member States introduce full vertical and horizontal offsetting of losses within groups of enterprises at the national level; and
- that the draft directive should be extended to allow full Community-wide loss offsetting within groups of enterprises.

To ensure that **bilateral agreements for minimizing double taxation** were on a proper footing, the Committee urged:

- Member States not only to conclude bilateral income tax treaties where none existed between them, but also to complete those where coverage was limited; and
- Action by the Commission, in concert with Member States, aimed at defining a common policy on double taxation agreements with respect to each other and also with respect to third countries.

To reduce discrimination between **the tax treatment of domestic and foreign source income**, the Committee recommended:

- that existing discrimination in the taxation of dividends from profits earned in another Member State be removed. Member States which applied imputation taxes on the distribution of profits earned in another Member States should be obliged, on a reciprocal basis, to allow such tax to be reduced by corporate income tax paid in another Member State in respect of dividends remitted by a subsidiary, or profits earned by a permanent establishment. Member States with various forms of tax relief for dividends received by domestic shareholders from domestic companies, should be obliged, on a reciprocal basis, to provide equivalent relief for dividends received by domestic shareholders from companies in other Member States.

To achieve a more fully **harmonised corporation tax system** within the Community, the Committee recommended:

- that the Commission and the Member States examine alternative approaches to determine the most appropriate common corporation tax system for the Community.

To reduce the risks of serious **erosion of corporate tax revenues**, the Committee recommended:

- that a draft directive be prepared by the Commission prescribing a minimum statutory corporation tax rate of 30% and a maximum of 40%, in Member States for all companies, regardless of whether profits were retained or distributed as dividends;
- that there should be only one kind of tax on corporate income in Member States. If this could not be achieved, local income taxes should be taken into account when fixing the statutory corporation tax rate so that the combined rate of tax fell within the range of 30% to 40% prescribed by the Committee. In addition, there should be:
- a set of minimum standards for the tax base to cover: depreciation practices, leasing, stock valuation, provisions, business expenses, headquarters costs of enterprises, pension contributions by or for expatriate workers, carry-over of tax losses, and capital gains.

The Committee also recommended:

- that the Commission should take appropriate measures to reduce the differences between **commercial accounts and the accounts used for tax purposes**;
- that the Commission should propose measures by way of a directive on **depreciation practices**. This should provide for historical cost as the basis for depreciation. It would allow a free choice for the taxpayer between declining-balance and straight-line depreciation for all depreciable assets other than buildings. Declining-balance depreciation rates should not exceed three times the rates applicable for straight-line depreciation. At the same time all special depreciation rules with an incentive effect should be abolished;
- the introduction of a free but irrevocable choice for business enterprise to use the following methods of **stock valuation**: FIFO, LIFO, average cost or base stock;
- that the Commission should propose common rules by way of a directive for the deduction **of business expenses** related to a trade or business;
- that Member States adopt the draft directive on the **carry-forward and carry-back of losses** of enterprises; and

- that the Commission propose a directive to the effect that, in the absence of reinvestment within a certain period of time, all **capital gains** realised on fixed assets and controlling shareholdings be taxed at the ordinary rate of corporate income tax; and that for all gains realised on fixed assets and on all financial holdings that do not constitute treasury placements, inflation should be taken into account by indexing the cost of acquisition. At the same time losses should be made deductible.

Finally, the Committee recommended that the Commission should seek to establish common rules, by way of directive, to **harmonise the dates** at which taxes of common application are payable.

In summary, the recommendations of the Committee included:

- extending of the scope of the Merger Directive and the Parent-Subsidiary Directive;
- adoption of the proposed Directives on inter-company set-off of losses;
- adoption of the proposed Directive on inter-company payment of interest and royalties;
- elimination of fiscal discrimination between domestic-source and foreign-source dividends at a shareholder level; and
- establishing a minimum and maximum corporate income tax rate.

The Commission's reaction

In June 1992 the Commission published its first reactions to the Ruding Committee report. Among the most important measures favoured by the Commission were:

- adoption of the proposals concerning abolition of withholding taxes on interest and royalties, as well as the cross-border set-off of losses, within a group;
- extension of the scope of the Merger Directive to cover all types of companies, as well as expansion of the scope of the parent-subsidiary Directive to cover all parent companies subject to corporation tax;
- introduction of a consultation procedure to be followed prior to any adjustment of transfer prices which would supplement the procedure for the retroactive elimination of double taxation provided for by the 1990 Convention;
- a uniform approach to the definition and treatment of thin capitalisation;
- the establishment of uniform rules which would govern the allocation of head office expenses and a uniform definition of the expenses borne by the shareholder;
- completion of the network of tax treaties between Member States. The Commission felt that, in addition, the agreements concluded by Member States with non-Member States should be in accordance with non-discrimination rules contained in European law;
- commencement of discussions on neutrality as between domestic-source and foreign-source dividends with a view to preventing the latter from being more heavily taxed; and
- a decrease in the minimum corporation tax rate for corporations proposed by the Committee, since the Commission was of the opinion that a rate of 30% was too high.

The Code of Conduct

The central proposal of the slimmed-down "Monti package" of 1997 was the Code of Conduct. This represented a completely new strategy. Instead of legally binding instruments, the Code took the form of a political agreement, under which the EU Member States agreed to respect principles of fair competition and to refrain from tax measures harmful to others.

The Code covered

> "*those business tax measures which affect, or which may affect, the location of business activity in the Community in a significant way,"*

identified as

> *"those tax measures which provide for a significantly lower effective level of taxation, including zero taxation, than that which generally apply in the country in question."*

In November 1997, the European Commission adopted the final version of the "Monti package". The Code was finally agreed at the ECOFIN Council meeting of December 1997[17].

Tax measures covered by the code

The tax measures covered by the Code include both laws or regulations and administrative practices. Such measures may operate by virtue of the nominal tax rate, the tax base or any other relevant factor. The measures particularly highlighted are:

- benefits that are given only to non-residents of the country in question; or are given only in respect of transactions carried out with non-residents;
- benefits that are otherwise ring-fenced from the domestic economy so that they do not affect the national tax base;
- benefits that are available without there being any real economic activity;
- a basis of profit determination in respect of activities within a multinational group of companies that departs from internationally accepted rules;
- measures that lack transparency, including where benefits are given by relaxing statutory rules at an administrative level in a way that is not made public.

Geographical extension

The Council considered it advisable that principles aimed at abolishing harmful tax measures should be adopted on as broad a geographical basis as possible. To this end, Member States undertook to promote their adoption in third countries. They also undertook to promote their adoption in territories to which the Treaty does not apply.

In particular, Member States with dependent or associated territories or which have special responsibilities or fiscal prerogatives in respect of other territories undertook, within the framework of their constitutional arrangements, to ensure that these principles were applied in those territories.

"Standstill" and "rollback"

The first measure aimed at applying the Code in practice was a "standstill": Member States committed themselves not to introduce new tax measures that were harmful within the

[17] Resolution of the Council and the Representatives of the Governments of the Member States, meeting within the Council of 1 December 1997 on a code of conduct for business taxation, OJ C 2, 1.6.1998, P.2.

meaning of the Code. Member States would therefore respect the principles underlying the Code when determining future tax policy.

The second measure was “rollback”: Member States committed themselves to re-examining their existing laws and established practices, having regard to the principles underlying the Code and to the review process outlined. Member States undertook to amend their tax laws and practices as far as was necessary to eliminate “harmful” measures, taking into account the Council's discussions following the review process.

Provision of relevant information

In accordance with the principles of transparency and openness, Member States finally undertook to inform each other of existing and proposed tax measures which might fall within the scope of the Code. In particular, Member States are called upon by the Code to provide, at the request of another Member State, information on any tax measure which appears to fall within the scope of the Code. Where envisaged tax measures need parliamentary approval, such information is to be given following their announcement to Parliament.

Under the Code, any Member State may request the opportunity to discuss and comment on a tax measure of another Member State that may fall within the scope of the Code. This makes possible an assessment of whether the tax measures in question are harmful, in the light of the effects that they may have within the Community.

Action to combat tax avoidance and evasion

The Code also covers co-operation in the "fight against tax evasion and avoidance". The Council noted that anti-abuse provisions or countermeasures contained in tax laws and in double taxation conventions played a fundamental role in counteracting tax avoidance and evasion.

State aids

The Council noted that some of the tax measures covered by the Code might fall within the scope of the provisions on State aid in Articles 92 to 94 of the EC Treaty (now re-numbered 87-89). Without prejudice to Community law and the objectives of the Treaty, the Council noted that the Commission would publish guidelines on the application of the State aid rules to measures relating to direct business taxation by mid-1998, after submitting the draft guidelines to experts from the Member States at a multilateral meeting. The Council committed itself to the rigorous application of the aid rules concerned, taking into account, *inter alia*, the negative effects of aid that might be brought to light in the application of the Code. The Council also noted that the Commission would examine, or re-examine, existing tax arrangements and proposed new legislation by Member States, case by case.

Regional and sectoral aid

In so far as the tax measures are used to support the economic development of particular regions or sectors, the Code provides for an assessment to be made as to whether the measures are in proportion to, and targeted at, the aims sought. In assessing this, particular attention is to be paid to special features and constraints in the case of the outermost regions and small islands, without undermining the integrity and coherence of the Community legal order, including the internal market and common policies.

The “ follow-up” Group

The Council agreement on the Code envisaged the establishment by the Council of a “follow-up” group to assess the tax measures potentially falling within the scope of the Code, and to oversee the provision of information on those measures. The Council invited each Member State, and the Commission, to appoint a high-level representative and a deputy to this group, which would be chaired by a representative of a Member State. The group would select and review the tax measures for assessment in accordance with the provisions laid down; and would report regularly on the measures assessed. These reports would be forwarded to the Council for deliberation and, if the Council so decided, published.

Role of the Commission

The Council invited the Commission to assist the follow-up group in carrying out the necessary preparatory work for its meetings, and to facilitate the provision of information and the review process. To this end, the Council requested Member States to provide the Commission with the relevant information.

The "Primarolo Group"

The "follow-up" Group envisaged in the Code was established by ECOFIN on 9 March 1998, and met for the first time on 8 May 1998, when it elected as its first chairman the UK Treasury Minister, Dawn Primarolo. It therefore became known as the "Primarolo Group".

The Group's first task was to examine a list[18], compiled by the Commission largely on the basis of information supplied by Member States, of national tax provisions which appeared to lie within the scope of the Code. The Commission identified a number of tax schemes and classified them under five headings:

- Intragroup services.
- Financial and insurance services, including "offshore" financial services in territories under the jurisdiction of a Member States (e.g. in Gibraltar).
- Special tax treatment for certain industrial or service sectors (e.g. the film industry).
- Tax advantages for certain geographical areas (e.g. the Canary Islands).
- Other measures, including tax incentives for certain kinds of company (e.g. "micro" enterprises).

The Group's first interim report was published at the end of November 1998[19]. The report identified 85 tax measures which were *prima facie* of a harmful nature. A further list of tax measures, based on direct submissions by Member States, was added at the end of January 1999.

A second interim report appeared in May 1999[20]; and a final report was submitted to the ECOFIN Council in November 1999. At its session of 28 February 2000

> *“the Council decided to make this report accessible to the public[21] without taking any position on its contents.”*

---

[18] "Initial Indicative List of Measures that might fall under the Scope of the Code of Conduct (Business Taxation)".

[19] 12530/98 FISC 164.

[20] 8231/99 FISC 119.

The report shows that the Group examined 271 tax measures within the Member States themselves, in “European territories for whose external relations a Member State is responsible under Article 299.4 of the EC Treaty” (i.e. Gibraltar) and in “Dependent or Associated Territories”.

Of these, 66 were given a “positive evaluation”, on the grounds that they *did* “affect in a significant way the location of business activity in the Community”. The remainder were evaluated negatively, because they did not (see Tables 2 and 3). The bulk of the report consists of detailed comments on each of the tax measures examined.

Table 2. Tax Measures examined by the Primarolo Group: Member States

Country	Examined	Harmful
Austria	6	2
Belgium	13	5
Denmark	4	1
Finland	3	1
France	48	4
Germany	13	1
Greece	11	1
Ireland	14	5 (4 being ended)
Italy	14	1 (but not operational)
Luxembourg	12	5 (2 being phased out)
Netherlands	14	10
Portugal	13	1 (being phased out)
Spain	17	3
Sweden	3	0
UK	9	0

Source: Final Report of Primarolo Group

Table 3. Tax Measures examined by the Primarolo Group: Associated and Dependent Territories

Territory	Examined	Harmful
UK (Gibraltar)	6	3
Aruba (Netherlands)	7	4
British Virgin Islands	5	1
Guernsey (incl. Alderney)	7	5
Isle of Man	11	6
Jersey	4	4
Netherlands Antilles	7	3
Other territories	38	0

Source: Final Report of Primarolo Group

The reasons for the Group’s positive evaluations are also summarised. In the case of eight tax measures connected to “the provision of financial services to third parties, intra group

[21] Available on the Internet: http://www.futd.nl/specials/staatssteun/doc01.html

financing and the provision or licensing of intangible property in return for royalty payments", for example, the Group took account of whether "some or all of the following features" were present:

- *they provide for a reduced nominal rate of tax*
- *they provide fixed margins for pass-though financing without a regular review of those margins against normal commercial criteria*
- *they allow the creation of substantial reserves which are in excess of the real underlying risks and which reduce taxable profits*
- *or they permit the profits to be allocated between a Head Office and a branch in a formulaic way contrary to the arm's length principle that can lead to a reduced effective rate of tax on the company as a whole.*

Similar considerations applied in the case of insurance, intra group services, exempt and offshore companies, holding companies and other miscellaneous tax measures.

The work of the Primarolo Group has also give rise to a number of other studies and papers, among them a cross-country review of the tax treatment of holding companies, carried out by the Commission; and a comparative study of Member States' administrative practices in taxation, carried out by consultants on behalf of the Commission.

The Primarolo Group now has the further mandate of monitoring the "roll-back" of those tax measures which have been identified as harmful: Member States have until 2003 to rescind them. It is also working closely with the Commission in the application of competition policy as it affects tax measures which have the effect of a state aid (see under "Reactions and Contrasts" below).

At the same time, the Group will monitor the "stand-still", with a further report due at the end of 2000 on the extent to which it has been observed. The work of the group, indeed, will in practice "never be finalised", as Mrs. Primarolo herself told Parliament's Economic and Monetary Affairs Committee at its meeting on 10 October 2000.

The taxation of interest and royalty payments,

The latest version of this draft Directive, one of the three elements of the "Monti package", was adopted by the Commission on 4 March 1998. The proposal is designed to eliminate taxes levied at source on payments of interest and royalties between associated companies of different Member States, including those between their permanent establishments which are associated with each other by way of a direct or indirect minimum holding of 25 %.

The intention is not to facilitate tax avoidance, but rather to abolish double taxation The proposal therefore includes provisions to ensure that Member States are not precluded from taking steps to combat fraud or abuse, and authorises them to withdraw the benefits of the directive from companies. It also authorises them not to apply the exemption from tax deducted at source if the beneficiary of the payments qualifies for a special tax rate on those payments that is lower than the rate normally applicable to such income in the Member State where it is established.

'The Council discussed the key political points of the proposal on 25 May 1998. To keep the right balance between Member States' views, the Council agreed on the following conclusions:

- The Directive was part of the tax package adopted under the Luxembourg Presidency on 1 December 1997. Only in that context could final adoption take place.

- A further balancing-out of interests was needed in the context of the scope of the directive
- Only a small body of associated companies might be offered financial and technological services free of withholding taxes in line with the OECD Model Convention of 1997 with respect to Taxes on Income and on Capital. This body would be limited to the forms of companies which are specifically listed, where they were directly associated with one another, and to their permanent establishments, and the concept of 'capital' would be interpreted narrowly in the case of associated companies.
- Subject to final adoption of the directive, Greece and Portugal would be granted final support in the form of a transitional period of eight years, with the tax rate not exceeding 10 % during the initial years and 5 % during the final years.
- The administrative procedures in the individual Member States for the reduction of withholding taxes should be observed as far as possible. This has proved sound in the context of the directive on parent companies and subsidiaries.
- Furthermore, departures from comparable arrangements under the directive on parent companies and subsidiaries which have proved sound should be made only in justified cases.

The taxation of personal savings

The third element of the “Monti package” was the proposal *“to ensure a minimum of effective taxation of savings income in the form of interest payments within the Community***”** (COM(1998)295). It was based on a “coexistence model”: Member States would either levy a 20% withholding tax on savings income paid to residents of another Member State; or they would provide information on payments to the tax authorities of the other Member State[22].

This was not, however, the first attempt by the Commission to tackle the issue. In 1989 the Commission had published a draft Directive for *a common system of withholding tax on interest income* (COM(89)60), to be levied at the rate of 15%. The proposal was eventually withdrawn when it failed to make any progress in Council.

General principles

Capital income, particularly interest income from savings, forms one of the the most mobile tax bases; and differences in taxation can therefore cause serious distortions to capital allocation and flows.

General economic principles suggest that, ideally, the taxation of income from capital should not interfere with the optimal allocation of capital across countries. If the marginal productivity of capital were higher in one country than in the rest of the world, global welfare could be increased by transferring capital from where it has a low productivity to where it has a high one. The ideal system would therefore ensure that the post-tax marginal productivity of capital is equalised across countries.

In principle, there should be no need for a Directive on personal savings income. A taxpayer in one Member State who receives interest from a bank deposit or other asset in another

[22] Actually, the Draft Directive contained *three* systems: Withholding Tax**;** Provision of Information; and Certificate of Notification, under which a taxpayer could prevent withholding tax being levied by proving that the interest had been declared to the appropriate tax authorities.

Member States is required to declare such income when making normal tax returns. In practice, as the Ruding Report observed,

"*the free movement of capital.. together with the existence of bank secrecy... will increase the potential for tax evasion by individuals.*"

Most Member States levy a withholding tax on interest paid to their own citizens; but when in 1989 Germany introduced such a tax at the modest rate of 10%, there was massive movement of funds into Luxembourg, where no withholding tax is levied The German tax had temporarily to be abolished. This experience became an argument both for and against the Commission proposal.

- For those **in favour**, it demonstrated the need, in conditions of free capital mobility, for common tax measures.
- For those **against**, it illustrated the danger of a capital flight to outside the Community if any such measure was introduced.

The proposed Directive

The Commission proposal has involved finding solutions to a number of technical problems: for example the definition of "interest". The Commission's draft defined it as

"a) income from debt-claims of any kind, whether or not secured by mortgage and whether or not carrying the right to participate in the debtor's profits, and in particular the income from public debt securities or bonds, including premiums and prizes attaching to the latter…;

b) the increase in value of debt-claims in respect of which the income, by contract, consists, wholly or partly, of that increase in value, irrespective of the nature of that increase. The interest to be taken into consideration in such circumstances is the difference, paid by the paying agent on redemption, between the capital reimbursed and the issue price of the corresponding securities"[23].

Some financial products, however, combine interest income (expressed as a percentage rate on the capital invested and covered by the Directive) and dividend income from equity (expressed as a return per share from profits, and not covered). The Luxembourg Government, in particular, argued that such "mixed" investment funds should be excluded altogether.

The rough-and-ready solution proposed by the Commission was that the income from such funds would incur tax where they invested

"directly or indirectly more than 50% of their assets in debt-claims or corresponding securities"[24].

However, the British Bankers' Association – among others – observed that "such broad coverage creates a range of practical difficulties…"

"It would be impossible for a paying agent to know whether a bond fund, which might be based in the EU or outside it, was within or without the rules on any particular day.

[23] COM(1998)195, Article 5: "Definition of Interest".

[24] Article 5(c).

> *Exchange rate and market fluctuations combined with changing investment policy will all have an impact on whether the 50 per cent test is met"*[25].

One alternative, which emerged during the discussions in Council, was the "look-through" approach: only that proportion of the income from a fund which derived from interest would be subject to the Directive. This approach could apply to all mixed funds, or be combined with an overall threshold of the kind proposed by the Commission.

The main objections to the Directive in Council, however, were of a broader nature. The earlier so-called "Scrivener" proposal (after the then tax Commissioner) had excluded the international market in "Eurobonds", worth some €4 000 billion in outstanding issues and largely based in the City of London. The latter, however, were included in the Monti proposal. As a result, the UK Government issued a paper in September 1999[26] arguing for their renewed exclusion, and pointing to the danger of the whole market moving outside Europe. Disentangling the holdings by residents of EU Member States (about 50% of the total), which would be subject to the tax, from holdings by non-EU residents, which would not, would present unacceptable administrative and legal problems (e.g. triggering options to "call" at par).

The other most outspoken critic of the proposal was Luxembourg, where financial services provide an important and dynamic sector of the economy. Opposition, as in the case of the UK, was based on the fear that implementation of the Commission proposals would drive investment outside the EU, notably to alternative financial European centres like Zürich, Liechtenstein, the Isle of Man, etc. or even further. Luxembourg and the UK therefore became "objective allies".

In one important respect, however, the interests of the UK and Luxembourg diverged sharply. The European Council meeting in Helsinki on 10-11 December 1999 reached an agreement to continue discussions on the draft Directive, based on the principle that

> *"all citizens resident in a Member State of the European Union should pay the tax due on all their savings income"*.

The UK Treasury then published a second paper in February 2000[27] arguing, incontrovertibly, that this could not be achieved by a withholding tax, since there was no guarantee that the rate levied would actually correspond to the "tax due". Only an exchange of information between tax authorities, the paper argued, could achieve this. Accordingly, the real problem was that

> *"a competent authority is not required to look for, or to transmit to the competent authority of another Member State, information which it would be prevented by its laws or administrative practices from collecting or using for its own purposes"*.

In other words, the problem was the tradition in a number of countries – including Luxembourg – of banking secrecy.

The broad thrust of the UK's arguments obtained majority support in Council. Luxembourg and a number of other Member States pointed out, however, that ending banking secrecy within the EU would also drive investment outside the EU unless similar reforms took place in countries like Switzerland. In addition, certain other problems came to the fore, notably

---

[25] Evidence to the UK House of Lords Select Committee on the European Communities, 15th Report of 1998-9 session: *Taxes in the EU: can co-ordination and competition co-exist?*, HMSO, July 1999, £20.

[26] "International Bonds and the Draft Directive on Taxation of Savings".

