EUROPEAN ECONOMIC COMMUNITY

SUPPLEMENT
TO
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of the European Economic Community

SECRETARIAT OF THE
COMMISSION OF THE EUROPEAN COMMUNITIES

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Tax harmonization programme

Programme for the harmonization of direct taxes

SECRETARIAT OF THE
COMMISSION OF THE EUROPEAN COMMUNITIES

Tax harmonization programme

(Commission Memorandum to the Council of 8 February 1967)

Further to a recent exchange of views on tax harmonization, the Commission, wishing to amplify and fill in more detail in the documents worked out during these discussions, has drawn up a concrete programme of work to be undertaken in the tax field.

When preparing this programme, the Commission started from the principle that harmonization must be limited to what is really necessary either for the establishment or for the smooth functioning of the Common Market.

In this respect the date of 1 July 1968 — at which the last customs barriers between the six States will disappear and the common agricultural market will have been fully established — marks an important stage. This time-limit must therefore be observed as the latest date by which certain fiscal measures must have been adopted by the Member States.

Consequently, the programme makes a distinction between those measures which would have to be taken before 1 July 1968 and those which could be carried out later.

Both before and after 1 July 1968, indirect taxes (turnover taxes and excise duties) and direct taxes will both be the subject of harmonization work.

Work to be undertaken in the tax field

BEFORE 1 JULY 1968

Indirect taxes

1. *Turnover taxes*

A third directive has been submitted laying down the procedures relating to the application of the value-added tax to agriculture.

2. *Further measures to eliminate discrimination due to excise duties*

The main task is to eliminate discriminatory arrangements surviving in one or several states in respect of excise duties on spirits and wine, sugar, coffee, yarns and cocoa.

The Commission's work on most of these discriminatory arrangements is nearing completion.

3. *Harmonization of excise duties*

The work on excise duties revealed that the discriminatory effects of certain excise duties on imported products can only be eliminated completely if the duties are harmonized in such a way that at least the structural differences are removed. This applies to the excise duties on manufactured tobacco, beer, sugar, spirits, and wine.

In addition, the common agricultural, transport and energy policies call for the approximation of the rates of certain excise duties; this applies in particular to excise duties on spirits and wine, diesel oil, other petroleum products, and sugar. Approximation work will require prior harmonization of the structures of these duties.

For these reasons, it would be advisable to consider in the near future a harmonization of the structures of excise duties on:

- i) Manufactured tobacco,
- ii) Spirits and wine,
- iii) Petroleum products and the like,
- iv) Sugar and sweeteners,
- v) Beer.

It must be noted that in the near future the excise duties on manufactured tobacco and spirits and wine will be harmonized under proposals to be worked out in connection with agricultural policy and the adjustment of monopolies.

The Commission intends to expedite matters in this field.

4. *Annual road tax on motor vehicles*

As far as possible, proposals will be submitted for the harmonization of structures and, later, rates. Harmonization is necessary if the objectives of competition and transport policy are to be attained. It would also meet the interests of those States which are contemplating adjustment of this tax.

5. *Indirect taxes on insurance contracts*

The territoriality rules for these taxes will have to be harmonized. The aim is to work out a transitional arrangement designed to create the tax conditions necessary for the establishment of freedom to supply services.

Direct taxes

The proposed measures are required by the gradual liberalization of capital movements, the need for structural reorganization and a higher degree of industrial combination, and the way competition is developing in the field of investment.

I. *Capital movements*

The aim is the complete elimination of international double taxation of dividends and interest and, in general, the removal of all the factors — distortions or discriminatory practices — likely to engender abnormal capital movements, to maintain market segregation and to curb the expansion of savings.

To this end the following measures are required:

1. The working out of a harmonized withholding tax system on interest on negotiable bonds and on dividends which would provide for the amount withheld to be set against the beneficary's total liability and for reimbursements where too much tax has been paid;

2. The adjustment in Belgium and France of certain procedures for the application of tax credits which are of a discriminatory nature;

3. The establishment of a single method for relieving the total tax burden on distributed dividends (tax relief for the company or for the shareholder);

4. The adjustment and harmonization of the tax implications of the operations of investment companies (including unit trusts) with a view to eliminating any tax discrimination against investments through such companies or trusts as compared with direct investment;

5. The harmonization of the tax arrangements applicable to holding companies and the amendment of certain regulations.

II. *Structural changes in industry and industrial combination*

The aim is to ensure that structural changes and amalgamations at Community level which appear necessary if the common market is to be developed further are not made too costly and as a consequence actually prevented by tax regulations.

To this end efforts are required:

1. To improve the functioning of the tax arrangements applicable to parent companies and subsidiaries where these are companies set up in different Member States; the same applies to both corporation tax and taxation at source;

2. To introduce, with a view to facilitating *inter alia* the creation of European companies, acceptable tax arrangements for mergers and transfer of assets as between companies in different Member States.

III. *Investment incentives*

In order to create roughly equal conditions of competition with regard to investment measures are needed:

1. To spell out more clearly the obligation of the Member States under Articles 93 and 102 to consult the Commission on all fiscal measures concerning the basis of assessment of such corporate taxes on company profits as are liable to constitute incentives and engender distortions of competition. Subject to prior consultation, any fiscal measures liable to constitute investment incentives should also be harmonized;

2. To effect a first alignment of factors taken into account in calculating the bases of assessment of profits tax, and in particular to establish certain basic rules for depreciation.

Indirect taxes

1. *Turnover taxes*

In connection with the harmonization of turnover taxes, a fourth directive will have to be submitted on the removal of the fiscal frontiers to intra-Community trade.

Proposals will have to be submitted concerning the additional arrangements for the application of the common system of tax on value added. These are provided for in the second directive.

2. *Excise duties*

a) Proposals will have to be worked out with a view to the removal of fiscal frontiers concerning the excise duties which the Member States are agreed to harmonize (manufactured tobacco, petroleum products, spirits, etc.);

b) Proposals will have to be drawn up on how to handle the other excise duties existing in one or more than one member country (yarns, mineral water, etc. and coffee, tea, salt, etc.) which have to be either harmonized or abolished or maintained without harmonization.

3. *Indirect taxes on insurance contracts*

Proposals will have to be submitted with a view to the harmonization of these taxes.

4. *Indirect taxes on capital movements*

Proposals will have to be submitted with a view to the harmonization of the indirect taxes on the stock exchange transactions and, where these exist, stamp duties, etc.

Direct taxes

Generally speaking, the efforts towards an alignment of direct taxes should lead to:

1. The harmonization of certain structures:

a) Schedular taxes.

b) Present taxes on company assets, which would probably have to be abolished.

