THE EEC REPORTS ON TAX HARMONIZATION

The Report of The Fiscal and Financial Committee and The Reports of The Sub-Groups A, B and C

An Unofficial Translation
prepared by
Dr. H. Thurston

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Foreword

In the course of 1962 the Commission of the European Economic Community (EEC) released the General Report of Sub-Groups A, B and C appointed for the study of the various possibilities for the harmonization of turnover taxes.

During this period the Report of the Fiscal and Financial Committee (the so-called Neumark-Report) was completed. The official text of this Report was released on 1 February, 1963, together with six Appendices.

These Reports have been published by the EEC in the four official languages: Dutch, French, German and Italian.

It was not intended that the EEC-Commission would prepare a translation of the Reports and it was felt therefore, that the International Bureau of Fiscal Documentation should undertake the preparation of an unofficial translation into English.

This was not an easy task, because the terms and expressions used in the Reports are derived from a specifically continental pattern of taxes which has been analysed and for which it has been difficult to find equivalent terms in English. In addition to this there arises the problem of the different general approach and concept of European Continental thinking compared with what might be a British or American approach.

It has been attempted as far as possible, to find a satisfactory compromise between, on the one hand, translating into English terms and expressions peculiar to European Continental taxation terminology and, on the other hand, departing too far from the structure and phrasing of the original versions.

Dr. Hugh Thurston, who is a British economist with a fluent knowledge of the four languages of the EEC, has based his translation upon the official texts as follows:

- The General Report of the Sub-Groups A, B and C:
  basically the French text has been used in comparison with the German and Italian texts.
- The Report of the FFC which in its original draft was written in German has been translated from the German text with comparison with the French and Dutch texts.

- The Appendices to the FFC-Report:

  Appendix A was translated from the French text.

  For Appendix B an existing translation of the Treaty of Rome has been used.

  Appendices D and E were originally in French and so the French text has been used.

  For Appendix F the Dutch text has been followed with comparison with the French text.

Every endeavour has been made to make the texts of the Reports as readily understandable as possible for English readers and to achieve this end, the translation has been carefully checked by the staff of the International Bureau of Fiscal Documentation.

For the translation of the FFC-Report and its Appendices acknowledgement is made of the assistance of Mr. G. Heerkens, Member of the "Direct Taxes" Department and Acting-Secretary to the FFC, as well as to Miss M.D. Schulte of the same department. Mr. G. Heerkens who is a Dutch economist, and Miss M.D. Schulte who is a German economist, have given their assistance in their personal and not their official capacity.

In these circumstances the sole responsibility for the English translation lies with the International Bureau of Fiscal Documentation and in no way with the EEC-Commission or any of its sub-divisions.

Amsterdam, May 1963.

BOOK I

GENERAL REPORT OF THE SUB-GROUPS A, B and C

appointed for the study of the various possibilities for the harmonization of turnover taxes

This Report was prepared in collaboration with the Taxation Authorities of the Six European Economic Community countries in order to provide the Commission with the possibility, in accordance with Article 99 of the Treaty of Rome, to examine how the regulations for turnover tax could be harmonized in the interests of the Common Market and to place appropriate proposals before the Council of Ministers. The various proposals in the Report are dealt with primarily from a technical point of view, without choosing one or other system as the basis for harmonization and without constraining national Governments or the Commission.

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PART I

GENERAL INTRODUCTION
TO THE REPORTS OF SUB-GROUPS A, B and C

A. Objective of the harmonization of turnover tax and the mandates of the sub-groups

Working Group No. I in its report of 17th December, 1959 (doc. IV/5285/59), approved by the second plenary session with government experts on fiscal questions which was held on 23rd February 1960 (doc. IV/1359/60), considered that the maintenance of the diversity of tax systems currently applied in the different Member States is prejudicial in character to the good working of the Common Market and that it is desirable, as well as being anticipated in Art. 99 of the Treaty, to go on toward a harmonization of the differing legislation relating to turnover taxes.

The principal disadvantages resulting from the diversity of current legislation which were pointed out by the Working Group No. I are as follows: -

1. the difficulty of the application of average rates foreshadowed under Art. 97;
2. the encouragement of vertical concentration (integration) of enterprises inherent in a multi-stage cumulative ("cascade") system of turnover taxes;
3. the barriers to the free circulation of goods caused by the maintenance of tax frontiers,
4. the complications in relation to international trade which stem from the multiplicity of tax systems.

At the time of its meeting of 23rd February, 1960, the plenary session decided to set up three sub-groups which have been charged with examining in greater detail the possibilities of achieving the harmonization which had been considered, according to one of the following hypotheses:-

- sub-group A: the removal of physical inspection at the frontiers;
- sub-group B: a single phase general tax applied at the stage prior to retail trade, combined eventually with a tax on retailers;
- sub-group C: a common tax applied at the production stage, together with an entirely autonomous tax applied at the trading stage and
  a common tax on added value, should occasion arise, combined with a tax levied at the trading stage.

The sub-groups have examined the extent to which each of these possibilities would allow the removal of the forementioned disadvantages. As it is nevertheless apparent that tax frontiers would not under any circumstances be able to be removed in a short period, the sub-groups B and C have judged the merits of each system studied from the aspect of both the removal and the maintenance of the internal tax frontiers of the Community.

Although certain delegations have understood that the concept "removal of tax frontiers" used in the report of Working Group No. I meant to express only "removal of physical inspection at the frontiers", the sub-groups B and C have agreed within the scope of their work, to interpret this concept not only as the removal of physical inspection at the internal political frontiers, but also as the removal of compensatory regulations on imports and exports between Member States.

B. Composition and meetings of the sub-groups

The list of participants at the meetings of the sub-groups and the schedule of the dates of meetings are added to the general report as Appendices A and B (pages 85 and 87).

In relation to the composition of the sub-groups, it should be noted that the permanent delegates listed in Part A of Appendix A have taken part on the work of all the sub-groups.

From the start it was expected, in conformity with the proposals of Working Group No. I, that each sub-group would consist of representatives of three Member States nominated in advance and that representatives of the other three Member States would have the possibility of taking part in the meetings of the sub-groups.

Given, however, the close relationship which exists between the problems being studied by the different sub-groups, it appeared useful that the composition of the sub-groups should be the same.

PART II

REPORT OF SUB-GROUP A

A. Mandate

The sub-group A has been charged with examining the possibility of removing physical inspection to which exchanges of goods between Member States are currently subject at internal frontiers in relation to turnover tax, without going on toward harmonization of the systems of turnover tax.

B. Outlines of the scheme considered

The system under consideration tends in general to establish the following scheme concerning the application of turnover tax to exchanges of goods between Member States:-

1) For the import of goods coming from other Member countries, the payment of turnover tax and the inspection connected with it currently made on crossing the frontier, are replaced by a declaration that the purchaser in the importing country is obliged to make periodically of the goods imported by him from the other Member country; the purchaser pays at the same time the turnover tax due on the import of these goods. The tax authorities of the importing country verify this declaration with the help of the accounts of the importer; to this end the authorities can also use as far as they need, information that the tax authorities of the other Member country can extract from the accounts of the exporter.

2) In relation to the export of goods to Member countries, physical inspection of these goods which at the moment is made or at least can be made, at the frontier, will be removed. The control of exemption and of the refund (if any) of turnover tax granted to the supplier of goods exported to a Member country relies solely on the accounts of the said supplier. In this case it will also be possible to use to this end information that the tax authorities of the other Member country can extract from the accounts of the purchaser.

This scheme is based on the concept that physical inspection in the far larger field of turnover tax on internal market transactions is applied only slightly. In relation to these transactions the supplier is, as a general rule, obliged to declare periodically the deliveries made and to pay the tax due as a result. The performance of these obligations is verified with the help of the accounts of the enterprises subject to turnover tax. It is therefore appropriate to examine whether the periodic further payment of turnover tax affecting imports made on the basis of a declaration, and the inspection of accounts of imports and exports would not together be sufficient also in the case of transactions between several Member countries, making unnecessary the physical inspection of goods exported and imported as well as the payment of the tax and the granting of rebate at the time of crossing the frontier.

A method of this type appears to give rise to the objection that in relation to international transactions the national tax authorities do not at the time have access, as is the case for internal transactions, to the accounts of the supplier and the purchaser. It is, however, this combined possibility which ensures the most efficient control.

This difficulty should be relieved, as is indicated in the description of the system given above, by the exchange of information between the tax authorities of the Member countries. This is why very close co-operation between the inspection services of the different countries, as well as a certain adaptation of methods of inspection form indispensible requirements for the application of the regulation under review.

C. Description of the systems at present existing in the six countries in relation to collection and inspection of turnover taxes

Since the system under consideration requires measures relating to the levying of and to the inspection of taxes to be applied to inland transactions, it is clearly desirable to give some brief survey of the situation which exists in each of the six Member States, as well as of the regulations currently applied in relation to imports and exports.

1. Inland Transactions

Belgium

Payment is made by means of a tax stamp, part of which is stuck on the invoice and part in the invoice book.

Inspection is conducted within enterprises and also covers the accounts of purchases as well as of sales. Physical inspection of goods in transit is also being considered.

The possibility of rejecting the entire accounts if a specific case of fraud is verified, and to go on to recover back taxes with reversal of the burden of proof, is very limited in Belgium. To achieve this end it is necessary for the tax authorities to prove that the fraud amounts to at least 10% of the turnover tax.

Germany

Turnover tax is paid by means of periodic declarations and payments to the tax office in conformity with these declarations.

Inspection is made periodically, in principle once every three years.

At the time of declaration of fraud or insufficient payment it is possible to reject accounts as invalid, to fix the sum of tax and to recover unpaid tax in arrears.

France

In this country too, the tax is generally paid to the tax office on the basis of periodic declarations made by the taxpayer. These declarations are checked with the help of accounts. In certain cases there is the possibility of rejecting invalid accounts and of recovering taxes in arrears.

There exists, however, special provision for a numerous group of so called "enterprises assessed by lump sum" ("entreprises forfaitaires"); these are generally enterprises which are only liable to the "taxe locale" (local turnover tax) and whose turnover is less than 400,000 F (Sales) or 100,000 F (services rendered). The basis of liability is set by the tax authorities after agreement with the taxpayer concerned. Enterprises that may pay taxes by lump sum are free of obligations under the common tax law system, but must hold and make available a purchase book.

Apart from inspection of accounts, French tax administration exercises physical inspection of goods in circulation.

Italy

In Italy there are different methods of paying taxes, of which the principal are:-

(a) payment by sticking tax stamps up to a maximum value of Lire 2,000 on invoices;
(b) payment of tax due on one or several invoices to the tax receiver through current account at the Post Office;
(c) payment by subscription of a fixed annual sum based on the turnover of the previous year.

In all these cases, accounts may be inspected. The rejection of an invalid account followed by the recovery of taxes in arrears is possible but often difficult in practice.

Luxembourg

The regulations applied in Luxembourg are practically identical with German regulations.

The Netherlands

Dutch regulations also correspond in practice with German regulations.

2. Imports

In the six countries the turnover tax due on imports is calculated on the import value which, except in Luxembourg, is based upon the fixed value for the application of import duties according to the Brussels Convention of 1950 on Customs values. For turnover tax, Luxembourg applies a special definition of value which hardly differs in practice from the Customs value. The items added to Customs value in order to calculate the import value for turnover tax (e.g. internal taxes and transport charges) are not identical in all countries.

The maximum rates indicated below are applied to the taxable value not including turnover tax.

Belgium

Turnover tax is also discharged in the case of imports by means of tax stamps at the same time as payment of import duties. Apart from physical inspection at the frontier, the account books of importers can be further subject to inspection. The rate on imports reaches a maximum of 23%.

Germany

Turnover tax is paid at the same time as import duties. The maximum rate is 6%.

France

As a rule the system of levy resembles that of Germany. The maximum rate is 33%.

Italy

The system of the levy is, as a rule, similar to that in Germany. Maximum rate: 23.3%.

Luxembourg

The levy of turnover tax on imports is made as a rule in the interior by various methods according to whether it is applied to registered concerns liable to tax, or to private persons. Exceptionally, for imports made by private persons the tax is levied on crossing the frontier of Luxembourg from Germany or from France. Luxembourg has, however, maintained physical inspection at the frontier. Maximum rate: 7%.

The Netherlands

Method of levy as a rule identical with the German method. Maximum rate: 29%.

3. Exports

Belgium

Export deliveries are exempt from turnover tax.

Tax already paid cannot be reimbursed. Exporting enterprises can nevertheless buy, free of tax, goods and raw materials intended for export; likewise they can be exempted from the tax on services that they have ordered in connection with the goods destined for export.

Although there is the possibility of inspection at the frontier, this inspection usually has a superficial character.

The exporter receives an export certificate stamped by the Customs service.

Germany

Export deliveries abroad are exempt from turnover tax. Moreover, taxes levied on the preceding stages of production and distribution may be reimbursed.

There exists a possibility of physical inspection at the frontiers but it is seldom employed. The certificate of export stamped by the Customs is sent to the statistics office.

The control of exemption and refund granted is based generally on the export documents which must be kept in the accounts of the exporter (letters making an order, transport documents, receipts and similar documents).

France

Export deliveries abroad are exempt from tax. Reimbursement is granted when tax paid in the previous stages cannot be set off as a deduction of tax due for inland deliveries. For goods destined abroad, exporters, moreover, have the right to make duty-free purchases.

Because of the high rate of tax, frontier inspection is made with special care. Each export certificate is stamped by the Customs service and sent back to the exporter. Physical inspection is made by scrutiny.

The account books of the exporter are subjected to periodical inspection.

Italy

Apart from exemption for export deliveries, exporters receive a refund of tax levied in the preceding stages of production.

Physical inspection is made at the frontier. The export certificate is granted by the Customs authorities on the basis of the aforementioned inspection. The refunds are calculated and settled by a special branch of the tax administration. This branch has the right to verify the accounts of the exporter.

Luxembourg

In this country exemptions are granted for exports but there are no refunds of tax. There is

scarcely any physical inspection. The check on exemptions granted takes place at the same time as the inspection of account books made to assist the general application of turnover tax.

The Netherlands

Apart from exemption, tax refund is granted on exports. An export document specially drawn up in relation to the system of turnover tax is stamped at the frontier and returned to the exporter. At the frontier there is scarcely any physical inspection. The check on exemptions and refunds granted is made with the exporter at the time of the periodic checks of the accounts in connection with the general levy of turnover tax.

D. Method of application of the proposed scheme on imports from Member countries

1. Declarations and payments

Each trader having bought goods in a Member country should be obliged by virtue of national legislation, to declare periodically the goods in question and to pay the tax due for their importation. This declaration and this payment should be able, in general, to be made at the same time and in the same way in most countries as those which are required for inland deliveries.

In countries where the retailers are not subject to turnover tax (Belgium, Italy and the Netherlands), the obligation to make periodic declarations and payments would bring a new administrative requirement, but this would be inevitable.

The obligations described above should be equally binding on retailers who are not customarily obliged to declare their turnover for inland deliveries. These comments apply to Belgium and France in connection with "enterprises assessed by lump sum" ("entreprises fortaitaires") and in part to Italy (cf. page 14 et seq., chap. C-1).

It would be difficult to impose such obligations on persons who are not retailers (private persons) and who are not otherwise required to keep books.

As for the technique of collection, the following objections could be raised against the system of declarations and payments described above:-

a) imports made by private persons will escape tax. This provision would carry with it an incentive to buy goods in Member countries with recourse to the possibility of achieving delivery under a provision for exemption and eventually for rebate of tax. Mail order houses, which are continually growing, would raise serious objections to this point of view. Even in the case of sales over the counter, where neither exemption or refund can be applied for, the goods being imported personally by private persons travelling, the exchange of goods particularly in frontier regions will be diverted to the benefit of a Member country where the rate levied is appreciably lower.