[27] "Exchange of Information and the Draft Directive on Taxation of Savings".

whether, and through what mechanism, the sums collected in withholding tax in one Member State would be transferred to the countries in which the taxpayers were resident.

After lengthy negotiations, a compromise was agreed at the Santa Maria de Feira European Council on 20 June 2000, under which the exchange of information model would be the ultimate objective, to be introduced within seven years after the adoption of the Directive. Meanwhile, Austria and Luxembourg – which maintain banking secrecy for non-residents – and possibly other Member States, would introduce a withholding tax on interest paid to non-residents, at a rate to be decided. An "appropriate share of their revenue" would be transferred to the investor's state of residence.

Introduction of the legislation would, however, be conditional on agreement being reached on similar measures with key third countries (notably Switzerland) and with the US. (The Commission had, in fact, already begun talks in early 1999 with Switzerland, Liechtenstein, Andorra, Monaco and San Marino). A decision, by unanimity, would be taken on the matter by the end of 2002.

Intensive negotiations then took place within a Council working party on a number of important technical issues:

- to what extent investment funds should be covered;
- what percentage of any withholding tax receipts should be transferred to the investor's state of residence, and through what mechanism;
- how the effective "beneficial owner" was to be identified;
- whether payment of a withholding tax would be "*libérateur*": i.e. would mean that no further tax was payable on the interest;
- the scope of a "grandfathering" clause to limit the effect on existing securities;
- the treatment of capital gains, zero-rate bonds, and "coupon washing"; and
- exactly how information would be exchanged between tax authorities.

The November Agreement

On 26/27 November 2000 ECOFIN reached agreement on a draft Directive.

Austria, Belgium and Luxembourg would introduce a withholding tax at a rate not below 15% for three years following the entry into force of the Directive. This would rise to not less than 20% for another four years. The tax would be *libérateur*.

All other Member States would adopt the exchange of information system following the entry into force of the Directive, and Austria, Belgium and Luxembourg after seven years.

The collecting country would retain 25% of withholding tax revenues, the rest would be cleared to the countries where the tax-payer was resident.

Mixed investment funds would be covered, on the "look-through" principle, when 40% of the holdings were interest-bearing.

Bonds issued before 1 March 2001 would not be subject to the Directive until the end of the projected transitional period (i.e. 2010).

The Commission would hope to have information on the positions of the US, Switzerland and other countries by July 2001.

This draft, however, does not necessarily mean that the issue is closed. Luxembourg and Austria have made it a condition of adopting the Directive that "equivalent" measures will be introduced in the countries with which negotiations are to take place. Luxembourg Finance Minister Luc Frieden has observed that

> *"If Switzerland does not move in the same direction, we shall not move in that direction…In 2002 we shall judge the situation on the basis of negotiations with third countries".*

In addition, the draft directive remains part of the "Monti package". If insufficient progress is made the package as a whole, including the savings directive, could fall. Austria and Luxembourg specifically inserted a statement into the minutes of the 26/27 November 2000 ECOFIN meeting that

> *"they will agree to the Directive on the taxation of savings only when there has been a binding decision on the roll-back of the sixty-six measures within the Code Conduct".*

At the same time, the Swiss government has on a number of occasions stated that its bank secrecy laws are "non-negotiable". Lukas Mühleman, chairman of Credit Suisse, declared on 22 January 2001[28] that a withholding tax would be

> *"effective to fight tax evasion and is compatible with our view of the state. A mandatory exchange of information between banks and governments is not."*

There was no way that Swiss banks would agree to "systematically and routinely" submit the accounts of their offshore customers to foreign tax authorities.

The OECD: "Harmful Tax Practices"

Meanwhile, parallel negotiations have been taking place within the broader context of the Organisation for Economic Co-operation and Development (OECD). In April 1998 a report[29] was adopted by the OECD Council – with Luxembourg and Switzerland abstaining – authorising further work on nineteen recommendations for action against "harmful tax practices", including a timetable for their identification and elimination. A Forum on Harmful Tax Practices was established to carry out the work.

The Forum presented a progress report[30] to the OECD Council in June 2000. Its observed that

> *"harmful tax competition is by its very nature a global phenomenon and therefore its solution requires a global endorsement and global participation".*

"Harmful" was defined as any tax practice which effectively eroded the tax base of other countries, in particular by facilitating tax avoidance. Where these were identified, the 29 OECD Member States undertook (as under the EU Code of Conduct) to refrain from extending them or from introducing new schemes ("standstill"), and to eliminate them within five years ("roll-back").

The main focus of the report's attention, however, was on non-OECD-members, and in particular on "tax havens". The main criteria for identifying these were:

- no, or only nominal effective tax rates;
- lack of effective exchange of information;
- lack of transparency; and
- absence of a requirement of substantial activities.

---

28 Reported in the *Financial Times* of 23 January 2001.

29 "Harmful Tax Competition: An Emerging Global Issue".

30 "Towards Global Tax Co-operation: progress in identifying and eliminating harmful tax practices".

Table 4. Jurisdictions meeting the OECD "tax haven" criteria of 1998

Andorra	Guernsey/Sark/Alderney[31]	Niue (New Zealand)
Anguilla (UK)	Isle of Man[31]	Panama
Antigua and Barbuda	Jersey[31]	Samoa
Aruba (Netherlands)	Liberia	Seychelles
Bahamas	Liechtensetein	St. Lucia
Barbados	Maldives	St. Christopher & Nevis
Belize	Marshall Islands	St. Vincent & the Grenadines
British Virgin Islands (UK)	Monaco	Tonga
Cook Islands (New Zealand)	Monserrat (UK)	Turks & Cacos (UK)
Dominica	Naura	Virgin Islands (US)
Gibraltar (UK)	Netherlands Antilles	Vanuatu
Grenada		

The Forum initially identified 47 possible havens. In advance of its report, however, six of these – Bermuda, the Cayman Islands, Cyprus, Malta, Mauritius and San Marino – issued "advance commitment" letters, undertaking to eliminate the offending practices by 2005. Following its investigations, the Forum eventually listed 35 jurisdictions "found to meet the tax haven criteria of the 1998 Report" (see Table 4). These included most of the EU associated and dependent territories listed in the Primarolo Report, as well as, within Europe, Andorra, Liechtenstein and Monaco.

The Report also outlined the "defensive measures" which could be taken by OECD members against tax havens. The jurisdictions listed would be encouraged to co-operate with the OECD in eliminating their harmful tax practices. But those that had failed to make such a commitment by 31 July 2001, or which failed to carry out a commitment already made, would be included on a "List of Uncooperative Tax Havens".

A range of more direct defensive measures might also back up this "naming and shaming" procedure, including the imposition of withholding taxes on certain payments to residents of Uncooperative Tax Havens, and of charges or levies on transactions involving them.

Reactions and Contrasts

The publication of the OECD report caused outrage in some of the listed "tax havens". The director-general of Jersey's Financial Services Commission[31], for example, claimed the OECD had "culled the names from airline magazines". A member of the Jersey senate submitted a formal request for a vote to be held on total independence from the British Crown; and in the Isle of Man there were calls for a similar move[32].

The authorities in a number of the listed territories also disputed the OECD's basic argument. A small country in principle enjoys the natural economic advantage that it can levy lower tax rates than a larger one, because it gains more revenue from international business than it loses in domestic revenue. Therefore, though the existence of "tax havens" may put pressure on large countries' tax take, the territories concerned are only acting rationally in the interests of their populations. For some small countries, indeed, the exploitation of this natural advantage may be the only way out of grinding poverty.

[31] Richard Pratt, quoted in the *Financial Times* of 4 August 2000.

[32] Neither the Channel Islands nor the Isle of Man are part of the United Kingdom, but are direct dependencies of the Crown (e.g. the Queen holds the title of "Lord of Man").

The OECD has now opened talks with the listed territories with a view to their avoiding Uncooperative Tax Haven listing. Most have also conceded that some reforms to their tax regimes were needed, and might even have advantages – an OECD “seal of approval” could help in establishing a reputation for sound financial management, and attract new business. A number have already reached some accommodation with the OECD.

In this context, one critical feature has been the *legal nature* of the financial transactions involved.

At one extreme, there has been little opposition to measures against **international financial crime**. Within the EU itself, legislation has existed for some time facilitating action against money laundering, including co-operation between tax authorities and the suspension of banking secrecy. Recent events in Liechtenstein have likewise illustrated the potential problems at international level.

Likewise, on the other side, few would deny companies and individuals the right to carry out **prudent tax planning** within the law, and for the providers of financial products to compete in attracting their custom.

It is between these parameters, however, that the argument is more cloudy. From the point of view of the taxpayer, there is a fundamental distinction between **tax evasion**, in which tax legally due in not paid (e.g. failing to declare interest from a foreign bank account); and **tax avoidance**, in which financial affairs are so arranged that a minimum of tax becomes due. The first is illegal, the second not. In the documents of both the EU and the OECD, however, the distinction between the legal and the illegal is often blurred. The Secretary-General of the OECD[33], for example, used the phrase “illegal tax avoidance” in a recent speech, as well as explaining that “by ‘tax avoidance’ OECD means ‘unacceptable avoidance’”.

These semantic distinctions conceal a number of critical issues.

- First, there is the question of whether agreements concluded in order to combat international crime – notably drug trafficking – can or should be used to combat tax fraud. Since tax laws differ from country to country, a tax crime in one jurisdiction is not necessarily illegal in another. For this reason, action – e.g. the lifting of banking secrecy – has often been refused when requested by a foreign tax authority. In recent years, however, the situation has been changing. The Luxembourg Parliament, for example, has approved the suspension of banking secrecy if requested to do so by the US tax authorities under bilateral tax treaties.
- Secondly the extension of agreements to combat international crime to tax fraud leads to a more controversial question: should there also be a further extension, not merely to prevent illegal activities like money laundering and tax evasion, but also to restrict the scope for legal tax avoidance and tax planning?
- Finally, there is the issue of how far international bodies like the OECD, and also the EU itself, should be used as a vehicle to enforce national tax laws. It is legitimate to ask whether the primary motivation of such action is not to protect the financial interests of richer and larger countries at the expense of the poorer and smaller.

In fact, a comparison of the EU Code of Conduct and the Primarolo Report on the one hand, and the OECD reports on the other, reveals some differences in motivation. The OECD documents show an almost exclusive concern with **erosion of the tax base and of revenues**

---

[33] The Honourable Donald J. Johnston, speaking at a High-Level Symposium on Harmful Tax Competition on 29-30 June 2000.

as a result of tax competition. Those of the EU, however, indicate more complex concerns, notably the effects of tax competition on **“the location of business activity in the Community**”, on the **structure and incidence of taxation**, and on **employment.**

In the case of the EU, there is also a direct link with the Community’s **competition policy**, under which not only direct state aids, but also “tax breaks” can be illegal.

> *“In applying the Community rules on State aid, it is irrelevant whether the measure is a tax measure, since Article 92 [that is now 87] applies to aid measures ‘in any form whatsoever”*[34].

It must, though, also be remembered that, to come within the scope of the Articles, *“the measure must affect competition and trade between Member States”* and that state aid rules do not apply to *“general measures*” which are “*open to all economic agents operating within a Member State”,* and *“extend to the entire territory of the State.”*

This link with competition policy also helps explain the importance of Court of Justice rulings. In its ruling of October 1999 on the Saint-Gobain case, for example, the Court found that it was illegal, for the purpose of offsetting losses in the context of taxation, to discriminate between the branch of a company and an incorporated subsidiary of a company. Despite the limitations of the Treaty in matters of taxation, the Court was able to strike down a “harmful tax practice” of the German authorities.

Finally, this illustrates another important distinction which exists between both the Code of Conduct (and the Primarolo Group) and the OECD measures on the one hand, and the EU’s normal legislative and legal activities on the other. The former are **inter-governmental**, where the main sanction (apart from the open use of financial or military power) is peer-pressure. In the case of the EU, however, the main instrument of enforcement is **Community law**, and the jurisdiction of the ECJ.

Taxes on Employment Income

Since there is little explicit provision in the Treaty for the harmonisation of direct taxes, action in this field has therefore necessarily been based on more general objectives: Article 39 (ex Article 48) on the **free movement of workers**; Article 43 (ex Article 52) on **freedom of establishment**; Article 56 (ex Articles 67 and 73b) on the **free movement of capital**; Article 94 (ex Article 100) on the **functioning of the common market**; and Article 96 (ex Article 101) on **preventing distortions of competition**. In addition, Article 293 (ex Article 220) requires Member States to "*enter into negotiations*" for "*the* ***abolition of double taxation*** *within the Community*", and Article 294 (ex Article 221) forbids **discrimination between the nationals** of Member States "*as regards participation in the capital of companies*".

Article 58 (ex Article 73d, introduced by the Maastricht Treaty) qualifies the free movement of capital by allowing Member States to

> "*distinguish between tax-payers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested."*

However, on 14th. February 1995 the Court ruled (Case C-279/93) that Article 39 of the Treaty is directly applicable in the field of tax and social security. The Article provides that freedom of movement for workers

[34] Communication on the application of the State aid rules to measures relating to direct business taxation, SEC(1998)1800.

"shall entail the abolition of any discrimination based on nationality between workers of the Member States as regards employment, remuneration and other conditions of work and employment."

Most of the arrangements in the field of direct taxation, however, still lie outside the framework of Community law. An extensive network of **bilateral tax treaties** – involving both Member States and third countries – covers the taxation of cross-border income flows.

General principles

The Single Market has several particular implications for the taxation of employment incomes.

- Incomes should not escape tax altogether, or be taxed at discriminatorily low rates, as a result of cross-border tax arbitrage, avoidance or evasion.
- Equally, frontier workers and other non-resident taxpayers should not be taxed at discriminatorily high rates. Problems such as the double taxation of the same income and the lack of co-ordination for individuals who pay taxes in one Member State and social security contributions in another act as a barrier to free movement.
- Differentials in social security contributions and personal income taxes between neighbouring countries, especially in border regions, can create tax-induced incentives to cross-border migration for work. As the internal market continues to develop, similar problems may affect larger groups, since labour mobility can be expected to increase. Thus, the countries with a high fiscal pressure in workers´ taxation could see their revenue levels diminished.

Several measures, both on a bilateral basis between Member States or at a Community level, have already been taken in the first of these two fields. In the third case, however, there are conflicting pressures.

At the very highest levels of income, avoidance of tax through "tax exile" is a well-known international phenomenon. Stars of sport or entertainment operate within a global market, and are to some extent able to choose where they will be taxed.

Diverse factors and circumstances, however, influence most workers' movements. Among them are cultural and linguistic differences, which remain significant despite the efforts of the European Union to reduce the barriers and boost labour mobility. Even those who do become migrant workers retain roots in their places of origin, and often repatriate much of their income.

For this reason, the likelihood of tax-induced mass labour migration within the European Union is actually quite small. Even skilled workmen will hardly emigrate for tax reasons alone: gross wages and the cost of living will exert at least an equal influence on any such decision.

It must therefore be concluded that national differences in Personal Income Tax are unlikely to cause any discernible distortions of competition in the labour market or in the workers´ choice of work place, except in the case of frontier workers.

Various reports, such as that of the Neumark Committee of 1963, have come out in favour of introducing a uniform type of personal income tax with the same pattern of charges but differing rates of taxation. The Commission’s harmonisation programme of 1967 also advocated measures of this kind; but deferred implementation to an unspecified time in the future.

However, in the opinion of most experts[35] in the field, a European Tax System should, initially at least, cover taxes that are easiest to harmonise; and this, does not include Personal Income Tax. Moreover, income taxes are of particular importance to national budgets and are considered matters of national economic sovereignty and prestige.

The harmonisation of Personal Income Tax is therefore neither necessary nor practicable. The most that is required, in the view of most experts, is the rationalisation of certain aspects.

Income Tax can therefore remain a primary means of pursuing national economic policy objectives. This seems be confirmed by the Commission's attitude during recent years.

Frontier workers[36]

Frontier workers are distinguished from traditional migrant workers by the fact of living in one State and working in another. They are accordingly covered by the Community legislation on freedom of movement for workers within the Community[37]. They have the right of residence in the country of employment and must be treated on an equal footing with workers of that country, enjoying the same social and tax advantages as national workers.

Taxation is one of the major problems facing frontier workers. Bilateral agreements between the Member States aim at preventing double taxation of income. These agreements are based on the principle that taxation must be payable either in the country of work or in the country of residence. Nevertheless, frontier workers quite often feel that the current tax rules discriminate against them. In 1979, the Commission attempted to find a satisfactory solution to the problem arising in this connection with a Proposal for a Directive[38]. The Commission intends to continue with measures to eliminate discrimination caused by certain national rules[39].

Co-operation and exchange of information

In order to increase co-operation and exchange of information among national tax authorities, the Community adopted Directive 77/799/EEC Concerning Mutual Assistance by the Competent Authorities of the Member States in the Field of Direct Taxation.

---

[35] See Komar, A., *Probleme der Steuerharmonisierung in der EG. Verträge,* Reden und Berichte aus dem Europa-Institut, Saarbrücken, 1983.

[36] See Pierini, F., "Frontier Workers in the European Union", European Parliament, DG IV, *Social Affairs Series,* Working Paper W-16, 1997 and Weizman, L., "Frontier workers and the Free Movement of Labour within the European Union", *EC Tax Review 1994/3,* pp. 100-111.

[37] Regulation (EEC) No 1612/68 of the Council of 15 October 1968 on freedom of movement for workers within the Community (OJ L 257, 19-10-1968, p. 2).

[38] COM/79/0737.

[39] The living and working conditions of frontier workers have been the subject of a steady flow of studies and reports from the Economic and Social Committee, the European Parliament and the European Commission. Following the recommendation made at the European Council in Fontainebleau, the European Commission presented a Communication to the Council on the question of frontier populations (COM/85/529 final), analysing the various problems and stating the European Commission's position of possible courses of action. The Economic and Social Committee (Opinion on cross-frontier labour market problems; 88/C95/06, OJ C95 of 11-4-1988), and the European Parliament (Resolution on transfrontier co-operation at the internal borders of the Community. Part -session of 12 March 1987; EP 112.804; report on the problems of cross-frontier workers in the Community; DOC A2/227/89 adopted on 16-12-1988. In 1990, the Commission presented a Communication on the living and working conditions of Community citizens resident in frontier regions, with special reference to frontier workers (COM/90/561 final).

However, tax authorities are not required to obtain for, and transmit to, other tax authorities information that they are prevented from collecting under their own laws or administrative practices. In 1989 a proposed amendment to this Directive would no longer have allowed tax authorities of Member States to refuse to share information on the grounds of administrative impediments.

The issue has now achieved a new topicality within the context of the proposed Directive on the taxation of savings income, and of international moves against money-laundering and tax evasion (see above).

Social security

A Council Regulation (1408/71/EEC)[40], with amendments, on the application of social security schemes within the European Union has been in force since 1971. The regulation covers a broad range of topics regarding the application of social security schemes to individuals who choose to work in another Member State.

Yet the taxation of those who work in or draw a pension from one Member State, but live and/or have dependent relatives in another, has been a continuing source of irritation. Bilateral agreements avoid double-taxation in general, but fail to cover such questions as applying various tax-reliefs available in the country of residence to income in the country of employment. Accordingly, a wide-ranging draft Regulation[41] was tabled by the Commission in 1999 to co-ordinate national social security systems as they apply to sickness, maternity, invalidity, old age, accidents at work, survival, death, unemployment, pre-retirement and the family. It would establish equality of treatment in the following cases:

- Persons residing in the territory of one of the Member States and to whom this Regulation applies shall be subject to the same obligations and enjoy the same benefits under the legislation of any Member State as the nationals thereof.
- Any Member State whose laws, regulations or administrative provisions attribute legal effects to the occurrence of certain facts or events shall, to the extent necessary, take account of the same facts or events occurring in any other Member State as though they had taken place in national territory.
- A benefit accorded under the legislation of a Member State shall, for application of the legislation of another Member State, be considered to be a benefit accorded under the legislation of that latter Member State.

This draft regulation also includes the following measures, *inter alia*:

- The competent institution of a Member State whose legislation makes the acquisition, retention or recovery of the right to benefits conditional upon the completion of periods of insurance, employment or residence shall, to the extent necessary, take account of periods of insurance, employment or residence completed under the legislation of any other Member State as though they were periods completed under the legislation which it administers.

[40] Council Regulation (EEC) No 1408/71 of 14 June 1971 on the application of social security schemes to employed persons, to self-employed persons and to members of their families moving within the Community (OJ L 149, 5.7.1971, p.2). The text of this Regulation has been amended several times. The most recent updated version is Council Regulation (EC) No 118/97 of 2 December 1996 (OJ L 28, 30.1.1997, p.1).

[41] COM(1998) 779.

- A benefit due under the legislation of one or more Member States or under this Regulation may not be refused or subjected to any reduction, amendment, suspension, withdrawal or confiscation on account of the fact that the beneficiary resides in the territory of a Member State other than that in which the institution responsible for providing benefits is located.

On the basis of two previous Communications: "The Future of Social Protection: a Framework for a European Debate" (COM (95) 466 final) and "Modernising and Improving Social Protection in the European Union" (COM (97) 102), the Commission has also presented a new Communication: "A Concerted Strategy for Modernising Social Protection" (COM (1999) 347), proposing a closer co-operation in the field of social protection, based on the exchange of experiences, mutual concertation and evaluation of ongoing policy developments with a view to identifying best practices.

Supplementary pensions

The Commission has also begun to tackle a problem that lies at the core of the supplementary private and occupational pension systems within the EU: the fact that some Member States tax the *contributions* to personal pension funds, but not the *pensions* themselves (for example, Germany); whereas others do not tax the contributions, but do subject the pensions to tax (e.g. the UK). It is therefore possible for someone who has worked and contributed in one Member State, but retires in another, either to pay *no* tax (work in UK, retire in Germany); or to pay *double* tax (work in Germany, retire in the UK).

Following a consultative “green paper” on supplementary pensions[42], the Commission published in 1999 a Communication[43] outlining the results of the consultations, and proposing a number of initiatives. In the section on “the co-ordination of national tax systems”, it observes that

> *“The diversity, complexity and specificity of national tax rules that have developed over the years have been identified as major barriers to the free movement of persons and the freedom to provide services in the field of supplementary pensions and life assurance”*.