2. A uniform definition and method of calculation of taxable corporate profits. To this end the provisions initially planned would have to be supplemented with regard to depreciation, and new provisions would have to be introduced regarding the tax treatment of the appreciation in value of fixed assets, the valuation of stocks, the carrying over of losses to subsequent years, and tax-exempt general and special reserves. Measures adopted as incentives and departing from these provisions would then only be permissible if they were fully co-ordinated to comply with general economic policy;

3. Sufficient alignment of the rates of corporation tax in the six countries;

4. Co-ordination of the methods of control and collection, without which harmonization would not have the desired effect.

Lastly, measures should be taken to eliminate permanently those cases of international double taxation which harmonization itself would not eliminate.

Programme for the harmonization of direct taxes

(Commission Memorandum to the Council of 26 June 1967)

The aim of this programme is to describe in detail the conditions under which certain current tax problems arise and to propose solutions to these problems. The questions involved concern in the main capital movements, industrial combination and investments. In order to fit these problems into their general context the Commission has preferred to start by setting out the reasons and prerequisites for the approximaion of direct taxes in the six countries and describing the objectives to be attained by approximation over the long term.

Outline programme: Reasons and objectives

I. Reasons and prerequisites for the approximation of direct taxes in the six countries

II. Long-term objectives of approximation

Urgent problems: Facts and suggested measures

I. Capital movements

A. Withholding tax on dividend and bond interest

B. Alignment of the French system of fiscal claim and the Belgian system of tax credit

C. Investments made through investment companies

D. Preferential treatment of certain holding companies

II. Industrial combination

A. Mergers

B. Acquisition of holdings

III. Depreciation

A. "Normal" depreciation

B. Special depreciation

OUTLINE PROGRAMME

REASONS AND OBJECTIVES

I. Reasons and prerequisites for the approximation of direct taxes in the six countries

1. It now appears to be generally recognized that there is a need for a certain approximation of the systems of direct taxation in the member countries of the EEC.

Before setting out the ultimate aims of the approximation of direct taxes, an account must therefore be given of the economic and social objectives to be attained:

a) So that conditions of fair competition can be established between the Member States, the cost of production and the yield of invested capital must not be influenced by taxation in a way which differs too widely from one country to the other.

b) The movement of capital and the choice of locality for the investment must not hinge on considerations of a purely fiscal nature but must be determined mainly by economic and social factors and must ensure the optimum utilization of the funds and the factors of production of the Community.

c) The growth and consolidation of undertakings, their reorganization and, more generally, reform of the structure of production and distribution must be facilitated, not impeded, by the tax systems.

Any tax obstacles to the amalgamations which will be needed if enterprises are to adjust themselves to the scale of the Common Market and if the firms of the Community are to hold their own against competition on the world market (mergers and acquisitions of holdings at national and Community level, creation of European companies, activities of associations of enterprises, etc.) must therefore be eliminated. Any tax provisions which are prejudicial to small and medium-scale enterprises will also have to be modified.

d) It will have to be possible to ensure, in the framework of the Community's general policy and in keeping with the common policies adopted in certain fields, the co-ordination of the policies of the Member States and the use of taxation as a means of economic and social intervention.

2. A study of the main aspects of corporate taxation and work done in co-operation with government experts have confirmed that the differences in the structures of the tax systems, the existence of arrangements which are more favourable in some countries than in others, the strictly national objectives pursued by the individual countries in the tax field, double or multiple taxation as a result of the simultaneous or successive application of the tax rules of several countries to one and the same transaction (despite conventions for the avoidance of double taxation) are all liable to impede the smooth working of the Common Market.

The aim must therefore be to arrive at an approximation of the structures, at a certain approximation of the rates and at the total elimination of double taxation.

But the short-term as well as the long-term measures to be envisaged must, like the process which is to lead up to them, meet certain conditions:

a) While any measure proposed must of course be in line with the economic and social objectives of the Common Market, it must at the same time represent a solution conforming with modern theory in the field. In addition, each tax must be evaluated in the overall context to which it belongs; it must remain an internally consistent unit and its structure must not be distorted by too many adaptations or concessions to special situations;

b) The recommended measures of harmonization must, even over the long term, leave the Member States sufficient power to administer the revenue under the budget and sufficient room for manoeuvre to take, if necessary, differentiated measures to influence their economies in the framework of the Community policy;

c) Sooner or later the question of allocating revenues among the Member States will be raised, particularly in cases where central handling of taxation, for instance in the country of residence, would appear to be the best way of avoiding double taxation, ensuring equal tax treatment and simplifying formalities for the taxpayer. A study is therefore needed at once of ways and means of allocating total tax revenue. Such methods would have to replace the system currently in operation between Member States of providing for offsetting arrangements almost transaction by transaction. A success in this field would greatly facilitate all problems of harmonization and would lighten the burden weighing on both tax authorities and enterprises;

d) Lastly, many measures designed to approximate legislation or align underlying tax theory will serve little purpose unless the methods of inspection, verification and collection are also harmonized. There is therefore a need for parallel action in this field.

II. Long-term objectives of approximation

1. The ultimate objective of the process of approximation of the tax systems in the Member States must fit into the economic framework and meet the conditions indicated above.

As pointed out already, the tax revenue of the six Community countries should, over the long term, be made up mainly of receipts from:

a) A tax on value added, harmonized to the greatest possible degree, and some major excise duties, also harmonized;

b) A general tax on company profits, having the same structure throughout the Community and based on broadly similar methods of assessment and rates;

c) A single comprehensive personal income tax which admittedly may differ from one member country to the other for a long time to come.

The problems to be solved in the field of direct taxation therefore relate mainly to the taxation of enterprises (particularly companies), of profits and of distributed dividends.

The following is an outline of the results to be aimed at.

2. *Complete harmonization of overall structures*

This result will be achieved by:

i) The elimination of the schedular income taxes still existing and the introduction of the same type of corporation tax throughout the Community;

ii) The elimination of those taxes on company assets the nature of which involves discrimination against capital-intensive firms;

iii) The adaptation to the homogeneous structure of the above-mentioned major taxes of the direct taxes local authorities impose on enterprises.

3. *Harmonization of the structures and approximation of the rates of corporation tax in the EEC*

The problem of the structure of corporation tax lies in the fact that some Member States have introduced methods calculated to reduce the double taxation of dividends occurring at two levels by the taxing of company profits and the taxing of the shareholder's personal income. These methods consist in either reducing the rate of corporation tax for distributed profits (Germany) or in granting the shareholder a "tax credit", i.e. in allowing him to deduct from the amount of his personal income tax part of the corporation tax paid by the enterprise distributing the dividends (Belgium, France).

In the short term it may be permissible to let the two methods run side by side despite their questionable implications and despite the difficulties that are bound to arise if efforts are made to avoid certain effects. A correction is none the less indispensable of certain effects of the French system of fiscal claims and the Belgian system of tax credit which may adversely affect the movements of capital. This problem will be dealt with in a later chapter.

