EUROPEAN FISCAL COORDINATION

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Abstract

The existence of 27 different taxation systems in the European Union represents an obstacle against the good operation of the domestic market, generates significant extra costs for the trans-frontier trade and business on administrative plan and with regard to the observance thereof, it hinders the restructuration of societies, reduces competitiveness of European companies at world level and leads to double taxing situations. These are the main reasons for which, at present, at European level, the issue of coordinating the national fiscal systems is more current than ever.

Under conditions in which accurate measurement of the fiscal burden is given by the effective taxation level, which corresponds to a nominal taxation quota and a taxation basis, and under conditions in which European cooperation and coordination must not lead to the abandonment of the national autonomy in the fiscal field, if the sovereignty of the member states with regard to setting the taxation quotas, the solution would be the adoption of a common consolidated basis of taxation at European level.

Although there exists a unique market and an economic and monetary union, there still does not exist a genuine community fiscal policy, at the level of the European Union operating at present 27 different fiscal systems. More than that, the recent extensions of the European Union lead to a considerable increase of the differences between the fiscal regimes within the European Union, the new member states of the European Union being generally states with more reduced levels of taxation as compared to the old member states (UE-15), which are, at the same time, the most developed in the European Union.

The member state fiscal systems present major differences with regard to the level of the taxation quotas, which range between 10 and 50 percent in the case of income obtained by physical entities, between 10 and 35 percent in case of taxing companies and between 15 and 22 percent in case of VAT.

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The differences do not refer only to the taxation quotas, but address the assembly of the rules of seating the taxes, from the setting of the taxation basis up to the fiscal facilities granted.

Also, global fiscal pressure varies in the different member states between 28.4 and 50.5 percent from the GNP, this having from case to case a different impact on the economy.

The following table presents the taxation quotas applicable to the main composing taxes of the fiscal systems in the European Union member states.

Table 1: Tax Rates in European Union (18 member states)

Member states	Individual Income Tax	Corporate Tax	Capital Gains	Dividend	Interest	Royalties	VAT
Austria	4 tax bands (0%-50%)	25%	25%	25%	0%	20%	Standard rate 20% Reduced rate 10%
Bulgaria	10% flat tax	10%	Added to the regular income	7%	15%	15%	20%
Czech Rep.	15% flat tax	21%	Are taxed as income for companies and individuals	15%	15%	15%	Standard rate 19% Reduced rate 9%
Estonia	21% flat tax	22% applies to an actual distribution of the profits	Added to the regular income	0%/24%	0%	15%	Standard rate 18% Reduced rate 5%
Ireland	0-34.000 20% > 34.000 41%	12,5% for trading income reduced rate 10% 25% on passive income	20% for individuals	20%	20%	20%	Standard rate 21% Reduced rate 4,8% and 13,5%
Greece	4 tax bands (0%-40%)	25%	Added to the regular income	0%	29%	20%	Standard rate 19% Reduced rate 9% and 4,5%
Germany	Progressive from 15% to 45%	25%	25% for companies	21,1%	21,1%	0%	Standard rate19% Reduced rate 7%
Italy	Progressive from 23% to 43%	33%	12,5%	12,5%	12,5%/27%	22,5%	Standard rate 20% Reduced rate 4,5% and 10%
Cyprus	Progressive from 0%-30%	10%, 25% for corporated bodies, lower rates for shipping companies	20% for individuals 25% for corporation	0%	0%	0%	Strandard rate 15% Reduced rate 5% and 8%
Latvia	25%	12,5%	2% for companies	10%	10%	5%-15%	Standard rate 18%

			0% for individuals				Reduced rate 5% and 0%
Lithuania	15% and 24%	15%, 13% for small companies	For companies are added to the regular income 15% for individuals	15%	10%	10%	Standard rate 18% Reduced rate 9% and 5%
Hungary	Progressive from 18% to 36%	Progressive from 10% to 16%	For companies are added to the regular income 25% for individuals	0%	0%	0%	Standard rate 20% Reduced rate 15% and 5%
Malta	Progressive from 0% to 35%	35%		0%	0%	0%	Standard rate 18% Reduced rate 5%
Poland	Progressive from 19% to 40%	19%	Are added to the regular income	19%	20%	20%	Standard rate 22% Reduced rate 7% and 3%
Portugal	Progressive from 10,5% to 42%	25% with the addtion of a local tax of 2,5%	For companies are added to the regular income For individuals 10%	20%	20%	15%	Standard rate 21% Reduced rate 12%, 5%
Romania	16% flat tax	16%	16%	16%	16%	16%	Standard rate19% Reduced rate 9%
Slovenia	Progressive from 16%-50%	25%	For companies are added to the regular income For individuals 5%-20%	25%	25%	25%	Standard rate 20% Reduced rate 8,5%
Finland	Progressive from 0% to 32,5% - national tax Municipal tax – 16%-21%	26%	26% for companies 28% for individuals	28%	28%	28%	Standard rate 22% Reduced rate 17%, 8%

Source: www.worldwide-tax.com

The existence of 27 different taxation systems in the European Union represents an obstacle against the good operation of the domestic market, generates significant extra costs for the trans-frontier trade and business on administrative plan and with regard to the observance thereof, it hinders the restructuration of societies, reduces competitiveness of European companies at world level and leads to double taxing situations.