Work on the problem has been under way in the Taxation Policy Group, on the basis of three principles identified in the consultation process:

- Co-ordination of national systems rather than harmonisation;
- No “unduly restrictive or discriminatory” tax treatment of cross-border pensions and life assurance;
- The safeguarding of national tax revenues.

However, whether a solution can be found which preserves all three principles remains to be seen.

Social issues

The evolution of taxes on labour over the last decade shows a substantial increase in these taxes in most European countries. However, while the taxation of labour has been increasing, the taxation of production factors other than labour has shown an overall decrease.

---

[42] COM(1997) 283.

[43] COM(1999) 143.

This lack of symmetry between the trend of taxes on labour and the trend in taxes on other production factors has had a number of repercussions:

- on the distribution of wealth – lower relative taxation of income from capital benefits the already well-off;
- on employment – it has encouraged the substitution of capital for labour, so increasing unemployment rates;
- on tax avoidance and evasion – high taxation of labour encourages tax evasion and, in particular, rising recourse to the untaxed "black economy".

In June 1996, the Commission proposed a European Confidence Pact for Employment. This highlighted the need to reverse the tendency of taxation systems detrimental to employment, as part of a wide-ranging strategy to create more jobs in the European Union. The Commission, however, emphasised that, in accordance with the principle of subsidiarity, Member States should have flexibility in choosing the method of reducing taxes on labour and the means of financing those reductions.

The obvious options for financing reductions in taxes on labour[44] are public expenditure cuts and increased taxation elsewhere. Public expenditure cuts may contribute, but are unlikely on their own to be able to fund significant tax reduction on labour. Alternative tax sources are also controversial: higher VAT rates or an energy tax.

Reversing the tax burden on labour could, however, to some degree be self-financing as increased employment levels increase tax revenues.

The European Council held on 20 and 21 November 1997 in Luxembourg confirmed the need to reverse the trend towards increasing the tax burden and stressed, in this context, the importance of co-ordinated action by Member States. Each Member State undertook to set a target, if necessary and taking account of its present level, for gradually reducing the overall tax burden. A target was also set for gradually reducing the fiscal pressure on labour and non-wage labour costs, in particular on relatively unskilled and low-paid labour.

Other issues

In order to ensure equal treatment between resident and non-resident workers the Commission in 1980 proposed, under Article 95, a *Directive on the harmonisation of income tax provisions with respect to freedom of movement* (COM(79)737). This would have applied the general principle of taxation in the country of residence; but was not adopted by Council and was withdrawn in 1993. Instead the Commission issued a Recommendation under Article 155 covering the principles that should apply to the tax treatment of non-residents' income.

Meanwhile, the Commission has also brought infringement proceedings against some Member States for discrimination against non-national workers. The Court ruled in 1993 (Case C-112/91) that a country could tax its *own* nationals more heavily if they resided in another Member State. The Court has also found, however, that a country cannot treat a non-resident national of another Member State less favourably that its own nationals (see Case C-279/93).

A full survey of direct taxes on personal incomes is contained in Part II of this study.

---

[44] See 2nd. Monti Report on Joint Action Envisaged in the Field of Taxation: Taxation in the European Union Evolution of Tax Systems, presented by the Commission, COM (96) 546.

Indirect Taxation

Value Added Tax

Article 99 of the original EEC Treaty (now 93) provided for the Commission to "consider" the harmonisation of

> *"turnover taxes, excise duties and other indirect taxes in the interests of the Common Market."*

The Article was strengthened by the Single European Act of 1987 to make such harmonisation mandatory where it was

> *"necessary to ensure the establishment and functioning of the Internal Market."*

Over the years, legislation under these provisions has ensured that the Community now has a more or less common system of Value Added Tax. Following adoption of the First VAT Directive of 11 April 1967, all Member States had introduced a VAT by the early 1970s. The main outlines of the common system now in effect were enacted in Directive 77/388/EEC of 17 May 1977 – generally known as the Sixth VAT Directive – which ensured that each Member State had a broadly identical "VAT base": i.e. levied VAT on the same transactions.

The Commission's original proposals within the context of the Single Market programme would have made a full change to an **origin basis** for the levying of VAT: goods moving between Member States would be treated in the same way as goods moving within a Member State. However, they proved unacceptable to Member State governments, which instead adopted the current "transitional" system. Under this, the origin principle generally applies to all sales to final consumers: that is, once VAT has been paid on goods in one country, they can be moved within the Community without further control or liability to tax. For movements between VAT-registered traders the **destination principle** applies: that is, the VAT rate charged is that of the country to which the goods are delivered. VAT rates remained un-harmonised, though a minimum standard rate of 15% was agreed.

Very little of the Commission's proposed legislation in the VAT field, in fact, has been adopted by Council. The **taxation of gold** was eventually resolved in 1998[45]; and an experimental scheme to charge a **reduced rate of VAT on certain labour intensive services** adopted in 1999[46]. Yet several other detailed VAT issues, on which both Commission proposals and opinions of the European Parliament exist, have remained unresolved. These include **the tax-exemption thresholds for SMEs** (*COM(87)525*); the definition of **non-deductible expenditure** (*draft 12th. VAT Directive, COM(82)870,* which has now been incorporated into the proposals for the reform of the 8th. VAT Directive procedure – see under *Special Tax Arrangements*); the taxation of **passenger transport** (*COM(92)416*); and the tax on various **non-food agricultural products** (e.g. wool, flowers, timber) (*COM(94)584*).

The differences between national systems in these areas all have a certain distorting effect on the operation of the Single Market. The fact that ECOFIN (but not the European Parliament) has failed to make progress on any of them over many years, however, indicates that they are not considered particularly harmful by national governments.

---

[45] See OJ L 281, 17 October 1998.

[46] See OJ L 277, 28 October 1999.

Telecommunications and e-commerce

Nevertheless, in at least one area Value Added Tax distortions have prompted urgent action: that of **telecommunications**.

Under the normal provisions of Article 9 of the 6th VAT Directive, services are taxed at the place of establishment of the service provider. A supplier within the EU must therefore charge VAT; one established outside need not. As long as the purchaser of the service is VAT-registered, this situation will cause only minimal distortion of competition, since input taxes can be deducted. But when the purchaser is not registered, there is a strong incentive to avoid VAT altogether by purchasing from a non-EU supplier.

Until recently, the scope for large-scale tax avoidance was limited. Rapid advances in technology, however, made the purchase of telecommunications services from non-EU suppliers increasingly economic. The problem for national revenues came not so much from individual phone-users as from large VAT-exempt organisations, notably those involved in financial services. As important was the distortion of competition between EU-based suppliers, and those based outside.

In March 1997, forestalling Commission proposals for a Directive on the matter, the fifteen Member States simultaneously applied for and granted each other a derogation from the normal provisions of Article 9. The place of taxation for telecommunications services was switched from the supplier's location to that of the purchaser, and the purchaser became liable for the tax – the so-called "reverse charge" procedure. This system was eventually made permanent in preference to the Commission's original alternative[47] – to switch the place of taxation, but retain the collection of tax by the supplier and oblige non-EU suppliers to register for VAT in a single Member State.

Telecommunications services, however, turned out to be only the tip of an iceberg. The sudden expansion of the Internet and the arrival of e-commerce led the Commission to publish a Communication on **Electronic Commerce and Indirect Taxation** in 1998[48]. This has now been followed up by a draft Regulation and a draft Directive[49].

Advances in information technology have made it possible for customers to download certain products from sources which can be, effectively, anywhere in the world. In addition, the distinction between "goods" and "services" has become blurred: software or electronic documents, for example, are "goods" without physical form. The Commission's solution is to classify all such products as "services"; and, as in the case of telecommunications, to propose that non-EU suppliers should register in a Member State. This would then become the place of supply from which VAT could be charged if sales were over €100 000 At the same time, EU-based suppliers would no longer have to charge VAT to non-EU customers.

The proposals, however, have run into a number of problems.

- Certain products – for example, books and journals – can take either a physical or an electronic form; and if the former are taxed as goods, the latter as services, there can be substantial distortions of competition (in the UK, for instance, the VAT rates would be 0% and 17.5%).

[47] COM(97)4.

[48] COM(1998)374.

[49] COM(2000)349.

- Non-EU suppliers would be likely to invoice all final consumers from the Member State with the lowest VAT rate, Luxembourg, creating the same competition issues and pressures for revenue-redistribution as in the case of withholding tax. The alternative proposed by Council[50] is that non-EU suppliers should register in *all* Member States where they have sales of over €5 000 a year. This, however, would place them at a competitive disadvantage compared to EU suppliers, with possible repercussions under international trade agreements.
- The proposed system rests heavily on the ability of suppliers to identify their customers correctly: whether they are businesses or private individuals; and whether they are within or outside the EU. In addition, customers (as in the case of distance sales) will have no way of telling whether their suppliers are correctly charging VAT or not.
- Finally, under the terms of the draft Directive, VAT would not be chargeable on radio and television broadcasts. Pressures from various Member States have already, however, caused the Council also to make possible exemptions from VAT on on-line sales of software and upgrades, information services, games, betting, down-loaded music and films, and distance learning.

The VAT system

One of the most serious defects of the transitional VAT system is its **complexity**: the scope it allows for varying national interpretations of VAT law. The basic system established under the Sixth VAT Directive is riddled with derogations, exemptions, options and special regimes. In particular, there are widely differing applications of Annex H, which allows Member States the option of charging **reduced rates** on certain goods and transactions.

Further problems are caused by the application of the three "special regimes": **distance sales**, **tax-exempt legal persons**. (i.e. hospitals, banks, public authorities, etc.) and **new means of transport**. The first of these is the cause of particularly acute problems: mail-order or similar companies having sales over a certain threshold to any Member State must levy VAT at the rate applied in that country (i.e. where the goods are delivered); and if necessary, they must appoint "fiscal agents" to account for the tax[51]. Consumers, meanwhile, have no way of knowing whether the correct rate of tax has been charged.

The Commission envisaged meeting these problems, in part, by allowing decisions on detail to be taken without the full application of Article 93. A draft Directive has been proposed which would give the **Committee on Value Added Tax,** which consists of national representatives and is chaired by the Commission, more powers of decision (COM(97)325). So far, however, Member States have been reluctant to take even this step.

The replacement of Mario Monti as Taxation Commissioner by Frits Bolkestein has now produced a change of direction in the Commission’s approach to VAT. Its Communication of June 2000[52] gives priority to improving the present “transitional” system rather than to creating a “definitive” one based on origin, though this remains a long-term objective. A new

---

[50] Presidency note to the Council Working Party on Fiscal Questions – Indirect Taxation (VAT), FISC 116, 25th September 2000.

[51] The Commission tabled a proposal to abolish the need for tax representatives in 1998*:* Proposal for a Council Directive amending Directive 77/388/EEC as regards the determination of the person liable for payment of value added tax, COM(1998)660. Parliament has given its approval; but not, so far the Council.

[52] A Strategy to Improve the Operation of the VAT System within the Context of the Internal Market, COM(2000)348.

three-phase, two-year Action Programme lists (or re-lists) nine proposed legislative measures (see Table 5).

Meanwhile, discussions have also been taking place within the OECD. Its fiscal affairs committee decided in January 2001 that a company doing business through a web-site would not be liable to tax in the country from which the site had been accessed (i.e. the country of the customer). Instead, such a company would normally pay tax in the country hosting the server through which the web site was accessed. This proposal has, however, been strongly criticised as unenforceable, since web sites can be moved from server to server within a few hours or even minutes.

Table 5. The new Action Programme for VAT

Phase	**Measure**	**Target date for *adoption*/publication**	**Actual date for *adoption*/publication**
I. Proposals already tabled	VAT Committee (COM(1997)325)	*2000/2001*	
	Mutual assistance on recovery (COM(1998) 364	*2000/2001*	
	Right of deduction (COM(1998)377	*2000/2001*	
	Persons liable for VAT (COM(1998)660)	*2000/2001*	*October 2000*
II. New proposals	Taxation of postal services	June/July 2000	
	Taxation of e-commerce	June/July 2000	June 2000
	Electronic Invoicing	Autumn 2000	November 2000
	Rules on mutual assistance (revision)	December 2000	
	Minimum standard rate of VAT (revision)	July 2000	September 2000
III. Assessment	*Progress report, and new work programme*	Early 2001	

Source: Commission Communication COM(2000)348

Rates of VAT

The Commission's original proposals on VAT rates (*COM(87)321*) were for "approximation" within two tax bands: a standard rate between 14% and 20%; and a reduced rate between 5% and 9%. However, the main provisions of Directive 92/77/EEC of 19.10.1992 were:

- a **minimum standard rate** of 15%, subject to review every two years;
- the option for Member States to apply either a single or two **reduced rates** over 5% to any of the goods and services listed in Annex H of the amended 6th. VAT Directive;
- **derogations** for certain Member States to apply a **zero rate**, a "**super-reduced**" rate or a "**parking**" (i.e. transitional) rate, pending the introduction of a definitive VAT system
- the abolition of "luxury" or **higher rates**.

In the event, successive subsequent Commission reports have found that the abolition of tax checks at internal Community frontiers have resulted in *no* significant changes in cross-border purchasing patterns, nor any significant distortions of competition or deflections of trade through disparities in VAT rates. This has been despite the fact that large differences in the rates on particular products can exist across particular borders – e.g. between goods rated at the standard VAT rate of 25% in Denmark, but the 7% reduced rate in Germany.

In 1995 the Commission therefore proposed (*COM(95)731)* no change in the 15% minimum; but suggested **a new maximum rate of 25%.** The Council only agreed to make "every effort" not to widen the current 10% span. Parliament also rejected the maximum rate, its major reason being incompatibility with the proposed Stability Pact limiting the ability of Member States to run budget deficits. Upper limits on tax rates, it was argued, would unduly restrict room for manoeuvre.

Table 6. VAT Rates applied in Member States (as of May 2000)

Member State	Super-reduced rate	Reduced Rate	Standard Rate	"Parking" Rate
Belgium	-	6	21	12
Denmark	-	-	25	-
Germany	-	7	16	-
Greece	4	8	18	-
Spain	4	7	16	-
France	2.1	5.5	19.6	-
Ireland	(0)/4.2	12.5	21	12.5
Italy	4	10	20	-
Luxembourg	3	6	15	12
Netherlands	-	6	17.5	-
Austria	-	10/12	20	-
Portugal	-	5/12	17	-
Finland	-	8/17	22	-
Sweden	-	6/12	25	-
UK	(0)	5	17.5	-

Source: Commission (DOC/2206/2000)

No new proposals on VAT rates were made in the Commission's 1997 Report on the working of the system (COM(97)559). However, a renewed proposal to fix VAT rates in a **15% to 25% band** was made in 1998 (COM(1998) 693). This was also rejected by Council. The latest proposal[53], tabled in September 2000, would extend the 15% minimum until the end of 2005, but makes no proposal for a maximum rate. Nor does it make any proposals on the complex issue of reduced VAT rates, which are applied at the discretion of Member States to Annex H transactions; nor the various exemptions and derogations on rates (for example, the zero rate applied by the UK and Ireland to basic foods and other products).

Excise duties

In the case of excise duties the situation has been even less satisfactory. Only the minimum agreement on systems and rates necessary to abolish frontier controls was reached within the context of the Single Market programme with the result that very wide differences exist in the rates charged by different Member States. This has lead to considerable tax-induced movements across certain frontiers: notably of alcoholic beverages and tobacco products from France and Belgium to the UK. It has been estimated that some 1 million pints of beer are being brought across the Channel to England *every day*[54], about half of which is being illegally resold (see under *Fraud* below).

The main effect of such movements is the distortion of competition: legitimate traders, who pay full UK excise duties, are unable to compete with the lower-duty imports. In addition, movements of beer alone are said to be costing the UK Exchequer some £1.5 billion a year.

[53] COM(2000)537.

[54] *Sunday Times*, 14th September 1997.

According to the UK Treasury, this has not yet had the effect of eroding the tax base, in the sense that revenue would be increased by reducing the excise duty rate. This finding is nevertheless disputed by UK brewers; and the *reduction* in the UK excise duty on spirits in 1996 can be cited as evidence of tax competition within the Single Market.

Alcoholic beverages

Decisions on the *rates* of duty have been complicated by continuing disagreements about the *structure* of the duties. In the case of alcoholic beverages, for example, all attempts to introduce a simple system based on alcoholic strength have foundered on the firm resistance of the producer countries to introduce an excise on wine. Instead, the products are roughly divided into separate tax categories of wine, beer, spirits and “intermediate” products.

The Commission's initial proposals within the Single Market programme (COM(87)328) were that for each alcoholic beverage there would be a single Community rate, fixed as the average of existing national rates. Unlike VAT, however, few national alcohol excises are close to the average rate. No Member State found the proposals acceptable. The Commission then proposed (COM(89)527) *minimum* rates; and *target* rates, on which there would be long-term convergence. In the end, only the minimum rates were retained in Directive 92/84/EEC. Under the terms of this, the Council should have reviewed the rates by the end of 1994, and adopted any necessary changes. But no Commission proposals were tabled. Instead a *Report on the rates of excise duties* was eventually published in September 1995 (COM(95)285).proposing that the whole issue should be examined in the course of general consultations with national administrations and with trade and other interest groups. Nothing has so far come of this.

Tobacco products

It is much the same story for tobacco products. Disputes over the tax structure resulted in an uneasy compromise on whether duty should be *ad valorem*, calculated as a percentage of the maximum retail selling price, or *specific,* calculated per unit of the product. Categories have been defined as cigarettes; cigars and cigarillos; fine-cut tobacco for the rolling of cigarettes; and other smoking tobacco. In the case of cigarettes the proportional and specific rates must be the same for all cigarettes; and the specific rate must be set "by reference to cigarettes in the most popular price category". The various Directives are now covered by a single consolidated text (COM(94)355). As far as rates are concerned, the specific element "may not be lower than 5% nor higher than 75% of the aggregate amount of the proportional excise duty and the specific excise duty..", nor more than 55% of the total tax burden (i.e. after VAT is added). The difficulty of reaching more harmonised rates reflects the structure of the Community tobacco industry. A specific tax benefits the more expensive products of the private companies by narrowing price differences. A proportional tax, particularly when combined with VAT, has the opposite effect, multiplying up price differences. Within the broad ratio so far laid down, some Member States have chosen a minimum specific element, others have chosen a maximum, so contributing to variations in retail prices.

Mineral oils

In the case of mineral oils there have been the added dimensions of transport, energy and environment policy. Duties are specific: i.e. calculated per 1000 litres of the product, or per 1000 kilogram. Product categories are leaded petrol; unleaded petrol; gas oil; heavy fuel oil; liquid petroleum gas (LPG); methane; and kerosene. For each there are minimum rates.

A recent Commission proposal in the field of energy taxation[55] has sought to build on the existing system for the taxation of mineral oils by extending it to all energy products, and in particular to products which are directly or indirectly substitutable for mineral oils: coal, coke, lignite, bitumens and products derived from them; natural gas; and electricity. So far it has made little progress – the effects of the costs on particular industries in particular Member States would be too drastic.

The most recent proposal, for the taxation of aircraft fuel[56], has run into a problem of a different kind (but similar to that in the case of withholding tax): a duty could only be effectively imposed upon domestic flights, or on flights originating within the EU, with damaging competitive consequences for EU-based operators.

However, what legislation has proved incapable of achieving – i.e. the approximation or harmonisation of fuel excises – may be coming about through market forces and tax competition. The sharp rise in oil prices during 2000, which led to consumers' protests in a number of Member States, also focused attention on disparities in tax rates on fuel. A key demand of hauliers in the UK, for example, was a reduction in the tax on diesel to French levels in order to remove the perceived distortion of competition. The UK Government eventually conceded.

Indirect tax fraud

However, perhaps the most serious criticism levied against both the transitional VAT system and the parallel system introduced in 1993 for the movement of goods subject to excise duties is the scope they create for fraud. The Commission's third report on administrative co-operation in the field of VAT[57] begins with the trenchant observation:

> *"The transitional VAT arrangements have been in place for more than 6 years. During this period, one would have expected that the implementing problems should have been solved and that the system should be running smoothly. However, this does not appear to be the case. The 6 years appear to have given the fraudsters time to appreciate the possibilities offered by the transitional VAT arrangements to make money, while, generally speaking, Member States have not met the challenge posed by fraud."*

An earlier report from the EU's Court of Auditors estimated that the gap between the amount of VAT theoretically payable, based on GDP figures, and the amount actually collected amounted to €70,000 million, or 21% of Member States' revenues.

As in the case of legitimate movements resulting from large differences in tax rates, the consequences of fraud are both revenue losses and damage to legitimate traders (i.e. "harmful tax competition"). Unlike legitimate movements, however – where at least some revenue accrues to the lower-tax country of supply – fraudulent movements generally escape tax altogether. This, in turn, can have consequences not only for national Budgets, but also for the "own resources" of the European Community. In addition, fraudulent movements are frequently carried out by organised groups which are linked to other criminal activities like the supply of illegal drugs, the evasion of immigration controls and money-laundering.

The illegal component of the movements such as that into the UK of alcoholic beverages and tobacco, already referred to, generally arises from abuse of provisions contained in the 1992

[55] "Restructuring the Community Framework for the Taxation of Energy Product", COM(97)30.

[56] COM(2000) 110.

[57] COM(2000)28.

Directive on the movement of products subject to excise duty[58]. Individual final consumers can take duty-paid goods from one country to another, without paying further duty, provided that the products are for their own personal consumption. "Indicative allowances" have been set, below which there is a presumption that this is the case. "Personal consumption", however, is a flexible term; and, from the start, white vans have been sent from the UK to France by ferry or tunnel to pick up stocks for weddings, parties, football matches and so on. More recently, however, there has been evidence of very large-scale movements by organised gangs, particularly of cigarettes, for illegal resale.

Cigarettes have also featured in much more widespread and expensive frauds throughout the EU. Abuse of transit procedures has enabled smugglers to bring products into one Member State for delivery, under the tax suspension regime, to another. In theory, duty becomes payable when the products are released for consumption in the country of final delivery. In practice, the goods have often vanished *en route*.

The fact that, under the transitional system, goods generally travel between Member States untaxed is also at the root of much VAT fraud. Under the pre-1993 system, exports from one Member State to another were also zero-rated; but VAT was levied at the frontiers when the goods entered the importing country. From the end of 1992 frontier controls were abolished, and VAT became liable only at the point of delivery. The scope for "carousel[59]" and similar frauds was enlarged. Opportunities for fraud also arise from complexities in documentation – for example, claiming deduction of input tax on forged or irregular invoices.