It should be possible for mail order houses to work out special regulations so that it would not be possible to escape tax in the country of destination. It should be possible to achieve this by obliging mail order houses to declare the despatch of goods made to Member countries and to pay the tax due in the country of destination to the tax authorities of the country where the enterprise is established. This procedure raises in practice an objection that the authorities of the country where the business is established must apply foreign legislation in relation to turnover tax, and that settlements between the different tax authorities will be necessary.

Following another and better method, the mail order houses would be able to send abroad only goods provided with a tax stamp. These tax stamps would be bought in the country to which the goods were sent. Each Member country would be able to set up simple rates for these goods, which would apply only to sales by mail order. For each rate there should be available a series of tax stamps of different values. If the stamps in question comprised two parts - one intended for sticking to the packing of the goods, the other on the order which the business would keep - it would be possible to exercise effective control. It would be possible to consider a European stamp carrying the various imprints of the Member countries.

In relation to private persons travelling, there is no possibility of a solution preventing the diversion of trade.

However, if the disparities between the rates in different countries are not too great, this diversion should not give rise to great concern. The higher cost of transport will in general dissipate entirely or partly the attraction caused by a lower rate of tax. In this case it might even be possible to abandon special regulation for mail order houses on condition that they should not have the right to exemptions or tax refund when exporting to Member countries.

b) The basis of the imposition of turnover tax on imports is currently derived in most countries from Customs value. On the one hand, it is sometimes difficult for the purchaser of goods to determine the taxable value at importation and on the other hand, it is difficult for the tax authorities to verify the value without inspecting the goods.

In order to overcome these difficulties, the collection of the tax should henceforward be considered on the basis, to be defined, of the price paid by the purchaser. In this case the question arises whether turnover tax at the external frontier [1]) should not also be levied on this basis.

c) The percentage of the tax at importation varies considerably in several countries according to the nature and composition of the goods, notably because of additional charges above the normal rate. It is often difficult in practice for the purchaser of goods to know the rate applicable. On the other hand, it is difficult for the tax authorities to verify only with the aid of invoices, when a comparison of the goods with the invoices is frequently not possible, that the rate has been correctly applied. We shall return below to the conditions in relation to sales invoices required in this connection.

2. Requirements placed on book-keeping

Given that import and export transactions are made as a general rule following contracts of sale and purchase, it should usually be possible to find without special regulations details of transactions in the account books of the seller and purchaser. Bearing in mind the inspection of the declarations made by the purchaser of the goods, the following measures must in any case be taken:

- the business which forwards the goods in a Member country is obliged to render invoices and to keep a copy in the account books. Exemption and refund of tax on exports should be subject to fulfilment of this obligation.
- The business which receives goods from a Member country is obliged to keep invoices of purchases in good order in its account books. In general the business has a close interest in doing this because it is possible in this way to provide proof of expenditures it has incurred in order to obtain its profit. Failure to respond to these obligations would be - apart from the possibility of rejecting the accounts and of levying the tax on the basis of an estimate - subject to sanctions.
- The invoices must contain all information on the nature of the goods in relation to the specifications of the nomenclature of the Customs Tariff, which are necessary for the calculation of the tax at importation. It should be settled that if the invoices do not contain an adequate description of the goods, the tax due in the country of destination shall be at the maximum applicable rate. The purchaser of the goods thus has reason to be concerned that the supplier send him completely explicit invoices.

The imposition of the obligations defined above would create an entirely new situation in certain countries for certain persons who are not at present obliged to keep account books; in France for example, in relation to the group already referred to as "assessed by lump sum", and in Belgium in relation to retailers and farmers.

As for the reliance that can be placed on accounts of purchases, certain delegations have observed that when a business buys goods in a Member country, entry in the accounts can be expected. If the purchase is not entered in the accounts, the tax benefit would appear in fact to be greater than it really is. On the other hand there is also the view that a fraudulent business would not place the sales in its books relating to the purchases which were also not entered.

In connection with the obligation to invoice sales, and to enter in the accounts and retain invoices of purchases, attention has been paid to the following dangers:

- the seller can collaborate with the purchaser to prepare invoices in the name of a fictitious supplier in the country of the purchaser.
- A business established in a third country and having no offices in one of the Member countries can buy goods in one of the Member countries and sell them in another Member country without invoices having been prepared.
- It would be difficult to identify false invoices which do not give exact specifications of the goods in order to benefit from lower rates of tax, comparison with the goods being possible in only a general way.

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1) i.e. the frontier with a non-member country (Publisher's note).

The sub-group is agreed that this method offers in fact, grave possibilities for tax fraud. These possibilities exist moreover for inland transactions, although more frequently revealed in such cases (see below, point 3).

In relation to the possibilities for fraud indicated above, it should be noted that in certain countries the legal possibilities of rejecting invalid accounts, and of recovering back taxes with additional charges and penalties, are relatively limited.

Finally, it should be noted that this method of levying taxes and of inspection provides far greater opportunities for tax fraud than the present system of levy and inspection at the frontiers.

3. Co-operation between tax authorities

The application as efficiently as possible of the scheme under review, necessarily requires close co-operation between the tax authorities in the Member countries, particularly in view of the fact that the tax authorities of the country of the buyer do not have access to the account books of the supplier situated in another country.

This co-operation should consist primarily of obligatory notification by the tax authorities of the exporting country to the authorities of the country of destination of information extracted from the accounts of the seller. This implies that it will be necessary to regulate legally in the six countries the power of the authorities to communicate these details. If necessary this right could be based on a convention concluded within the framework of the EEC.

From a technical point of view the granting of mutual assistance could be achieved in the following manner. The tax authorities of the exporting country collect on their own initiative or on request from the authorities of another Member country, a certain number of copies of invoices contained in the account books of a business and relating to deliveries to a Member country, and transmit these copies to the authorities of the Member country, which employs them while checking the books of the purchaser. Inversely the authorities of the exporting country can request from the tax authorities of the importing country the information necessary for the control of exemptions and rebates.

The sampling of copies of invoices in the account books could be achieved at the time of the special checks relating to exemptions and rebates granted for exports or at the time of periodic general checks.

Several delegations consider that because of the considerable possibilities of fraud, it is necessary in general to provide for a systematic and complete exchange of sales invoices. The sub-group considers nevertheless, that such massive despatches and inspection of documents are not feasible.

Other delegations are of the opinion that the employment of copies of invoices sent from Member countries must be considered as a complementary means of control and that they should be limited to samples.

4. Imports resulting from transactions other than sales and purchases

The foregoing account deals exclusively with the import of goods as the result of purchases effected in a Member country. It is also necessary to take measures aimed at bringing within the levy system goods imported on a basis of other contracts. This is notably the case for the forwarding of goods made by enterprises to subsidiaries or to storehouses situated elsewhere, as well as despatches stemming from contracts for hire.

In principle the system of applying the levy can be made in the same way as in the case of despatch of goods made in accordance with contracts for sale and purchase, on condition that the obligation to employ invoices is also applied to such despatches of goods.

At the time of the inspection made for direct taxes it should be possible to examine these particular cases and if transactions of this type are indicated, measures should be taken to inform the authorities concerned with turnover tax.

E. Import and transit of goods coming from third countries

The system investigated has been solely conceived for trade between member countries, but it is also necessary to examine to what extent it can influence trade with third countries after the removal of internal customs frontiers.

This study is made somewhat difficult by the fact that the Customs formalities applied to trade

with third countries, in transit to a member country after the removal of customs duties for internal trade, are not yet known.

The sub-group has taken into consideration the following cases: -

1) Import of goods coming from third countries and for which customs duties are discharged in the country of destination.
   Turnover tax on imports, due in the country of destination, can be paid at the time that the goods are released from Customs as a result of payment of customs duties, in the same way as it is completed at the present time.

2) Imports of goods coming from third countries and for which customs duties are discharged in a Member country other than the country of destination of the goods.
   There are two possibilities: -

   (a) In the importing Member country, turnover tax is levied at the same time as customs duties for the account of the country of destination and according to the practice applied by that country. Against this method it can be objected that the authorities levying the tax must apply a system that is unfamiliar to them and there must also be provision for the balancing of payments between the tax authorities. For this reason the method in question does not seem feasible.

   (b) The obligation to make periodic declarations is related not only to goods coming from one of the Member countries but also to goods coming from third countries, and for which it is not possible to prove that turnover tax due at importation has been paid in the usual way at the time of the release from Customs of the goods in the country of destination. In this case it is desirable that the Customs service to whom the customs duties are discharged reports the import to the authority concerned with turnover tax at the place of destination.

3) Goods from third countries which are sent in transit through the territory of Member countries to another third country.
   As a rule the formalities relating to turnover tax should be the same as those for customs duties, it being clear that if the transit is not made on a regular basis it is necessary to determine according to which national tariff the turnover tax should be calculated.
   It should be possible to decide in this case that the turnover tax should be paid according to the highest tariff applicable in the Member countries.

F. Method of application of the scheme proposed for exports of goods to Member countries

In comparison with current systems of exemption and reimbursement of turnover tax on exports, the setting up of the proposed system would have the sole result of removing the present possibility of verifying exports and of examining goods at the frontier. The checking of exemptions and refunds would then only be possible through inspection of account books.

As has already been observed in chapter D-2 (page 18), the exporter of goods to a Member country would be obliged to render invoices and keep copies in his account books. Failure to apply this provision would prevent obtaining exemption or refund.

There is possibility of fraud when delivery made within a country is entered in the accounts as a delivery abroad. The business concerned would in this way have the advantage of being able to escape tax due on inland delivery and also to receive the rebate due on exports. If the inspection of account books is made systematically with inspection of the books of the other contracting parties, this tax fraud should not go undetected. In these circumstances it is possible to establish either that the purchase entered in the account books of the inland purchaser has not been entered in the books of the supplier as a sale to that purchaser, or that the fictitious sale to a purchaser in another Member country does not correspond to the registration of the purchase with the purchaser, or that this latter is purely fictitious.

Complementary verification of the correct entry of exports in account books is also possible with the help of the exchange of information mentioned in chapter D-3 (page 19).

The sub-group has established that certain countries already control exemptions and refund solely with the help of account books of exporters, and of transport and payments documents contained in the books. It would appear that the proposed method would represent an improvement rather than a disadvantage for these countries if the co-operation under consideration functioned well.

Other countries in contrast, attach great importance to inspection of exports at the frontiers. The delegations of these countries consider that unless the exchange of copies of invoices is not made in a comprehensive and systematic way - which would be difficult to achieve in practice - the proposed scheme would bring greater dangers of fraud than the current system.

G. Advisability of the scheme in connection with other frontier controls

Since frontier control for collection of turnover tax is carried out by the Customs service in connection with the levying of customs duties, the establishment of the proposed scheme would have no purpose unless the levying of customs duties on trade between Member countries is entirely removed.

It is possible that even later on, certain customs formalities may be maintained at internal frontiers, for example, in order to establish the origin of goods. Furthermore, some measure of inspection may continue to exist in connection with the collection of excise duties, the application of trade statistics, the maintenance of restrictions on imports, exports and transit traffic in the interests of public morals, public policy, public health and the health of animals, plants etc.

It is perhaps not necessary to subject the ultimate removal of inspection relating to turnover tax to the previous removal of other generally less important and more limited controls.

H. Summarised assessment of the proposed scheme

It must be noted that the application of the proposed scheme will not lead to any harmonization of the different systems of turnover tax applied in the six countries. The diversity of the present systems and the disadvantages which arise from them, such as the application of average rates for compensatory taxes on imports and for refunds on exports, and the incentive to integration which - unless special measures are intended - spring from multi-stage cumulative tax systems, will continue to exist.

The tax frontiers between Member states will not be removed when only physical control is ended, for there remain compensatory measures on exports and imports.

In consequence, if it is desired to reach as the ultimate aim of harmonization the removal of the four disadvantages in the current situation noted in Part I, chapter A, page 13, the eventual adoption of the scheme in question can only be considered as a temporary measure waiting upon a harmonization which would allow the complete removal of physical controls at the tax frontiers. It is also possible to consider that the technique of the proposed scheme could be applied in a harmonized system, particularly in ensuring the payment of tax in certain cases in the country of destination.

In any case it can be noted that the introduction of the proposed scheme will meet fewer difficulties to the extent that it is possible to achieve a comparability of rates and of exemptions, which at the moment are still very diverse.

Starting from the hypothesis that the scheme would be applied to the current situation and to the still very diverse systems, the sub-group stresses the following objections: -

- The present system offers the best guarantees against fraud. There is no doubt that the proposed system would have the consequence of an increase in tax frauds. Important distortions and even unfavourable repercussions on the balance of trade of the Member countries concerned could result from the proposed system. The means reviewed for countering this fraud - namely the exchange of information between the tax authorities - would, according to the opinion of several delegations, only have a satisfactory effect if they were extended systematically to all transactions, which is not feasible.
- The administrative obligations of importers would be considerably increased, particularly in countries with widely different rates for turnover taxes on imports.
- In certain countries new financial and administrative obligations would be imposed on rather large groups of small concerns which have been free of turnover tax until now.
- For a large part of the imports made by private persons, the possibility of levying turnover tax would be lost to the importing country.

These objections, given varying weight by the different delegations, can be opposed by the great advantage that the forwarding of goods by a supplier of a Member country to a purchaser in another Member country, will no longer meet with any difficulty at the common frontier as a result of turnover tax (payment of tax, inspection of goods and putting of documents in proper form); from the point of view of the supplier there would no longer be any difference from the inland market.

This advantage, from which a favourable psychological effect could also be expected, was also judged in various ways by the different delegations, however, certain delegations were of the opinion that the difficulties resulting from the completion of formalities at the frontier should not be overestimated, above all if customs duties disappeared. As a general rule these formalities are performed carefully by experienced customs agents and are not the cause of considerable delay to the movement of goods. Besides, it is not incompatible that as the result of the removal of customs duties the formalities currently imposed for the recovery of these duties would appear superfluous in future and could be replaced by speedier methods of customs clearance. On the other hand the proposed scheme will impose on importers supplementary administrative obligations and subject them to further strict controls.

The special situation of Italy has the effect that the system proposed offers that country small advantage while only 5% of international transactions cross the Franco-Italian frontier. Italy must apply the system throughout the country and this would bring about many difficulties.

As a result of the foregoing considerations the sub-group was unable te reach a unanimous conclusion.

Some delegations consider that the scheme examined is a workable plan in spite of the objections they raised.

The majority of the sub-group think, moreover, that if there is no move as a preliminary toward a large measure of harmonization of rates and exemptions, the advantages possessed by the scheme will not balance out the disadvantages.

PART III

PRELIMINARY REPORT

TO THE REPORTS OF SUB-GROUPS B and C

It appeared opportune to group in a preliminary report some points of a general nature and certain technical matters which are common to the different systems studied in the reports of sub-groups B and C.

A. General conditions required for a turnover tax system

Before going on to studies of the different systems, the sub-groups believed it useful to examine certain of the principal general conditions to which the most ideal turnover tax system possible should adhere. It is clear that apart from the criteria set out above, there are others of a more general nature; for example, the fact that turnover tax should be integrated in the general tax structure and should with other taxes, tend toward an equitable distribution of the tax burden.

In addition to the removal of the disadvantages mentioned in Part I "General Introduction to the Reports of Sub-Groups A, B and C" (page 13), it appears that among the other requirements of a general type, the following should be considered as particularly important: financial rationality, neutrality as to competitive positions as well as the influence of taxes on prices and productivity.

1. Financial Rationality

Leaving out of account economic and social objectives that may be pursued by the application of turnover tax, the tax represents in all Member States one of the principal means of matching official financial requirements of the central authorities. This is why the following two conditions should be fulfilled as fas as possible:

a) High and constant yield with Rates as low as Possible

It is important that the optimum return from the tax and the relative stability of this return should be ensured. It should be noted that the broader the base of the tax, the lower the rate and also the more stable the return that can be ensured.