The differentiations regarding the fiscal regimes applicable in the European Union crate a strong fiscal competition between the member states, which competition distorts the character of the unique market, acting as a genuine obstacle for the free circulation of goods, services, labor force and capital.

Besides disadvantages in the field of European integration, fiscal competition presents a series of disadvantages in the field of economic efficiency and fiscal equity.

In the field of economic efficiency, when the decrease of the taxation of one country has as effect the decrease of the fiscal collections of other countries due to the trans-frontier mobility or to the reduction of the economic activity it provokes, the countries will set taxation quotas al lower levels than in the case of the existence of concentration, since, in case of fiscal competition, the negative externality on collective collections, collections directed to public goods and services will be neglected, which will lead to an under-dimensioning of the collective sector. As such, elimination of trans-frontier differences in matters of taxation will contribute to the reduction of the geographical distortions in investment, perception of income, etc., decision making, allowing creation of the Union efficiency.

In matters of equity, fiscal competition distorts both intra-territorial equity between the tax-payers of the same state, but also the equity between countries, since this encourages a speculative behavior at companies and particular entities, by use of the public services of a country or other but paying taxes in only one country.

This fragmentation of the taxation systems constitutes, in some of its elements, a way towards tax evasion, the loss of fiscal income following fraud and tax evasion being estimated only in the case of value added tax, between euro 200 and 250 bln.

Coordination of the fiscal regimes of member states could be a solution for the removal of the prejudices which competing national fiscal policies could bring to the domestic market and achievement of the European Union goals.

But, in matters of taxation, the decisional procedure requires unanimity in the European Union Council, which until now hindered the adoption of common rules in matters of direct and indirect taxation. The reason would be that, observing the fiscal sovereignty of each member state, it if not agreed to apply pressure in establishing fiscal regimes, which are influenced, besides other factors, by the politic and cultural ones.

Achievement of a genuine fiscal coordination in the 27 member states of the European Union is a difficult, costly and long-duration process.

Fiscal coordination at European level must consider the nature of taxes. Thus, while in case of indirect taxes it is imposed a high degree of harmonization, as these influence free circulation of goods and services, in case of direct taxes the harmonization has mainly as effect taxation of the income of large, trans-national companies and the income of persons with activities in several countries, regulation of the other categories of taxes being left in the responsibility of the member states.

Further on, the issue of European coordination will be approached exclusively from the point of view of direct taxes.

Thus, although in the field of direct taxes, the freedom of member states is as yet large enough, the domain of application thereof being less regulated at European Union level, there still exists a series of initiatives by which there is envisaged a better coordination aimed at eliminating double taxation to the benefit of persons and businesses as well as to fight tax evasion and conserve the taxation bases.

The main problem which could occur under conditions of a large freedom of the member states in seating the direct taxes appears in case of trans-frontier businesses. Thus, physical entities and companies which wish to work or invest in other member states can be affected by double taxation of certain income or the appearance of extra costs generated by the necessity of fiscal conformity.

Fiscal barriers in case of trans-frontier activity have constituted the subject of a large debate in the last years, by which there was pursued modification of the fiscal regimes of member states so that these do not hinder assurance of the four fundamental freedoms stipulated by the European Union Treaty (*free circulation of goods, services, persons and capitals*).

In the field of company taxation, at European Union level there are envisaged, on the one hand, prevention of fiscal competition harmful between member states and on the other hand, assurance of the free circulation of capitals.

As such, the possibility of occurrence of double taxation of profits in case of companies which carry out trans-frontier economic activities have imposed adoption of certain legislative measures common to all member states.

These were initiated in 1990 by two directives and a convention:

- "Parent Subsidiary" Directive (90/435/CEE), on the common fiscal regime applicable to parent-companies and their branches, which regards abolition of double taxation between various member states of the profit distributed between the parent-company situated in one country and its branches situated in other member states;
- "Merger" Directive (90/434/CEE), which has in view reduction of the fiscal burden which can hinder reorganization of companies;

- Convention 90/436/CEE, based on article 239 of the European Union Treaty and which introduces an arbitrary procedure of avoidance of double taxation regarding adjustment of the profit between associated companies situated in different member states.

In 1997 there was adopted a package of measures regarding direct taxation, whose scope is to fight harmful fiscal competition, with the intention to sustain a fiscal coordination in the European Union, applicable especially to companies.

Three domains were especially approached: company tax, taxation of income resulting from savings and taxation of royalties between companies.

The package of measures adopted on December 1, 1997, by the Council of Europe, also named "Package of measures regarding taxation" or "Monti Package", had in view:

- fighting competition in the field of taxation;
- elimination of distortions in the unique market;
- reorientation of the increasing tendency of taxing labor by a taxation system oriented towards the labor.