When the transitional system was adopted, it was hoped that the scope for fraud would be limited by very close co-operation between national tax authorities. The proposal for an autonomous EU customs service was rejected; but initiatives were adopted for improving co-operation between national authorities through integrated systems, exchanges and training programmes for national customs officers – for example, the MATTHAEUS programme, and its successor, FISCALIS[60]; and measures to improve mutual assistance on the recovery of unpaid tax[61]. In its Communication on the latter, the Commission observes that

> *"growing anecdotal evidence suggests that fraudsters are increasingly exploiting weaknesses in tax regimes and incompatibilities both between national tax regimes and between tax and Customs administrations".*

The Commission's report of January 2000 outlines the findings of its research into the fraud problem. Its examination of a thousand reported VAT frauds revealed €1 300 million of real VAT losses, which it believed were "the tip of the iceberg". One problem was that a relatively small number of VAT officers had to police 24 million VAT traders making intra-Community transactions worth €930 000 000 000 a year. A second was "very low activity in the field of administrative co-operation", and "extreme slowness of response to requests for information". In addition, the computerised VAT Information Exchange System (VIES) was not being optimally used.

The Commission has now published a draft Decision, amending the FISCALIS programme, in an attempt to get Member States to devote more resources to control.

---

58 Directive 92/12/EEC.

59 Goods are "exported" at zero VAT, and then returned for sale VAT-free.

60 COM(97)175, implemented by Council/Parliament Decision 888/98/EC and Commission Decision 98/467/EC.

61 COM(1998)364.

PART II: TAXES ON LABOUR, ON INCOME FROM CAPITAL AND ON CORPORATIONS IN THE EUROPEAN UNION: A COMPARATIVE ANALYSIS

Foreword

After the General Introduction of Part I of this study, which covers the recent history of tax policy within the European Union, this second part focuses on Direct Taxation in the European Member States. The importance of recent measures adopted in the coordination of Direct Taxation within the EU is the main reason for this section.

First, taxes on labour are examined. Analysis of the main tax elements, particularly effective tax rates, makes possible a comparison between countries.

The second part provides a description of the basic provisions concerning the taxation of interest and dividend income from both domestic and foreign sources in European Union Member States.

Finally the third part of this section analyses the tax treatment of corporate income.

The information provided usually relates to tax regulations in force at the end of 1999, but includes the recent tax reforms of year 2000. The countries surveyed include all European Union Member States, although in some cases data from Greece and Portugal were not available.

Taxes on Labour[62]

Personal Income Tax constitutes, at the present time, the main element in Member States´ fiscal systems. The importance of Personal Income Tax has steadily increased in recent decades. Cnossen (1987) attributes this to:

- the fact that income is widely seen as the fairest basis for taxation; and
- the increasing use of deduction at source of taxes on wages (allied to the concentration of jobs in larger and increasingly well-organised production units).

Personal Income Tax is applied at central government level in most Member States. In some cases these taxes are supplemented with one or several local taxes, though in the majority of European countries personal income taxes at subordinate levels of government are either non-existent or relatively unimportant in terms of yield.

The Income Tax-to-GDP ratio varies enormously between countries. In 1998, the ratio ranged from 4.5% in Greece to over 25% in Denmark and similarly the Income Tax share ranged from 13.2% in Greece to 52.4% in Denmark.

Main tax elements

1. Tax unit

All countries apply the residence principle. Residents are taxed on all their income, independently of the country where income is earned. Non-residents are only taxed on their earnings in that country.

Each country, however, applies different criteria to determine if a person is resident in that country. The majority of Member States determine the residence of a person in the country where he/she possesses his/her habitual home or where he/she resides for a period of at least six months during the fiscal year. Also taken into account is the place where the centre of economic interest is situated, or where the partner and children reside.

[62] This section has been elaborated from: Martinez Serrano, A. *Taxes on Employed Labour in the European Union: Comparative Analysis and Convergence Analysis,* Doctoral Thesis, University of Murcia (Spain), 2000. Full text in ES. Summaries available in EN and FR.

Table 7. TAXES ON PERSONAL INCOME AS PERCENTAGE OF GDP AND AS PERCENTAGE OF TOTAL TAXATION

	% of GDP	**% of total taxation**
AUSTRIA	9.8	22.1
BELGIUM	14.3	31.0
DENMARK	25.9	52.4
FINLAND	15.5	33.3
FRANCE	6.3	14.0
GERMANY	8.9	23.9
GREECE	4.5	13.2
IRELAND	10.3	31.4
ITALY	11.2	25.3
LUXEMBOURG	9.5	20.4
NETHERLANDS	6.5	15.6
PORTUGAL	6.1	17.7
SPAIN	7.4	21.9
SWEDEN	18.2	35
UNITED KINGDOM	8.8	24.8
European average	10.96	25.71

Source: OECD, Revenue Statistics, Paris, 1999

The Netherlands, Italy, the United Kingdom, Belgium, Denmark, Austria, Finland and Sweden separate, for personal income tax purposes, the earned income of spouses where both are gainfully employed. France, Portugal, Greece and Luxembourg use joint taxation, and in Spain, Germany and Ireland, there is possibility of election between separate or joint taxation. In countries using joint taxation, tax liability is calculated by applying the appropriate rate schedule to the aggregated taxable earned income of the spouses. Under separate taxation, liability is calculated by applying the appropriate rate schedule to the taxable earned income of each spouse separately.

In order to reduce the effect of accumulation of earned income under joint systems, most of the countries with joint taxation apply "income splitting", under which each of the spouses is deemed to have the same income, whatever their actual earnings may be. Where tax rates are progressive, this has the effect of reducing tax liability.

2. Incomes subject to tax

All countries tax employment income: wages and salaries. However certain income sources are generally excluded from total income to arrive at the income subject to tax.

Of special importance is the exclusion from taxation of certain social transfers: for example, family subsidies are excluded from taxation in France, Belgium, Germany, Denmark, Greece, Ireland, and Italy. Social transfers for sickness or invalidity are also exempted from taxation in the majority of countries. The situation in relation to social transfers is summarised in Table 8.

Table 8. MAIN SOCIAL TRANSFERS SUBJECT TO TAX

	A	B	DK	FI	FR	GE	GR	IR	IT	L	NL	P	SP	SW	UK
Unemploy-ment.	N	S	S	S	S	N	S	N	S	S	S	S	S	S	S
Sickness	N	S	S	S	S	N	S	N	S	P	N	P	S	S	P
Invalidity	P	S	S	S	S	N	S	N	S	P	N	P	S	S	P
Fam. Transf.	N	N	N	N	N	N	N	N	N	S	N	P	N	N	N
Non monetary payments	S	P	S	S	S	S	S	S	S	S	P	P	S	S	S

S Income source subject to tax.
N Income source not subject to tax.
P Some components subject to tax, others not.

Source: Own elaboration from: IBFD, European Taxation, Section B, Amsterdam, 2000.

3. Tax rates

In all European countries, central government levies a tax on personal income. Although the rate structure of these income taxes shows wide variation, the fundamental structure of personal income tax systems imposed by central governments is very similar in most European countries.

Personal Income Tax rates at Central Government level are progressive in all the countries of this study. Under a progressive system, income taxable is divided up into brackets. All of the taxable income within a bracket is taxed at the same rate. The rate applied to the income in successive increases. The result is a progressive tax: as total taxable income rises, a growing share of it goes – at least in principle – in tax, although there are important differences in maximum and minimum rates and number of brackets (see table 9). With the exception of Germany, which applies several tax formulae, income in excess of the personal exemption or zero-rated band is divided up into brackets. The number of brackets varies significantly from country to country. The maximum number of brackets is 17, applied in Luxembourg and the minimum is two, in Ireland and Sweden. The average is approximately five brackets.

Table 9. RATES OF CENTRAL GOVERNMENT INCOME TAX

	Number of brackets (1)	Maximum rate (%)	First positive rate (%)
AUSTRIA	5	50	10
BELGIUM	7	55	25
DENMARK	3	40	8
FINLAND	6	38	5.5
FRANCE	6	54	10.5
GERMANY (*)	Variable	51	12.9
GREECE (*)	5	45	5
IRELAND	2	48	24
ITALY	5	46	19
LUXEMBOURG (*)	17	46	6
NETHERLANDS	3	60	6.2
PORTUGAL	4	40	15
SPAIN (*)	6	48	18
SWEDEN	2	(4)	(4)
UNITED KINGDOM	3	40	10
European average	5.2	47.4	14.2

(*) These countries have a zero rate bracket

(1) Excluding zero rate as a bracket
(2) In Sweden, the tax schedule at central government level is:
Up to 213.000 200 Skr.
Over 213.000 200 + 25% Skr.

Source: Own elaboration from: Taxing wages, OECD, Paris, 1999 and IBFD, European Taxation, Section B, Amsterdam, 2000.

The first positive rate is at its highest level in Ireland (24%) and the lowest in Greece (5%). The average is 14.2%. Top marginal rates of Personal Income Tax levied by central government range from 38% in Finland to 60% in the Netherlands. The European average of maximum rate is 47.4%.

4. Tax reliefs: tax allowances and tax credits

European Member States provide tax reliefs in a variety of ways. The main distinction is between tax allowances and tax credits. A tax allowance is a certain amount of income which is exempted from tax. The alternative system is to tax all income, and give taxpayers a reduction in their tax bill in the form of a tax credit.

Tax allowances are one of the most frequently employed ways of implementing standard tax reliefs. Allowances take the form of deductions from income subject to tax, so that under progressive income tax schedules their value increases as income increases.

Tax credits are lump-sum deductions from payable tax, so the value of tax credits is independent of the taxpayer’s income level.

Tax allowances and tax credits included in table number 10 refer exclusively to basic reliefs available to all taxpayers and basic reliefs for earned income, under individual taxation.

Most European countries apply tax allowances. Tax credits are applied in Austria, Denmark, Portugal and Italy, although some of them apply both kinds of tax relief. Since 1-1-2000, Ireland has applied tax credits instead of tax allowances.

The most generalised method of giving relief is allowances for actual costs of certain work-related expenses Austria, Denmark, Luxembourg and Sweden apply this method if actual costs exceed a minimal deduction.

Employees' Social Security contributions are deductible from the tax base in almost every European Member State, with the exception of the United Kingdom. In Netherlands and Denmark, employees’ Social Security contributions are included in Personal Income Tax, and in most countries, these contributions are deductible up to a limit.

Table 10. TAX ALLOWANCES AND TAX CREDITS

	Basic tax allowances (National currency)	Social Security contribut ions	Standard tax allowance for earned income. (National currency)	Allowances related to earned income	Allowances for actual costs of certain work-related expenses	Tax credits (National currency)
AUSTRIA	819	C	1.800		Yes, if > 1.800	8.840+ 1.500
BELGIUM	206.000	D		3% - 20% variable max. 110.000 (*)		
DENMARK		D			Yes, if > 4.000	9.954+ 2.512 (1)
FINLAND		C		3% max. 2.100	Yes	
FRANCE		C		Optional (2)	Yes	
GERMANY		C	2.000		Yes	
GREECE		D			Yes	
IRELAND (3)	3.150	C	800		Yes	
ITALY		D				Variable Máx. 1.680.000
LUXEMB.		D	24.000 + 18.000		Yes (*)	
NETHERL.	8.617	C		12% min 258 max. 3.174(*)	Yes	
PORTUGAL		Optional (4)		Optional (4)		32.500
SPAIN	550.000	D	Variable (5)			
SWEDEN		C	Variable (6)		Yes, if > 1.000	
UNITED KINGDOM	4.335	N			Yes	

D Deductible N Not deductible C Deductible subject to conditions

(*) In these countries applying allowances for actual costs if they are above a maximum limit is allowed.

(1) Denmark applies a tax credit of 8% of 31.400 (central government tax) and of 31.7% of 31.400 (Copenhagen local tax).

(2) In France, the taxpayer is allowed to apply: 10% of net earned income (minimum 2.310 FF and maximum 77.460) or actual costs.

(3) From 1-1-2000, Ireland applies tax credits instead of tax allowances. Tax credit for a single worker: 24%(1000 and 4.200)

(4) In Portugal, the taxpayer is allowed to opt between the allowance of 70% of the salary with a limit of 498.000 escudos or the Social Security contributions.

(5) In Spain the tax allowance depends on earned income and others revenues.

(6) Between 8.700 and 18.100.

Source: Own elaboration from: Taxing wages, OECD, Paris, 1999 and IBFD, European Taxation, Section B, Amsterdam, 2000.

5. Effective personal income tax rates

Finally, a global comparison of workers´ taxation in the European Union requires calculation of effective average rates. This is based on the socio-economic group identified by reference to the average gross earnings from employment of all adult full-time production workers in the manufacturing sector.

Income tax payments are calculated in the following way: first the tax allowances applicable to a taxpayer with the characteristics and income level of an average production worker are determined, the schedule rate of tax is then applied and the tax liability thus calculated is reduced by relevant tax credits.

The average effective rate is 17.2%. Spain, France, Netherlands, Luxembourg, Austria and Portugal are below that percentage, while Belgium, Germany, Denmark, Ireland, Italy, Finland and Sweden are higher. The figure for the United Kingdom is approximately the EU average. Denmark applies the highest rate (33.5%), and Greece the lowest (2.9%).

6. Effective average rates including employees´ social security contributions

It is sometimes difficult to define if Social Security contributions are really taxes or payments for some form of social protection. In part, the answer depends on the degree to which these payments are directly linked to the value of the benefits they offer. In some countries Social Security revenues are earmarked to finance programmes that essentially cover the whole population, and the tax base may be identical to that for personal income tax. However, in contrast to the rate structure of the income tax, a ceiling is often applied and income above that ceiling is not subject to further contributions.

Most European countries run social insurance programmes, which only protect workers, or at least sections of them. The tax base to finance such employee social insurance is wage income, usually up to a ceiling, which in turn is related to the maximum amount of wages insured against the risks of unemployment and disability.

From our point of view, when comparing effective rates, employees' compulsory contributions to statutory social insurance schemes should be included in order to provide a basis for comparison. Denmark, for instance, funds its insurance scheme almost entirely out of general taxation, and would thus perform very badly in an international comparison that overlooked insurance contributions.

Following the OECD method: in this study compulsory Social Security Contributions paid to general government are treated as tax revenues. Being compulsory payments to general government they clearly resemble taxes. They may, however, differ from taxes in that the receipt of Social Security benefits depends, in most countries, upon appropriate contributions having been made, although the size of the benefits is not necessarily related to the amount of the contributions.

In the last column of Table 11, the employees' social security contributions have been added to personal income tax, expressed as percentage of gross salary. The comparative data of effective tax rates and social security contributions, expressed on gross earnings, again show Denmark in the lead, though Belgium and Germany are only two points percent below. Netherlands, Finland, Sweden also exceed the EU average (29.1%), which is kept down by countries such as Portugal, Spain, Luxembourg and France. Rates in Austria and Italy are approximately the EU average.

Table 11. EFFECTIVE AVERAGE RATES (as % of gross salary) [(1)]

	Effective average rate (%)	Employee Social Security (%)	Effective average rate including employee social security contributions (%)
Austria	10.9	18.1	29
Belgium	28.0	13.9	41.9
Denmark	33.5	10.5	44
Finland	27.3	7.4	34.7
France	14.2	13.4	27.6
Germany	21.2	20.8	42
Greece	2.9	15.9	18.8
Ireland	19.4	5.1	24.5
Italy	20.2	9.2	29.4
Luxembourg	11.5	14.7	26.2
Netherlands	6.7	28.9	35.6
Portugal	6.6	11.0	17.6
Spain	11.7	6.4	17.1
Sweden	27.2	6.9	34.1
United Kingdom	16.5	8.1	24.6
EU average	**17.2**	**11.9**	**29.1**

(1) Of a single individual at the income level of the average production worker.

Source: Own elaboration from: Taxing wages, OECD, Paris, 1999 and IBFD, European Taxation, Section B, Amsterdam, 2000.

Effective tax rates by family type and wage level

Average tax rates also vary significantly across various types of households. Tables 12 and 13 show data for the following eight household types, which differ by income level and household composition:

- A single individual with no children earning 67% of average production worker earnings.
- A single individual with no children earning 100% of average production worker earnings.
- A single individual with no children earning 167% of average production worker earnings.
- A lone parent with two children earning 67% of average production worker earnings.
- A married couple with two children and a single earner at the average production worker level.
- Two-earner married couples, with two children with earnings spilt between the two partners at 100-33 per cent of average production worker earnings.

- Two-earner married couples, with two children with earnings spilt between the two partners at 100-67 per cent of average production worker earnings.
- Two-earner married couples, with no children with earnings spilt between the two partners at 100-33 per cent of average production worker earnings.

The differences found in effective tax rates calculated for different wage levels and according to family status (Table 11) are important. The comparison between the effective tax rates of a single taxpayer and the rate applied to a married one and with two children show a decrease of rates in all countries except Finland where it remains at the same level. The most important relative decreases are in Luxembourg and Germany.

Comparing the case of a single income family, and the case of a two income family, in the case of a two income family, in which one earns the average wage and the other receives 1/3, in six countries – Austria, Finland, Greece, Italy, the United Kingdom and Sweden – tax rates are lower than in the case of a single income family in spite of the fact that family revenues have increased by 33%. In the rest of European countries tax rates are higher, except in Luxembourg, and Spain where they remain at the same level. The lowest increase of rates takes place in Portugal. The most important increases of rates are in Spain and Belgium.

If family revenues grow 33% more than in the previous case, in all the countries tax rates are higher except in Greece and Spain, where they are the same. Germany continues to be the country with the highest increase of relative variation. Again Denmark is the country with the highest rates: 31.8% and Luxembourg and Greece are the countries with the lowest levels: both with 2.5%

Table 12. EFFECTIVE TAX RATES BY FAMILY TYPE AND WAGE LEVEL

(as % of gross wage)

Family Type (1)	Type 1	Type 1	Type 1	Type 2	Type 3	Type 3	Type 3	Type 4
Wage Level (2)	**67%**	**100%**	**167%**	**67%**	**100-0**	**100-33**	**100-67**	**100-33**
AUSTRIA	5.2	10.9	17.3	-5.5	5.0	4.6	6.1	7.8
BELGIUM	21.2	28.0	34.8	14.4	17.1	21.7	24.8	23.8
DENMARK	29.3	33.5	41.8	29.3	26.7	29.3	31.8	29.3
FINLAND	21.2	27.3	34.5	21.2	27.3	23.8	24.9	23.8
FRANCE	10.0	14.2	19.0	7.6	7.6	8.7	10.0	10.7
GERMANY	15.3	21.2	28.7	-4.0	0.1	7.8	12.6	15.3
GREECE	1.2	2.9	8.2	0.0	3.3	2.6	2.5	2.9
IRELAND	12.5	19.4	30.0	3.2	10.1	12.5	14.8	12.5
ITALY	16.0	20.2	24.9	10.8	16.1	15.4	17.5	16.6
LUXEMBOURG	5.9	11.5	20.7	0.0	0.0	0.0	2.5	3.5
NETHERLANDS	5.1	6.7	21.7	2.9	4.8	5.8	6.0	5.8
PORTUGAL	2.7	6.6	13.3	0.0	2.5	2.9	4.1	4.9
SPAIN	5.4	11.7	16.8	0.0	2.5	6.9	6.9	8.8
SWEDEN	24.9	27.2	34.9	24.9	27.2	26.1	26.3	26.1
UNITED KINGDOM	13.2	16.5	19.1	11.6	15.4	12.4	14.5	12.4
European average	12.6	17.2	24.4	7.8	11.0	12.0	13.7	13.6

(1) Family types:
Type 1= Single, no children
Type 2 = Single, two children
Type 3 = Married, two children, two-earner family
Type 4 = Married , no children, two-earner family

(2) Wage level as percentage of APW (Average Production Worker) earnings.

Source: Own elaboration from: Taxing wages, OECD, Paris, 1999 and IBFD, European Taxation, Section B, Amsterdam, 2000.

Table 13. INCOME TAX PLUS EMPLOYEE CONTRIBUTIONS LESS CASH BENEFITS

(as % of gross wage)

Family Type (1)	Type 1	Type 1	Type 1	Type 2	Type 3	Type 3	Type 3	Type 4
Wage Level (2)	**67%**	**100%**	**167%**	**67%**	**100-0**	**100-33**	**100-67**	**100-33**
AUSTRIA	23.3	29.0	35.4	-6.6	10.3	13.1	16.4	25.9
BELGIUM	34.2	42.0	48.9	12.2	20.9	28.0	32.7	37.8
DENMARK	40.6	44.0	51.7	14.1	30.7	35.7	38.8	40.6
FINLAND	28.5	34.6	41.9	8.8	24.8	23.7	26.3	31.1
FRANCE	23.4	27.6	31.0	12.0	15.0	17.6	19.8	24.1
GERMANY	36.1	42.0	47.5	16.8	20.9	28.6	33.4	36.1
GREECE	17.1	18.8	24.1	15.9	19.2	18.5	18.4	18.8
IRELAND	14.8	24.5	35.5	-14.1	10.3	12.7	15.8	16.3
ITALY	25.2	29.4	34.1	3.8	16.1	22.1	25.8	25.8
LUXEMBOURG	20.6	26.2	35.4	-8.2	-0.6	3.2	8.0	18.1
NETHERLANDS	31.2	35.6	39.2	9.7	23.8	26.7	29.6	32.0
PORTUGAL	13.7	17.6	24.3	3.5	8.5	10.1	12.0	15.9
SPAIN	11.8	18.1	23.2	6.4	8.9	13.6	13.3	15.5
SWEDEN	31.8	34.2	40.4	19.7	26.1	27.0	28.4	33.0
UNITED KINGDOM	20.4	24.6	26.5	7.4	16.7	14.5	18.2	19.6
European average	24.8	29.9	35.9	6.8	16.8	19.7	22.5	26.0

(1) Family types:
Type 1= Single, no children
Type 2 = Single, two children
Type 3 = Married, two children, two-earner family
Type 4 = Married , no children, two-earner family

(2) Wage level as percentage of APW (Average Production Worker) earnings.

Source: Own elaboration from: Taxing wages, OECD, Paris, 1999 and IBFD, European Taxation, Section B, Amsterdam, 2000.