In order to obtain the broadest base possible, it would be necessary to tax not only deliveries of goods but also the rendering of services. It would also be necessary to reduce to an indispensable minimum, the exemptions and other special provisions considered necessary for reasons of economic or social policy.

It appears that the relative stability of the return might be better ensured if the tax were split among the greatest possible number of economic stages. This is why it would be desirable that the tax affects not only stages of production, but also those of commerce. With such an extensive base it would be possible in large measure to balance out and mitigate the fluctuations in the yield of the tax.

b) Lowest Possible Costs of Collection

The system of turnover tax should be conceived in such a way that collection may be effected with the minimum cost for the State as well as for the taxpayer:

- The simpler and easier the inspection, and also in some measure if the number of taxpayers is limited, the lower will be the expenses for the State. In order to achieve this situation it is necessary that the taxation system should not be too complicated. Although it is possible in certain cases to conceive that exemption can lead to simplification of the system, it is necessary, however, to take into account that in extending exemptions and in setting up multiple rates and numerous special alleviations, the technical aspect of the system becomes complicated.
- It should be avoided as far as possible for the taxpayer, that the application of the tax should increase legal and book keeping obligations, with the result that overhead costs would be raised and larger concerns placed at a greater advantage than smaller concerns.

The work resulting from calculation and inspection should therefore remain within reasonable and tolerable limits.

2. Neutrality in relation to competition

A turnover tax should discriminate as little as possible from the point of view of the effect on competition. It is appropriate to consider this aspect in relation to competition both from an international as well as a national standpoint.

a) The International Aspect

If it is wished to apply turnover tax in a way that may be as non-discriminatory as possible in the field of international exchange of goods, it is necessary on the one hand to ensure that the tax has no influence on the price structure of goods exported and on the other hand, that goods imported are taxed to the same extent as similar goods which are produced within the country. To achieve this end the system of turnover tax should permit complete and precise freedom from tax liability of goods exported and to determine exactly the tax which must be applied to imported goods in order that the turnover tax may be equal to the weight of tax on goods produced internally. This problem, which has less importance for exchange of goods between Member countries as long as these countries maintain compensatory measures on imports and exports between each other, will continue to remain at all events for exchange of goods with third countries.

b) The National Aspect

Turnover tax must also and especially reach a satisfactory degree of non-discrimination in the national aspect of competition. In this aim it appears that it must pay particular regard to the following four conditions:

- Prevention of the advantage resulting from concentration of enterprises

The tax burden borne by a product should not differ according to the number of stages that this product or its components have passed through in the process of manufacture or distribution. Any such discrimination would once more have the effect of raising the tax advantages stemming from the concentration of enterprises, a problem whose solution runs up against grave difficulties in certain turnover tax systems currently applied.

It is customary to distinguish two types of concentration; so called vertical concentration also called integration, and the other called horizontal concentration.

Vertical concentration or integration takes place when a product passes through a series of production processes within one and the same enterprise and develops from a state of raw material to that of a completed product. The enterprise broadens its scope in order to comprise as many stages as possible of the cycle of production and/or distribution. Instead of relying on other specialised enterprises to supply it with raw materials, semi-manufactured products or certain fittings, the enterprise becomes enlarged and itself manufactures the materials which it requires. For example, the same enterprise concerned with extracting iron ore from a mine belonging to it, successively changes this ore into cast iron, steel, rails, sheet iron, etc.

Horizontal concentration takes place when two or more enterprises producing the same product (for example cast iron) set out agreements between each other. Within the framework of these agreements, enterprises can more or less preserve their independence while establishing different legal forms of horizontal concentration.

It is above all in the sense of integration (vertical concentration) that certain turnover tax systems can have an influence. In order to avoid encouragement toward integration prompted by tax advantages which arise from it, it is necessary that goods passing through a long series of economic cycles should not be at a disadvantage in comparison with those passing through a short series of cycles.

It is also necessary that the turnover tax system does not constitute an obstacle to technical progress or to productivity through specialization. An enterprise which wishes to specialize, should not come up against obstacles of a fiscal nature. If, in spite of its specialization, the enterprise wishes to continue to supply the same requirements to its customers as previously, it will in practice be forced to buy products whose manufacture it has abandoned as a result of specialization. These purchases should not lead to the collection of a supplementary tax, so that the financial advantage that the enterprise would expect to derive from rationalization of production may not be reduced by this new charge; if not, enterprises will tend to avoid rationalization for tax reasons to the occasional disadvantage of economic forces.

- Establishment of an equal tax burden for comparable goods

It seems eminently desirable that turnover tax should by definition be non-discriminatory, that

is to say that its normal application to all economic fields does not produce any distortion which however, does not exclude the possibility of any discrimination desired on economic, social or other grounds.

- The tax should be easy to pass on

It is generally accepted that turnover tax is a cost factor. Businesses must take it into account like all other cost factors in the calculation of sales prices, in order to pass on the burden to the consumer. Thus, it is possible to say that turnover tax represents from an economic standpoint, a tax on consumption and that consequently its transfer to the consumer should be assisted as much as possible. In these circumstances it is therefore desirable to avoid any extreme opposition on the part of the buyer who must bear the ultimate charge.

- Simple and equal application of the turnover tax for businesses

As previously said, it must be avoided that the arrangements concerning turnover tax do not become too complex even in endeavouring to improve and bring economic realism to the scales of the taxation, since as a product of technical complications small businesses will experience great difficulties in comparison with better organized concerns. This disadvantage could become more serious if taxation legislation is subject to frequent changes that small and medium sized businesses could, with only great difficulty and in any event with some delay, know how to apply.

Instability in taxation legislation is a disturbing factor for the majority of businesses which must take the tax burden into account in price and production cost calculations.

In any event, producers will perhaps tend to be very prudent and to raise the base of their calculations if tax regulations do not have sufficient prospects of stability.

3. Influence of the Tax on Prices.

The problem of the effects of the tax on prices is clearly connected closely with that of passing on the tax mentioned in the previous section headed "tax must be easily passed on".

It is, moreover, convenient to take into consideration along with the process of shifting the tax, the secondary effects of the calculation required by each type of the tax system.

In addition to the direct effect on prices corresponding to the real burden of the tax, there exists an indirect effect when the profit margin is calculated as a percentage of the sale price including tax, and this indirect effect increases with the number of price stages which follow that at which the tax is levied.

This indirect influence of the tax on prices is particularly apparent when there is any change in the taxation system; for this reason Part VII of the report is devoted among other things to this aspect (page 81 et seq.).

4. Influence of the Tax on Productivity.

The absence of any effect of discrimination in the tax in the various aspects already mentioned (absence of discrimination affecting competition, simple and easy application) forms an essential requirement so that productivity shall not be hindered.

Among the different factors which contribute to the growth of productivity and are specially influenced by turnover tax, there is notably technical progress which is always reflected in better equipment as well as the specialization of enterprises.

5. Conclusions

The different conditions which have been enumerated above have shown certain requirements that a turnover tax as near ideal as possible should fulfil. In practice it would not be possible to satisfy at the same time and in the same measure all these conditions. In fact, in certain circumstances the fulfilment of one of these provisions excludes the possibility of fulfilling one of the others completely. It would therefore be necessary to find a turnover tax system which, taking into account the different ends desired, fulfills to as great an extent as possible the conditions described above.

B. Budgetary aspects in relation to problems of harmonization

As already explained, turnover taxes currently in force must be considered as general taxes on consumption from a practical economic point of view.

The turnover taxation legislation of the six Member States is comparable to the extent that it

relies largely on the principle of collection in the country of destination, while in each country imports of goods are subject to taxation which is intended to match the turnover tax burden borne by similar internally produced goods. Conversely, deliveries for export are exempted from the tax in the six countries, while most of these countries also give a rebate to compensate for turnover tax levied at earlier stages of production.

The application of the principle of collection in the country of destination has the result that the product of the turnover tax benefits if not completely, at least for the greater part, the country where the goods are consumed. In the event of the adoption of a common system for turnover tax together with the removal of tax adjustment at the frontiers and the adoption of the principle of collection in the country of origin, it is possible by applying the following measure to construct the system in such a way that the tax yield continues in large measure to benefit the consumer country;
- either establish the common system in such a way that in practice the collection takes place in a comprehensive and automatic way in the consumer country (for example, through a retail trade tax or - less comprehensively - through a tax on wholesalers);
- or alternatively, in the event of a tax which, because of the system adopted would be collected principally in the country of origin (for example, through a tax on production), apply measures for financial adjustment by means of a common clearing house or some other method.

The mandate given to the sub-groups by Working Group No. I does not bring within its scope budgetary problems. The study of such questions - and notably the eventual sharing of the yield derived from a common turnover tax - which anyway should be studied in relation to the budgetary consequences of the harmonization of other aspects of taxation and in relation to the collection of common external tariff customs duties, should be confided to a special group of experts.

Nevertheless, the sub-groups in their reports on different turnover tax systems have not entirely passed over these matters. They have judged it necessary in their reports relating to the various alternatives studied, to draw attention to the cases where the application of the system in question would not benefit the consumer country. The sub-groups considered that they had good reason since the majority of the delegations are of the opinion that it is the present situation under which the consumer country acquires the yield from taxation, which corresponds best with the consumption tax character which is inherent in a turnover tax, and that it would be appropriate to maintain this system as far as possible even after the harmonization of these taxes.

C. Concept of goods liable to taxation

The sub-groups are of the opinion that the common system should in principle be applied to all goods - except for particular exemptions allowed for special reasons - and not just on certain categories of goods (such as is the case with the purchase tax system).

This outlook is based on the following considerations:
- if a limited number of products are taxed, it would be necessary in order to ensure the necessary yield from turnover tax, to fix the rates at a level that might be unbearable.
- taxation of a limited number of products is likely to cause certain distortions in competition and to create problems of choice and interpretation between differing groups of goods.

A second general question posed within the framework of deciding the type of goods liable to tax, is whether transfers of immovable goods should be subject to turnover tax. It has been established that these operations, which in most countries are subject to provisions of civil law, should be left outside the scope of turnover tax in all Member countries. Generally, such operations are subject to registration duty or special taxes, and the delegations considered that little purpose would be served by making them fall within the scope of turnover tax.

As far as taxation of deliveries of goods is concerned, the goods liable are, in general, all movable material goods.

A special situation arises in the field of building construction. These operations fall within the scope of turnover tax but it has not yet been specified if these operations should be considered as a delivery of goods and be taxed according to the system applicable to movable material goods, or if they should be considered as the result of a series of services and be taxed according to the system applied to services.

D. Concept of delivery and similar operations

The various turnover tax systems applied in the different Member States occasionally contain notable differences in relation to the cause for taxation and the definitions employed so that it

would appear ultimately necessary to settle a common concept for deliveries when choosing a common tax system.

Delivery can result from various legal acts: sale, conditional sale (deferred or with provision for dissolution of contract), exchange, hire-purchase, gift, requisition by public authorities etc.

It will be necessary to decide if solely operations involving transfer of property are liable or again, if each time there is exchange of a good or an object there is cause for taxation.

In the same way it will be necessary to determine if the delivery of goods worked for account of third parties and the employment by manufacturers or businesses for their own consumption of goods they produce or in which they trade, should be counted as a delivery in examining whether the taxation of such operations is justified from an economic point of view within the structure of the system adopted.

It will be necessary to specify if the actual physical exchange of a good or only the simple availability of the good constitutes cause for taxation even if the recipient has not taken actual possession.

It seems sufficient in any case, for the present examination of taxation systems to leave the concept of delivery of goods without determining where and at what moment delivery must be considered as consumated, since such precision is not decisive for the adoption of one system or another.

It should be noted that the common concept in the chosen taxation system would have to be compatible with the differing national legislation but that this does not appear to present insurmountable difficulties.

E. Rendering of services

1. General Remarks.

Examination of the possibilities of harmonization of legislation relating to turnover taxes cannot be limited to deliveries of goods because of the close relationship between the tax on deliveries of goods and that which affects the rendering of services. Working Group No. I for that reason commented in its report of 17 December 1959 (doc. No. IV/5285/59) that it will also be necessary in studying each system to examine taxation of the rendering of services.

The legislation of the Member countries relating to turnover taxes all contain a tax system for the rendering of services.

From an economic standpoint, it is indeed logical and justified to include in a turnover tax system not only deliveries of goods but by the same token the rendering of services. Likewise it does not seem suitable for budgetary reasons to abolish taxation of provision or services in a harmonized system.

The systems currently applied contain considerable divergences in the scope of the taxation of services as well as in the rates of tax and the exemptions.

This is a suitable point to observe that the relationship between taxation of deliveries of goods and those of services is the object of different concepts. While in certain countries (Germany, Italy, Luxembourg, the Netherlands), the rendering of services and deliveries of goods are subject to the same turnover tax, in other countries (Belgium, France) services are subject to special taxes. Further, it should be noted that in certain countries (Germany, Belgium, Luxembourg) the rate of tax established for services is, in general, identical with the normal rate applicable to deliveries of goods, while in other countries all or certain services are subject to a rate which is lower than the normal rate applied to deliveries.

Such differences in classification or in the rate of tax clearly pose the problem of defining deliveries of goods on the one hand, and the rendering of services on the other. In this matter certain countries have adopted the method of making a definition of delivery of goods and of considering as the rendering of services, all services which do not represent delivery of goods, while other countries have given special definitions. In any event it will be necessary within the framework of harmonization, to set up a common concept of services.

It seems premature however, to develop already such a concept since in any case it will have to be defined a relation to the concept of "delivery" whose consideration has been left over (see chapter D above).

2. Classification of Services with regard to Harmonization.

The harmonization of taxes in the sense of Article 99 of the Treaty having been taken to the point required by the interests of the Common Market, it is convenient to examine if it would be possible to leave part of the field of taxation of services to the care of Member countries. In this connection it appears that harmonization is not indeed indispensable for a significant group of services. Referring to the studies of this subject made in the Benelux countries it is possible to distinguish two groups of services:
- provision of services whose cost has a marked influence on the cost price of goods likely to be exchanged in international trade (hereafter called for the sake of simplicity "services influencing prices");
- others (called hereafter: "services without influence on prices").

In the Benelux study of "services influencing prices" there are noted among others: work not considered as manufacturing which relates to new goods, the transport of goods and ancillary services, publicity services, brokerage services, independent intermediaries and general agents concerned with the sale, publicity or transport of goods.

Included as "services without influence on prices" are the following: hairdressers, beauty salons, medical gymnasia, as well as other similar institutions; the services of hoteliers and proprietors of boarding houses; the services of cinemas and theatres and of organizers of sporting events; the services of certain liberal professions (doctors, dentists and others). As regards "services without influence on prices", each country may be left its complete liberty of initiative without serious prejudice to the good functioning of the Common Market. Nevertheless, even for this group of services it will be necessary to co-ordinate the relative arrangements at the place where the service is presumed to be effected in order to avoid, as far as possible, double taxation and tax evasion. It must be admitted that the disparities in taxation of this group of services could cause certain diversions of traffic particularly in frontier areas, but this problem which already exists elsewhere at the present time, does not appear to form an insurmountable obstacle.

On the other hand "services influencing prices" should be included in the harmonization of turnover taxes. There has also been examined for each system of taxation of deliveries in the reports of the sub-groups B and C, the way in which the tax system for "services influencing prices" could be harmonized.

3. Double taxation and non-taxation in the Current Systems

Generally the six countries only levy a tax on services rendered within the country. The exact definition of "services rendered within the country" varies in the different countries.

A first study conducted in this field has shown that these divergences in the application of the principle of territoriality can, in certain cases, lead to the same service being taxed in two countries at the same time or that some services improperly escape all tax liability.

In any case within the aims outlined in Article 99 of the Treaty endeavours should be made to avoid, between the six countries, cases of double taxation which result from the concept of the place where the service is deemed to be taxable. In all probability it will be possible to achieve a reconciliation of this type as a forerunning measure for the eventual harmonization of the systems.