In the long term it will, however, be necessary to adopt a single method for the whole of the Community. No doubt methods other than the one used at present might be contemplated to reduce the burden weighing on dividends as a result of the taxing of company profits on the one hand and of the shareholder's income on the other. It would, for instance, be possible to lower the rate of corporation tax irrespective of the way profits are used, or to deduct from taxable profits — up to a certain percentage of the invested capital — the dividends distributed to shareholders, or to consider only part of the dividends received by the shareholder as counting towards the total of his taxable income. The solution to be adopted eventually would, however, have to allow of a sufficient approximation of the rates of corporation tax applicable in the six member countries.

4. *Approximation of the bases of assessment for taxes on company profits*

In the long term it will be necessary to arrive at a common definition of taxable company profits and a common method of calculating them so that the basis of assessment is harmonized to the greatest possible extent.

The degree of precision of the harmonized rules will depend on the elements taken into account for calculating taxable profits.

For depreciation, certain rules will have to be kept to with regard to the time at which depreciation is deemed to begin, the methods of calculation and the extent to which depreciation arrangements are compulsory; measures departing from the general rules and constituting special investment incentives will have to be approved through a prior consultation procedure. These measures, set out in one of the following chapters, would have to be taken rapidly.

There will also have to be precise rules to govern the tax treatment of appreciation of assets in the course of the operation of a business and to align sufficiently the methods

admissible for the valuation of stocks and the constitution of reserves. A description of the possible solutions to the different problems will follow later.

5. *Approximation of the tax arrangements applicable to parent companies and subsidiaries, to company mergers and winding- up operations*

In the long run these arrangements will have to be harmonized in the EEC so that it will not be mainly fiscal considerations which determine whether and how firms should purchase interlocking holdings, merge or go into liquidation.

In the short term, the immediate aim must be to remove the tax obstacles, i.e. to make the tax cost of these transactions acceptable if the parties to them are companies set up in different Member States. These problems will be dealt with in a later chapter.

6. *Harmonization of the systems of withholding tax on dividend and interest*

Although in principle an advance payment of personal income tax and for this reason outside the scope of the proposed general programme of harmonization, the withholding tax generally levied on distributed company dividends and interest paid to bondholders is a source of serious difficulties. As these difficulties, which should be overcome without delay, are of topical importance, they are dealt with below.

7. *Multilateral convention*

Lastly, a multilateral convention should be drawn up for the avoidance of such double taxation phenomena as would not disappear completely in spite of harmonization measures planned.

In the preceding account of the ultimate objectives to be attained, special mention has been made of certain measures relating to particularly urgent problems.

To allow for an examination in greater detail, these measures, which are listed among the questions to be solved before 1 July 1968, are divided into three chapters:

i) Capital movements

ii) Industrial combination

iii) Depreciation.

URGENT PROBLEMS : FACTS AND SUGGESTED MEASURES

I. Capital movements

The efforts made to ensure the free movement of capital between the countries of the Common Market, overcome the fragmentation of the capital markets and create a truly common capital market, give rise to problems of a fiscal nature:

i) Not only the consequences of the simultaneous or combined application of the tax rules of two or more countries to one and the same transaction (case of double or multiple taxation or the creation of tax havens)

ii) But also the effect of the mere existence in certain member countries of tax rules favouring certain groups of taxpayers or types of investment more than the corresponding rules do in other countries.

Taxation is therefore:

i) A major obstacle to the free movement of capital and the interpenetration of the capital markets, and

ii) One of the main causes of "abnormal" capital movements, i.e. of movements springing from other than the traditional economic or financial considerations.

In the long run the remedy for such a situation lies in the alignment and harmonization of the tax systems of the individual Member States, the aim being the creation of fiscal neutrality — which is indispensable for the free play of the forces of competition — with a continuous adjustment of taxation to the economic policy pursued by the Community.

A solution would thus have to be found to all tax problems relating to capital movements and the utilization of funds in the Community, irrespective of whether it is a question of simple portfolio investment transactions or of investments more directly connected with the operation, the management and the control of enterprises or groups of enterprises.

Meanwhile, practical solutions must be found to certain tax problems connected, in particular, with investment capital since obstacles other than fiscal ones to the movement of these funds are being gradually removed.

In practice this refers to.

a) The systems of withholding tax charged on dividends and interest,

b) Methods of reducing the economic double taxation of dividends,

c) Discrepancies in the tax arrangements applicable to holding companies,

d) Tax treatment of income from investments handled by financial intermediaries, particularly by the various types of investment company.

A. Withholding tax on dividend and bond interest

The withholding of tax at source, although in principle only an advance payment of personal income tax, is of threefold interest to any State, because:

i) It is a means of speeding up the flow of revenue;

ii) It cuts back the loss of receipts due to tax fraud, as the tax withheld is irrecoverable unless a tax return is made in respect of the income against which the tax has been withheld;

iii) It enables the State to assert its tax claim in international transactions and to secure part of the tax eventually charged on the income involved when it is paid to a non-resident.

This explains why the States cling to this type of taxation particularly in international transactions.

There is a wide range of rates charged as withholding tax on dividend and interest at the level of each Member State and in the framework of the 30 bilateral groupings possible among the Six. The rate for the same income may vary from 0 to 30%. In addition, the total tax eventually borne by the recipient of dividend or interest varies with the EEC country in which the income arises. This discrepancy is due to the fact that, depending on the individual case, the tax withheld at source is not, is only partly or is totally charged to personal tax liability, or is even refunded.

Added to these discrepancies there are differences in the methods and the efficiency of the control of the final tax charged on dividend and interest paid to residents of the Member States. The situation in the EEC is as follows:

i) There are systematic supervision arrangements in some countries; this is the case in France and in Italy[1] for dividend in general; any dividend received in these countries is immediately reported to the revenue department. In France the same applies also to bond interest, even if the creditor opts to pay the flat-rate deduction of 25% in full discharge of his personal income tax liability. Dividend and bond interest paid to foreign creditors, however, escape supervision unless the creditor claims the benefit of a double taxation convention;

ii) In other countries investment income may be received without systematic notification to the revenue department; this is the situation in the other Member States with regard to dividend and bond interest — except in Italy where the rule applies only to bond interest — unless the creditor claims the benefit of a double taxation convention.

The situation facing the recipients of dividend or bond interest therefore varies:

i) From country to country,

ii) In one and the same Member State according to the country where the income arises,

iii) In one and the same Member State sometimes according to whether the income is collected in this State or abroad.