Employers' contributions

In all countries except in Denmark, there are also very large employers' Social Security Contributions. It is possible to consider these as part of employees' income; but they have no tax implications for the employees themselves. From the point of view of employers, however, they can be considered as taxes on labour, adding to non-wage labour costs. They also, of course, contribute to total tax revenues. In table 14, you can find employee and employer social security contributions as percentage of labour costs. Employer social Security contributions are above the EU average in France (at 28%, the highest), Belgium, Sweden, Italy, Austria and even in countries such as Spain, Greece and Portugal, where personal income tax rates are the lowest. In other cases, (see Denmark), social security contributions are very low and by contrast, personal income tax rates are the highest.

Table 14 shows effective average rates as percentage of labour costs: income tax, employee and employer social security contributions and finally, in the last column the total amount.

Table 14. INCOME TAX, EMPLOYEE AND EMPLOYER SOCIAL SECURITY CONTRIBUTIONS

(as % of labour costs) [(1)]

	Effective average rate (%)	**Employee Social Security Contributions (%)**	**Employer Soc. Sec. Contributions (%)**	**Total**
AUSTRIA	8	14	24	46
BELGIUM	22	10	26	57
DENMARK	34	10	1	44
FINLAND	22	6	21	49
FRANCE	10	9	28	48
GERMANY	17	17	17	52
GREECE	2	12	22	36
IRELAND	18	5	11	33
ITALY	14	7	26	47
LUXEMBOURG	10	11	12	34
NETHERLANDS	6	23	14	44
PORTUGAL	6	9	19	34
SPAIN	11	5	24	39
SWEDEN	21	5	25	51
UNITED KINGDOM	15	8	9	32
European average	14.4	10.1	18.6	43.1

(1) Of a single individual at the income level of the average production worker.
Source: Own elaboration from: Taxing wages, OECD, Paris, 1999 and IBFD, European Taxation, Section B, Amsterdam, 2000.

Table 15. (GRAPH) EFFECTIVE RATES AS PERCENTAGE OF GROSS SALARY

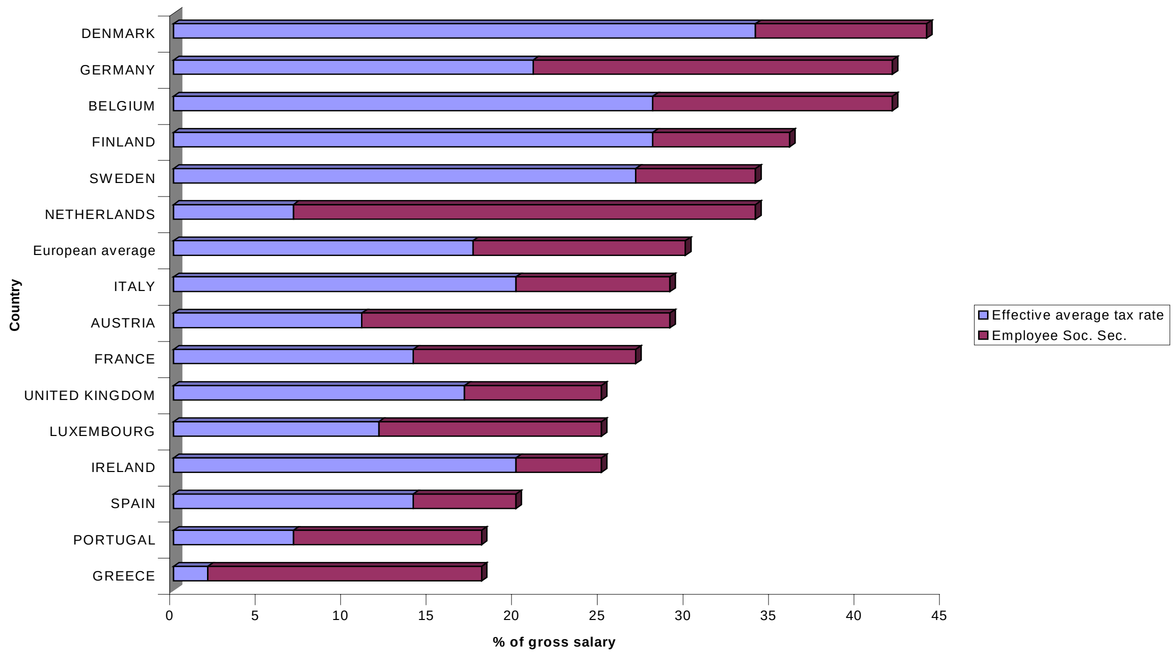
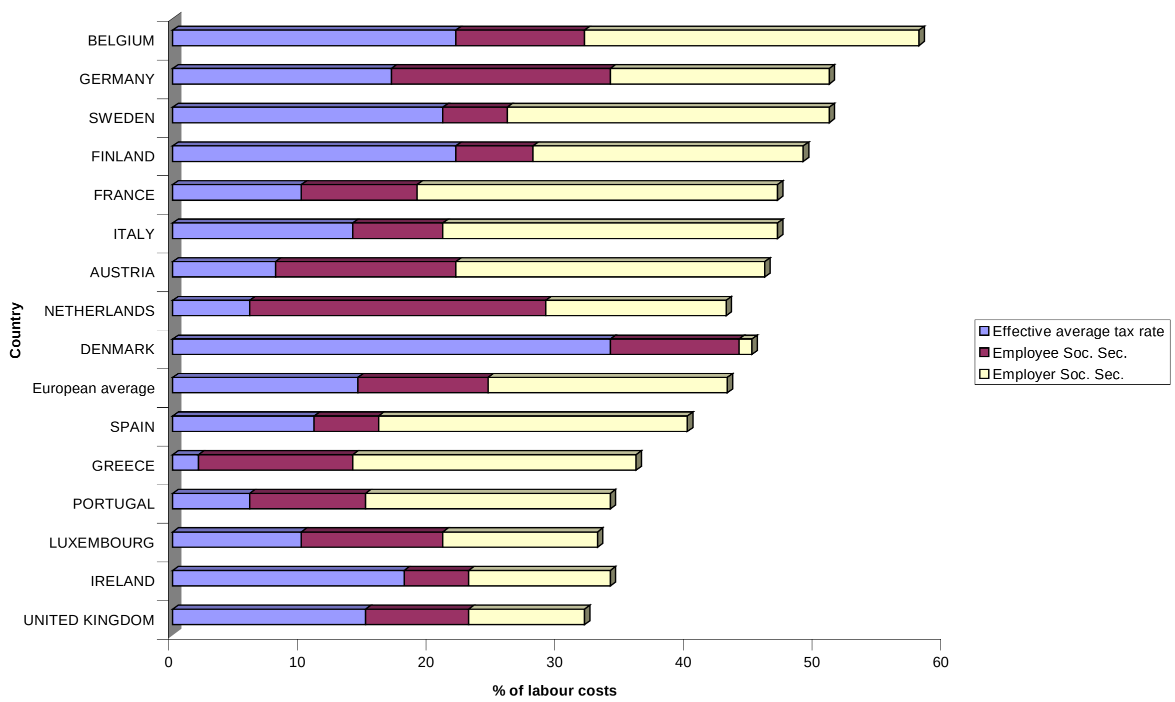


Table 16. (GRAPH) EFFECTIVE RATES AS PERCENTAGE OF LABOUR COSTS



Other personal income taxes

1. Local and regional taxes

When comparing different tax systems, most studies compare only the rates of Personal Income Tax imposed by central government. However, many countries also levy other taxes on personal income.

In some European countries workers have to pay local, regional, provincial or state income taxes on top of the central government income tax. This is the case in Belgium, Denmark, Finland and Sweden. In some of them, these taxes are quite significant: for instance in Sweden and Denmark, rates are around 31%, and in Finland local tax rate in Helsinki is 16,5%. In local and regional taxes, rates are not progressive, most countries apply flat rates, and these rates vary from municipality to municipality.

2. Temporary surcharges and church taxes

Central governments sometimes impose temporary increases on the income tax, such as the Austerity Surcharge in Belgium, the German Solidarity Tax and the Unemployment Surcharge in Luxembourg. Such surcharges, 3%, 5.5% and 2.5% respectively, jack up the total income tax bill.

Another feature to watch out for, is the tax some national governments impose on income behalf of the state church. Austria[63], Germany, Sweden[64], Finland and Denmark all have such a church tax, although rates are in general quite low (from 0.39% to 1.5% in Denmark, from 1% to 2.25% in Finland, and from 8% to 9% in Germany). However, someone may ask whether the church tax really is a tax as defined by international organisations: a compulsory, “unrequited”[65] payment to general government.

[63] In Austria church tax rates depend on authorities negotiations every year. In 1998 rates ranged from 1.1 % to 1.5%.

[64] In 2000, church tax was abolished. Now there is a surcharge on the income tax.

[65] Here, “unrequited” means that benefit provided by government to taxpayers are not normally in proportion to their payments.

Taxes on Income from Capital

The importance of saving lies in its potential to cause macroeconomic imbalances in the short term, and its key role in capital accumulation and economic growth in the long term.

General economic principles suggest that ideally the taxation of income capital should not influence economic decisions made by economic agents and should not interfere with the optimal allocation of capital across countries. Tax differences may cause inefficiencies in the real economy.

One of the main objectives in this chapter is to identify differences in the tax treatment of savings: interest and dividend income among the European Union Member States.

The first part of this chapter provides a brief description of the basic provisions concerning the taxation of interest and dividend income from both domestic and foreign sources in European Union Member States. The information provided usually relates to tax regulations in force at the end of 1999. The countries surveyed include all European Union Member States, although in some cases data from Greece and Portugal were not available.

Secondly, the co-ordination of this type of tax is analysed.

Taxation of domestic interest income

There is no withholding tax on interest income in Denmark, Luxembourg and the Netherlands. Income from interest is included in the taxable income of the resident individual investor. Tax is calculated in accordance with the progressive income tax tables with maximum ordinary tax rates ranging up to 60% in the Netherlands, and 58% in Denmark.

Interest withholding tax is not final in Germany (30%), Spain (18%), and the United Kingdom (20%), but treated as a prepayment to the income tax liability. The tax withheld on the interest is credited against the resident investor's final income tax liability. The withholding tax is the final income tax for resident individuals in Austria (25%), Belgium (15%), Finland (28%), Ireland (15%, 10% or 26%), Italy (12,5% to 27%), Norway (28%) and Sweden (30%). In France, a final withholding tax of 15% on interest income is optional, and the ordinary income tax may be replaced by this withholding tax.

Table 17. DOMESTIC TAXATION OF INTEREST INCOME

	Withholding Tax		**Personal Income Tax**		
	Final	Not Final	Maximum Rate	Reduced Rate	Basic Tax-free amount
AUSTRIA	25%	-	50%	-	-
BELGIUM	15%	-	55%	-	-
DENMARK	-	-	58% (1)	40% (for capital income)	-
FINLAND	28% (2)	-	55.5% (3)	28% (2) flat rate on capital income	-
FRANCE	15% (standard), 35% or 60%	Optional	54% + surcharges (optionally replaceable by a final withholding tax)	-	FF 8.000 for single individuals and FF16.000 for married couples
GERMANY	-	30% or 35%	53% (+ surcharges)	-	DM 6.100 for individuals and DM 12.200 for married couples (4)
IRELAND	26%, 15% or 10%	-	48%	-	-
ITALY	12.5% or 27%	-	46%	-	-
LUXEMBOURG	-	-	46%(+ 2.5% unemployment fund contribution)	-	LUF 60.000 for individuals and LUF 120.000 for married couples
NETHERLANDS	-	-	60%	-	Dfl. 1.000 for individuals and Dfl. 2.000 for spouses
SPAIN	-	18%	48%	-	-
SWEDEN	30%	-	56% (5)	30% on capital income	-
UK	-	20%	40%	20%	-

(1) Including local tax in Copenhagen at 31,8%. The total limit is 58%.
(2) From 1-1-2000, this figure is 29%
(3) In Finland, this figure includes 16.5% of local tax.
(4) In Germany, in the year 2000 these amounts have been reduced to 3.000 DM for individuals and 6.000 DM for married couples.
(5) Including Swedish local tax at 31%.

Note: Data from Greece and Portugal are not available.
Source: Own elaboration from: Confédération Fiscale Européene, The Taxation of Savings, C.F.E., Paris, 1997 and IBFD, European Taxation, Section B, Amsterdam, 2000.

Taxation of domestic dividend income

There are four different systems of dividend taxation:

- partial imputation systems
- full imputation systems
- shareholder relief systems
- classical system

These very different ways of treating dividend income provide varying degrees of relief from double taxation. Only the Netherlands operates a classical corporate tax system, under which profits distributed in the form of dividends are fully taxed twice, once at the corporate level, and again at the shareholder level. The other countries provide varying degrees of relief.

Ireland, Spain and the United Kingdom apply partial imputation systems, allowing part of the corporate tax paid on distributed profits to be credited against the resident investor's personal income tax liability. Spain levies a withholding tax of 18% on domestic dividends, which is credited against the resident investor's personal income tax. Ireland and United Kingdom do not levy withholding taxes on dividends paid to shareholders by domestic companies; the company must, when it pays a dividend, make a prepayment of its corporate tax liability as advance corporation tax (ACT). Residents in receipt of such dividends are subject to income tax on the gross dividend, then a tax credit is obtained against the individual's tax liability for the credit on the dividend.

Under the full imputation system, as operated in Finland and Germany, the entire tax paid by the company on its distributed profits is credited against the shareholder's personal income tax liability. This eliminates the double taxation of dividends in full. France and Italy are quite close to full imputation. Germany and Italy is subject to withholding tax at 25% and 12.5%, respectively. In these countries the tax imposed on dividends is credited against the resident investor's tax liability. For personal income tax purposes, the dividend is included in the total taxable income of the taxpayer. Shareholders are entitled to a full tax credit, which amounts to 3/7 and 9/16, respectively, on the dividend paid.

In Finland, income from dividends is taxed at 28%, dividends appear to be tax-free for shareholders, who only need to state the amount of the dividend in their income tax return, the authorities then gross up this amount and net off the corporate tax (also 28%). In France, no withholding tax applies to dividends from domestic source to French residents. Dividend income is included in total personal taxable income. Avoidance of double taxation is accomplished by granting resident shareholders a tax credit equal to 50% of the dividend paid.

The withholding tax on dividend income is final in Austria (25%) and Belgium (25%, in some cases reduced to 20% or 13%). These countries provide no imputation tax credit, but rather achieve relief from double taxation by applying the above reduced final tax rates on domestic dividend income of resident investors. In Luxembourg, shareholders are taxed only on 50% of the gross amount of dividends received. The withholding tax of 25% levied at source by the corporation on the gross dividend is deducted from the final tax of the recipient. In Denmark, dividends are subject to a 25% withholding tax. If the investor's total income from shares does not exceed a limit, the withholding tax is a final tax. Any income in excess of this limit is taxed at a maximum ordinary tax rate for dividend income of 40%. Sweden, in principle, also falls into this category (final taxation at 30%. However, individual shareholders are exempted from payments of any tax on dividend income from Swedish companies.

In 1997, the Netherlands changed over to a mixed systems: a new shareholder relief system for shareholders with a participation of 5% or more was introduced, and the old classical system continued applying to all other shareholders. Under the new Dutch system, there is a final withholding tax of 25% on qualifying dividends, and any capital gain realized by the investor is subject to the same rate of 25%.

Table 18. DOMESTIC TAXATION OF DIVIDEND INCOME

	Withholding Tax		**Personal Income Tax**			
	Final	Not Final	Maximum Rate	Reduced Rate	Imputation Tax Credit	Basic Tax-free Amount
AUSTRIA	25%	-	50%	-	No Tax credit	-
BELGIUM	25% (1)	-	55%	-	No Tax credit	-
DENMARK	25% (2)	Only if limit is exceeded	40% on dividend income	-	No Tax credit	-
FINLAND	-	-	55.5% (3)	29% for capital income	Full imputation	-
FRANCE	-	-	54% + surcharges	-	Tax credit equal to 50% of the dividend paid	FF 8.000 for single and FF16.000 for spouses
GERMANY	-	25%(+ surcharges)	53%(+ surcharges)	-	Tax credit equal to amount of corporation tax paid on distributed profits (full imputation)	DM 6.100 for individuals and 12.200 for spouses
IRELAND	(5)	(5)	48%	-	Tax credit equal to the ACT paid (partial imputation)	-
ITALY	12.5%		46%	Tax credit equal to 9/6 of the dividend paid. Almost full imputation	-	-

LUXEMBOURG	-	25%	46% (+surcharges)	-	-	(6)
NETHERLANDS	25% (in case of a participation of min. 5%	25% in other cases	60%	25% (under new system)	Classical system or shareholder relief under new system	Dfl. 1.000 for individuals and Dfl 2.000 for spouses
SPAIN	-	18%	48%	-	Gross dividend multiplied by 140%, then imputation credit of 40%	-
SWEDEN	30%	-	56%	30% for capital income	-	-
UNITED KINGDOM	(7)	(7)	40%	20%	Tax credit equal to the ACT paid (partial imputation system)	-

(1) In some cases, reduced to 20 or 15%.
(2) 25% of final taxation if dividend income is below inflation adjusted limit.
(3) In Finland, this figure includes 16.5% of local tax.
(4) There was no withholding tax in Ireland. However, a company must make a prepayment of corporation tax (ACT). ACT equal to 21/79 of dividend paid. From 6-4-1999 there has been a withholding tax (not final) of 24%
(5) LF 60.000 for individuals and LF 120.000 for married couples of dividend and interest income are tax-exempt.
(6) There is no withholding tax in United Kingdom, however company must make a prepayment of corporation tax (ACT). ACT equal to 20/80 of dividend paid.

Note: Data from Greece and Portugal are not available.

Source: Own elaboration from: Confédération Fiscale Européene, The Taxation of Savings, C.F.E., Paris, 1997 and IBFD, European Taxation, Section B, Amsterdam, 2000.

Tax treatment of interest income from foreign sources

Generally, individuals are taxed on their world-wide income, from whatever source; so resident investors who invest abroad are subject to tax on interest income in both the country of residence and the country of source. However, bilateral tax treaties have in most cases brought withholding taxes on interest payments down to low levels, quite often to zero. If the interest is still subject to tax in the source country, the country of residence usually gives a credit against the domestic tax liability for tax charged by the foreign jurisdiction . Countries typically impose a limitation on these foreign tax credits, which in most cases is equal to the domestic tax liability on the foreign-source income.

In Austria (25%), Belgium (15%), Finland (28%), France (15%), Ireland (26%, 15% or 10%), Italy (12.5 to 27%), Sweden (30%), Norway (28%), domestic interest received is subject to a final withholding tax at the indicated rate. By contrast, interest income from a foreign source in principle is considered as ordinary income and taxed as such at progressive rates. Only Belgium and Finland tax foreign interest at the same rate. Other countries - that is, Germany and Luxembourg - tax all interest income, whatever the country of source, at progressive income tax rates. In some countries foreign interest income cannot benefit from the tax allowances attributable to domestic savings income. In France the option to have the withholding tax as a final tax is not available for foreign interest income.

Tax treatment of dividend income from foreign sources

The tax treatment of dividend income from foreign sources depends on the system applied in the investor’s country. If the investor lives in a country with a classical system - e.g. the Netherlands - there is in principle no discrimination between domestic and foreign source dividend income. No matter whether dividends are distributed from domestic or foreign companies, they are fully taxed twice: once at the corporate level in the country of source and again at shareholder level in the country of residence of the recipient of the dividend.

If the investor lives in a country with an imputation system, when a domestic company distributes foreign source income to domestic shareholders, it is usually fully taxed, because there is no imputation tax credit for foreign corporation taxes paid. This results in discrimination against investment in foreign companies.

Where domestic dividend income is subject to a final reduced tax and where no tax credit is granted in respect of corporate income tax already paid, discrimination against foreign dividends is, in principle, avoided – provided that the same tax rates apply to domestic and foreign source dividends. This is the case in Belgium, where dividend receipts are subject to a final tax of 25%, whatever the source.

Other countries like Austria and Sweden, despite operating a similar tax system, discriminate against ownership of shares in foreign companies. Austria applies a final withholding tax rate on domestic dividends of 25%, while foreign source dividend income is taxed at progressive tax rates. In Luxembourg, only 50% of the gross dividend received from resident companies is taxable, whereas foreign dividends are fully taxable. In Sweden, individual shareholders are exempted from payments of any tax on dividend income from Swedish companies, but this treatment is not applicable to foreign dividends.

Table 19. TAX TREATMENT OF INTEREST INCOME FROM FOREIGN SOURCES

	Taxation at progressive income tax rates		**Reduced Rate**	**Credit for foreign tax**
		Maximum Rate		
AUSTRIA	Yes	50%	25% if interest credited to Austrian bank account	-
BELGIUM	No	55%	15%	-
DENMARK	Yes	58%	-	-
FINLAND	No	55.5% (1)	28% (2)	Yes
FRANCE	Yes	54%	-	Yes
GERMANY	Yes	53% (+ surcharges)	-	Yes
IRELAND	Yes	48%	-	-
ITALY	No	46%	In general 12.5 or 27% final taxation	-
LUXEMBOURG	Yes	46%(+ 2.5% unemployment fund contribution)	-	-
NETHERLANDS	Yes	60%	-	-
SPAIN	Yes	48%	-	Yes
SWEDEN	No	56% (3)	30%	Yes
UNITED KINGDOM	Yes	40%	-	Yes

(1) Including 16,5% of Helsinki local tax.
(2) From 1-1-2000, this figure is 29%.
(3) Including 31% of Swedish local tax.

Note: Data from Greece and Portugal are not available.

Source: Own elaboration from: Confédération Fiscale Européene, The Taxation of Savings, C.F.E., Paris, 1997 and IBFD, European Taxation, Section B, Amsterdam, 2000.

Table 20. TAX TREATMENT OF DIVIDEND INCOME FROM FOREIGN SOURCES

	Taxation at progressive income tax rates		**Reduced Rate**	**Credit for foreign tax**
		Maximum Rate		
AUSTRIA	Yes	50%	25% if interest credited to Austrian bank account	-
BELGIUM	No	55%	25%	-
DENMARK	Yes	58%	-	-
FINLAND	No	55.5%	28% (1)	-
FRANCE	Yes	54%	-	-
GERMANY	Yes	53% (+ surcharges)	-	-
IRELAND	Yes	48%	-	-
ITALY	No	46%	In general 27% final taxation	Yes
LUXEMBOURG	Yes	46% (+ 2.5% unemployment fund contribution)	-	-
NETHERLANDS	Yes	60%	-	-
SPAIN	Yes	48%	-	-
SWEDEN	No	56%	30%	-
UNITED KINGDOM	Yes	40%	-	-

(1) From 1-1-2000, this figure is 29%.