On the basis of these reflections the sub-groups consider that it will be convenient to appoint at a given time, a special working group which would go on to make a detailed study of exemples of double taxation or of tax evasion resulting from different interpretations of the concept of "place where the service is liable to taxation" and to formulate proposals to eliminate these effects.

F. Concept of investment goods and general costs

When studying each system, sub-groups B and C have been concerned with the taxation system applied to deliveries of investment goods and to certain general costs. For each of the systems studied, there arose the question of whether it would be necessary in order to avoid certain double taxation effects, to grant to these goods or costs either an exemption or a suspension, or a tax allowance, or if they should be subject to taxation in order to lower the normal overall rate of taxation.

In the reports on the studies on the different systems the terms "investment goods" and "general costs" have been used several times. For this reason it is considered useful to describe in this preliminary report what the sub-groups understand by these terms.

1. Investment Goods.

It should be stipulated that the intention is to clarify the meaning of the term "investment goods", as used in the reports in question, and it should be stressed that this in no way prejudices any legal concept which might later have to be established for the application of a common system.

Subject to this reservation, "investment goods" are considered to be:
- Goods (other than materials which are physically incorporated in manufactured products and other than goods intended for re-sale) which contribute directly or indirectly to manufacture or to distribution, whose normal life is greater than one year and which are treated because of this fact as amortizable assets in the accounts.

It is however, necessary to stress that according to several delegations, when a legal tax definition of investment good is worked out, it will not be possible to turn solely to commercial or accounting definitions, as long as they differ from country to country.

Clearly the foregoing concept only forms a general criterion and does not imply that in each system of turnover tax, all goods falling into this category should necessarily be subject to a system settled for investment goods.

Various reasons can in fact lead to a non-application, in various instances, of relief (for example, freedom from taxation) for investment goods.

Firstly, there should be considered whether it is not better to exclude from such a system goods which are used exclusively or partly by businesses for their own requirements. Moreover, the question arises whether it would not be desirable to exclude at the same time, goods of a luxury type as well as, from a practical point of view, those which could be alienated from their official application and applied to private purposes.

On that point, complete exclusion of certain assets from special provisions applicable to investment goods requires a choice determined by the structure of the taxation system adopted and by budgetary and economic considerations.

Among the assets which, if occasion arose, could be considered as suitable for exclusion from the system, are buildings, vehicles and furniture.

Finally, it may be noted that raw materials that are physically included in manufactured products and goods destined for re-sale, are excluded from the concept of investment goods. In the systems studied by the sub-groups these assets either fall within a system of delivery with suspension of tax or a so-called system of "physical" deduction.

In production processes there must be included among "raw materials consumed" (such as primary raw materials, semi-finished products, and parts), goods that are not included in manufactured products but which are used up in the course of the manufacturing process (such as fuel, gas, electricity, oxygen, etc.). Special provision could also be made for certain rapidly consumed products (such as sand moulds, engraved rollers for printing fabrics, etc.).

On the other hand, for goods intended for re-sale, the question arises whether packaging should be included in this category.

2. General Costs.

"General Costs" are considered as expenditures (purchases of goods or of services) which contribute directly or indirectly to the manufacture or distribution of goods, but which are not related to raw materials or similar materials or to investment goods.

These expenditures are usually attributable to the year in which they were incurred. The following are examples of these expenditures: purchases of small tools and office requisites, publicity costs, cost of office heating, workshop requirements such as oils, fats, belts, etc.

It must also be stressed here that this description of general costs in no way prejudices the legal concept which might later be established for the application of a common agreed system.

In relation to general costs, corresponding to provision of services performed for a business, the taxation system that can be applied to them, is examined in the reports of sub-groups B and C for each system of taxation of deliveries.

In relation to general costs, corresponding to the purchase of material movable goods (for example small tools, office requisites), it is not excluded that in a certain system of taxation it will be deemed desirable to apply the same system as that for investment goods.

PART IV

REPORT OF SUB-GROUP B

A. Mandate

The sub-group B was charged with examining the possibilities which exist for the common application of a single phase general tax at the stage prior to retail trade, ultimately combined with taxation of retailers, and with examining in what measure the application of this tax would forwarded the proposed aims of the Commission.

In a single phase tax system levied at the stage prior to retail trade, the tax is levied on deliveries of goods made to retailers or when this stage is omitted, on deliveries of goods made directly to final consumers (1). Consequently, among taxable deliveries are included deliveries made by manufacturers, as well as those made by wholesalers if they are deliveries to retailers or the final consumer.

The studies should also bear on the possibility of a mixed form of taxation, namely a combination of taxation of the retail stage and taxation of the stage prior to it. The mixed system can only be taken into consideration if the tax applied to the retail stage can be set at a moderate rate, so that it has a subordinate character.

B. The systems applied outside the Member States which have been taken into consideration during the study

In assessing the system of taxation before the retail stage, the sub-group B has above all taken into consideration in its studies, as far as it appeared appropriate, the tax on wholesalers levied in Switzerland and purchase tax charged in Great Britain (see page 88).
In chapter C which follows, where the more important problems raised by a tax levied at the stage prior to retail trade are listed, in the order in which they have been examined, consideration together with comments is given to comparisons with the foregoing systems.
A brief comparative survey of these systems is included in Appendix C (see page 88).

C. Study of a single phase general tax levied at the stage prior to retail trade

This system is a single phase tax which is levied only once, namely at the time when the goods in passing from the producer to the consumer enter a retail trade stage. Whatever the length of the cycle of production or distribution, this system results in the same tax burden at equal prices (tax base). It therefore has the great advantage of being in large measure non-discriminatory in relation to competition and avoiding an incentive to vertical concentration (integration). One of the disadvantages contained notably in a multi-stage cumulative tax is therefore removed. Moreover, this single phase tax allows the application of fairly exact tax credits at exportation and reasonably exact taxation at importation.

The following factors with regard to the technical method of application were considered as essential:

1. Taxable Persons

Producers and wholesalers are liable under this system - that is, are obliged to pay tax - insofar as they make deliveries to retailers or directly to final consumers.
In this way the point of impact of the tax is the delivery by a producer or a wholesaler to a retailer or final consumer, deliveries at earlier stages of production or distribution - that is, deliveries by a producer or a wholesaler to another producer or another wholesaler - are not taxed (delivery under provision of suspension of tax) (2). At the same time in conformity with the precise character of this single phase tax, all deliveries following the delivery which has been taxed - that is, as a general rule deliveries made by retailers to final consumers - are not further taxed (deliveries beyond the scope of the tax).

(1) The final consumers will, as a rule, be private persons. In certain cases deliveries to persons other than the final consumer must be included, for example, deliveries to a producer who finds himself for special reasons outside the scope of the tax (possibly farmers), or the delivery to a producer or a wholesaler of goods which do not enjoy suspension of tax as well as all deliveries of goods to providers of services. It is in this sense that the expression "final consumer", often used in this report, must be understood.

(2) Although certain delegations preferred to speak in this case of "tax exemption", the sub-group has agreed to use the term "suspension of tax" in its report.

All producers and wholesalers are registered in order to be classified as free of tax liability. In this system, such registration is also necessary in order to settle if the delivery by a registered person is taxable (delivery to a person not registered) or if it can be made under a tax suspension provision (delivery to a registered person). Registration is obligatory for producers and wholesalers compelled to pay tax because they regularly fulfil the conditions under consideration. Optional registration of retailers will be possible (voluntary registrations) in order to allow them to buy goods free of tax.

The question arises whether voluntary registration implies that the suspension of taxation would be granted to all purchases or solely to those purchases made with the intention of being re-sold to registered persons. The second alternative would inevitably require accounts clearly distinguishing between purchases made under suspension of tax and those where tax in not suspended because of sale from a registered person to an unregistered person. The first alternative, namely suspension for all purchases, whould on the other hand be more simple and also suited to a system of obligatory registration. But in these circumstances the voluntary registered retailer is completely liable to tax on deliveries to unregistered purchasers, but conversely can also buy under tax suspension from other registered persons and export free of tax the goods purchased tax-free or deliver them under the tax suspension provision to registered persons within the country. The largest retailers (for example, mail order houses) have a motive for voluntary registration when they fairly frequently make deliveries to registered persons within the country or make exports.

The relatively limited number of taxpayers (producers, wholesalers and registered retailers), usually keep account books which assists the collection of the tax and makes tax inspection by the authorities easier.

2. Taxable Goods.

Deliveries of all movable material goods are taxable in this system except for exemption for special reasons (see Part III, chapter C, page 26).

3. System applicable to Investment goods and General Costs [1]

a) Investment Goods. The application of the tax at the stage prior to retail trade means that the tax is levied only at the time when the goods pass from a registered person to an unregistered person (retailer or final consumer). This method of levy - a single phase tax - excludes taxation at previous or at later stages. There remains the question whether this system will be suitable for the taxation of investment goods.

Clearly a certain cumulative effect results if investment goods whose cost is included within the price of taxable goods, are subject to tax.

In the Swiss system of taxation of wholesalers, this disadvantage has been accepted and investment goods are subject to taxation. British purchase tax is levied on selected consumer goods in a way that in general investment goods are not taxed.

The problem of the taxation or freedom from taxation of investment goods does not have economic importance solely. Its solution is also related to the burden of the rate of tax which is under review, for taxation at the stage prior to retail trade.

The following alternatives have been studied in relation to this problem:
- Suspension of tax for deliveries of investment goods between registered persons.
- Complete or partial exemption from tax for investment goods.
- Full tax liability for all investment goods.

Following the first alternative, there would not be any difference between tax treatment of investment goods and that of other goods. However, it is considered that certain goods should be excluded from any provision for tax suspension (for example certain goods which are completely or partly used for personal needs; goods of a luxury character, etc.).

Among the advantages of this alternative are the following:
- The concept of a single phase turnover tax levied at the stage prior to retail trade maintained in its purest form would be the simplest to put into effect without special provision for investment goods (except for certain excluded goods).
- No cumulative effects involving distortion of competition would be caused between businesses with a high and businesses with a low level of investment.

(1) For the concept of "Investment Goods" and "General Costs" see Part III, chapter F, page 28.

- Practically complete tax relief and fairly precise taxation would be possible for exports and imports respectively.

This alternative, however, contains the following disadvantages: it requires a higher rate of tax and can lead to differences of treatment between registered and unregistered persons; the working out and particularly the definition of a list of goods which would be outside the suspension provisions, as well as the application of the system to mixed businesses would cause serious difficulties from a technical standpoint.

Following on the second alternative of complete exemption of deliveries of investment goods, deliveries from registered to unregistered persons would also be exempt. Apart from the advantages quoted above in relation to the first alternative, there would occur from an economic standpoint a very great incentive to invest, and in the field of investment there would be no difference between the treatment of registered businesses and unregistered businesses.

On the other hand the following disadvantages would arise:
- The formulation of a list of exempted investment goods together with technical difficulties, particularly those of definition;
- The need to consider a higher rate of tax than in the preceding alternative.

It is also conceivable that investment goods should not be granted total exemption but a reduced tax. In this way it would be possible to reduce the cumulative effects of taxation on investment goods on the one hand, and on the other hand to reduce the consequential effects of complete exemption from tax.

The third alternative suggests general taxation of investment goods.

Advantage: the complete taxation of investment goods would give scope for a corresponding reduction in the rate of tax without adversely affecting the yield.

Disadvantages:
- a partial cumulative effect, with the result that strict non-discrimination in relation to competition is no longer observed;
- a lack of incentive to technical progress;
- total relief from tax of exports made by registered persons and unregistered persons as well as precise taxation of imports made by unregistered persons could not be achieved without special measures for compensation;
- for registered persons a taxation system different from that of other goods for investment goods.

Complete taxation of investment goods could be applied in a fairly simple way if the system operated in Switzerland were adopted. In this system there does not exist any concept of investment goods but taxation of these assets derives from the fact that exemption (suspension) of tax is granted for deliveries to registered persons only if they are intended for re-sale or as raw or partly finished materials used in production. It would be possible to extend this last category to cover "materials which are physically included in manufactured products and similar materials" (cf. Part III, chapter F, page 28).

It is apparent in any discussion of the advantages and disadvantages of the foregoing alternatives that:

- on the one hand, there is the problem of the influence of taxation of investments on prices as well as the problem of cumulative effects and distortions of competition which can result from them, because a turnover tax affecting investment goods will be included in the framework of depreciation and then in the price of the products, and therefore will affect the purchasers;

- on the other hand there is the problem of the interrelationship between the rate of tax and its application to taxable or non-taxable investments.

Professor Keller in his appraisal, "The problem of the justification of a turnover tax on goods" of 7 IX 1956 (page 18) considers the effects of a tax on investment goods as far as Switzerland is concerned, as very small.

The sub-group B has considered it necessary to make their own study of this important question.

The directorate of Fiscal Problems has made a study to this end of the effect of the taxation of investment goods on prices and on tax rates, and has submitted it for discussion by the sub-groups (see Appendix D, *infra* page 89).

The operation of taxation of depreciable assets in Luxembourg could not be dealt with owing to the lack of input-output statistics.

It should be noted that this study has been made on the basis of statistics which for the most part are unofficial and that consequently the results obtained are only approximate. These results are as follows:

Table no. 1 in Appendix D shows for each country the percentage (total incidence) that amortization of investments (in previous years) represents in relation to turnover.

For the base year 1953 the figures are as follows:

Germany	Belgium	France	Italy	Netherlands
8.3%	7.2%	7.6%	7.0%	6.25%

The cumulative effect of the tax on investment goods raises prices by 0.9 - 1.2% if the rate of the tax is 15%.

It is not yet possible to draw conclusions from these figures about the rate of tax (including or excluding taxation of investments), because the depreciation during 1953 which served as a base for the calculation of these figures, dealt with investments made in the years before 1953 and not with the new investments made during 1953.

Table no. 2 in Appendix D infra (page 92) shows the percentage represented by amortization in relation to turnover for each industrial category:
- For textiles, paper, chemical, metallurgy, metal and electro-technical manufactures the percentages are spread with small variations near the same level as the overall figures in Table 1.
- The percentages for the coal industry are noticeably higher than those overall.
- The percentages for electricity, gas and water are considerably higher than those overall. In Germany, Belgium and Italy they are 2 to 2½ times, and in the Netherlands nearly 4 times the overall figure.

In the last Table (Table no. 3) in Appendix D (infra page 92), where there are also shown figures for 1953, there is compared total turnover for taxable goods (including investment goods) of registered persons at the time of the transactions with unregistered persons on the one hand, and on the other hand, the foregoing turnover with the addition of turnover relating to ultimately taxable deliveries of investment goods which are made mutually by registered businesses.

Table no. 3 shows that with a tax of 20%, with exemption for investment goods, application of tax to these assets will reduce the rate to:

16.9% in Germany
17.6% in Belgium
17.2% in France
16.8% in Italy
16.7% in the Netherlands

With a tax of 15% the reduction will be:

12.6% in Germany
13.2% in Belgium
12.9% in France
12.6% in Italy
12.6% in the Netherlands.

It will be recalled that the foregoing figures are only approximate.

After having weighed all the advantages and disadvantages, and notably for budgetary reasons, the sub-group B takes its stand on the third alternative by which investment goods are taxed.

It appears that this solution is further supported by the following consideration:

The adoption of the possibility of exempting or suspending taxation for investment goods sets in train strong pressure for the acceptance of the same measures for services, because economic arguments particularly in relation to the avoidance of cumulative effects which follows from the tax freedom of investment goods, are in some measure equally justified for tax free services rendered to manufacturers, and traders.

b) General Costs.

It seems logical that the general costs composed of purchases of goods (for example, small tools, office requisites, etc.) follow the same tax provisions proposed for investment goods and there-

fore are taxed. In relation to services falling in the category of general costs, the principles described in point 8, "Taxation system for services", (page 36) are applicable.