As a result there are the following disadvantages:

i) In spite of conventions for the avoidance of double taxation concluded between Member States, the withholding of tax at source results in many cases in double taxation, either because conventions do not yet exist (Germany - Belgium,[2] Italy - Luxembourg, Luxembourg - Netherlands), or do not cover income from securities (Belgium - Netherlands) or because some of them, being very old, are no longer appropriate to present-day tax systems. These instances of double taxation impede the movements of capital and make for the fragmentation of the capital markets;

ii) The bilateral conventions currently in force are based on differing and sometimes even conflicting principles so that the methods used to eliminate double taxation vary greatly from one country to another; this is one first source of difficulties. Much greater difficulties arise from the fact that the conventions are applied in a way which very often requires compliance with formalities by taxpayers and paying agencies for each individual payment. To qualify for the application of

[1] In Italy the supervision arrangements are of an even more rigid nature because as a general rule shares must be registered in the owner's name.
[2] The Convention has been signed but has not yet been ratified.

a convention, the taxpayer is in most cases bound:

a) Either to submit, prior to the receipt of a dividend or interest payment, to the paying agency a certificate of residence certified by his revenue office. this certificate is then being sent to the country in which the income is earned so that the rate of tax withheld on payment is that provided for by the convention,

b) Or to file, after receipt of the income on which the normal rate of withholding tax has been charged in the country of origin, through the paying agency an application in that country asking for a refund, the time elapsing till the refund is made being sometimes rather long.

In many cases these formalities are so complicated that individuals waive the benefit of the conventions and accept double taxation.

Lastly, these differences in the methods provided for in the conventions and the complicated application procedures are a further factor discouraging certain investors from committing their funds abroad.

a) If the tax withheld exceeds the tax liability of the beneficiary, his income is overtaxed unless the amount paid in excess is refunded. At present not always effected for income earned at home, this repayment is never made for income of foreign origin because States refuse to "refund" taxes not collected by them;

b) If the beneficiary does not file an income tax return or if he is exempted without possibility of refund, the tax withheld represents in practice a final tax in full discharge of personal income tax liability.

The consequence of disparities in the withholding tax rates applicable in the various countries, then, is that the tax burden on income from securities varies according to the country where it is earned; it is therefore only natural that funds should have a tendency to flow into countries where the rate is lowest.

This tendency is particularly pronounced in the case of interest, which, unlike dividends, has not been reduced by an amount due as corporation tax and for which the withholding tax represents the only tax burden. In this case the differences between the countries take on added importance since they influence directly the cost of borrowing, which is already particularly sensitive to the forces of supply and demand; these differences, the EEC Monetary Committee has already pointed out, may by themselves induce major movements of capital.

To sum up, it must therefore be emphasized that — even if modified by the existing double taxation conventions — the withholding of tax at source as practised at the moment in the member countries remains a frequent cause of double taxation or over-taxation and complication for the investor, and is the basic reason for abnormal movements of capital.

It is therefore an obstacle to the free and sound movement of capital in the Community and to a better interpenetration of the capital markets of the member countries.

To remedy this situation there has to be a certain harmonization of the arrangements at present governing the withholding of tax on dividend and bond interest.

1. To avoid any double taxation, the common system to be adopted must first of all provide for restoring to the withholding tax its basic character of an advance payment and therefore for enabling the beneficiary to obtain a refund of tax paid in excess if he has no tax liability or only limited tax liability.

2. Two methods may therefore be contemplated for overcoming the problem of abnormal capital movements.

The first method consists in ensuring by all available means automatic and efficient verification of incomes collected within the Community by individuals residing in one of the six member countries. Such a very strict system could for instance be operated by generally introducing the French "coupon schedule" system which calls for close co-operation between the Member States and active collaboration of the banks and other paying agencies; co-operation on this scale is, however, unknown in several Member States, where the principle of banking secrecy would also be an obstacle.

In this case the rate of tax withheld by each country is of no practical importance and may even be nil; what matters is that any tax withheld could be fully charged to personal income tax liability and should if necessary be reimbursable in part or in full. Such a system offers the great advantage of making it possible to eliminate withholding tax within the EEC and thus to introduce taxation of income in the country of residence only and to provide a better guarantee that the progressive tax scale is applied.

It must, however, be pointed out that such an arrangement, which would mean a very wide disparity between the tax rules applied within the Common Market and the tax rules applied in certain non-member countries, would be liable to engender capital movements not from one member country to another but from the Community to non-member countries. The solution to be adopted should therefore not be based on technical tax considerations alone

but should also take into account the economic and social interests of the Community as a whole.

In contrast to this, a second arrangement, while in principle making the withholding tax retain its character of being claimable and reimbursable, consists in waiving for the time being the extension of the automatic control procedure to all EEC residents. It must, however, be realized that in this case all taxpayers would in practice be free to collect their income without the revenue departments' knowledge — in their own country or in another member country — and that thus some of them would prefer to consider the withholding tax as irrecoverable and not claim for it against personal tax liability. For this reason this solution must provide for the application of a common withholding tax rate every time income is paid to an EEC resident but not reported to the revenue department at the time of payment.

In view of current taxation practice in most Member States and the prospect of complete liberalization of capital movements in the EEC, this arrangement would appear more realistic, and the general principle involved should be adopted, at least initially: this arrangement does not preclude later adaptation to a very strict general inspection and verification system and the elimination of withholding tax or to a system offering the taxpayer an opportunity to opt for a tax withheld at source in discharge of all other tax liability in respect of the income concerned.

To sum up, the main lines of a common solution to the problem of withholding tax could be as follows:

a) To avoid double taxation in a way which is satisfactory in principle as well as in practice, it would be appropriate:

i) In all cases to make the withholding tax once again an *advance payment*, both in the relations between the Six and in the individual member countries;

ii) To avoid the numerous and complicated formalities to be complied with at present by the recipients of incomes and the paying agencies if double taxation is to be avoided effectively.

In practice this means that:

i) Any tax withheld at source would have to be allowed in full for tax purposes and be reimbursed to the extent that it exceeds the beneficiary's tax liability or if the beneficiary is not liable to tax;

ii) In the relations between the Member States, reimbursement would always have to be made by the revenue departments of the country of domicile as if the incomes involved had been collected in that country.

The application of such a principle could undoubtedly result in reimbursement by one State of tax which it had not collected; the States could, however, make the desired adjustments through appropriate equalization payments effected on an overall basis instead of from case to case as is being done today.

b) To avoid abnormal capital movements, there should be common rates for tax withheld at source in the EEC:

i) For dividends a rate of 25% appears feasible. This is the rate applied by several Member States;

ii) For bond interest, a lower rate appears to be called for: interest payments are sometimes subject to a lower rate of withholding tax or are even exempt from this tax. In certain cases or within certain limit interest payments can even be totally tax-exempt.

The introduction of a withholding tax of 25% on bond interest in countries which at the moment do not withhold tax on such income would lead to serious disturbances on the bond markets of these countries. Various reforms of this type show the considerable influence changes in the rate of withholding tax have exerted on capital movements in the recent past. The rate of 10% is probably a maximum if disturbances on the bond markets are to be avoided.