Note: Data from Greece and Portugal are not available.

Source: Own elaboration from: Confédération Fiscale Européene, The Taxation of Savings, C.F.E., Paris, 1997 and IBFD, European Taxation, Section B, Amsterdam, 2000.

Corporate Taxes

Corporation Tax can be considered an essential adjunct to personal income tax. Where the latter taxes individuals or families as legal entities, corporate taxes are levied on commercial bodies having legal personality.

Such bodies are generally, of course, owned by individuals – the shareholders – who are taxed on the dividends they receive. In principle such corporate income therefore has a double liability; but a number of arguments can be advanced for this situation.

- Taxation can be levied on retained profits, which accrue to shareholders in the form of capital appreciation, and would not be taxed (if at all) until the appreciation was realised[66].

- It taxes pure profits or rents, defined as the difference between the accrued revenue of a firm and the full imputed cost of producing that revenue. It is argued that if the corporate tax base could be restricted to pure profits or economic rents, the tax would not affect investment decisions.
- Corporate tax can be used as an instrument of economic policy to influence the allocation of capital within the private sector[67].

There are many differences in the corporate tax systems operated by each Member State, including considerable variations in the tax rates and tax base. In addition to these differences, there are, more specifically, differences in other aspects of corporate taxes. This chapter provides a brief summary of the key features of the systems in the European Union[68].

Structure of corporation tax rates

All EU countries levy corporation taxes at the central government level. The rates vary between 28% (Finland and Sweden) to 37% (Italy). In Belgium, Ireland, Netherlands and United Kingdom, rates are progressive, the maximum rate being 45% in Germany, and the minimum rate 21% in United Kingdom. Germany distinguishes between retained income (rate is 45%), distributed income (30%), and non-resident companies (40%), and Greece applies a rate of 35% for resident companies, and 40% for non-resident companies. Germany, Austria, Italy, Luxembourg and Portugal levy a tax at the local level, and in most of these countries the rates at the local level vary from region to region.

---

[66] This argument was considered by the Carter Commission to be the only real function of the corporate tax. See Report of Royal Commission on Taxation, Ottawa, Queen´s Printer, 1966.

[67] A more detailed description of the various functions of corporate taxes can be found in the Mead Committee Report published by the Institute for Fiscal Studies and Report of the Committee of Independent Experts on Company Taxation, Commission of the European Communities, Luxembourg, 1992.

[68] See Di Malta, P., *Droit fiscal européen comparé,* Presses Universitaires de France, Paris, 1995, and IBFD, *European Taxation, Taxation of Corporations,* Section A, Amsterdam, 1997.

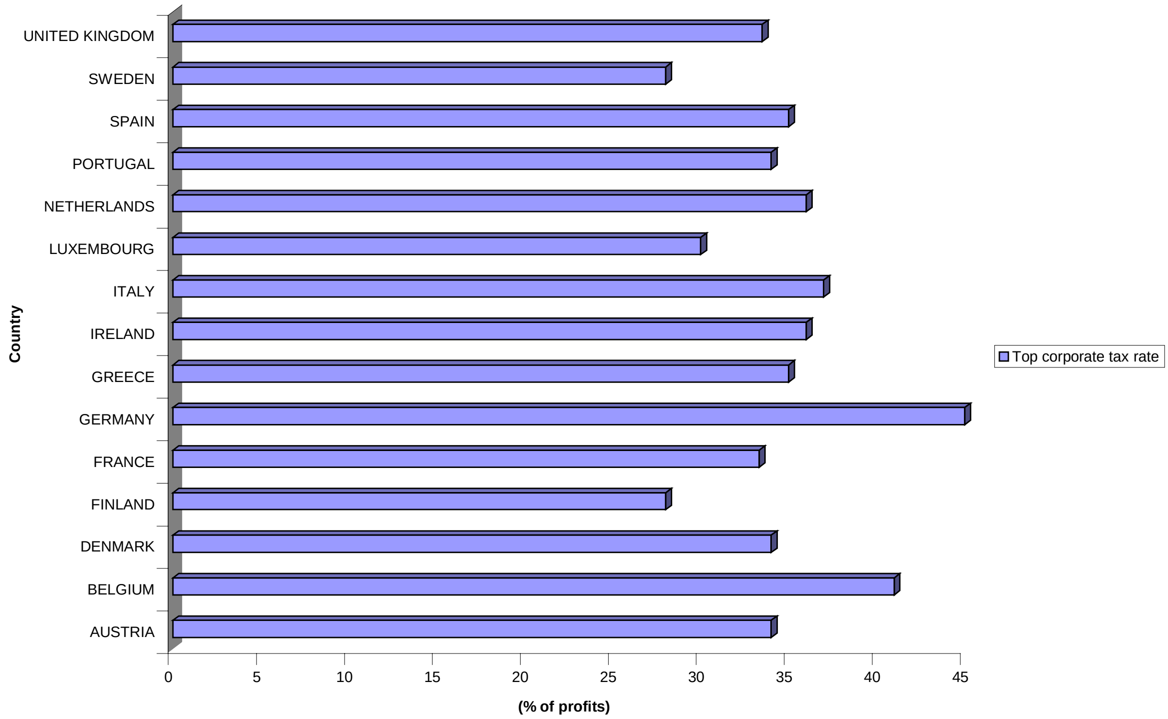
Table 21. CORPORATION TAX RATES AT THE CENTRAL GOVERNMENT LEVEL

Country	Rate (%)
AUSTRIA	34
BELGIUM (1)	28-41
DENMARK	34
FINLAND	28 (2)
FRANCE	33.33
GERMANY	30-45 (3)
GREECE	35-40 (4)
IRELAND	28-36 (5)
ITALY	37
LUXEMBOURG	30
NETHERLANDS	35-36 (6)
PORTUGAL	34
SPAIN	35(7)
SWEDEN	28
UNITED KINGDOM	21-33.5 (8)

(1) In Belgium, the rates are progressive: first BEF 1.000.000: 28%; next BEF 2.600.000: 36%;
Next BEF 9.400.000: 41%; excess over 13.000.000: 39%
(2) From 1-1-2000 this figure is 29%
(3) Retained income: 45%; Distributed income: 30%; Non-resident companies 40%. From 1-1-2000 the retained income rate has been reduced to 40%
(4) Non- resident companies: 40%
(5) First IEP 100.000 25%; Excess there over: 28%. In 2000, there is only one rate of 24%. In 2001, this rate will be 21%.
(6) First NLG 100.000: 36%; Excess there over: 35%
(7) In Spain, rates for small corporates (with incomes below 250.000.000 ptas) are 30% from 0 to 15.000.000 ptas and 35% up to 15.000.000.
(8) Up to £300.000: 21%; Next £1.200.000: 33.5%; Excess over £1.500.000: 31%

Source: Own elaboration from: IBFD, European Taxation, Section A, Amsterdam, 2000.

Table 22. (GRAPH) CORPORATE TAX RATES IN THE EUROPEAN UNION



The corporation tax base

Taxable income is calculated in similar ways under the different tax regimes. Income arising from all sources, including non-business income as well as business or trading income, is normally included in the base. Taxable income is computed on the basis of ordinary principles of sound commercial accounting practice, and is generally based on the profits shown in the company accounts. In order to arrive at the profit for tax purposes, some adjustments are often required by statute. The general rule is that expenses incurred in earning taxable income, and in maintaining the assets used in the company's activities, are deductible.

In all Member States there are some measures that have the effect of correcting for inflation. Correcting for inflation may be relevant to three aspects of the measurement of the tax base:

- the depreciation system;
- capital gains taxation; and
- the treatment of stocks.

In order to achieve the objective of taxing real income, capital gains in most countries are partly exempt. Depreciation rules and rates may be favourable (accelerated depreciation). As regards the treatment of stocks, the use of the LIFO method in some countries provides some adjustment for the impact of inflation on the cost of stock replacement.

The treatment of interest

Interest payments are deductible in all Member States if incurred for business purposes, and if the capital amount is used for generating taxable income. Belgium and Portugal provide for some restriction on the amount of interest that may be deducted.

In Italy interest expenses are deductible. However, if a company receives exempt interest from public or private bonds, interest paid is not deductible up to the amount of the exempt interest. Any excess interest paid is deductible for an amount corresponding to the ratio of gross taxable income to total gross income (including the exempt interest).

The treatment of losses

All countries allow a company to carry the amount of trading losses forward, and some allow a carry back of trading losses. The number of years over which trading losses can be carried forward ranges between five years and indefinitely. Germany, France, Ireland, Netherlands and United Kingdom allow the carrying back of trading losses, the period varying from one to three years. In some countries there are, however, limitations for certain types of losses.

Depreciation allowances

An allowance for the depreciation of assets is given in all countries. Various systems are used in different countries, the most frequent being straight-line depreciation (equal allowances over a number of years) and declining balance. In the latter case the actual allowance will be larger in the initial year and gradually diminish in subsequent years.

Machinery is generally depreciated through the declining balance method, except in Austria, Italy and Greece, which use the straight-line method. In a number of countries taxpayers have a choice of depreciation method.

For **buildings** the straight-line method is the more common way of depreciation. In some cases, where the tax authorities allow the declining balance method, a change to the straight-line method is allowed or prescribed. Some countries allow accelerated depreciation: this is the case in Germany, Belgium, France, Finland, Luxembourg and Italy. In most, however, it is only allowed in some exceptional cases and under certain restrictions.

Treatment of inventories

There are a variety of methods to value stock for tax purpose. Inventories can be valued according to the FIFO method in all European countries. The LIFO method is allowed in Germany, Belgium, Austria, Italy, Greece, Portugal, Luxembourg and the Netherlands, though some of them impose severe restrictions on the use of this method. In France, LIFO can be authorised in some exceptional cases.

Table 23. TREATMENT OF TRADING LOSSES

	Carry forward (maximum years authorised)	**Carry back (maximum years authorised)**
AUSTRIA	Unlimited	Not allowed
BELGIUM	Unlimited (1)	Not allowed
DENMARK	5	Not allowed
FINLAND	10	Not allowed
FRANCE	5	3 (with certain limitations)
GERMANY	Unlimited (2)	1 (3)
GREECE	5 or 3 (4)	Not allowed
IRELAND	Unlimited	(5)
ITALY	5	Not allowed
LUXEMBOURG	Unlimited	Not allowed
NETHERLANDS	Unlimited	3
PORTUGAL	6	Not allowed
SPAIN	7	Not allowed
SWEDEN	Unlimited	Not allowed
UNITED KINGDOM	Unlimited	1

(1) The previous limitation on the amount of losses that could be carried forward has been completely abolished with effect from the assessment year 1998 onwards.
(2) Restrictions apply to the set-off of losses derived from foreign operations.
(3) Only when losses are below two millions DM (year 2000) and one million (year 2001)
(4) 5 years in the case of an industrial or production company and 3 years in the case of a trading company.
(5) A loss incurred in the last year of trading can be set off against trading profits of the 3 prior years.

Source: Own elaboration from: IBFD, European Taxation, Section A, Amsterdam, 2000.

Table 24. DEPRECIATION SYSTEMS

	Method of depreciation		**Rate of depreciation (%)**			
			Machinery		***Buildings***	
	Machinery	***Buildings***	SL	DB	SL	DB
AUSTRIA	SL	SL	10		2-4	
BELGIUM	SL/DB	SL/DB	10-33	2xSL	3-5	2xSL
DENMARK	DB	SL/DB		30	6	4-8
FINLAND	DB	DB		30		4-20
FRANCE	SL/DB	SL	(1)	2.5-3.5xSL	(1)	
GERMANY	SL/DB	SL/DB	10	3xSL	2-4	1.25-5
GREECE	SL	SL	10-15		5-8	
IRELAND	SL/DB	SL	15	20	4	
ITALY	SL	SL	20-25		3-7	
LUXEMBOURG	SL/DB	SL/DB	10-25	3xSL	2-5	3xSL
NETHERLANDS	SL/DB	SL/DB	(2)	(2)	(2)	(2)
PORTUGAL	SL/DB	SL	12.5-33.33	0.5-1.5x SL	2-5	
SPAIN	SL/DB (3)	SL	8-30	0.5-1.5xSL	2-3	
SWEDEN	SL/DB	SL	20	30	1.5-5	
UNITED KINGDOM	DB	SL		25	4	

Symbols: SL: straight line; DB: declining balance.

(1) Rates in this method are computed by dividing the expenditure by the estimated useful life of the asset.
(2) No official guidelines for depreciation exist; in practice, the rates are agreed upon between the taxpayer and the tax authorities.
(3) And also the sum- of- the- years´-digits method.

Source: Own elaboration from: Confédération Fiscale Européene, The Taxation of Savings, C.F.E., Paris, 1997 and IBFD, European Taxation, Section A, Amsterdam, 2000.

Table 25. TAX TREATMENT OF INVENTORIES

	Methods of evaluating cost		
Country	**FIFO**	**LIFO**	**Cost price or market value**
AUSTRIA	Yes	Conditional	Yes
BELGIUM	Yes	Yes	Yes
DENMARK	Yes	No	Yes (1)
FINLAND	Yes	No	Yes
FRANCE	Yes	No (2)	Yes
GERMANY	Conditional	Yes	Yes
GREECE	Yes	Yes	Yes
IRELAND	Yes	No	Yes
ITALY	Yes	Yes	Yes
LUXEMBOURG (3)	Yes	Yes	Yes
NETHERLANDS	Yes	Yes	Yes
PORTUGAL	Yes	Yes	Yes
SPAIN (4)	Yes	Yes	Yes
SWEDEN	Yes	No	Yes
UNITED KINGDOM	Yes	No	Yes

(1) In Denmark, the value may, for tax purposes, be reduced by up to 16%in 1995, 12% in 1996 and 8% in 1997.
(2) Can be authorised in some exceptional cases.
(3) LIFO, HIFO, FIFO and averages cost method are generally allowed, however, the base-stock method is not allowed.
(4) Inventory is generally valued according to the weighted average cost method, but other methods, like LIFO and FIFO are also accepted.

Note: In some countries, other methods may also be allowed. In most countries, whatever method is adopted, it must be consistently applied from year to year and may not be changed without the approval of the Directorate General of Taxes.

Source: Own elaboration from: Confédération Fiscale Européene, The Taxation of Savings, C.F.E., Paris, 1997 and IBFD, European Taxation, Section A, Amsterdam, 2000.

Treatment of provisions

The rules for the treatment of provisions for contingencies vary considerably from one country to another. Germany, the Netherlands, and Luxembourg could be considered liberal, while other countries, such as Italy, Belgium and France are rather restrictive. According to some estimates, the percentage of the tax-free provisions as a proportion of balance sheet value is 27% in Germany and only 6% in Italy and Belgium.

Special incentives

Current expenditures on **research and development** are generally deductible in the year in which they are incurred, except in the Netherlands, where in some cases costs must be spread over a number of years. Research assets qualify for accelerated depreciation or shorter agreed useful lives in a number of countries, whereas in others, special tax credits are applied.

Certain countries have special tax regimes for **specific locational zones**. A number of Member States have created special advantages for financial and management activities. These advantages may be in the form of partial or total exemption from corporate tax, special definition of the tax base, etc.

Table 26. GENERAL INVESTMENT RELIEFS

Country	General investment allowance available	General investment credit available	General cash grants available irrespective of sector or activity
AUSTRIA	9% of the costs of acquisition or production of qualifying assets, which have a minimum useful life of 4 years.	No	No
BELGIUM	Normal investment deduction of 13.5% for investments in patents and research, and small and medium sized companies may take a deduction of 3% on investment in other assets. There is a special investment deduction for certain companies.	No	No
DENMARK	No	No	No
FINLAND	No	No	No
FRANCE	No	A tax credit for research and development equal to 50% of the difference between the expenditure during the year and the average during the preceding 2 years.	No
GERMANY	No	No	No
GREECE	Between 40% and 100% of the amount invested	No	No
IRELAND	No	No	No
ITALY	No	No	No
LUXEMBOURG	No	A tax credit of 6% for investments in qualifying assets, other than buildings, livestock, and mineral deposits.	No
NETHERLANDS	The investment deduction is calculated as a percentage of the cost price of total annual investment. The deduction is only available if the total amount is between certain limits. (1)	No	No

PORTUGAL	No	Tax credit equal to 8% of the amount by which the investments of the current year are in new tangible fixed assets, and a tax credit of 30% of the difference between the expenditure during the year and the average during the preceding 2 years.	No
SPAIN	No	Tax credit of 5% of investments in new tangible fixed business assets and 20% for research and development expenses.	No
SWEDEN	Yes, investment reserve provisions	No	No
UNITED KINGDOM	The investment incentives mainly take the form of the enterprise investment scheme.	No	No

(1) The deduction is only available if the total annual amount is between NLG 3.800 and 556.000. From 3.800 to 61.000, the percentage is 27%, and for excess this percentage is lower.

Source: Own elaboration from: Confédération Fiscale Européene, The Taxation of Savings, C.F.E., Paris, 1997 and IBFD, European Taxation, Section A, Amsterdam, 2000.

Part III: Competition or Co-operation?

Part I of this study has indicated that full agreement as to what constitutes "harmful tax competition" is still some way off. Is it actually the case, for example, that national tax bases have been eroded as a result of competition between tax systems?

The tax base

Within the EU, total government revenues as a percentage of GDP currently vary from under 40% in Spain to over 58.5% in Sweden. In most countries, these percentages have remained fairly constant over the last ten years. Overall in the EU there has been a marginal but steady trend upwards: from 42.5% of GDP in 1980 to 44.5% in 1990 and 46% in 1998. Only over the last two years has there been a marginal fall to 45.5% (see Table 27). The pattern is the same for OECD countries, with a gradual rise from 34.7% of GDP in 1981 to 37% in 1998 (see Table 28).

Table 27. Evolution of total tax receipts by EU Member States

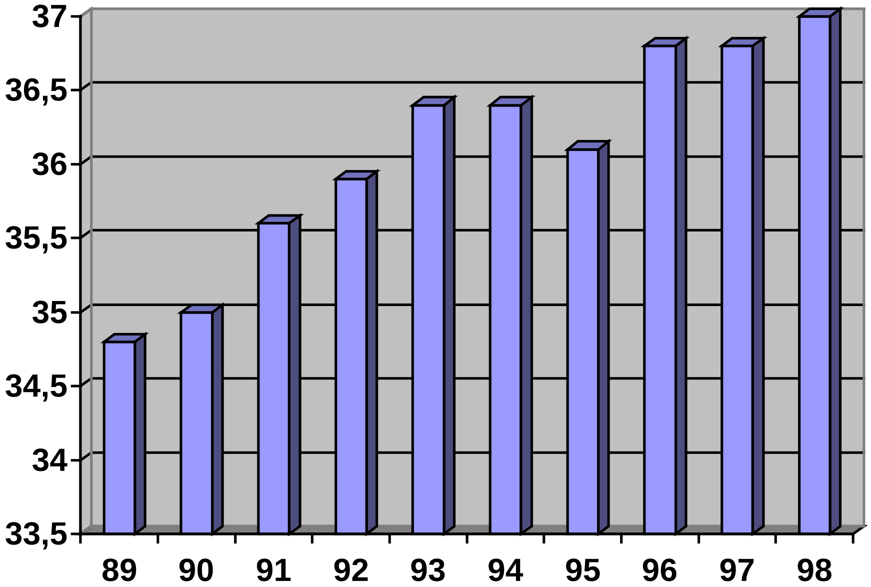
(% of nominal GDP)

	1980	1990	1998	2000
Belgium	48.3	47.4	49.4	49.5
Denmark	51.5	55.1	57.6	56.4
Germany	45.1*	43.3*	44.9	45.6
Greece	26.5	32.9	38.7	47.1
Spain	30.3	39.8	40.8	39.1
France	44.7	48.2	50.7	49.3
Ireland	37.5	36	35.1	34.8
Italy	34.3	42.8	46.8	46
Luxembourg	55.1	50.5	46.1	50.5
Netherlands	52.4	49.9	47.4	44.6
Austria	46.4	47.8	50.4	48.8
Portugal	33.1	35	40.9	43.8
Finland	42	51.4	52.6	51.2
Sweden	57.6	64.9	62.1	58.5
UK	39.9	38.5	39.5	40.1
EUR 14**	42.5*	44.5*	46	45.5

**West Germany only ** excluding Luxembourg*
Source: European Economy

These figures are hardly consistent with any theory of overall "tax degradation" as a result of competition between systems.

Table 28. (Graph) Total tax revenues as a percentage of GDP, OECD countries



Source: OECD

However, certain differences between Member States can be observed, and are perhaps of significance. Some countries – Ireland, Spain, the Netherlands, Finland and Sweden – have experienced a small reduction in the burden of taxation over the last ten years. The last two of these countries have been among the higher-taxed in the EU. In addition, Denmark, France, Italy and Austria have seen a slight fall over the last two years.

There has thus been a convergence of total tax burdens, despite the gap between highest and lowest percentages.

It is also necessary to look at changes in the *structure* of taxation. EU statistics distinguish between "taxes linked to imports and production (indirect taxes)"; "current taxes on incomes and wealth (direct taxes)"; social security contributions; and "other current receipts".

Overall, **indirect taxes** in the EU have risen by 1.5 percentage points over the last twenty years: from 12.7% of GDP in 1978 to 14.2% in 1998. The increases, however, were concentrated in a limited number of Member States, notably Italy, Portugal and Spain.

Direct taxes have risen by marginally more: 1.6 percentage points, from 11.8% of GDP in 1978 to 13.4% in 1998. The pattern as between countries, however, is more complex, with the percentage having fallen in some countries over the years (Germany, Luxembourg, the Netherlands and the UK), and risen in others (e.g. Denmark, Greece, Spain, Ireland, Italy, Portugal and Austria). In the case of **social security contributions** the overall increase has been by 1.4 percentage points: from 13.8% of GDP in 1978 to 15.2% in 1998. The UK (6.3% in 1998), Denmark (2.8%) and Ireland (4.2%) raise little revenue in this category, and the percentage has been stable. **Other current receipts** have remained stable at 3.2% of GDP.