4. The Treatment of own Consumption.

a) A producer or trader can in his business set aside all manner of goods and use them privately for purposes outside the scope of the business. This practice is usually referred to as own consumption for private purposes.
The producer or the trader can further set aside from current production or business stocks, goods intended for the future development of his business. This type of consumption for own purposes occurs for example, when a motor car manufacturer uses within his own business vehicles that he has himself produced.

b) It seems desirable in principle to tax goods set aside by registered producers or traders each time that the goods set aside cannot be bought free of tax from other producers or traders. This would lead to own consumption for private purposes being included with taxable deliveries, and that own consumption for purely business purposes would be taxable so far as purchases of investment goods and other business materials from other registered producers and traders would be taxable.
The foregoing principle seems justified, particularly since it ensures equality of treatment between registered persons and unregistered persons who would only be able to put on one side taxable goods, and between producers who buy and those who themselves manufacture goods.

5. Tax base

The character of a tax levied on turnover requires that the value of the goods sold, which is indicated by the payment, should be the basis of taxation. As a general rule, the figure which is subject to tax is represented by the price paid or agreed. This is also true for taxation at the stage prior to retail trade which is studied here. There arise, however, certain problems which the sub-group B felt it must investigate, taking into account special aspects of the aims confided to it.
Leaving aside general discussion of the problems of the basis for taxation in the case of own consumption or of price manipulation which arises in all taxation systems, there are notably problems of a just base for taxation proper to the study of a tax system levied at the stage prior to retail trade. The taxable transfer of goods from a producer or dealer to a wholesaler can be made at prices differing from the wholesale price and likewise in the case of transfers from producer to retailer and wholesaler to final consumer. If, in this case, it is decided to take the price of actual sale without other modification as the base for taxation, disturbing tax changes for identical goods occur. In order to ensure equal taxation it will be necessary to establish as uniform a tax base as possible by price corrections (reductions or increases) or to establish different rates for the tax in the absence of harmonization of the tax base. Under the Swiss system of a tax on wholesalers, a system of differing rates has been chosen. In the report of the "Swiss Commission for the study of turnover tax and other consumption taxes" placed before the Federal Department of Finance and Customs on 30 May 1956, it is noted on page 34 1) that: "The fact that the tax is not always levied at the same point in the chain of transactions requires in the interests of achieving the most uniform burden possible on retail prices (a safeguard for competition), a graduation of the rate of tax according to wholesale deliveries and to retail deliveries . . . "
The majority of sub-group B delegations consider that adjustment is only necessary in the case of a direct sale by a producer or wholesaler to a private person. The case of a sale by a producer to a retailer or to a final consumer other than a private person would not give rise to any adjustment. The delegations are not agreed about the method to be used. The majority consider that the adjustment should be achieved by lump sum reductions in prices (correction of the base of taxation) and not by the application of differing rates of tax. Although under this system it would be legal for Member States to settle their tax rates indeprendently and consequently it would also fall to them to fix the base for taxation in place of rates, certain delegations consider it desirable if occasion should arise, to agree on a method that could be applied mutually.

6. Rates and Exemptions.

The mandate granted to sub-group B took into account expressly the possibility of independent settlement by Member States of tax rates and exemptions from taxation at the stage prior to retail trade during a transitional period. This is why it is held necessary to study the various problems which result from the application in the six Member States of rates of tax and exemptions.

1) French text.

Turnover taxes currently in force produce a considerable part of the budget income of Member States. It must be reckoned that this yield should not be less in a future common system of turnover tax.

Moreover, it must be made clear that turnover taxes currently in force are split among several economic stages in most Member States, while on the other hand, taxation in the stage prior to the retail stage would be a single phase tax to be paid in full in that stage. The rate of such a single phase tax must consequently be high.

In arriving at the assumed normal rate of such a tax and where it is held:
- that the allowances, exemptions and special provisions which are currently granted to certain goods are retained,
- that future yield of the tax on services remains unchanged,
- that investment goods are taxed,
the following overall calculations can be made for each Member country:

	excluding tax	including tax
Belgium	17.5	15
Germany	12.5	11.1
France	20.5-22	17-18
Italy	13	11.5
Luxembourg	6.22	5.85
Netherlands	8.7-11.1	8-10

If deliveries of investment goods between registered persons are entirely exempted, an increase of 1.5 to 2.5 points in these rates must be expected. If under the same system non-durable investment goods and services are also exempted, a further increase of about one point in these rates must be expected.

7. Registration and Inspection.

The special character of a single phase tax system levied at the stage prior to retail trade makes it necessary for taxpayers (see discussion under point 1, page 30) to register in order to
- on the one hand distinguish persons liable to taxation and those who are not, and
- on the other hand, see to it that deliveries by registered persons to unregistered persons (taxable deliveries) and deliveries made by registered persons to other registered persons (where tax is suspended) are subject to different tax treatment as is intended in the system.

The registration system moreover gives the tax authorities the possibility of efficient inspection. The tax authorities as well as the sellers and purchasers have the opportunity to evalue if a delivery is taxable or not.

a) Firstly, the sub-group studied the possibility of applying the registration and inspection system in a national context in each Member country, namely from the standpoint of the maintenance of tax frontiers within the Common Market.

The system of registration and inspection applied in Switzerland relies on a public register. This allows the tax authorities the possibility, insisted upon by several delegations, of making the supplier and the purchaser liable when the tax has not been paid and where if follows that the purchaser falsely claims that he is properly registered and where the supplier without any check has accepted this declaration as being true, although he might be able to check on the inaccuracy in question by consulting the public register.

In spite of the quite definite advantages of a public register, a deeper study shows that the setting up, day to day running and consultation of such a register although achievable in a small country such as Switzerland, would be almost impossible for some of the larger EEC countries with a more varied economic structure.

These remains the possibility of non-public registration. In this instance the tax authorities issue a certificate to the registered person containing date and registration number. A registered person liable to tax cannot make deliveries under provision of suspension of tax to another registered person if this person has returned to him be it with each delivery, or on a single occasion, or for a determined period, an order note making the order and showing the date and number of the certificate issued by the tax authorities, or a certified photocopy, or copy of the certificate. The supplier is obliged to retain this document of the order or should occasion arise the certified photocopy or copy available in his account books for the tax inspectors.

A non-public register, which the taxation authorities should have anyway, is easier to establish than a public one. The day to day running of a non-public register can in any case be arranged on a district or local basis. A certain disadvantage arises since the desired joint responsibility of the seller and purchaser is not feasible as strictly because omission to check the register can no longer be held against the seller. At the most the seller could be held responsible for payment of tax when he might reasonably suppose that the purchaser did not have the right to place an order under a provision of tax privilege. Each country could adopt the system (public register or certificate) that seems the more convenient.

b) In the alternative of the removal of tax frontiers, a registered person belonging to a Member State would be able in some measure to make deliveries without payment of tax (suspension of tax) to a registered person of another Member State. The problem of registration and of control arises in the Common Market as well as for a large inland market.

Whatever the registration system that would be adopted in this case, some delegations expressed preference for a public register just for deliveries between Member countries, particularly because this method would lead to the joint responsibility of the seller and purchaser. But the majority of the delegations considered that the establishment, day to day running and consultation of such a register for six countries would not be feasible, particularly since it would be too bulky.

Therefore it seems that the system of order notes or certificates outlined above would also be a feasible solution for deliveries beyond frontiers to registered persons.

Moreover the sub-group has noted in general terms that the operation of common systems risks being unsatisfactory if the efficiency of control varies to much from country to country. It would also be necessary in this field to match the differing techniques so that different national tax authorities obtain results which could be considered as equivalent and so that there are no distortions in competition between countries, which would be the case if tax evasion was less efficiently detected in one country than another.

The question whether an adequate system of inspection along these lines for these deliveries, can be set up will be studied under point 10 "Exchanges between Member countries", page 39.

8. Tax System for Services.

a) In accordance with the criteria settled in Part III, chapter E, page 27, the study of a taxation system for services should only be related to "Services Influencing Prices", that is to say, to services whose cost influences in a marked fashion the cost price of goods likely to feature in international trade. It is appropriate to note that within the outline of a tax system levied at the stage prior to retail trade, "services influencing prices" correspond in very large measure to "services rendered by registered persons" who are either obliged to register or voluntarily register (for example, retailers who import and export fairly frequently).

The taxation system for services has several aspects in common with the taxation system for raw materials (commission work) as well as with that for investment goods (publicity, research work). It seems useful in this connection to study the following alternatives:
- suspension of tax for services rendered to registered persons;
- comprehensive exemption of services influencing prices, even for deliveries to unregistered persons;
- taxation of services influencing prices.

According to the first alternative, all transactions performed for registered persons would be subject to the same system whether for a service or for delivery of goods; this alternative would have the following advantages:
- No cumulative results would be produced leading to distortion of competition between businesses employing services rendered by third parties and those performing their own services. As a result the incentive toward integration which would arise from the cumulative effect of the tax would be eliminated.
- Practically complete tax relief and fairly precise taxation would be possible for exports and imports respectively.

On the other hand this system would have the following disadvantages:
- The tax rate established for deliveries of goods would have to be raised in order to maintain the yield. This rise would be the more important if added to that caused by a suspension of tax for investment goods.

- Difficulties could arise in dealing with registered and unregistered persons and technical difficulties relating to mixed businesses and to services rendered by small businesses.
- Since it is expected that, as for investment goods, certain services will be excluded from the suspensory provisions (for example services having a luxury character, services likely to be used for private purposes), the setting up and definition of the services liable to tax would raise certain technical difficulties.

It may be noted if the first alternative is taken up, that the Member States will be able to subject all services to special or independent taxes without distinguishing between services influencing and those not influencing prices of goods, given that in very large measure "services influencing prices" correspond to "services rendered to registered persons", since because of tax suspension the ultimate difference of taxation would have no influence on the taxation of deliveries of goods made by registered persons.

The second alternative implies the preparation of a list of "services influencing prices" and their exemption, regardless of the state of the recipient (registered or unregistered).

This alternative contains with only small differences, the advantages of the preceding alternative.

On the other hand, the rate for deliveries of goods to achieve the same tax yield, will have to be higher than in the first alternative; on the other hand, the setting up and preparation of a list of "services influencing prices" brings about certain difficulties.

The third alternative envisages the taxation of services rendered to registered persons. It should also be studied whether it would not be preferable to grant tax suspension to certain services (for example, commission work). This possibility contains the advantage in relation to the other possibilities studied, of making possible a certain lowering of tax while maintaining the same yield. Further, certain disadvantages mentioned under the first alternative namely, differences in the treatment of registered and unregistered persons and technical differences in relation to mixed and small businesses, would be avoided.

On the other hand the following disadvantages can be listed together with the advantages common to the first alternative:
- a certain cumulative effect occurs where strict non-discrimination in the effect of the tax on competition is not respected;
- comprehensive tax freedom for exports and precise taxation for imports cannot be achieved without special measures.

The cumulative effect arising from the taxation of the services and practical interest in going on to compensatory measures for exports and imports will depend naturally on the tax rate applied to services rendered to registered persons.

The sub-group considered it desirable that the same solution should be adopted for services and investment goods; consequently taking into account the conclusions relating to taxation of investment goods and after having considered the advantages and disadvantages of the three alternatives studied, the sub-group is agreed notably for budgetary reasons, on the third alternative which proposes taxation of services rendered to registered persons with the eventual exception of certain services which can be included with sales of raw materials (for example, commission work).

b) The problem of the system applicable to services or delivery of goods made to renderers of services arises in connection with the taxation of services.

It appears that of the two possible solutions, suspension or taxation, the second must prevail; the application of a provision for suspension would require the registration of a wide group of service businesses which include numerous small and medium sized businesses, and consequently would cause practical difficulties from a technical aspect. On the one hand it is true that the taxation of services made to renderers of services and the taxation of deliveries made to them, will cause a certain cumulative effect which could be diminished by a reduction of the rate of taxation or even by exemption. But it seems on the other hand, somewhat illogical to grant a suspension provision in this case when the sub-group has suggested the adoption of taxation for, among others, services rendered to persons subject to taxation at the stage prior to retail trade.

c) Finally, the problem of the rate on "services influencing prices" must be considered.

In the first place for practical reasons and for reasons of equity in taxation, it would be preferable that deliveries of goods and the rendering of services influencing prices should be subject

to the same rate. However, bearing in mind the level of the rates considered for deliveries of goods (see point 6 "Rates and exemptions, page 34) it appears that services should be subject to lower rates. Moreover this would reduce the importance of the cumulative effect of taxing services rendered to registered persons and to other renderers of services. A relatively low rate, if necessary even an exemption, might be considered in particular for special categories of services, insofar as the taxation of such services would have a very strong cumulative effect.

In the second place, it should be noted that if services influencing prices were subject to rates which differed appreciably from country to country, there could arise certain distortions within the Community in the exchange of goods manufactured or traded with the aid of services rendered and taxed in the country of origin, unless compensation provisions are maintained which would take into account this indirect tax burden for these exchanges.

9. Trade with Third Countries.

In relation to third countries, tax frontiers will in any event be maintained.

a) In relation to exports made by registered persons, namely for the greater part of exports, the system allows satisfactory tax relief both in the case of retention and of removal of tax frontiers between Member countries, while for the exports in question, straightforward exemption is sufficient. The granting of refunds on exports is not necessary because deliveries or previous imports have not been taxed.

It would not be entirely possible to achieve this result if the system were to stipulate that deliveries of investment goods and goods falling within the category of general costs as well as services to registered persons are not made under provision of suspension of tax. In this instance a special refund would be necessary in order to ensure complete freedom from tax for exports.

The study of the effect of taxation of investment goods on prices and tax rates (see Appendix D, infra page 89) provides certain points of reference enabling conclusions to be drawn from the economic effects of the taxation of investment goods and relating to the possibility of ignoring refunds on exports, as is done at present in the majority of Member countries. Should occasion arise when it is decided to start a system of refunds, it should be noted that the exact calculation of these refunds would not be possible. In this case it would be desirable that from country to country differences in the weight of taxation of investment goods, of general costs and of services would nevertheless be settled by means of the same tax percentage rate in all the Member countries.

b) Complete relief from taxation for exports through simple exemption is not possible when export is made by an unregistered person (retailer) because according to this system an unregistered person can only deal in taxed goods.

It has not been possible to go on to valid assessments concerning the size and importance of exports made by unregistered persons. It can be taken however, that
- the volume of exports made by retailers is relatively small in comparison with the volume of exports of producers and wholesalers, but
- the volume of retailer's exports is rising (mail order houses, tourist purchases).

The problem could be solved by allowing retailers making exports to register on request. Large retailers will often register because there will be registered businesses among their clientele within the country and they will wish to deliver to these clients under provision of tax suspension. It may be assumed that retailers making some measure of exports will have the same interest in voluntary registration.

The grant of refunds to unregistered retailers making exports might also be considered. The sum of the refund would be calculated on the base of tax paid at the final stage (in principle therefore, the tax levied on the sale price). The calculation of refunds granted to exporting retailers becomes too complicated if it is also desired to achieve relief of tax levied on investment goods, general costs and services.

Certain delegations made serious reservations in relation to refunds to exporting retailers because in practice it is difficult to apply all special tax provisions when retail trade is involved. But it would be possible to consider granting unregistered retailers who export, indirect exemption, by allowing that goods intended for export may be purchased without tax by the retailer or by granting to these retailers the right to buy goods untaxed in the future to a sum corresponding to the value of the goods exported.

c) In relation to imports from third countries, the imported goods should be taxed in order to be subjected to a taxation burden equal to that borne by national products.

Such taxation is applied automatically and without provisions for adjustment when the goods are imported by registered persons and passed on by them to unregistered persons or directly to the final consumer, or when the goods in question are applied to own consumption which is taxable. Identical tax treatment of imported goods and national products would not be entirely ensured if the taxation of investment goods, etc., imported by registered persons would naturally also have to be taxed (see remarks above concerning exports to third countries).

d) If importation is made at a stage following that at which tax is levied on internal deliveries (imports made by unregistered retailers or by consumers), it must then be taxed at the rate applicable to deliveries within the country because the system does not provide for taxation of transactions at this stage and because goods imported cannot be subject to taxation in a way different from that for national products. In the case of taxation of investment goods, general costs and services, it would naturally no longer be sufficient to levy imports at the rate applicable to deliveries within the country in order to place them in tax matters on the same footing as national products, but it would be necessary to consider special compensatory taxes.