It may be held that even at a rate of 10% the introduction of a withholding tax is liable to lead to a diversion of certain issues from the EEC countries not charging such a tax at the moment to non-member countries. Given the international mobility of capital, borrowers tend to compare yields net of all tax; as long as there are countries which do not charge a withholding tax, the tax burden will therefore tend to weigh only on the debtor without affecting the creditor. The private borrower is the one mainly affected by this charge; for public authorities calling on the capital market the charge is generously compensated by tax revenue corresponding to the tax withheld.

c) In order to confer a certain flexibility on the system and not to jeopardize later developments leading towards a common system of rigid control accompanied by the elimination of the withholding tax or conversely towards the charging of a withholding tax in full discharge of any other tax liability, the Member States could, however, reduce the common rates or even abolish the practice of tax deduction at source:

i) If the revenue department of the recipient of the income is informed immediately by the paying agency of any payment of dividend or interest;

ii) If the recipient is exempt from tax, for instance, where the recipient is a parent company.

Obviously the question must be raised as to whether the first, rather general exception is necessary: it must be admitted that, once capital movements have been liberalized completely, the supervision systems at present in force will in practice, if not *de jure*, lose their strict compulsory nature, as taxpayers will always be able to escape the automatic operation of the system by collecting their incomes, even if earned in their own country, in another country in which such supervision does not exist. But it will in practice not pay for the shareholder to act like this unless the tax due exceeds the amount he is entitled to claim for, i.e. is higher than the withholding tax (compulsory in this case) plus any tax credit — in France a sum equal to the net dividend collected. This sum being very high, such a practice will be of interest to a very small number of persons only. Most taxpayers will continue to prefer the present system of supervision with elimination of the withholding tax. To compel France to re-introduce a 25% withholding tax on the dividends paid to residents would entail many refunds and would therefore complicate the system. In the final analysis, supervision and consequently the exception to be made in this case therefore appear to be useful suggestions.

The second exception which is to be made if the beneficiary is not liable to tax appears to be self-explanatory: one cannot see why in this case a withholding tax should be charged which would have to be reimbursed later.

It should also be noted that by providing for the reimbursement or elimination of the withholding tax, this system solves the problem of withholding tax on dividends in the relations between parent companies and subsidiaries.

d) Lastly, the common withholding tax system as outlined above would be useless if it did not preclude the possibility of other deductions being made.

The Member States which at present make a deduction on incomes from other Member States would, for instance, have to abandon this system.

B. Alignment of the French system of fiscal claim and the Belgian system of tax credit

Generally speaking, the system of fiscal claim or tax credit in operation in France and Belgium consists in allowing the shareholder to deduct from the amount of personal tax liability a portion of the corporation tax paid by the company distributing the dividend. In France, a reimbursement is also made if the taxpayer's liability is too small to allow such deduction. In Belgium, a flat-rate allowance is granted which can never take the form of reimbursement.

Seen as an alleviation of the tax burden on the recipients of dividends (comprehensive personal income tax or corporation tax), this system benefits only individuals or companies liable to such taxes in France or Belgium, i.e. in principle, residents of these countries.

In the two countries, however, the deduction applies only to dividend distrbuted by companies established in the country itself and not to dividend paid out by foreign companies.

The question therefore arises as to what the practical effects of this measure have been. Are these effects acceptable if measured against the present state of development of the Common Market or should there not be attempts to modify them by asking the countries concerned to adjust their rules? What points should be modified?

There is general agreement on the first question: from a practical, if not strictly legal point of view, the measures have some discriminatory effect incompatible with the development of the Common Market and particularly with the increasingly complete liberalization of capital movements and the interpenetration of the capital markets.

Here, however, there are conflicting theories based in particular on the fact that the measures at present in force provide for a twofold exception:

i) Dividends on foreign shares do not qualify for tax deduction;

ii) Non-residents cannot claim any tax alleviation.

1. The first theory accepts the way the system is presented as leading to a reduction of the personal income tax of shareholders, no allowance being made for the precedent set by Germany, which grants a simple reduction of the rate of corporation tax for the distributed portion of profits. Then, however, one must also accept all consequences of this approach.

It is not compatible with the principles of the Common Market that in a given country the personal income tax of one and the same shareholder should be fixed in a way which differs according to whether the dividend collected is paid by companies established in his country or by companies established in other member countries.

The way the system of tax credit operates at present is an inducement to Frenchmen to invest in French and Belgians in Belgian enterprises, and contributes to the fragmentation of the capital markets, while the aim should be fiscal neutrality ensuring for investors the same tax treatment irrespective of where they invest funds in the EEC.

From this point of view the French and Belgian systems of tax credit must be extended to cover dividend distributed by companies established in the other countries of the Common Market.

2. The second theory questions the notion that the tax credit or the fiscal claim can be regarded as a reduction of the shareholder's personal income tax. It refers in particular to the explanatory memorandum attached to the French law and to the fact that, as far as actual tax alleviation is concerned, this method yields the same result as the German method of applying a split rate.

In France as in Belgium, about half the corporation tax companies pay on dividends in the form of profits tax is chargeable to tax liability while in Germany it is the corporation tax to be paid on the distributed portion of profits which in practice is reduced to about half.

To avoid the granting of a reduced rate of corporation tax to foreign shareholders — which is obviously the case when there is an across-the-board reduction of corporation tax as in Germany — this reduction is therefore given the form of tax credit or fiscal claim. The system of fiscal claim should therefore be extended to residents of the other Member States so as to eliminate the discriminatory effect, and equilibrium should be restored between residents and non-residents by providing for the reimbursement of a sum equal to the tax credit or for the possibility of charging it to the tax liability these residents of the Community may have in France and Belgium.

The introduction of the system of tax credit in its present form has discouraged non-residents from purchasing shares in French or Belgian companies (to the extent that these companies have cut their dividend to increase self-financing) and has therefore contributed to an increase in the fragmentation of the capital markets.

However this may be, the system of tax credit therefore would have to be modified rapidly if it were to be made acceptable to the Community as a whole.

If they want to maintain the alleviation of the "economic double taxation" of dividends, the Member States will, in the long run, have to adopt a standard system either by applying in all the countries the system of tax credit amended as described above or by applying in all the countries the system of split rates at the moment in force in Germany. To arrive at this end other and simpler methods may in addition be considered, as for instance the ones previously mentioned in the section on the approximation of the corporation tax. If the systems of tax credit and split rates do in fact reduce "double economic taxation", they do not appear to appeal to the shareholders to the extent expected, nor have they solved the problem of the excessive preference given by companies to loans for financing operations.