Table 29. Implicit tax rates on production factors

	Labour			**Other production factors**		
	Level 1998	*change over 1985 (%)*	*Deviation from EU average*	*level 1998*	*change over 1985 (%)*	*Deviation from EU average*
Belgium	45.8	+ 1.5	5.3	38	-2.5	2.8
Denmark	46.6	+ 2	6.1	31.9	-5.1	-3.3
Germany	42.7	+ 3.2	2.2	40.9	-7.1	5.7
Greece	39.8		-1.7	8.7	-6.3	-26.5
Spain	38	+ 6.1	-2.5	26.6	+ 6.7	-8.6
France	44.4	+ 4	3.9	44.9	-6.6	9.7
Ireland	31.6	+ 1.4	-8.9	29.2	+ 3.6	-6
Italy	42.9	+ 6.3	2.4	34.8	+ 7.9	-0.4
Luxembourg	29.5	-3.1	-11	49.3	+ 16.4	14.1
Netherlands	51	+ 0.1	10.5	37.3	+ 6.8	2.1
Austria	43.4	+ 2.5	2.9	37.1	-3.8	1.9
Portugal	35.8	+ 14.4	-4.7	16.3	-8.2	-18.9
Finland	55	+ 12.1	14.5	21.3	+ 5.4	-13.9
Sweden	52.6	-0.1	12.1	34.7	+ 0.9	-0.5
UK	26.2	0	-14.3	32.4	-30.1	-2.8
EU average	40.5	+ 3.1		35.2	-8.1	

Source: European Commission

Even these figures, however, do not give a precise picture. They fail to identify, in particular, differences within the direct taxation category between the taxation of personal incomes, the taxation of wealth, and corporate taxation. The analysis carried out by the Commission in preparation for the "new approach", *Taxation in the European Union: report on the development of tax systems* (1996), distinguished **taxes on labour** from **taxes on other production factors** (notably capital). The results showed an average increase in the former between 1985 and 1994 of 3.1%; and an average fall in the latter of 8.1% (see Table 29).

The detailed figures, however, also showed certain important variations between countries. In Luxembourg and Sweden labour taxes fell (in the latter case from a high level), and other taxes rose. Other taxes also rose in Spain, Ireland, Italy, the Netherlands and Finland, in all but the latter case by a greater percentage than the rise in labour taxes. Much of the overall EU figure was accounted for by a massive cut in capital taxation in the UK.

The figures also showed that the division between labour taxes and taxes on other production factors varied widely between Member States: in the case of taxes on labour between a 26.2% rate (UK) to 52.6% (Sweden); and in the case of other production factors between only 8.7%

(Greece) and 49.3% (Luxembourg). The overall levels, both in the case of taxes on labour, and of taxes on other production factors, also deviated widely around the EU average.

Table 30. Changes in certain direct tax rates, 1986-1997 (% points)

	Top marginal rates of personal income tax	Basic rate of corporation tax
Germany	-	- 11.0
France	- 11.0	- 11.7
Italy	- 11.0	0.0
UK	- 20.0	- 2.0
Austria	- 12.0	- 16.0
Belgium	- 15.3	- 6.0
Denmark	- 14.0	- 16.0
Finland	- 13.0	- 5.0
Greece	- 23.0	- 9.0
Ireland	- 10.0	- 12.0
Luxembourg	- 7.0	- 7.0
Netherlands	- 12.0	- 7.0
Portugal	-	- 6.0
Spain	- 10.0	0.0
Sweden	- 25.0	- 24.0

Source: OECD

Here, however, figures for **corporate tax rates** may also be relevant. In both EU and OECD countries they show a steady recent decline from rates of around 50% in 1985 to rates between 30-40% in 1995. Only in Italy was there an increase, from 46% to 52.2%, while Spain held the rate steady at 35%, and Germany introduced a split rate. In some cases the fall was dramatic: in Finland and Sweden, for example, the rates were more than halved, from 57% in 1985 to 25% and 28% in 1995 (see Tanzi, V. (1996)).

A similar picture emerges from changes in the **higher marginal rates of personal income tax**. These have come down sharply in all countries except Germany and Portugal, despite the fact that overall direct taxation has risen.

What conclusions can be drawn from these figures?

- First, it is clear that tax competition has not had the long-term effect of *reducing* tax bases, either within the EU or the OECD. Rather, the percentage of GDP taken in tax has shown a steady tendency to rise. However, the increase in overall taxation over the last few years has only been marginal compared to the previous twenty, and some EU countries have even experienced a modest fall. This allows the possible conclusion that tax competition has effectively "capped" the tendency for taxes to rise in relatively high-tax countries, and produced a convergence within the EU.

- The figures do not show any recent tendency for direct taxes or social security contributions to rise more markedly than taxes overall. Over the period 1985-94 there was, however, a shift to taxes on labour from taxes on other production factors in the EU as a whole, though this was not the case in all Member States. Falling rates of corporate taxes tend to confirm an average shift of the tax burden from the "mobile" to the "immobile" tax base.
- On the other hand, differing tax structures make for sharp variations in these effects. For example, countries like Denmark and the UK rely relatively less on direct social charges than countries like France. Factors such as this may well explain why tax competition classified as "harmful" by one Member State is not considered to be so by another.

"Unfair competition"

To the picture given by these highly aggregated statistics must be added evidence, both statistical and anecdotal, about the effects of particular taxes, and the way in which they are administered. Although "tax competition" at this micro level may not have the effect of eroding tax bases overall, it is possible for them to distort economic behaviour of consumers, workers or investors in such a way as to prejudice the fair working of the Single Market.

Among the areas of most obvious concern have been:

- Substantial differences in indirect tax rates across particular borders, which can distort consumers' purchasing patterns.
- Distortions caused by the VAT and excise systems themselves, or by differing application and interpretation in Member States.
- High marginal direct tax rates, which encourage those earning large salaries to become "tax exiles" in countries with lower rates.
- Untaxed and undeclared foreign earnings, particularly bank and other interest, which may both erode revenues and distort the market in savings.
- The failure of existing bilateral tax agreements to eliminate the double taxation of certain transactions, so maintaining trade barriers within the Single Market.
- Tax incentives designed to attract footloose investment, which can distort the capital market and lead to "tax-holiday[69] auctions" (but which are, on the other hand, often part of the Community's own policies for regional development).
- Disparities in income tax and social security systems which can penalise those working in a Member State other than the one of nationality, residence or domicile.

To what extent do these issues, and the differences between Member States' tax systems and rates that lie behind them, amount to "unfair" tax competition?

It is perhaps useful to distinguish between competition between *tax systems as a whole,* including the overall level of taxation, the balance between direct and indirect, and the general structure of rates; and competition based on *special arrangements* for particular activities or areas, or administrative features that have the effect of distorting competition.

[69] A "tax holiday" exempts firms from normal taxation for a period after establishment in a particular location.

Competition between systems

Whether competition between tax systems can be considered "fair" or "unfair" is at heart a political question. Given that all EU Member States are democracies, it is hard to argue that they should not be able to make choices in favour of relatively low tax levels, or of particular tax structures, even if the result is an apparent competitive advantage.

It also worth remembering that it is not tax systems in isolation that are in competition, **but fiscal systems as a whole** – that is, the pattern of both revenue and expenditure. A choice in favour of low overall taxation implies a choice in favour of low overall public expenditure as well, with a trade-off between benefits and penalties. For example, low corporate tax rates may attract investment; but poor infrastructure and a poorly-educated workforce may repel it.

The details of such a trade-off can also be considered a matter for Member States' governments and parliaments alone. Only when there are spill-over effects – e.g., if the consequences of low public expenditure can be "off-loaded" onto neighbouring States, as in the case of measures to reduce pollution – is the case for harmonisation or co-ordination at an EU level clear-cut.

Choices concerning the **structure of tax systems** raise more complex issues. For example, certain Member States (e.g. Denmark) finance the bulk of their welfare systems out of indirect taxation, applying relatively high rates of Value Added Tax. Others (e.g. France) have chosen a system of high direct social security contributions. One effect of this, under the current VAT system, is to enable a proportion of the costs of the indirectly-financed Danish social security expenditure to be rebated on exports to other Member States, which is not the case where the expenditure is directly financed.

The main effect in the case of divergent tax structures is that competition is likely to exert pressure on the **rates of individual taxes** rather than directly on the overall tax burden.

For example, two countries, A and B, may both have a general level of taxation equal to 50% of their GDPs. Country A, however, may finance this through high rates of indirect taxation, with relatively low rates of corporate tax; country B in the reverse way. Tax competition will exert a downward pressure on indirect tax rates in country A, and on corporate rates in country B. The results will be:

- downward pressure on the overall tax level in both countries; and
- convergence of tax structures.

It is possible to welcome or to deplore either one of or both these consequences. Whereas a tax-sovereignty purist may reject any such pressures on the power of Member States to determine their own tax regimes – which often reflect long-standing political and cultural factors – a convergence of structures may be a natural consequence of the Single Market.

Similarly, many will welcome both the convergence of systems *and* the downward pressure on rates exerted by market forces. However, the erosion of revenues will also induce efforts to secure the convergence of systems *without* the downward pressure on rates – the primary objective, indeed, of co-ordination.

Special tax arrangements

It is these, rather than tax systems as a whole, that are generally meant when "unfair tax competition" is targeted. The previous sections have already outlined a number of specific examples, which can be analysed as being of two kinds.

1. **Tax arrangements which distort competition as an incidental consequence of their main purpose.** A number of the problems involved in the "transitional" VAT system provide examples. In the past, the actual level of VAT rates, or the method of collection, has been of less concern to national governments than ensuring that the revenue raised is paid into the correct national budget. Indeed, the main stumbling-block to a full origin system has been the perceived need for a "clearing system" to rebate VAT collected to the countries of final consumption.

   This concern has led to such cumbersome procedures as that provided for in **the 8th VAT Directive**. If a firm in one Member State pays VAT in another, it is entitled to claim this back as input tax. However, it cannot merely deduct the input tax from its VAT liability in the home country in the normal way, because nothing has been paid in there. Instead, it has to reclaim the tax from the second country – a procedure which can take months or even years. The effect is a disincentive to purchase services from a foreign supplier.

   The Commission has recently proposed a simple reform[70] to remove the distortion: i.e. the deduction of input tax being made in the normal way, with any revenue effects being sorted out through bilateral "clearing" between the relevant Member States.

   The Commission has also highlighted the differences in the **corporate tax base**, which result in a large number of marginal effective corporate tax rates. These can vary by around 200%, depending on industrial sector, mode of finance and category of investor; and can strongly influence the choice of tax jurisdiction in which companies invest.

2. **Tax arrangements the primary purpose of which *is* to affect competition.** The most obvious example of the second category is **regional aid**, distributed *via* preferential tax arrangements rather than cash grants from national or the EU budgets. As the continuing debate over state aids in general has indicated, the moral and political position in such cases is not always clear-cut. On the one hand, there is no doubt that preferential treatment for one geographical area is "unfair" to others. On the other hand, this is usually the precise point of the policy. The creation of the euro area and the need to limit the danger of "asymmetric shocks" within it, is likely to heighten this dilemma in the future[71].

   It can also be argued that **zero rates of withholding tax on interest paid to non-residents** are specifically intended to attract savings. The Commission, indeed, has referred to "unbridled tax competition for non-residents' deposits" as a factor both in the erosion of Member States' tax bases and the misallocation of investment. However, in this case the competition is not merely within the EU, but global (see earlier “The Withholding Tax”).

The elimination of any specific tax distortion is also likely to affect one group of Member States more than others, with possibly damaging effects on growth and employment, at least in the short term. Since these Member States will, on the face of it, gain nothing in return, there is little incentive for them to agree. An example of this is again provided by the proposed withholding tax on interest paid to non-residents, which would have had an adverse effect on the significant financial services industries of Luxembourg and the UK.

It is for this reasons that the Commission attempted to make progress through "packages" of measures, in which benefits and penalties were more or less evenly divided between Member

[70] COM(1998)377.

[71] See "Adjusting to Asymmetric Shocks", *Economic Affairs Series*, Working Paper ECON 104, European Parliament, DGIV, September 1998.

States. The original "Monti package", for example, linked progress on the contentious issue of taxing interest paid to non-residents with parallel progress on the taxation of interest and royalties, the Code of Conduct, and improvements to the VAT system.

How far this tactic will succeed, however, is still open. The European Parliament's own resolution on the development of tax systems (1998) warned that the Monti package:

> *"should be taken as a broad target to be achieved in the medium term, and not be used, on the contrary, as a tool by Member States to delay the approval of the various elements of the package."*

The original package was, in any case, trimmed back by the Council at an early stage (see above), while the Code of Conduct was adopted ahead of the rest.

Competition v. Co-operation

Although many theoretical economic models exist, they provide no clear-cut answer to the

> "*deceptively simple question... :Is international tax competition... a good or a bad thing?"* (Edwards and Keen, 1994).

Much appears to depend on political rather than purely theoretical criteria.

Competition

It is evident, for example, that one decisive factor is the view taken of government in general, and of the functions of taxation in particular. Sinn (1993) envisages a situation in which

> *"...fiscal competition will wipe out redistributive taxes on mobile factors and reduce the tax system to one of mere benefit taxation."*

Other analyses disregard social or redistributive functions, and consider systems only in terms of a taxation/public expenditure trade-off: the benefits of high public provision have to be balanced against the effects of high consequent tax levels. The dangers of international tax competition in this context are considered to arise from countries

> *"attracting to them a larger share of the world tax base, thus exporting some of their tax burden."* (Tanzi, 1996).

A contrasting view, however, sees tax competition as bringing at least two important benefits.

- First, it serves

  > *"a valuable purpose in supplementing inadequate constitutional constraints on the intrinsic pressures towards excessively high tax rates implied by policy-makers' pursuit of their own interests."* (Edwards and Keen, 1994).

  The assumption that all public expenditure is intrinsically beneficial – whatever the trade-off between expenditure and taxation as a whole – is consequently rejected. To the extent that a proportion can be considered "wasteful", welfare improvements cannot fully compensate for rises in the tax burden.

- Secondly, tax competition is seen to be in accordance with the "decentralising presumption" of subsidiarity; and, in any case, to produce a maximisation of economic welfare. The desired mix of taxation/public expenditure is not necessarily the same in all places. Where the decisions are devolved levels of taxation and of public services provision are therefore more likely to correspond to citizens' preferences.

Co-operation

These sharply differing attitudes towards tax competition are reflected in similar views concerning the benefits of co-operation.

- The need for co-operation between states is, first of all, seen as an obvious consequence of economic integration. "*One member state's tax revenue becomes endogenous to other member states' tax policies"* (Deheijia and Genschel, 1996), so that

  > *"like tectonic plates grinding against each other, the tax systems of different countries.. develop arbitrage pressures created by different tax rates, by differences in the bases that are taxed, by different possibilities of avoidance and evasion..."* (Tanzi, 1994).

  The form of co-operation to which this situation is seen to lead need not take the extreme form of full harmonisation. The analysis of cross-frontier tax competition carried out by Kanbur and Keen (1991) prior to the completion of the Single Market, indeed, found that *common* rates of indirect tax produced overall losses; but that *minimum* tax rates, in contrast, produced overall benefit. This corresponded to the actual system adopted.

- Co-operation – if not centralisation – is seen as the only way in which effective macro-economic stabilisation policies can be pursued. In the case of Economic and Monetary Union, it was recognised from the start that the euro area would have a particular feature "unique in history": "a single monetary policy coupled with a largely decentralised fiscal policy[72]". Yet the participating governments have found themselves obliged to reduce this uniqueness both through specific restraints on national fiscal policies (e.g. the Stability and Growth Pact), and the creation of institutions for enhanced co-operation (e.g. the Euro Council).

- The model of welfare maximisation through competition is believed to work only to the extent that all factors are perfectly mobile between tax areas: i.e. when both investment and people can move effortlessly between competing tax jurisdictions. Where one factor is mobile (capital), but another (labour) is not, there will be fiscal distortions. Only through co-operation will such externalities be eliminated.

- Finally, any redistributive element of taxation is only likely to be fully achieved through co-operation or centralisation.

However, measures to co-ordinate tax regimes can also be regarded as the formation of "tax cartels", which use monopoly power to maximise revenues at the expense of other equally important economic requirements (corporate investment, private savings and consumption, etc.). A Kangaroo Group paper on taxation noted that:

> *"In practice, rather than compete, fiscal authorities are much more likely to copy each other's successful revenue raising measures. It was Adam Smith who observed that 'there is no art which one nation more swiftly learns of another than that of draining money from the pockets of the people'."*

Any assumption that co-operation will produce a better overall outcome than competition must therefore be heavily qualified. For example

---

[72] "Stable money - sound finances: Community public finance in the persepctive of EMU", *European Economy,* No. 53, 1993.

- Areas of cartelisation tend to become uncompetitive: i.e.

  "If tax co-ordination remains limited to a subset of countries, there is no guarantee that the gains from co-ordination will not dissipate to outside countries." (Dehejia and Genschel, 1996).

- The gains from co-operation are not necessarily shared equally between the participants, and can result in losses for those that would otherwise compete most effectively. Analysis by Dehejia and Genschel (1996) indicates that "small is competitive": i.e. that smaller economies gain from tax competition as opposed to larger ones, and that the larger economies thus gain from co-operation at the expense of the smaller.

- As has been already observed, tax competition also provides one of the mechanisms by which a relatively poor country can institute a process of catching up.

  "When capital is mobile and the country is small, the revenue cost to the country that provides tax incentives can be low or even negative if it succeeds in attracting foreign investment from other countries. If the country has high unemployment, the foreign capital can be combined with workers who would have been unemployed." (Tanzi, 1996).

  Ireland provides the clearest recent example of this mechanism.

- In so far as the "profits" from tax cartelisation are larger revenues,

  "*some 'firms' in the tax harmonisation case may not desire to increase 'profitability'...: a desire to curb public spending by restricting the growth of taxation was certainly one of the motives underlying Britain's obstructive attitude under Mrs Thatcher during the debates on harmonisation between 1986 and 1990."* (McDowell and Thom, 1993).

Conclusions

The conclusions to which this analysis leads are unsurprising: that some – but not all – tax competition can be harmful; and that some – but not ubiquitous – co-operation may therefore be beneficial. Put formally by Edwards and Keen, some degree of tax co-ordination is desirable if the welfare gains from eliminating "*the inefficiency of non-co-operative behaviour"* exceed "*Leviathan's tendency to waste*".

This common-sense judgement was reflected in Parliament's own resolution of 18 June 1998, which gave general support to the Commission's approach. Increasing competition between national tax systems, it pointed out, was likely "*as a result of the greater transparency achieved by the introduction of the single currency*"; and it welcomed

> "*beneficial tax competition among Member States as a tool to increase the competitiveness of the European economy confronted with the challenges of globalization.*"

Co-ordination was, however, justified when the degree of competition resulted in

> *"a potential failure to harvest the full benefits which the single market can provide in terms of growth and employment, given the increased tax burden put on labour compared with the more mobile capital."*

A broad measure of agreement indeed exists on the elimination of "unfair competition" which arises from the complexity of tax systems. The more complex a tax system, the more scope it creates for (illegal) tax evasion, and the more incentive for companies, in particular, to devote resources to (legal) tax avoidance. The Kangaroo Group paper's primary conclusion is that

> *"tax structures should be as simple and transparent as possible; and any proposals should seek to simplify them further".*

It was for this reason that Parliament's Secchi report strongly criticised the dropping from the final Monti package of "*the measures designed to eliminate significant distortions in the area of indirect taxation.*"

When it comes to the *rates* of tax, however, there is less agreement. As far as *maximum* tax rates are concerned, there is a general inclination to leave this to competition and market forces. A natural upper limit in any case exists at the point when any *increase in rates* results in *falling aggregate revenue* from the tax concerned. There is reason to believe that this position may already have been reached in the case of some Member States' very high levels of excise duty on alcohol and tobacco (though governments may nevertheless choose to maintain them at this level in pursuit of public health or social policy objectives).

On even minimum rates, however, there are differing views. Although a 15% minimum VAT rate has been set, there has been no agreement on any minimum rate of corporation tax at all, despite the recommendations of the Ruding and other reports.

The balance between competition and co-operation which emerges is therefore as follows:

- where particular features of tax systems distort competition – either inadvertently as a result of excessive complexity, or deliberately – there is a case for Community action;
- experience indicates this action is more likely to be successful if it takes the form of co-operation (e.g. the Code of Conduct) than of formal harmonisation through legislation;
- in certain areas, however, legislation is inevitable, most obviously to remove differing and distorting application of existing provisions – e.g. in the case of VAT;
- agreement on maximum tax rates is unlikely, and even on minimum "floor" rates extremely difficult. Tax rates are widely considered the proper preserve of national sovereignty and of market forces.

Community legislation in the tax field

There remains one key issue: in those cases where Community action is desirable, by what legislative processes should this be achieved? This question can in fact be subdivided into two:

- How far should the principle of unanimity in Council on tax matters be modified to allow qualified majority voting (QMV)?
- How far can decisions on “technical” tax matters be delegated to committees of experts (e.g. the VAT Committee)?

On the first of these questions, it is possible to give a categorical answer on at least one aspect: no-one is seriously advocating QMV on the headline *rates* of tax, not even the minimum VAT rate already set. There is less certainty, however, about features of a tax system which are *equivalent* to tax rates: for example, the complexities of corporate taxation which result in *effective* rates of tax being considerably lower than nominal headline rates.

The position of the Commission is that QMV should be used on tax matters when this is "necessary to keep the single market going[73]". The Commission President has recently given a number of examples:

> *"It is absurd that a company based in one EU country should have to wait three years to recover VAT from the authorities of another. It is crazy that truck drivers filling up with diesel on their way across Europe should have to apply for a VAT refund in every state they pass through.*
>
> *In a genuine single market, European multi-nationals should not have to wait for years before tax authorities accept transfer prices on intra-company exchanges of services. Nor should companies have to set up pension funds for their employees in every country in which they operate."*

Such arguments, however, have not proved convincing to national finance ministers. Past experience – for example with the proposed "clearing system" needed in a "definitive" VAT system based on the origin principle – indicates that they are unwilling to contemplate any changes that might threaten revenues.