The disadvantages which follow in the case of a multi-stage cumulative "cascade" tax, of calculating and applying average rates for the taxation of imports will disappear, in any event if a single phase tax prior to the retail stage is applied or will be maintained within reasonable limits if it is intended to tax investment goods, general costs and services. In relation to this last example it might be possible perhaps to accept a slight inequality.

Furthermore, registered persons can make imports without paying tax on simple presentation of a registration certificate, which will greatly simplify the task of the tax clearance authorities and economic circles concerned.

In the event of the removal of internal tax frontiers, the fact that there may be differences in rates and exemptions between one state and another could raise certain problems. In this case serious trade diversion, varying according to the differences, could arise in connection with imports from third countries to the advantage of the state where the tax on these imports is lowest. Two delegations consider that the danger does not exist if the rates in Member States were very close to each other. As for the problem arising from the fact that in this case the tax is not levied in the country of destination and also the means of solving the problem, see point 10 below.

10. Trade between Member Countries.

It is notably in the field of trade relations between Member countries that a common system must prove itself.

a) In the hypothesis of the retention of tax frontiers, there naturally occurs the same situation as in the case of exchanges with third countries. For deliveries beyond frontiers to purchasers in another Member country, a simple exemption at exportation is sufficient, as occurs for deliveries to purchasers in third countries and taking into account the reservations stipulated above under point 9. In the same way, in relation to imports from other Member countries, the alternatives are the same as for imports originating in third countries.

b) In the hypothesis of the removal of tax frontiers it is essential that the system that may be applied takes into account the option of Member states to fix the rates of tax and exemption independently in relation to their requirements of a budgetary type or for other motives. In relation to the application of the system under the foregoing conditions, the studies of the sub-group have led to the following results:

The conception of a system according to which inside a country deliveries by registered persons to other registered persons can be made without payment of tax (suspension of tax), while deliveries by registered persons to unregistered purchasers are taxable, seems to offer the possibility of finding solutions which would also be valid for tax problems arising from exchanges between Member countries.

- Deliveries made by registered persons to other registered persons.

As is the case within a Member country, deliveries made within the scope of a greater Common Market where frontiers are removed, by a registered person in Member country A to a registered person in country of destination B would not be taxable. Further deliveries to other

registered persons in country B or in other Member countries, even re-export intended for registered persons in country A, would not be taxable.

As a result it would not be necessary in the foregoing cases to take measures for tax relief in country A or for tax measures in country B or any other country of destination. Deliveries further on made by the purchaser in the country of destination, are only taxable if his client is not registered.
As a result it follows that:
- present disadvantages for relief of taxation for exports and taxation of imports on the basis of average rates would disappear;
- the rates of taxation of each Member country - possible differing from one another-would be applied automatically and
- without going on to compensation measures at the frontiers, taxation according to the same system would take place in the country of destination which would also benefit from the yield of the tax.

Nevertheless, the foregoing conclusions would not be altogether correct if it was intended to tax investment goods, general costs and services. Leaving aside this particular problem, the answer to whether a delivery within the scope of the Common Market could be made under a provision for suspension of tax depends solely on whether the supplier and the purchaser are registered. The verification of registration either by parties involved who wish to procure information about their rights and obligations, or by national tax authorities for purposes of inspection, contains great difficulties.

According to the opinion of the majority of the delegations, a public register open to all interested parties and covering the entire area of the Common Market, is a thing which it would be difficult to achieve in practice (see explanation contained in chapter C, point 7, "Registration and inspection", page 35).

The employment of a non-public register (requiring the purchaser to provide an order note showing that he is registered - see also explanations on this matter under point 7, page 35) would be liable to difficulties of a different character.

The tax authorities of the different Member countries cannot themselves directly go forward to the necessary inspection of eventual registrations in other countries without the help of legal and tax authorities of the Member country in which the registration is made according to the order note. The authorities of the country of destination should therefore inform the authorities of the country of origin on their demand, if the purchaser has been duly registered and has the right to make an order under special provision. The authorities of the country of origin on the other hand, should when making regular inspection of the purchaser, pass on information to the authorities of the country of destination.

Such mutual administrative assistance would only be feasible if the volume of inspection were to remain relatively limited. Certain delegations have expressed the opinion that the tax authorities should in general restrict themselves to sample inspections. The majority of delegations considered nevertheless that closer control would be required in order effectively to prevent tax fraud (by means of false proofs of registration, or through illegal attempts to pay tax in a country where the rates are lower, or by deliveries made without invoice or with falsified invoices). It seems that the volume of control and inspection might exceed the administrative power of the tax authorities to such a degree that the system under review might hardly be practicable. However, a system of inspection with the help of photocopies or certified copies of registration conforming to the certificate of registration issued by the authorities, should not be immediately rejected if the work of inspection and administration could be limited by this system.

The sub-group has not found itself in agreement with other suggestions intended to counteract the difficulties described, for example the suggestion leading to the examination and certification of all purchaser's order notes before their despatch to the seller.

- <u>Deliveries made by registered persons to unregistered buyers</u>

are taxable according to the provisions of the outlined system of a single phase tax levied prior to the retail trade stage. The application of this provision to goods moving between Member countries would, in the event of the removal of tax frontiers, make these goods liable to tax in the country of origin on the basis of application in the country of destination.

Taxation in the country of origin would give rise to distortion in competition and to diversion

of trade if the rates and exemptions differed appreciably from country to country, as would probably be the case if Member countries were free to fix the rates in question. Two delegations consider that this danger would not exist if rates in neighbouring countries were very close to each other. Furthermore, the application of the principle of levy in the country of origin would have the result that the yield of taxation of these deliveries would no longer be related to the consumer country.

The majority of the delegations is of the opinion that in present circumstances it would not be possible to refuse to grant the consumer country the right to obtain the product of the tax levied on goods consumed in that country (cf. Part III, chapter B, page 25). If financial compensation were granted to the consumer country, for example through a common clearing house, the application of the principle of taxation in the country of origin would be effected.

The sub-group has studied different ways of checking the methods of payment of tax so that the tax yield may be immediately assigned to the consumer country and diversion of trade avoided. However, the sub-group has come to the conclusion that there is no practical effective solution likely to fully satisfy the majority of the delegations.

Consequently the sub-group can only state that with a taxation system applied at the stage prior to retail trade, the removal of tax frontiers would bring tax difficulties of a technical nature to the extent that it affected deliveries between registered persons. It has not been possible to find any satisfactory solutions for the far more difficult problems raised by the removal of tax frontiers in connection with deliveries made by registered persons to unregistered persons if, as considered above, it is desired to assign the yield to the country of destination and avoid all distortion and diversion of trade.

The foregoing difficulties would be reduced if this taxation system was levied with a nearly similar range of application and exemptions and at similar rates. In this case, it could be considered if it is possible to apply the forementioned system of tax suspension to deliveries made by registered persons of a Member State to registered persons in another Member State.

For those deliveries made by a registered person of a Member State to an unregistered person situated in another Member State, it could be studied whether it is possible technically to organize the collection of tax in a way that for example, the tax might be adjusted with the help of the concept of place of delivery so as to bring about the same effects as when taxation is based on the principle of the country of destination. If it should not be impossible to find a satisfactory solution by these means, it would be appropriate to study whether the yield of taxes derived from taxation of these deliveries should be subject to compensation through a common clearing house or by other means.

D. Study of a combination of a single phase general tax levied at the stage prior to retail trade together with a tax levied on retail trade

After studying the first alternative of taxation at the stage prior to retail trade, the sub-group has also examined the second alternative of an eventual combination of taxation at the stage prior to retail trade with taxation of retailers, in accordance with the mandate given to it by Working Group No. I (see notes in chapter A, page 30).

As outlined in chapter C, point 6 "Rates and Exemptions", page 34, the rate levied at the stage prior to retail trade should be set at a high percentage if it is wished to maintain the taxation yield of the current systems.

It is possible to lower the rate of tax levied at the stage prior to retail trade without dimishing total receipts if the tax burden is split into two parts, namely the stage prior to retail trade and at the retail stage. As stated by the Working Group No. I, it is clear that the tax on retailers could only be set at a very moderate rate.

Taxation of retailers would encounter the following disadvantages:
- in several countries it would be extremely difficult for practical and psychological reasons to introduce or reintroduce, taxation at the retail stage, even in the instance where the tax would be applied at a low rate;
- the number of taxpayers would increase considerably.

Furthermore, it would be necessary to avoid the two tax phases forming another incentive to integration (for example, the integration of numerous retail sales branches of large factories).

This effect would not occur if two taxes arranged according to a non-cumulative system were established. In this instance, the rate of tax levied at the retail stage could be set at the same

rate applied to the stage prior to retail trade, while allowing the deduction of tax paid by producers and wholesalers from tax due from retailers. It is clear that this solution would greatly complicate the taxation of retailers and make the creation of this tax more difficult in the countries mentioned above (cf. first disadvantage). Another solution would be to subject sales made by manufacturers or wholesalers directly to consumers to the two taxes; the tax prior to the retail stage and that made at the retail stage. This system implies the necessity of settling the tax base for the tax applied at the stage prior to retail trade, but this difficulty does not appear insurmountable.

But whatever may be the technical disadvantages described above, it must be stated that the alternative of complementary taxation at the retail trade stage cannot form a general solution as long as there are still Member States which consider that such a tax is not feasible in their country.

However, as has already been stated by the Working Group No. I, there is no disadvantage to the good functioning of the Common Market if certain countries which are able to place a tax at the retail stage as well as at the stage prior to it, in fact introduce such a tax.

E. Conclusions

The single phase general tax levied at the stage prior to retail trade is only fully in accordance with the principle of non-discrimination in relation to competition from the point of view of the economics of finance, when double taxation of investment goods, general costs and services would be eliminated; this means therefore that the system must provide that deliveries of investment goods, similar goods and services to taxpayers could be made without collection of tax.

In this scheme, taxation prior to the retail stage contains the following substantial advantages:
- From an international standpoint the tax does not have any discriminatory effect because it is possible to apply taxation and relief from tax in a precise way to imports and exports respectively.
- From a national standpoint the tax does not have any discriminatory effect because it establishes an equal tax burden for comparable goods without regard to the number of stages that these goods or their constituent parts have passed through in manufacture or distribution. It follows that the tax does not encourage integration of businesses.
- It encourages the growth of technical progress.
- It is easily applied, although it contains serious difficulties for mixed businesses. The relatively limited number of taxpayers, in general provided with adequate accounts records, assists the collection of the tax at relatively low cost and makes possible the exercise of inspection by the taxation authorities. Furthermore the method of application of the tax causes hardly any difficulties for businesses.
- In a considerable degree it simplifies the system to imports and exports. The largest part of these operations, namely those made by producers, wholesalers, and voluntarily registered retailers, do not give rise to tax collection at importation or to refunds at exportation.

On the other hand, this system of turnover tax contains a number of serious disadvantages which almost all arise from the fact that the rate of taxation would have to be set at a very high level. (It is appropriate to recall that the taxation system which has been studied presupposes that each Member country will have the option of fixing in an independent manner the rate of tax and the exemptions in relation to their budgetary needs or for other motives.)

Approximate estimates show that the introduction of the system such as that outlined above, would make it necessary to set the rate of taxation (applied to an untaxed price) in the Member countries at a rate varying from 6.22% to 22% if the countries wished to maintain the present yield as well as the alleviations and exemptions in force.

It is evident that the application of a single phase tax collected once at the stage prior to retail trade at a rather high rate, would constitute an almost unbearable burden for wholesalers whose profit margin is often somewhat moderate.

Experience has clearly shown in general that the possibility of passing on the tax burden in the price, diminishes as the rate of tax is increased. If passing on the tax is not achieved, the state of competition can be distorted. Furthermore distortions of competition will be created because with such a heavy tax levied at a single stage, considerable evasion could not be countered in spite of the strictest inspection.

It should be further noted that the change of current systems - which as a rule spread out the tax burden over several stages - to the single phase under consideration, would set off serious disturbances in price structure.

There are two possibilities which would more or less alleviate the disadvantages of a high tax rate:
- either share the tax burden out over all stages by introducing a system dividing the payments into parts;
- or give up suspension of tax for investment goods, general costs and services.

Sub-group B has not studied the first alternative deeply because in this instance the system would, in practice, become a tax on added value which is studied by sub-group C.

It is the second possibility, namely taxation of investment goods, similar goods and services performed or rendered for registered persons, that has been taken into consideration by sub-group B for a single point tax prior to retail trade.

If this idea is retained, the rate of tax would have to be reduced by several points (see chapter C, point 6, page 34). But even in this case the rate would remain rather high.

In this way the tax system would lose one of its main advantages. Cumulative effects are introduced into the system through the taxation of investment goods, general costs and services, and consequently prejudice the principle of non-discrimination of the tax in relation to competition. Another disadvantage is that if there is complete tax relief for exports made by registered persons, it would also be necessary to have refunds if it was wished to have equivalent taxation for imported goods, and it would be necessary to introduce compensatory duties.

The sub-group has further studied - in conformity with its mandate - the possibility of a reduction of the rate of tax at the stage prior to retail trade, by the establishment at the retail stage of an ancillary tax which could be set up by Member States independently. Such a solution would encounter in the majority of Member countries serious difficulties of a practical psychological and political nature.

Starting from the conclusion that the system studied should therefore be a single phase tax prior to the retail trade stage, without a provision of suspension of tax for investment goods, general costs and services, and without an ancillary tax on retailers, it is appropriate to study from both the aspect of the removal and the retention of tax frontiers between Member countries (cf. Part I, page 13) in what measure the disadvantages of the present situation outlined by Working Group No. I could be removed by the adoption of this system.

In the event that tax frontiers between Member countries are retained, the adoption of this tax system by Member countries would have the following results:
- difficulties arising from the multi-stage cumulative ("cascade") system would disappear in relation to the application of Articles 95-97. The need to establish average rates for compensatory duties at importation and refunds at exportion would, however, continue to exist if it was desired to compensate the indirect tax burden caused by the taxation of investment goods, general costs and services. In any event the refunds and compensatory duties would have a far smaller importance as an influence than at present, and it would seem possible to arrive at a common method;
- the encouragement of business integration inherent in cumulative tax systems would be almost eliminated.

The change from the present systems to that under consideration would however, cause serious difficulties. On the other hand it must be stated that, leaving aside the difficulties raised by a high rate of tax, the technical application of this form of taxation which also contains certain difficulties in relation to mixed businesses, would not in general seem to encounter serious obstacles.

In the event of tax frontiers between Member countries being removed (as well as the rates and exemptions differing from country to country), the possibility of applying this system has been studied for deliveries within the Community between registered persons.

The sub-group has arrived at the conclusion that from a theoretical standpoint, the system of taxation prior to the retail stage in effect allows the delivery of goods - other than investment or similar goods - by a registered person placed in a Member country to another registered person placed in another Member country, without any provision of compensatory payment or of

inspection at the frontiers, when the difference in indirect tax burden which can result from the taxation of investment goods, general costs and services at rates which differ from country to country is ignored. In this case the seller situated in country A can deliver goods to a purchaser in country B under provision of suspension of tax if he has received an order note from the purchaser eventually accompanied by a certified photocopy or verifying that the purchaser has been registered in country B.

The application of such a system presupposes, however, close co-operation between the tax authorities of the different countries which must exchange information in order to be able to check if a purchaser has in effect, the right to buy under provisions of suspension of tax and if he has noted the purchase in his accounts.