C. Tax treatment of investments made through financial intermediaries

When investments are made through financial intermediaries it must be possible to pass the accruing investment income on to individuals or other institutions as though they had made the investment direct, in such a way as to avoid penalizing, from the tax point of view, persons who prefer to have their savings administered by expert intermediaries. "Fiscal transparency" must permit the ultimate beneficiary to set against other income tax liability any withholding tax which has not already been refunded or allowed to the intermediary; it must also preclude the imposition of additional tax on investment income in the hands of the intermediary. This is a principle which to a greater or lesser extent as already been observed in the tax legislation of all countries, particularly with regard to intermediaries which are under the statutory obligation to pursue a policy of very diversified investment and in cases where the intermediary is a company holding a major participation in another company. The example of several Member States shows that it would be of advantage to apply the principle of "non bis in idem" (not twice in the same matter) as a general rule to all investments made through financial intermediaries.

D. Preferential treatment of certain holding companies

Certain objections raised in the EEC in this respect mainly concern Luxembourg holding companies. These are companies whose strictly financial activities consist principally in buying, administering, exploiting and selling securities (shares, company rights, bonds, etc.) and patents and in floating loans. Independently of the advantages these companies may also be offered from a financial point of view, they are granted preferential tax treatment.

In Luxembourg these companies pay no tax on their incomes. They are subject to the payment of only a very moderate annual charge and are also exempt from withholding

tax on the profits they distribute. However, they cannot claim for or recover any tax withheld on the income they collect, nor do they qualify for the application of conventions for the avoidance of double taxation.

Exemption from corporation tax seems reasonable with regard to the dividends which have already been subject to profits tax in the hands of the distributing company. This is not an arrangement peculiar to Luxembourg. What may be objectionable is the extension of tax exemption — as applicable to Luxembourg holding companies — either to capital gains realized upon the sale of securities or to bond interest or patent royalties which in principle are not liable to tax in the hands of the borrower or of the patentee respectively.

Interest on loans floated by Luxembourg holding companies is exempt from withholding tax. This exemption, however, does not suffice to explain the large number of loans floated nor is it a special arrangement existing in Luxembourg only. There are other Member States which do not withhold tax on bond interest either as a general rule or in special cases, as for instance when the loan has been floated abroad. In Luxembourg it looks as if ease of access to the capital market is the key to the heavy volume of borrowing.

From a strictly fiscal point of view, the solution to these problems would consist in harmonizing the relevant laws in the Member States.

However, the problem cannot be solved by fiscal means without due regard to general factors, the Luxembourg holding companies being often used to maintain appreciable funds in the EEC or to introduce them from non-member countries.

Another requirement would be a common attitude on the part of the Member States towards certain non-member countries (e.g. Switzerland), where companies of this type operate under very advantageous tax arrangements, the objective being to avoid rendering certain companies of non-member States still more attractive.

Certain Member States have tried to combat unilaterally this form of tax evasion. A Belgian law of 1954, for instance, forbids the deduction from taxable profits of the royalties and bond interest paid to a holding company set up abroad and operating under tax arrangements which are not subject to general law, unless the taxpayer proves that this remittance is made in connection with true and genuine transactions and stays within normal limits. The same considerations have led France to charge in these cases an irrecoverable withholding tax (24% on royalties, 25% on interest).

The questions referred to above can be settled only gradually, with due regard to their monetary, financial and economic implications. The introduction, during a first stage, of a compulsory withholding tax charged at a harmonized rate on all bond interest, as proposed in an earlier chapter, might represent a first step togards a solution.

II. Industrial combination

The tax problems raised by industrial combination vary with the forms combination takes. Combination may be effected in widely varying ways; from the point of view of taxation the phenomenon may be classified under two headings:

i) The merger of companies, i.e. the regrouping into a larger legal unit (merger by take-over or by the establishment of a new company);

ii) The acquisition of a holding, i.e. the purchase of an interest in another company by a company wishing to establish a parent company/subsidiary relationship or to create a holding company.

These two types of combination are not used to the same extent in all six countries; this is due only to the differences in company law (mergers automatically entailing the dissolution of the company or the companies being taken over are unknown in the Netherlands) but also to differences in the economic structure, the degree of concentration already reached, the size of enterprises, and industrial and commercial practices.

In the Community context both phenomena call for consideration. It should be borne in mind that:

i) Mergers are generally impeded by the cost of the transaction itself, and

ii) Acquisition of holdings is not impeded by the cost of the transaction itself; in this case it is the tax rules subsequently applicable to the group (parent company and subsidiaries) which may constitue an obstacle to combination.

A. Mergers

The types of merger which, depending on the Member State, are at the moment to be found in the Community can be classified under two main headings:

i) The purely "legal" merger by the setting up of a new company or by take-over (and possibly a company split) entailing the dissolution of the acquired company;

ii) The partial or complete acquisition of assets against issue of company securities without dissolution of the acquired company.

The main direct taxation problems raised by these types of transaction may be divided into three categories:

i) Those affecting the acquired company;

ii) Those affecting the acquiring company;

iii) Those affecting the shareholders of the acquired company.

1. As regards the acquired company, the problems of capital gains on fixed assets represent the main tax obstacle:

a) If the acquired company is dissolved, the profits not yet taxed and particularly any capital gains previously concealed and now disclosed normally attract tax immediately under the rules on company liquidation. To avoid such heavy taxation, which would make mergers impossible even at national level, the Member States generally grant preferential treatment consisting in the postponement of taxation until the time when the capital gains have in fact been realized by the acquiring company: no tax is charged at the time of merger, but the acquiring company must calculate depreciation and subsequent capital gains in respect of the assets acquired according to the value at which they had been carried in the balance sheet of the acquired company. Sometimes a combined system is applied which provides for either the postponement of taxation, the phasing of tax payment over a number of years or immediate payment of tax at a reduced rate.

b) If the acquired company is not dissolved, the take-over none the less gives rise to capital gains in respect of fixed assets resulting from the difference between the book value and the real value of the assets transferred. The same problem therefore arises for capital gains realized not as a result of the dissolution but in the course of business operations. These gains are normally part of the taxable profits. As in the case of mergers affecting only the legal status of the firms concerned, the Member States in which such operations are effected have adopted internal measures to avoid such an immediate charging of tax at the normal rate.

International mergers involving the dissolution of the acquired company may, in addition to the problem of capital gains, give rise to the problem of the liquidation increment realized by the members when the dissolved company distributes its assets. The exemption of this increment from taxation in the case of mergers is reasonable because no assets are distributed to the members and the increment is in a way transferred to the acquiring company, the charging of tax being postponed until this company is dissolved. The application of this rule to cases of international mergers does not appear to raise major difficulties in so far as the increment is treated as investment income — (dividend) — which is the practice in most member countries. The State of the acquired company may, at the time of dissolution of the foreign company making the acquisition, tax the liquidation increment to the extent it is distributed to its residents (subject to the charging of a withholding tax in the other State). But this does not apply in a country which, like Belgium, taxes the liquidation increment at the level of the dissolved company and not in the hands of that company's members. However, this problem could be solved unilaterally as it concerns only Belgium.