In addition, a number of governments remain opposed to the use of QMV on taxation as a matter of principle. The position of the UK, for example, is that the ability to determine "supply" lies at the heart of national parliamentary sovereignty[74].

No change to the Treaty in this area was therefore agreed at the Nice Summit in December 2000.

Another alternative proposed by the Commission to un-block tax *dossiers* is the delegation of decisions on "technical" matters to committees composed of national experts. One such proposal has been on the table for some time: to make the VAT Committee responsible for such decisions, so avoiding the long process of adopting amending Directives to the 6th VAT Directive.

The Council has so far rejected this proposal on the grounds that the voting procedure proposed was QMV. For its part, the European Parliament has given cautious approval, while stating its general disquiet about "commitology" procedures which are not subject to parliamentary scrutiny.

---

[73] Commission President Romano Prodi, writing in the *Financial Times* of 16 November, 2000.

[74] The power of the House of Commons can be said to derive from the historical bargain struck with the Crown, whereby the "granting of supply" was traded for the "redress of grievances".

Appendix: Tax competition and capital taxation

Models of capital taxation make a number of basic assumptions:

- ♦ capital - and consequently the tax base - is mobile internationally;
- ♦ rates of return on capital are broadly determined within the international economy as a whole, on which the fiscal policies of any one country can have only very limited influence;
- ♦ tax can be levied on the income from capital at source (i.e. where the income is generated) and/or in the country of residence (i.e. where the investor is normally taxable);
- ♦ each individual country will try to optimise its position in terms of both tax revenues and the volume of domestic investment.
- ♦ revenue-maximisation will involve a trade-off between the rate of tax, and consequent gains or losses of tax base.

Given these assumptions, there are two limiting cases:

Model 1

Tax is levied in the country of residence, but not in the country of source. If any one country levies tax at a higher comparative rate, the post-tax rate of return on investment for residents of that country will be lower than in other countries.

The *investment effects* will be:

- a lower comparative level of investment by residents of that country, both domestic and abroad; but
- an unaffected level of direct inward investment.

The *revenue effects* will depend heavily on the extent to which tax can be levied on the foreign earnings of residents. In the absence of effective information-exchange systems between countries, or of an efficiently-policed system of tax returns, the regime will be vulnerable to tax evasion. (This is without taking into account the possibility of tax-payers themselves becoming mobile).

Model 2

Tax is levied at source, but not in the country of residence. If any one country levies tax at a higher comparative rate, the post-tax rate of return on all investment in that country will be lower than in other countries.

The *investment effects* will be both

- a reduced level of inward investment; and
- a flight of domestic capital to other countries.

The *revenue effects* will be initially neutral. However, the fall in the level of investment will erode the tax base over time, leading to progressively lower tax revenues.

Under Model 2, therefore, tax competition between countries will clearly result in a downward pressure on the rates of tax on investment. The same will be true, though to a lesser extent, under Model 1, particularly if there is no cooperation between national tax authorities.

This theoretical analysis, however, is subject to a number of practical qualifications.

♦ Capital is not perfectly mobile between countries. Distinctions have to be made between short and long-term capital: between, for example, bank deposits; portfolio investment in public debt and in equity; and the capital investment in plant, etc. of companies. Changes in comparative tax levels may have an instantaneous effect on "hot" money flows, but only affect the investment plans of multi-national companies over a period of many years

♦ A distinction has to made between investments where the return is entirely or largely in the form of income: e.g. bank interest; and those where the return is substantially in the form of capital growth: e.g. equities. In the second case, the tax regime applying to income payments can be of only minor significance, so that its taxation at source will lead to little comparative disadvantage.

♦ Most investors, particularly small investors, are inherently risk-averse. They will prefer to put their savings into securities which are familiar to them - local savings banks, national savings schemes, the equity of domestic companies, etc. - than into foreign assets, even at the cost of higher rates of tax. Exchange risk constitutes another important obstacle to mobility - though one that disappears within the euro area.

- For large investors - for example, institutional investors - portfolio diversification to spread risk can be as important as tax considerations. Tax planning will be just one element in the management of funds.

- The integration of markets is leading to an increasing exchange of capital between countries - higher levels of both inward and outward investment, cross-border take-overs and mergers, strategic investments by multi-nationals, etc. - unrelated to tax considerations. The opportunity for countries to obtain revenue by taxing foreign-owned investment can outweigh the fear of losing the investment through tax competition.

- In any case, the damaging effect of tax competition on taxation at source is largely removed if investors receive a tax credit for payments in the country of source to set against their liability in the country of residence. This is the objective of the existing network of bilateral tax treaties governing the international payment of dividends.

A system of tax credits generates a third, more realistic model:

Model 3

Tax is levied at source *and* in the country of residence. The tax paid at source can be offset against liability in the country of residence. Post tax returns in any given country will be the same whether the income is generated domestically or abroad.

The *investments effects* will be as in the case of Model 1.

The *revenue effects*, however, will no longer depend on the efficiency of tax collection. They will be determined by the relative levels of tax in the country of source and the country of residence.

By contrast with Models 1 and 2, tax competition will therefore result in *an upward pressure on rates of tax,* as countries attempt to maximise their share of revenues.

Tax competition, therefore, does not necessarily erode either the tax base or the rates of taxation on capital. Taxation in the country of residence combined with efficient cooperation between tax authorities, or taxation in both the country of source and of residence combined with tax credits can result in broadly neutral investment effects, and a neutral or upward pressure on tax rates.

References and Bibliography

Aujean, M. (1997), *The Development of Tax Systems in the European Union: Competition or Co-ordination*, Paper presented at the Public Investment and Public Finance 53rd. Congress, Kyoto, 1997.

Belmont, C. and L. (1989), *European Tax Law: a guide to Community, EFTA and Member State Legislation,* Financial Times Management, London, 1989.

Blumenberg, J. (1994), "Recent Devleopments in German International Taxation", *The International Tax Journal,* vol. 20 no. 3, 1994. Pp. 68-88.

Bratton, W.W. and McCahery, J.A. (1999), *Tax Co-ordination and Tax Competition in the European Union: evaluating the Code of Conduct on Business Taxation,* http://www.law.edu/facweb/wbratton/fiscalfedcml.htm

Brounchi, C. and Flip de Kam (1999), *The Income Taxes People Really Pay,* OECD Observer, no.2, 1999 p.13.

Cnossen, S. (1987), *Tax Structure Developments: Tax Co-ordination in the EC,* London,1987.

Code of Conduct for business taxation (1998), *Resolution of the Council and the Representatives of the Governments of the Member States, meeting within the Council of 1 December 1997.* OJ C2 of 6.1.1998.

Collection Jupiter (1998), *Le droit des affaires dans les pays de la CEE. Tome Fiscalité. Allemagne. Textes législatifs en langue originale*, Textes législatifs traduits en francais, LGDF, Paris, 1998, pp. 37-104.

(1998) *Le droit des affaires dans les pays de la CEE. Tome Fiscalité. Belgique-Luxembourg,* Textes législatifs en langue originale, LGDF, Paris, 1998.

(1998) *Le droit des affaires dans les pays de la CEE. Tome Fiscalité. Espagne-Irlande-Pays-Bas,* Textes législatifs traduits en francais, Paris, LGDF, 1998.

(1998) *Le droit des affaires dans les pays de la CEE. Tome Fiscalité. France*, Textes législatifs, LGDF, Paris, 1998.

(1998) *Le droit des affaires dans les pays de la CEE. Tome Fiscalité. Royaume-Uni de Grande-Bretagne,* Textes législatifs en langue originale, LGDF, Paris, 1998.

(1998) *Le droit des affaires dans les pays de la CEE. Tome Fiscalité. Italie*, Textes législatifs en langue originale, LGDF, Paris, 1998.

Commission of the European Communities

(1969) Draft Directive concerning the Common System of Taxation Applicable in the Case of Parent and Subsidiaries of Different Member States, COM (69)6.

(1975) Draft Directive concerning the Harmonization of Systems of Company Taxation and of Withholding Tax on Dividends, COM (75) 392.

(1980) The Scope for Convergence of Tax Systems in the Community, COM(80)139.

(1989) Draft Directive for a common system of withholding tax on interest income (COM(89)60).

(1990) Guidelines for Company Taxation, SEC(90)601.

(1995) Proposal for a Directive on Value Added Tax (level of the standard rate) COM(95)731.

(1996) A Common System of VAT: a programme for the Single Market, COM(96)328.

(1996) Taxation in the European Union (First Report of Monti Group), SEC(96)487.

(1996) Taxation in the European Union: report on the development of tax systems (Second Report of Monti Group), COM(96)546.

(1997) Proposal for a Decision establishing a programme of Community action to reinforce the functioning of the indirect taxation system of the internal market (FISCALIS programme), COM(97)175.

(1997) Proposal for a Council Directive...as regards the value added tax arrangements applicable to telecommunications services, COM(97)4.

(1997) Environmental Taxes and Charges in the Single Market, COM(97)9.

(1997) Proposal for a Council Directive restructuring the Community framework for the taxation of energy products, (COM(1997) 30).

(1997) Proposal for a Council Directive amending Directive 77/388/EEC on the common system of Value Added Tax (the Value Added Tax Committee), COM(97)325.

(1997) Towards Tax Co-ordination in the European Union: a package to handle harmful tax competition, COM(97)495.

(1997) Job creation: Possibility of a reduced VAT rate on labour-intensive services for an experimental period and on an optional basis, SEC(97)2089.

(1997) Report from the Commission... on the common system of value added tax: uniform basis of assessment, COM(97)559.

(1997) A package to tackle harmful tax competition in the European Union, COM(97)564.

(1998) Proposal for a Directive on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States, COM(1998)67.

(1998) Proposal for a Directive to ensure a minimum of effective savings income in the form of interest payments within the Community, COM(1998)295.

(1998) Proposal for a Directive.. as regards the rules governing the right to deduct value added tax. COM(1998)377; and Proposal for a Regulation (EC) on verification measures, measures relating to the refund system and administrative co-operation, COM(1998)377

(1998) Electronic Commerce and Indirect Taxation, COM(1998)374

(1998) Proposal for a Directive with regard to the level of the standard rate..of value added tax, COM(1998)693

(1998) Communication on the application of the State aid rules to measures relating to direct business taxation, SEC(1998)1800

(1998) Proposal for a Regulation (EC) on co-ordination of social security systems (COM1998) 779

(2000) Third Article 14 Report on Administrative Co-operation in the Field of Indirect Taxation (VAT), COM(2000)28

(2000) Proposal for a Directive as regards the determination of the person liable for payment of value added tax, COM(1998)660.

(2000) A Strategy to Improve the Operation of the VAT System within the Context of the Internal Market, COM(2000)348.

(2000) Proposal for a Regulation on administrative co-operation in the field of indirect taxation (VAT); and Proposal for a Directive as regards the value added tax arrangements applicable to certain services supplied by electronic means, COM(2000)349.

(2000) Communication on the Taxation of aircraft fuel, COM(2000)110

(2000) Proposal for an Directive on…the length of time during which the minimum standard rate [of VAT] is to be applied, COM(2000)537

Confédération Fiscale Européenne (CFE), (1997), *The Taxation of Savings*, Paris 1997.

Convention on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises of Different Member States (1990), *Official Journal of the European Communities* L225, 20.8.1990.

Council of Europe

(1977) Directive 77/799/EEC of 19.12.1977, concerning Mutual Assistance by the Competent Authorities of the Member States in the Field of Direct Taxation and Value-Added Tax, OJ L336 of 27.12.77, p.15.

(1990) Directive on the Common System of Taxation Applicable to Parent Companies and Their Subsidiaries of Different Member States, OJ L225 of 20.8.1990, p.6.

(1990) Directive on the Common System of Taxation Applicable to Mergers, Divisions, Transfers of Assets and Exchanges of Shares Concerning Companies of Different Member States, OJ L225 of 20.8.1990.

(1997) Decisions authorising Member States to apply a measure derogating from Article 9 of the Sixth Directive, OJ L 086, 28/03/1997

(1998) Directive on a special scheme for investment gold, OJ L 281, 17/10/1998

(1999) Directive as regards the Value Added Tax arrangements applicable to telecommunications services, OJ L 162, 26/06/1999.

(1999) Directive as regards the possibility of applying on an experimental basis a reduced rate of VAT on labour-intensive services, OJ L 277, 28/10/1999.

Court of Auditors (1998), *Special Report 9/98 concerning the protection of the financial interests of the European Union in the field of VAT on intra-Community trade,* OF C349 of 17.11.1998.

Dehejia, V.H. and Genschel, P. (1996), *Tax Competition in the European Union: a theoretical model and a plausibility probe,* German-American Academic Council, August 1996.

Di Malta, P. (1995), *Droit Fiscal Européen Comparé*, Presses Universitaires de France, 1995.

Edwards, J and Keen, M. (1994), *Tax Competition and Leviathan,* Institute for Fiscal Studies, Working Paper 94/7, 1994.

European Parliament (1992), "The Need to Harmonise Direct Taxes in the Internal Market", *Economic Affairs Series*, Working Paper W-6, DG IV, Luxembourg, 1992.

(1997) "Frontier Workers in the European Union", *Social Affairs Series,* Working Paper W-16, DG IV, Luxembourg, 1997.

(1998) Report on behalf of the Committee on Economic and Monetary Affairs and Industrial Policy by Mr. Carlo Secchi MEP on taxation in the European Union (PE 221.840), adopted on 18 June 1998 (OJ C 210, 6.7.1998).

(1998) "Adjusting to Asymmetric Shocks", *Economic Affairs Series*, Working Paper ECON 104, DGIV September 1998.

Filori, J.C. (1991), *L'harmonisation fiscale européenne: Premier Pas*, Europe Information Service, Bruxelles, 1991.

Gordon, R.H. (1983), "An Optimal Taxation Approach to Fiscal Federalism", *Quarterly Journal of Economics*, 98, 1983, pp.567-586.

Guardino, J. (1995), "Comparative Tax Systems: United States vs. Great Britain", *The International Tax Journal*, vol.21, no 1, 1995, pp. 31-38.

House of Lords (UK Parliament) (1999), Taxes in the EU: Can Co-ordination and Competition Co-exist?, House of Lords Select Committee on the European Communities, Session 1998-99, 15th report, 20 July 1999.

Hudson, D. and Lind, S. (1987), *Federal Income Taxation*, West Publishing Co., St Paul. Minnesota, 1987.

IBFD (1997), *European Taxation*, International Bureau of Fiscal Documentation, Amsterdam, 1997.

Inman, R.P. and Rubinfeld, D.L. (1994), "The EMU and Fiscal Policy in the New European Community: An Issue for Economic Federalism", *International Review of Law and Economics*, 14, 1994, pp.147-161.

Kanbur, R. and Keen, M. (1991), *Tax Competition and Tax Co-ordination when countries differ in size*, World Bank, August 1991.

Kangaroo Group (1998), *Discussion Paper on Taxation*, September 1998.

Komar, A. (1983), *Probleme der Steuerharmonisierung in der EG*, Verträge, Reden und Berichte aus dem Europa-Institut, Saarbrücken, 1983

Kopitz, G (1992), *Tax Harmonization in the European Community, Policy Issues and Analysis*. International Monetary Fund, Washington DC, 1992.

Mackenzie, G.A., Oorsmond, D., and Gesson, P. (1997), *The Composition of Fiscal Adjustment and Growth Lessons from Fiscal Reforms in Eight Economies*, International Monetary Fund, Washington DC, 1997.

Martinez Serrano, A. (2000) *Taxes on Employed Labour in the European Union: Comparative Analysis and Convergence Analysis*. Doctoral Thesis, University of Murcia (Spain), 2000. Full text in ES. Summaries in EN and FR.

McDowell, M. and Thom, R. (1993), *Tax Competition and the Internal Market*, University College, Dublin, Department of Economics, May 1993.

Messere, K. (1993), "Recent Tax Revenue Developments in OECD Countries and Some Policy Implications", *Bulletin for International Fiscal Documentation*, Vol. 47, no 6 1993, pp. 323-341.

Mintz, J. and Tulkens, H. (1986), "Commodity Tax Competition Between Member States of a Federation: Equilibrium and Efficiency", *Journal of Public Economics*, 2, 1986, pp. 133-172.

Moll Pedersen, B. (1993), "Denmark: Tax Reform", *Bulletin for International Fiscal Documantation*, Vol. 47, no 12, 1993, pp. 711-715.

Neumark Report (1962), Rapport du Comité Fiscal et Financier, Luxembourg, 1962.

OECD (1998) *Harmful Tax Competition: An Emerging Global Issue*, April 1998.

(2000) *Towards Global Tax Co-operation: Progress in Identifying and Eliminating Harmful Tax Practices*, June 2000.

Owens, J. (1993), "Globalisation: The Implications for Tax Policies", *Fiscal Studies*, 14,1993, pp. 21-44.

"Primarolo Group" (1998), *First Interim Report,* 12530/98 FISC 164, November 1998.

(1999) *Second Interim Report*, 8231/99 FISC 119, May 1999.

(1999) *Final Report*, November 1999, released February 2000. http://www.futd.nl/specials/staatssteun/doc01.html

Razin, A. and Sadka, E. (1991), *International tax competition and gains from tax harmonization,* Economics Letters, no 37, 1991, pp. 69-76.

Ruding (1992), *Report of the Committee of Independent Experts on Company Taxation,* Official Publications of the EC, ISBN 92-826-4277-1, March 1992

Sans i Llado, J.M. (1993), *El I.R.P.F. Estudio Comparativo entre España, Francia, Alemania, Italia, Inglaterra y Bélgica,* Barcelona Management School, 1993.

Sinn, H-W. (1990), "Tax Competition and Tax Harmonization in Europe", *European Economic Review,* 3, 1990, pp. 489-504.

(1993), *How Much Europe? Subsidiarity, centralization and fiscal competition,* CEPR Discusssion Paper no. 834, 1993.

Tanzi, Vito (1994), *Taxation in an Integrated World,* Brookings, Washington 1994.

(1996) *Globalization, Tax Competition and the Future of Tax Systems*, International Monetary Fund Working Paper, December 1996.

(2000) *Globalization and the Future of Social Protection*, IMF, January 2000

United Kingdom Treasury (1999), *International Bonds and the Draft Directive on Taxation of Savings,* HM Treasury, Inland Revenue, September 1999.

(2000) *Exchange of Information and the Draft Directive on Taxation of Savings,* HM Treasury, Inland Revenue, February 2000.

United Nations (1997), *Cooperation Internationale en Matière Fiscale*, New York, 1997.

Williams, D. (1997) "Trends in Social Taxation", *Bulletin for International Fiscal Documentation,* Vol. 51. Nº6, 1997, pp. 254-264.

Recent Economic Affairs Series Publications

These documents are all available in printed form. A number are also available on the INTERNET, through page *http://www.europarl.eu.int/dg4/wkdocs/catalog/en/catecon.htm*

The Economic Situation of the European Union and the Outlook for 2001-2002
(ECON-126, January 2001, En, Fr, De)

A Single Market in Financial Services: Effects on Growth, Employment and the Real Economy
(ECON 124, January 2001, En, Fr, De)

Improving cross-border payments in the euro area
(ECON 123, August 2000, En, Fr, De)

Strategies for the EU Economy
(ECON 122, April 2000, En, Fr, De)

Consumer protection aspects of the UCITS amending directives of 17 July 1998
(ECON 121, November 1999, En, Fr, De)

Exchange Rates and Monetary Policy
(ECON 120, August 2000, En, Fr, De)

The Functioning and Supervision of International Financial Institutions
(ECON 118, March 2000, En, Fr, De)

EMU and Enlargement: a review of policy issues
(ECON 117, January 2000, En, Fr, De, summary/conclusions in all languages)

The Determination of Interest Rates
(ECON 116, December 1999, En, Fr ,De)

Options for the Exchange Rate Management of the ECB
(ECON 115, October 1999, En, Fr, De)

The Euro as 'Parallel Currency', 1999-2002
(ECON 114, September 1999, En, Fr, De)

Public and Private Investment in the European Union
(ECON 113, May 1999, En, Fr, De)

The Monetary Policy of the ECB under Treaty Article 105
(ECON 112, May 1999, En, Fr, De, summary/conclusions in all languages)

Labour Costs and Wage Policy within EMU
(ECON 111, April 1999, En, Fr, De)

Monetary Policy Transmission in the Euro Area
(ECON 110, April 1999, En, summary/conclusions in all languages)

Forecasting budgetary deficits
(ECON 109, April 1999, En, Fr, De)

The Feasibility of an International 'Tobin Tax'
(ECON 107, March 1999, En, Fr, De, summary/conclusions in all languages)

Prudential Supervision in the Context of EMU
(ECON 102, rev. March 1999, En, Fr, De, summary in all languages)

EMU: Relations between 'ins' and 'outs'
(ECON 106, October 1998, En, summary/conclusions in all languages)

Tax Competition in the European Union
(ECON 105, October 1998, En, Fr, De , summary/conclusions in all languages)

Adjustment to Asymmetric Shocks
(ECON 104, September 1998, En, Fr, De)

The Social Consequences Changes in VAT
(ECON 103, April 1998, En, Fr, De)

The International Role of the Euro
(ECON 101, March 1998 En, Fr, De, summary in all languages).

The Social and Economic Consequences of Abolishing "Duty Free" within the EU
(W 30, October 1997, En, Fr, De, summary in all languages)

The Co-ordination of National Fiscal Policies in the Context of Monetary Union
(E 6, October 1996, De, En, Fr, summary in all languages).

Options for a Definitive VAT system
(E 5, October 1995, De, En, Fr, De, summary in Da, El, Es, It, Ne, Po).

New .eu Domain

Changed Web and E-Mail Addresses

The introduction of the .eu domain also required the web and e-mail addresses of the European institutions to be adapted. Below please find a list of addresses found in the document at hand which have been changed after the document was created. The list shows the old and new address, a reference to the page where the address was found and the type of address: http: and https: for web addresses, mailto: for e-mail addresses etc.

Page: 2	**Old:** mailto:gpatterson@europarl.eu.int
Type: *mailto*	**New:** mailto:gpatterson@europarl.europa.eu
Page: 109	**Old:** http://www.europarl.eu.int/dg4/wkdocs/catalog/en/catecon.htm
Type: *http:*	**New:** http://www.europarl.europa.eu/dg4/wkdocs/catalog/en/catecon.htm