Within the frame of the "fiscal package" there were adopted:

- a code of behavior for business taxation, which represents the common wish of the member states, even though it is not a legal instrument. According to this code, the member states will fight competition in the field of taxation and will avoid introduction of measures having as effect competition in this sphere. There was also established a system of exchange of information on fiscal measures and an evaluation of this system;
- a normative instrument aimed at removing existing distortions in effective taxation of income resulting from savings, guaranteeing a minimum level of taxation of the income from interest obtained within the European Union (Directive 2003/48/CE, on saving operations);
- a legislative measure aimed at eliminating retentions at the source on trans-frontier payment of interest and royalties, made between associated companies (directive on payment of interest and royalties).

At present there exist ever more intense preoccupations to trigger a harmonization process of profit, unifying the taxation rules of corporations by a consolidated, common taxable basis.

Also, in the field of taxing physical entities, an European level preoccupation is that of preventing fiscal discrimination in case of taxing savings and pensions. Thus, the European Commission considers that the citizens of Europe must not be hindered in working in other member states by such issues as pension transfer and taxation.

In the field of savings, the citizens of Europe must be free to place them where they think they obtain the best income, the fiscal obligation remaining in the state of residence. On the other hand, the member state governments can record losses of income when their residents avoid declaring income from savings. An important step towards tax evasion avoidance in case of saving operations was achieved by coming into force, on July 1, 2005, of Directive 2003/48/CE, by which member states must introduce automatic exchange of information regarding payment of income by non-residents.

In December 2006, the European Commission presented three communications (COM 2006/823, COM 2006/824, COM 2006/825), regarding coordination of fiscal policies of member states, of which two approach specific issues such as trans-frontier losses and tax imposed in another country. These communications treat almost exclusively taxation of companies (only the communication regarding the tax imposed in another country makes reference to physical entities) and pursue more an improvement of interaction between various national fiscal systems than a harmonization in this field.

The communications were presented, on the one hand, in an attempt to find quick solutions to issues related to trans-frontier economic activities which, on a long term, can be solved by way of a common consolidate basis for company taxation (CCTB), and on the other hand, to solve any issue which could survive after introduction of such a consolidated taxation basis.

According to the European Commission (COM(2206)823), coordination of the fiscal systems is required to remove discrimination and double taxation, thus avoiding lack of taxation and reducing the costs related to the assurance of conformity for companies and physical entities which must apply several fiscal systems.

The European Economic and Social Committee supports[1] the European Commission proposal of elaboration of a common, consolidated basis for company taxation, one of the principles formulated in the CESE endorsement being that CCTB must be mandatory in order to be completely efficient.

Another issue under the attention of the European Commission is the fiscal treatment of trans-frontier losses[2]. It is taken into consideration the fact that, lacking a trans-frontier compensation of losses, a company with activities in several countries will pay greater taxes than a company carrying out its activity in only one country. Application of CCTB could solve this issue, but until its elaboration, the Commission suggests various trans-frontier compensation methods for the losses of a parent-company when the losses are covered by a branch and for companies with work points/branches in other countries.

In the majority of the member states, for groups there is possible a compensation of losses incurred inside the same state. If there are branches in

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[1] Opinion of the European Economic and Social Committee/2007/1264 on the COM(2006) 823, COM(2006)824 and COM (2006) 825

[2] COM (2006) 824

other countries, compensation is possible only in exceptional cases. This was the situation in the *Marks and Spencer* case. According to the award pronounced by the European Court of Justice, the losses will be compensated at the parent-company only when there are no other possibilities to obtain compensation of the loss in the country where the branch has its headquarters.

The companies within a group are separate entities from the legal point of view and are taxed individually. In spite of that, 19 member states have opted for the introduction of national systems of collective taxation of the group inside the country. The majority have opted for accumulation of the total taxation, while other accept only the possibility of loss compensation. Under the circumstances in which national provisions regarding trans-frontier compensation of losses differs from one state to another, application of CCTB could be a solution for the companies which carry out activities in several countries.

In Communication COM(2006) 825, on the tax imposed in another state and the necessity of coordinating the fiscal policies of member states, the European Commission deems that, when income not achieved between companies are transferred, there must be applied the same rules regarding deferment of tax payment on the territory of one country or between different countries. In spite of that, issues occur because the provisions regarding income not achieved doffer one from another. Furthermore, the insufficient flux of information between fiscal authorities and companies or physical entities involved may lead to lack of taxation or double taxation.

By the Resolution of October 2007/2097(INI)[1], the European Parliament supports the efforts of the European Commission to create a common, consolidated basis of taxation of the companies (CCTB) and deems that this will lead to an increase of transparency, allowing the companies to operate overseas according to the same rules used in the country of origin, to the intensification of trans-frontier commercial exchange and investments and considerable reduction of administrative costs and possibilities of tax evasion and fraud.

It also reminds that CCTB will mean common norms regarding the taxation basis and will not affect in any way the freedom of member states to set further on their own taxation quotas.

In the opinion of the European Commission, CCTB must be uniform, to determine a simplification, at the same time establishing a framework of common standards, but in order to establish a genuine unified basis of common taxation, there must also be created a documentation comparable, or at best, common, in order to record trans-frontier economic activities.

[1] European Parliament resolution of 24 Octomber 2007 on the contribution of taxation and customs policies to the Lisbon Strategy (2007/2097(INI))

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