2. As regards the acquiring company, the obstacles appear to be much less serious, at least if none of the companies involved holds shares in other parties to the merger.

A problem may however arise in connection with the merger premium. This premium represents the difference between the real value of the acquired assets and the increase in the nominal capital to cover these assets. It represents the portion of undisclosed capital gains and reserves backing the new shares. As a general rule this premium appears to escape corporation tax in the various countries.

Certain difficulties do, however, arise if one of the two companies hold shares in the other.

If the acquired company holds shares in the acquiring company, the corresponding shares received through the take-over must be cancelled[1] unless the acquiring company is allowed to hold its own shares. Conversely, i.e. if the acquiring company is a shareholder of the acquired company, the shares must be either cancelled or exchanged against shares of the acquiring company if the latter is allowed to hold its own shares.

These operations are apt to yield capital gains; the absence of preferential arrangements then leads to double taxation because in practice the same capital gains are taxed twice — once at the time of acquisition and once at the time of cancellation or exchange of shares.

3. For the shareholders of the acquired company exchanging their shares against shares of the acquiring company, the question arises as to whether this transaction can attract tax. Taxation at this stage may constitute an obstacle to company mergers since it may induce certain shareholders, paricularly those owning large blocks of shares, to oppose the merger.

[1] Or disposed of as appropriate.

However, this question does not arise if it is a case of acquisition of assets where shares are handed over in exchange while the acquired company is not dissolved; the shareholders of this company keep these shares.

Lastly, it must be remembered that mergers occasion registration tax problems. In this respect the proposed directive submitted by the Commission to the Council will ensure the harmonization desirable from a Community point of view and preclude double taxation between Member States.

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Several factors must be taken into account if a solution is to be found to the tax problem created by international company mergers.

a) Any solution must be based on the principle that some measure of tax relief should be granted; this does not mean that the States are going to lose revenue, since there have been no international mergers so far; there would, however, be some "loss of profit". The principle should be accepted by all the Member States.

b) There is, moreover, general agreement that there can be no question of applying to international mergers more favourable tax rules than to mergers at national level.

c) However, an examination of the various problems set out above has shown that it is not possible purely and simply to extend to international mergers the various arrangements currently applied to mergers in the individual Member States, because:

i) In the first place, these arrangements vary according to country; an extension may lead to mergers which are always effected in the same direction, i.e. to the detriment of the country with the most liberal rules, and

ii) On the other hand, they are in general based on the postponement of taxation (provided the same assets remain with the acquiring company); such a system would be too complicated for application at international level.

A more simple system must therefore be worked out, acceptable by all countries at international level and providing a suitable basis for the harmonization of the national arrangements.

In principle, this solution could consist in determining, at the time of merger, the total capital gains liable to tax; this total would then be taxed but payment of the tax to the State of the acquired company would be spread over ten years, the acquiring company being entitled, of course, to show in its balance sheet all acquired assets at their real vaule.

Ten years would seem roughly the right length of time, having due regard to all the items likely to appreciate in value, from stocks to land, irrespective of whether these items can be written off or not.

An objection to this suggestion, however, is that certain items, particularly those which cannot be written off such as stocks, land or securities, account for a major part of the assets: in these cases the proposed overall calculation would be too remote from reality.

It would, therefore, be preferable to provide for certain modifications in relation with the items which do appreciate in value:

i) The capital gains on items qualifying for depreciation would always be shown separately and would remain taxable, the payment of tax normally being spread over ten years;

ii) For land and certain items which cannot be written off the enterprises could be offered a choice between:

Not disclosing capital gains and taking advantage of the postponement of taxation, the items being shown at the same value in the acquiring or new company; in this case a procedure would have to be worked out to enable the State of the acquired company to exercise if necessary its right of taxation, or

Disclosing capital gains and paying the tax immediately at a reduced rate, the acquiring company then being able to carry in its balance sheet the corresponding items at their real value;

a) If realized on participations, the capital gains disclosed could be made subject to:

Either a tax to be paid in instalments, or

A tax to be paid immediately at a reduced rate.

b) No special arrangement would then be applied to stocks, the capital gains disclosed being in principle taxable immediately at the normal rate.

c) Tax-exempt general or special reserves built up by the acquired company would, on the occasion of the merger, have to be taxed only if they lost their economic justification. If this were not the case it would have to be possible for the acquiring or new company to bring them in without paying tax.

d) If one of the two companies holds shares in the other one and if these shares must be cancelled or exchanged, the capital gains resulting from these transactions should, to preclude economic double taxation, be exempted from tax as is the general practice under the preferential national arrangements.

e) For the shareholders of the acquired company the exchange of the shares they possess in this company against shares of the acquiring or new company is nothing but a

simple technical transaction from which they draw no material advantages. It should be recognized — as is generally the case for mergers within a single State — that this exchange should not attract tax, at least as long as the new shares are not sold and — if the party involved is an enterprise — provided that the balance sheet of this enterprise shows the new shares at the value of the old ones.

Obviously the same solutions could be applied to the partial or total acquisition of assets against the issue of shares, acquisitions which give rise to some of the above-mentioned problems.

f) The result of an international merger usually being the conversion of a company into a permanent establishment of a foreign company, such an establishment should not attract heavier taxation than a legally independent company (subsidiary). Here, it would be useful if certain national provisions were amended which apply to permanent establishments and are of a more or less discriminatory nature, such as:

i) Taxation of profits of permanent establishments of foreign companies at a standard rate of 49% in Germany and at a rate of 35% in Belgium;

ii) The tax procedures applied in France to profits distributed by permanent establishments of foreign companies;

iii) The French and Italian rules according to which all income of national origin collected by a non-resident is charged to any permanent establishment the non-resident may own in that country "Power of attraction of the permanent establishment").

Such provisions are liable to constitute an obstacle to the building up of large permanent establishments.

B. Acquisition of holdings

The acquisition of shares of one company by another is the most common form of industrial combination; this method can be employed at both national and international level because in general it does not raise any tax problems at the moment of transaction.

However, the established fiscal arrangements applicable to interlocking companies may prove an obstacle to combination in this form, particularly at Community level, if the total tax burden borne by the two companies is too much in excess of what would have been the liability of a single company.

1. *Taxation of profits*

For this reason the tax arrangements governing the transfer of profits from one company to another have had to be specially adjusted in the individual countries so as to make it impossible for the same profits to be taxed successively in two or more companies.

Four member countries have, for instance, made special arrangements applicable to parent companies and subsidiaries (Schachtelprivileg) under the terms of which the dividends collected by one company are practically tax-exempt in this company if they arise from a major holding in another company (10% in France, 25% in Germany, the Netherlands and Luxembourg). A fifth country, Belgium, applied the general rule that the dividends collected by a company do not form part of its taxable profits and therefore escape taxation irrespective of the size of the holding. Lastly, in Italy double taxation is of limited incidence because corporation tax is only a supplementary tax raised at a low rate in addition to schedular tax which in turn is levied only once on the same profit.