The majority of the sub-group is of the opinion that these checks should be made in a detailed manner (systematically and not only by sample) in order to prevent effectively tax fraud and diversion of trade which will undoubtedly arise if the rates applied in different countries contain considerable differences. But it seems that the volume of these controls may exceed what is possible in practice for the tax authorities.

Study of the possibility of applying the system to deliveries within the Community from registered to unregistered persons in the event of removal of tax frontiers contains still more serious difficulties. For these foregoing deliveries - in contrast to those between registered persons - the principle of taxation in the country of origin would be applied and this would raise special difficulties (see the notes above at the end of chapter C, page 40-41). The problems will be made worse because deliveries of investment and similar goods between registered persons could not be made under provision of suspension of taxation. The difficulties described for deliveries from registered to unregistered persons will apply in this case, as well as for deliveries of investment and similar goods between registered persons.

The sub-group, after having weighed the factors in favour and against, were able to come to the conclusion that the introduction of a single phase general tax collected at the stage prior to retail trade, applied in different countries at appreciably different rates and fixed independently, could not lead to the removal of tax frontiers between Member countries.

Moreover, the difficulties arising from the removal of tax frontiers for the taxation of deliveries in trade within the Community could be reduced, if it was possible to settle the scope and exemptions of the tax as similarly as possible and the rates as near as possible in the Member countries. Such a possibility does not appear to exclude being able to apply the system of tax suspension for deliveries made by registered persons in a Member country to registered persons in another Member country. It is further possible to conceive for taxable deliveries made by registered persons in a Member country to a registered person in another Member country, the assignment of the yield of the tax to the country of destination, in a way that, by means of the concept of the place where the delivery is completed, for example, the collection of the tax, takes place in the consumer country. If this last possibility did not lead to a satisfactory solution, the balancing through a common clearing house or other means of tax receipts from deliveries liable to taxation should be necessary.

In regard to the other disadvantages described above - particularly the high rates of tax and the cumulative effects arising from taxation of investment and similar goods and of services, it seems very doubtful that the introduction in the six countries of a taxation system prior to the retail trade stage could constitute a satisfactory and final solution for the harmonization of turnover taxes which would be helpful to the interests of the Common Market and of the Member States.

Certain delegations are nevertheless of the opinion that the introduction of such a system would be some measure of improvement on the currently applied systems of multi-stage cumulative ("cascade") taxes.

PART V

REPORT OF SUB-GROUP C

A. Mandate

Sub-group C has been charged with studying the possibility of adopting one of the following systems in the six Member countries, and with examining to what extent the setting up of such a system would be in accordance with the aims of the Commission:

1. A common tax levied at the production stage combined with a separate tax levied at the retail stage;
2. A common tax on added value, combined if occasion should arise with a tax at the retail stage.

In relation to the tax on production listed under point 1, the Working Group No. I has considered the possible extent of levying this common tax with common rates which should be set at a moderate level. This common tax would cover a more or less important part of the budgetary needs of Member countries which would have the option of themselves making up the tax yield by introducing a tax at the retail stage whose rates, system of exemptions and method of collection, would be adapted to national requirements.
In this system it would further be possible to consider the removal of tax frontiers between Member countries.

As for the system of production tax, two alternatives have been studied:
- a tax levied at the last production stage;
- a tax levied through a system of fractional payments.

In relation to the tax on added value mentioned under point 2. Working Group No. I has indicated that there should be examined whether a common tax on added value should be applied either at the production stage only, or at both the stages of production and wholesale trade, or at all stages of production and trade.

The possibility of a combination of a common tax on added value with a tax levied at the trade stage clearly depends on the field reserved to the common added value tax.

B. Production tax levied at the last stage of production

This system corresponds to a single phase tax which is only levied once at the time that the finished product passes from the manufacturing stage to that of trading. Although the scope of the tax covers all production cycles, the tax only affects the last producer. All transactions between producers prior to this, are not taxed (are made under suspension of tax) 1) and all transactions after this stage, in general namely deliveries made by retailers among themselves or to final consumers 2), are not further taxed because they are beyond the scope of the tax.

1. Taxable persons.

Under this system only the final producer is taxable - that is to say obliged to pay tax - as a general rule the final producer is the producer who delivers the product to traders or directly to final consumers.

To apply this system it is thus necessary to give a definition of "producer" and to determine the concept of "final producer".

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1) Although certain delegations prefer to speak in this context of "exemption from tax" ("exonération de la taxe", "Steuerbefreiung"), the sub-group has agreed to use the term "suspension of tax" ("suspension de la taxe", "Steueraufschub") in its report.

2) The "final consumers" will as a general rule be private persons. In certain cases it will be necessary to include deliveries made to final consumers with other deliveries, for example delivery to a producer who is situated for special reasons outside the scope of the tax (such as farmers), or delivery of goods to a producer, without right to tax suspension. It is in this sense that the expression "final consumer" often employed in this report, must be understood.

a) Concept of "producer".

In order to set down a tax concept of "producer" it seemed necessary to establish what functions create the state of a producer. Manufacture or treatment of goods as well as the winning of primary raw materials made directly by the producer or by other persons previously, undoubtedly belongs to the state of producer. But it is also advisable to settle if repairs, renewal, making-up of goods, etc. also conveys a quality of being a producer to these performing these acts. On the other hand, it does not seem necessary to regard as acts of production simple commercial handling which is made necessary exclusively by reason of negotiations as opposed to treatment which brings an intrinsic or qualitative alteration to the product, if not it would extend the concept of a producer so that numerous traders would be deemed producers. In any case, it would be of prime importance to apply the most precise definition possible to acts of production and acts of trading, so as to be able to draw limits for cases which arise (for example, the case of someone buying unclothed dolls, clothing them and then re-selling them clothed: this business man should be considered as a producer because he adds considerable value to the goods and it would be appropriate to tax this).

It would also be necessary to achieve as clear a distinction as possible between acts of production and rendering of services, in order to avoid similar difficulties.

The definition of a producer should be very clear and exhaustive so as to cause persons with the character of producers, to register themselves and so as to be able to apply the necessary sanctions where they have not done so.

Another question which has been studied at length, was whether farmers and persons in similar occupations such as fishing, hunting, horticulture, cattle raising, forestry, etc. should be subject to turnover tax. In current tax legislation these occupations are often treated in the same way as agriculture. The question arises whether these two types of occupation should have the same taxation regulation under a common system.

A study of different national legislation has shown in most cases that for practical reasons or reasons of policy, the reduction or even withdrawal of the application of turnover tax to farmers and similar occupations has often been sought. It would be advisable to study later whether a common system should be set up under which farmers and similar entrepreneurs are not in principle considered as producers; this is to say not taxable because they are beyond the scope of the tax, or a system which includes them in principle in the taxable category but which reduces the effect of the tax by its application at a later stage, or through a system of exemption for their products or by other means.

In short, the sub-group holds that a common definition for producers under this system presents certain problems. A study of national concepts of the definition of "producer" has shown that there are numerous differences, but these do not seem so large or serious that a common concept might not ultimately be reached.

b) Registration.

Registration of producers is necessary as much so that the taxation authorities can know the person who comes in the scope of the tax, as for producers, who must know each other in order to be able to make sales and purchases of raw materials, half finished goods and secondary materials, under provision of tax suspension.

Registration would be obligatory for all persons with the quality of a producer.

Together with this group which is obliged to register, the question arises whether there should not also be considered a voluntarily registered group made up of the traders placed between registered producers. If not authorised to register voluntarily, these traders would in effect receive their goods taxed. Leaving aside the risk of the elimination of these traders, a cumulative effect would be produced in the event where they went on to re-sell these goods to registered producers who would incorporate them in their manufactured products, when it follows that these goods would be taxed once more on leaving the group of registered persons.

The sub-group is, as a result, of the opinion that under such a system it would be necessary to allow the traders in question to register voluntarily. Whatever the reason, this option would exist for all traders who usually sell to registered producers. In relation to traders who only occasionally conduct these operations, only a system of refund of tax paid at purchase could ultimately be considered.

Another question has been raised: whether the consequences of voluntary registration, notably the suspension of taxation on the goods purchases, should be accepted for all the business conducted by these traders or only for the part conducted with registered producers? The same problem also arises for producers who are obliged to register but who also have commercial trading operations.

After having studied the advantages and disadvantages of total or partial suspension for "mixed businesses", the sub-group has, in the end formed the opinion that for practical reasons it seems preferable that mixed businesses should be considered as having two activities, so that they may by adequate bookkeeping determine which of their operations relates to their state as producer and which to their state as trader.

Where the accounts do not allow a separation of the two activities, "mixed businesses" would be considered in principle, as producers for all their operations, unless they are able if occasion arises, to find adequate means to settle what these activities are.

An analogous difficulty arises in relation to taxpayers operating both as a producer and as a supplier of services.

c) Definition of "final producer".

Under this taxation system the obligatory registration of all producers, while certain traders can be registered voluntarily, allows the definition of a "final producer" or person liable to tax, to be made in a practical way. Given that deliveries between registered persons are made under suspension of tax, the person deemed to be liable to tax ("final producer") shall be the registered person who sells to an unregistered person.

2. Taxable operations.

Deliveries made by a registered person (producer or trader registered voluntarily) to an unregistered person will be liable to taxation. Deliveries on the other hand, between registered persons will be made under provision of suspension of tax.

A common definition of delivery must therefore be worked out (see Part III, chapter D, page 26).

3. Taxable Goods

Deliveries of all movable material goods shall be taxable under this system, with the exeption of exemptions for special reasons (see Part III, chapter C, page 26).

4. System for investment goods and general costs. 1)

a) Investment goods

In the single phase tax systems on production which have already been applied, exemption has not in general been granted to investment goods.

Given that this single phase production tax is meant to apply only once to goods, it seems at first sight illogical to exclude investment goods whose value enters into the price (base for taxation) of manufactured products through amortization provisions, so that a certain cumulative effect will be produced.

The problem of the taxation or relief of investment goods has, however, another very important aspect, namely the direct influence that it has on the rate of the tax being considered.

It may be noted that the rate of a production tax - leaving aside the system provided for investment goods - intended to provide the same yield will already be higher than that of a tax levied at the wholesale stage; if complete or partial exemption is additionally granted to investment goods, the rate of the tax would have to be even higher to ensure the same yield.

This means that if this production tax was introduced into the six countries according to a common system and at a low rate, the yield of the tax which must more or less provide an important part of the budgetary needs of Member countries, would be considerably reduced, so that the complementary budget provision arising from an independent tax at the trading stage would have to be raised to the same degree as if complete or partial tax relief were given to investment goods.

It is appropriate to note that this problem of taxation or relief of investment goods does not contain any essential differences from those which have been studied by sub-group B (see Part IV,

1) For concept of "investment goods" and "general costs" see Part III, chapter F, page 28).

chapter C-3-a, page 31). The considerations set forth for each of the three alternatives (suspension of tax between registered persons; partial or complete tax exemption; comprehensive taxation) by sub-group B can be applied in effect, mutatis mutandis, to a single phase tax levied at a single occasion at the end of the production cycle. This is why it seemed also suitable for the sub-group C to support this system under the same assumption as sub-group B, to the effect that comprehensive taxation of investment goods for budgetary reasons should be envisaged.

b) General costs.

It appears logical that general costs representing purchases of goods (for example, small tools, office requisites, etc.) follow the same tax system as that proposed for investment goods and that these goods should also be taxed. The following chapter applies in relation to general costs arising from services rendered.

5. System applicable to services.

For the same reasons as those mentioned in the report of sub-group B (see Part IV, chapter C-8, page 36), namely to be able to lower the tax rate while at the same time maintaining the present yield and having a similar system for investment goods and services, it appeared suitable also for this system to start from the hypothesis that a certain cumulative tax effect on services will be accepted, while refusing as a general rule the suspension of taxation for services rendered to registered persons. Nevertheless, the possibility of tax suspension for certain making-up of goods must be envisaged, to the extent that it may be considered as a service but comparable to delivery of raw materials.

Under the same hypothesis, services rendered to renderers of services and deliveries of goods which are made to them, should also be considered as taxable (cf. Part IV, chapter C-8, page 36). It follows from this that taxation of services would be of a cumulative type.

The cumulative effects of taxation of services indicated above, could be reduced, however, by the general application of a moderate rate; perhaps for certain categories of services where the cumulative effect of the tax would be particularly heavy, by the introduction of a special reduced rate or an exemption.

6. Extent of suspension of tax.

As has been written above, the sub-group started from the idea that suspension is only granted to raw and similar materials, excluding investment goods, general costs and services which will be taxed, and from which there arises a certain cumulative effect (see chapters B-4, page 47 and B-5, above).

The sub-group has studied the question of the extent of suspension of tax at length, and considered that it would not in principle be necessary to allow suspension for purchases of primary and secondary raw materials which go into the production of goods.

By "raw materials", must be understood goods which physically, completely or in part, go into the make-up of the goods.

By "secondary materials" must be understood materials and products which are not tools, and which normally and without going into the finished product, are destroyed or lose their particular qualities in the course of single manufacturing operation; for example, sulpharic acid, sodium carbonate, steam, gas, other supplies of energy, etc.

On the other hand it does not appear necessary to grant exemption to so-called "rapidly consumed" products; that is to say products which may only be used for several manufacturing operations, for example, filtration and polishing media, etc., because they can be included with tools which, falling into the group of general costs, are deemed taxable under this system.

Nevertheless, it is advisable to note that the perfection and practical application of definitions relating to raw materials, secondary materials and goods rapidly consumed in production, will encounter difficulties and it will clearly be necessary to rely on lists for certain products.

7. System applicable to own consumption.

A "producer" can set aside in his business all sorts of goods from stocks or from current production for private use or for the needs of his business. A system for registered producers who set aside goods is the only one of concern, while unregistered producers according to this system are taxed since they are beyond the point of impact of the tax.

a) It appears desirable that setting aside for the business needs of a registered producer should not be taxed so far as it affects goods that the producer would have been able to acquire from others registered under suspension of tax. The general practice for similar goods acquired from registered persons should be followed. Taxation will follow at a later stage of the production cycle.

b) On the other hand, setting aside for personal needs or for different activities other than those of production, should be taxed since these are similar to consumption.

8. Tax Base

As a general rule, turnover tax is levied for operations made within a country on the value of the goods delivered, represented by the sale price paid for the goods or by an agreed price. In the hypothesis where the tax would be applied in six countries at common rates, it will be necessary to reach agreement on whether these rates are applicable to value including tax (rate with tax included), or at the value exclusive of tax (rate excluding tax).

In the system under consideration, price forms the tax base in normal circumstances, corresponding to the value of the goods when leaving the production cycle, that is to say the sale price listed by the final producer for deliveries to wholesalers.

If deliveries are made by the final producer direct to a private person, or even in certain cases to a retailer or to a final consumer other than a private person, the real sale price will, in general, be higher than the normal price listed for deliveries by a final producer to a wholesaler; the tax burden will thus also be raised. To ensure equal taxation either the tax base must be corrected by a reduction in list prices, or for these operations lower rates must be fixed for these prices. These two methods lead to the same result, that of obtaining equal taxation corresponding to the tax that would be levied at normal rates if the real listed prices had been those of the last producer for his deliveries to wholesalers.

The majority of the delegations considered that it would only be necessary to go on to adjustment in the case of direct sale of the final producer to a private person, and that there was no place for adjustment for direct sales of producers to retailers or to final consumers other than private persons.

The majority of the delegations thought it preferable in relation to the method used for these adjustments, for psychological and practical reasons, to employ correction of the tax base by lump sum reductions in real prices and not through the application of reduced tax rates. To be more realistic, these reductions could be altered according to the economic sector involved.

The tax base applicable to imports of goods in derived in the majority of the six countries from Customs value, which is based on the Brussels Convention of 1950. However, Luxembourg applies a special definition of value, but in practice this hardly differs from Customs value. The items added to Customs value to calculate the base for turnover tax (for example, internal taxes, transport costs) are however, not identical in all the countries. Clearly in any common system where there are common rates, it is also necessary to set up a common base for the levy of tax at importation.