But these exceptions do not always apply when the subsidiary is a foreign company. While France, the Netherlands and Belgium make no distinction according to whether the subsidiary of a national parent company is a national or a foreign company, Germany and the Netherlands refuse these companies equal treatment unless there are bilateral conventions to this effect; owing to the special nature of the Italian system, Italian parent companies are always subject to some measure of double taxation whether the subsidiary is a foreign or a national company.

It is therefore indispensable that the national arrangements should be applied systematically "across the frontiers between Member States", and there do not seem to be any major obstacles in the way of this; where they fail to remove all obstacles to company regrouping these arrangements should also be improved within the member countries.

It can, however, be conceded that — at least at the present stage of the Common Market — the fact that the minimum holding required if companies wish to claim the benefit of the arrangements provided for parent companies and subsidiaries varies from one Member State to the other is not a major impediment: an industrial combination operation presupposes relatively large holdings and the minimum holdings generally raise no problem.

2. *Withholding tax and fiscal claim*

There are other aspects of established tax arrangements which also have a bearing on industrial combination. Withholding tax on dividends in the six countries and the system of fiscal claim (tax credit) granted to French shareholders (individuals or companies) in respect of dividend received from French companies can influence projected amalgamations.

a) At purely national level, the withholding tax on distributed dividend is charged only once; in Germany, Luxembourg and the Netherlands withholding tax is not charged when dividend is distributed by the subsidiary to the parent company but when it is redistributed by the parent company to its own shareholders. In Belgium (and, until the recent elimination of withholding tax as between French taxpayers, also in France), however, the withholding tax is levied at the time of distribution by the subsidiary to the parent company and this tax is subsequently set against the withholding tax due on the dividends distributed by the parent company.

The last-mentioned procedure is tantamount to an inducement to parent companies to redistribute the dividend received from their subsidiaries if they do not want to lose their right to claim for tax paid.

The system of tax credit currently in operation in France has the same effect: if the parent company does not immediately distribute the dividends received from the subsidiary, the shareholders of the parent company practically lose the tax credit attached to these dividends.

In some member countries the profits of the subsidiary can thus be transferred freely to the parent company, which can then use them in the best interests of the group, while in other countries such transfer would practically call for an immediate redistribution if a provisional or final penalization of a fiscal nature was to be avoided.

In the first case such arrangements may entail a strengthening of the position of parent companies with regard to their subsidiaries while in the second case the result is the opposite; in view of the need to promote industrial combination in the Community, it is not desirable that these conflicting arrangements should exist side by side.

b) Another aspect of current tax arrangements which may affect amalgamation is the way in which the various member countries charge withholding tax if the enterprises concerned are parent companies and subsidiaries established in different member countries. In this respect it must be remembered that:

i) International double taxation which results from the practice of charging withholding tax is not always avoided between member countries because the withholding tax is not always fully set off against total tax liability in the country receiving the dividends; this general observation also applies to the case of parent companies and subsidiaries;

ii) Even if double taxation were completely avoided, there still might be a case, varying from country to country, of inducement to parent companies to redistribute profits if parent company and subsidiary are not of the same nationality.

The problem of inducement to redistribution and of double taxation raised by the current practice of charging withholding tax on the transfer of dividends from a subsidiary to the parent company would be solved if the solution proposed in the Chapter on withholding tax were adopted, whereby withholding tax is not to be charged or is to be reimbursed if the benefifiary is exempt from tax as is the case for parent companies. Generally speaking, the tax rules governing redistribution should be harmonized if a situation is to be avoided in which amalgamations take place only among companies established in the countries where tax legislation does not call for redistribution. The best solution would be to drop the redistribution requirement altogether: there is some doubt as to whether it is of any real economic value; it may in fact constitute an obstacle to the optimum administration of financial resources in a group.

III. Depreciation

As pointed out at the beginning of this memorandum, certain depreciation rules would have to be imposed:

A. Normal depreciation

1. *Beginning of depreciation period.* In some countries it is possible to start writing off an asset as soon as it has been ordered while in others this cannot be done before delivery is taken or before the asset is actually used. If the economic concept of depreciation is taken as a basis, it is obvious that writing-off should start as soon as an undertaking has committed itself to taking delivery of an asset.

In the circumstances it appears to be reasonable to suggest that it should be possible in all countries to write off the depreciation taking place between the time of order and the time of arrival.

To avoid the building up of tax-exempt reserves, the amount charged to depreciation before delivery is taken should, however, not exceed the advance payments made.

In addition, a special amount could be written off upon delivery representing depreciation between time of order and time of arrival and accounting for the total of such depreciation if no advance payment had been made or accounting for the part of depreciation not yet written off if the advance payment had not been high enough.

In any case, the first amount that may be charged to depreciation for the tax period in which the beginning of depreciation falls should represent depreciation for one full year, whether the depreciation period starts at the beginning or at the end of this tax period.

2. *Methods of depreciation.* In the six countries firms should be allowed to use either the straight-line method or a decreasing-charge method of depreciation. A decreasing-charge method, however, should normally be applied to buildings in special cases only. The rate of depreciation according to a decreasing-charge method should moreover not be higher than two and a half times the corresponding straight-line depreciation rate.

3. *Compulsory nature of depreciation.* To make balance sheets provide a truer picture, secure observation of the rules governing the carrying-over of losses to the following year and ensure the desired uniformity in the presentation of company results in the six countries depreciation should in certain respects be made compulsory in all member countries even during periods of loss. To this end it might be suggested that enterprises should be required to charge every year and in all circumstances a certain amount to depreciation in such a way that at the end of each trading year the total amount actually written off cannot be lower than the accrued total of depreciation admissible under the straight-line method, it being impossible to make up losses later if failure to observe this rule leads to the writing-off of too low an amount.

B. Special depreciation

Prior consultations should be held in respect of measures which are considered to constitute a special incentive, namely:

1. Measures leading to the speeding up of depreciation to an extent not justified by technical or economic depreciation and to a postponement of the date at which tax becomes due, such as:

a) A rate of depreciation according to a decreasing charge method which exceeds the corresponding straight-line rate by more than two and a half times;

b) Depreciation according to a decreasing-charge method covering in general all buildings;

c) Special more rapid depreciation for the benefit of certain industries or for exporters.

2. Measures leading to actual exemption of profits from tax such as:

a) Deductions made, on account of investments made, from taxable profits or even from actual tax due;

b) The charging to depreciation of an amount which is higher than the historic cost.

It is not desirable that the Member States should adopt investment incentives not in line with the general policy defined by the institutions of the Community.