9. Registration and inspection.

As seen above (cf. chapter B-1-c, page 47) the system of production tax levied at the stage of the final producer makes registration necessary for all persons with the quality of a producer, so that registered persons can make deliveries among themselves under provision of tax suspension and so as to know in practice who is the final producer liable to the tax.

The practical application of registration has been studied in the report of sub-group B and remarks concerning the advantages and disadvantages of each method - public register or a system of order notes eventually accompanied by a photocopy or a certified copy of proof of registration - are also valid for the present hypothesis. It is advisable to refer to the outline which has been made in the report of sub-group B (Part IV, chapter C-7, page 35) and to recall the conclusion reached, that the day to day running and consultation of a public register would hardly be feasible for the six countries, the order note system seems to be the only feasible solution.

It is also advisable to refer to the remarks made in the report of sub-group B on the necessity of ensuring that the efficiency of the system does not vary too much from one country to another (see Part IV, chapter C-7, page 36).

10. Rates and Exemptions.

According to the mandate entrusted to sub-group C (see chapter A above, page 45), it had been expressly anticipated that the study would bear on a single phase tax at a moderate rate at the production stage, to the extent that this is possible in common, together with a tax levied autonomously according to need at the trading stage.

It may be noted that the mandate for this system envisaged the adoption if possible of a common rate, so as to bring about one of the requirements necessary for the removal of tax frontiers between Member countries. Nevertheless, two delegations consider that this requirement would also be fulfilled if the rates in the six countries were not identical but very close to each other. It is in this sense that the delegations in the part of the report which follows, understand the term "common rate".

A common rate of tax on production should be established at a moderate level in order to be acceptable to all countries. Such a common production tax would allow the coverage of a more or less important part of the budgetary needs of Member countries, which would moreover, have the option of independently complementing their receipts from turnover tax by eventually introducing a tax levied at the trading stage. In this way requirements of national policy in the field of turnover tax could in large measure be respected.

a) The sub-group has, however, thought it useful before going on to study the hypothesis contained in the mandate, to see if harmonization could also be achieved by the introduction in the six countries of a single general tax levied at the last stage of production, with independently fixed rates and exemptions differing from country to country.

In this concept, the system of a production tax would be comparable with that studied by sub-group B, with the difference only that the scope of the common system would be limited to producers.

It should be noted on the one hand, that the production tax should have a rate higher than that considered for the tax on wholesalers, the base and scope of the tax being small, and, on the other hand, the volume of deliveries from registered persons in one Member country to unregistered persons in another Member country would be higher, which aggravates the problem of taxation of these deliveries in the case of the removal of internal frontiers.

Consequently it seems clear that considerations relating to a tax system for wholesalers and set forth in Part IV, chapter E, page 42, applied mutatis mutandis to the single phase tax levied at the final stage of production with rates which differ sensibly from country to country, must necessarily lead to the conclusion that this latter system does not seem able to form a satisfactory solution for harmonization together with the removal of tax frontiers.

b) After having considered this hypothesis, the sub-group has gone on in conformity with its mandate, to study the possibility of introducing in the six countries a single phase general common tax levied at the final production stage at a moderate common rate, complemented according to the budgetary needs of each country by a tax levied autonomously at the trading stage.

In relation to the common rate set up for production tax, it must be stated that, leaving aside the great difficulty of reaching agreement on a percentage suited to the six countries, the unification of the rate clearly implies the harmonization of a great range of exemptions currently existing in the different countries. It appears too, that at first sight the establishment of a common system for exemptions at this stage would encounter great difficulties.

However, in the supposition that the Member countries succeed in overcoming these difficulties and establish a common rate and a common system of exemptions for a common production tax, it must be expected that the majority of countries might be obliged to introduce a complementary autonomous tax at the retail stage in order to ensure the necessary total tax yield. For certain countries it appears practically impossible to cover their present budgetary requirements by means of such a complementary tax above all if the rate of production tax should be set at a moderate level.

On the other hand, in other countries it may occur that the sole common tax on production could furnish the yield that is required from turnover tax.

The complementary tax could be levied at the retail trade stage, or at the wholesale trade stage; the two possibilities should be taken into consideration since, in spite of the disadvantages presented by a tax on retailers, it is not excluded a priori that certain countries, notably those

taxing retailers at the present time, prefer such taxation in place of levying a complementary tax at the wholesale trade stage. It is appropriate to recall that the sub-group B, while having excluded that complementary taxation at the retail trade stage could be adopted as a general solution, has stated that there are no disadvantages for certain countries that could introduce a retail trade stage tax in doing so (cf. Part IV, chapter D, page 41).

The sub-group will therefore analyse below the problems posed by the two possibilities of a mixed system (common tax on production combined with either an independent tax on wholesalers or with an independent tax on retailers). But before going on to such an analysis it appears useful to study what, within the outline of the two systems, should be the machinery of a single phase tax on production in relation on the one hand, to trade with third countries and, on the other hand, to trade between Member countries. The appropriateness of this study also has a bearing on the possibility raised above, that in certain countries solely the common production tax can provide a sufficient yield.

11. Trade with third countries.

The situation of registered persons (producers and wholesalers who have opted for the state of producer) and of unregistered persons must be considered:

a) registered persons make exports under exemption and imports under provision of tax suspension, this being granted on condition that the importer proves (by means of a verified certificate, for example) his registered state;

b) unregistered persons must pay the production tax at importation. The exporter, in order to be relieved of tax, must receive a refund of production tax levied at the last stage. In relation to the question whether or not it will be necessary to grant refunds for exports made by retailers or give them the possibility of voluntary registration, it is advisable to refer to the considerations raised on this subject by sub-group B (Part IV, chapter C-9, page 38).

It should be noted because of the cumulative effect arising from the absence of provision for tax suspension for investment goods, general costs and services, that if it is wished to arrive at taxation of imports equivalent to that borne by similar national products, a certain compensatory tax will have to be levied on goods imported by registered persons (under provision of suspension of production tax) and to increase the rate of production tax applicalbe to imports made by unregistered persons by a sum equivalent to the compensatory duty.

Conversely, a certain special refund will have to be granted on goods exported by registered persons and normal refunds equivalent to the sum of the special refund for exports made by wholesalers and if necessary by retailers, will have to be increased.

The establishment of compensatory duties and refunds will raise problems similar to those listed in the report of the sub-group B (Part IV, chapter C-9, page 38).

In relation to trade with third countries and in the event of the removal of internal tax frontiers, it must be observed that some diversion of trade flows is not to be feared, given that in accordance with the hypothesis in view, the rates of taxation and the exemptions would be identical. Unregistered persons must pay production tax in the Member country where the importation takes place at importation of goods coming from third countries. In the cases where the country of importation is not the same as that of consumption, budgetary problems can arise (see page 52).

12. Trade between Member countries.

a) In the hypothesis of the retention of tax frontiers between Member countries, the machinery for the levy of the production tax is identical with those studied under the preceding point concerning trade with third countries.

b) In the hypothesis that tax frontiers between Member countries are removed the following cases of exchanges between Member country A and Member country B must be taken into consideration:

- Deliveries made by a registered producer in country A to a registered producer in country B.

Transactions between registered producers within a country are made under provision of suspension of production tax on condition that the producer-buyer gives proof of his state by an order note eventually accompanied by a photocopy or a certified copy of the certificate of registration (see chapter B-9, page 49). There do not seem to be serious objections to applying

the same system beyond frontiers within the Community, for deliveries made between registered producers in country A to registered producers in country B. The rate of tax being identical in countries A and B, there are no grounds for making arrangements to try to shift from the taxation of one country to that of another. In order to hinder other possibilities of tax fraud (for example, by means of false indications relating to registration), it will clearly be necessary to set up close collaboration between the tax authorities of the different Member States. It may be noted that taxation of investment goods, general costs and services, will not raise problems of distortion in this case, since the tax affecting these goods, etc. will not differ from country to country.

Thus it can be concluded that the system under review pays regard in this group of transactions to taxation in the country of destination and the assignment of the tax yield to that country without any compensation measures.

- Deliveries made by a registered producer in country A to an unregistered person in country B

The application of the normal rules of the system to these transactions would cause the collection of production tax in the country A of origin. In this case no distortions would result (the rates in countries A and B being the same), but it would happen that taxes coming from a levy on these deliveries would not be attributed to the country of destination.

- Deliveries made by an unregistered dealer in country A to a registered producer in country B

If the dealer in question wishes to avoid the goods being twice subject to taxation, he will be obliged to take on the state of a registered producer. In this case the situation analysed under the first point above arises (12 - b, page 51).

- Deliveries made by an unregistered dealer in country A to an unregistered person in country B

Production tax has been collected at an earlier stage (normally in country A) and in general will not be to the profit of the country of destination.

13. Study of a combination of a common tax levied at the final stage of production with an autonomous tax levied at the stage prior to retail trade.

The "producers" are registered in order to allow the levying of production tax; moreover the wholesalers who have registered voluntarily are included with the producers. These two categories make up the "registered producers" group.

In order to apply the complementary system of a tax on wholesalers it will be further necessary to go on to special registration of wholesalers who have not opted for the state of producer, as well as of retailers who have opted for voluntary special registration so as to be considered as wholesalers (cf. Part IV, chapter C-1, "taxable persons", page 30). These two categories make up the "registered wholesalers" group.

Since the tax on wholesalers is additional to the production tax, it will also be necessary to subject registered producers to production tax insofar as they make deliveries to retailers or to consumers (unregistered persons). This means that it will be necessary to consider all producers as "taxable persons" for wholesaler's tax and that provision of suspension of this tax must be applied to them for deliveries to other registered producers or registered wholesalers.

From the foregoing it arises that this mixed system produces two registrations made under two different heads whose consequences are also differing. It could happen, for example, that two wholesalers might be registered, the one having opted for the state of producer for the application of production tax and wholesaler's tax, the other having opted solely for the levy of wholesaler's tax.

This superimposition of two registrations could be the cause of confusion, and its practical application could turn out to be rather complex.

Moreover, it must be taken into account that the importance of the wholesale trade stage tends to diminish in certain countries and certain economic sectors; consequently in the cycle where the wholesale trade stage does not always exist, producers who deliver directly to retailers are always affected by two taxes - production tax and tax on wholesalers. In such cases no correction in the tax base will be necessary, but in the case of direct delivery from the producer to the consumer, the real sale price would be subject to two different adjustments; one to determine the price at the end of the manufacturing cycle, the other to determine the wholesale price.

The complementary tax at the wholesale trade stage, to the extent that it frequently affects the

production stage, contains a range of difficulties in application as much for practical as for psychological reasons, even within a national framework.

In relation to trade with third countries and trade between Member countries, a detailed study of the application of this mixed system to all possible cases, has shown that even for operations in relation to third countries, the complications which arise are rather serious. In relation to trade between Member countries and in the event of the removal of tax frontiers (1), the difficulties incease and become almost inextricable if it is desired to prevent distortions, and if the yield of the tax must be assigned to the consumer country. This is notably the case for deliveries by a producer or a wholesaler in a country A to a retailer or a consumer of country B.

Given that the disadvantages of this mixed system appear distinctly greater than its advantages, the sub-group is of the opinion that the combination of a common production tax with an autonomous tax on the wholesale trade stage, would not form a satisfactory solution.

14. Study of a combination of a common tax levied at the final stage of production together with an autonomous tax levied at the retail trade stage.

The tax at the retail trade stage is an autonomous tax which is superimposed in a cumulative way on production tax, which implies that it affects all retail sales, whatever the normal state of the seller (producer, wholesaler or retailer). Thus, sales made by producers directly to consumers are subject to two taxes, production tax being levied on a recalculated base (see chapter B-8, page 49), and the tax on retailers on the actual list price.

The practical application of such a tax raises problems of technique and inspection presented notably by the large number of taxpayers who, in general, only possess rudimentary accounts. Moreover, it will be necessary to determine the conditions under which a delivery made by a producer or by a retailer must be considered as a retail sale. Different solutions can be considered, particularly taking into account the experience of several Member States; it does not seem appropriate at this time to go into the question more deeply, all the more so because of the autonomous character of the tax and that nothing should hinder Member countries from dealing with this technical aspect independently.

From the point of view of international trade, this mixed system contains numerous advantages. In relation to trade with third countries, the retail trade stage tax in almost all cases does not require measures for adjustment since, in general, it will be levied after importation and also has not been levied before exportation.

The system for production tax outlined above (see chapter B-11, page 51) should not be modified or complemented if the production tax is combined with a tax at the retail trade stage, except in the case of direct imports by consumers; these operations would be subject to both production tax and to the tax on retailers.

In relation to trade between Member countries and in the event of the removal of tax frontiers2), the functioning of this mixed system seems equally satisfactory. In effect for all deliveries which take place before the stage of retail sale (producer of country A to producer or wholesaler or retailer of country B; wholesaler of country A to producer or wholesaler or retailer of country B) the tax on retailers does not raise any problems and international trade is carried on under the conditions outlined for production tax (see chapter B-11, page 51).

There remains for consideration therefore, the case of delivery by a producer or a wholesaler or a retailer of country A to a consumer of country B. If is assumed that country A has adopted the tax on retailers, this delivery will be liable to tax according to the normal system in country A and taxation will take place in the country of origin. On the other hand, if it is assumed that only country B introduces a complementary tax, it seems practically impossible to subject to the tax of country B a delivery made to a consumer of that country by a producer or a dealer of country A where there is no tax on retailers.

From the foregoing it follows that in the case of retail sales beyond intra-community frontiers, distortions can be produced, either because a rate differing from that of the country of destination is applied, or because these deliveries inevitably escape all taxation if the country of origin does not apply a tax on retailers.

1) This hypothesis is the only one considered within the outline of a mixed system; the combination of a production tax with another tax is, in effect, only taken into consideration in arriving at the aim of removing tax frontiers.

However, it must be emphasised that these distortions, which are clearly more serious in the case of complete evasion, can in practice be ignored by reason of the fact that autonomous taxes at the retail trade stage are necessarily applied at rather moderate rates. On the other hand, on the supposition that producers or dealers of country A regularly make sales to consumers of other Member countries (for example, mail order houses), solutions could be envisaged to subject these deliveries to the tax on retailers of the country of destination.

The taxation of retailers would, however, run into serious disadvantages in several countries where it would for technical, psychological or political reasons be extremely difficult if not impossible, to introduce, or even reintroduce a tax at the retail stage, even on the supposition that this tax would be levied at a very low rate.

Moreover, given that on one hand, the production tax would be levied at a moderate common rate and that on the other hand, as has been stated by Working Group No. I, a tax on retailers could only be settled at a very low rate, it is possible that the total yield of these two taxes might be insufficient to cover the budgetary requirements of certain countries.

C. Production tax with fractional payments

Production tax with fractional payments is, in spite of its appearances, a single tax like the tax at the last stage of production since it only affects in principle the price of goods on a single occasion.

Technically this tax is split up between all the taxpayers and thus is levied at all stages of the production cycle.

Each taxpayer pays the tax on the sum of liable sales, but deducts the tax he has paid at purchase of his raw and similar materials, so that finally each taxpayer only pays a fraction of the total tax. The tax is thus levied in its entirety when the product passes at the end of the production cycle to that of trading.

All deliveries made by non-producers are no longer taxed because they are outside the scope of the tax.

1. Taxable persons

Under this system all producers are liable. They are obliged to pay the tax without regard to the state of their trading partners. Therefore those who are producers must be defined, but it is not necessary to go on to registration of taxpayers and it is also not necessary to determine the "final producer", which simplifies the task of the tax authorities.

The concept of producer raises the same problems as those which occur for production tax by single payment (see chapter B-1-a, page 46).

For producers who also trade, the question arises whether they must be considered as producers over the entire range of their activities, or if they should be considered as producers solely for their production activities. It appears that the conclusions arrived at for the single payment production tax may be equally valid in this instance, namely the consideration of "mixed businesses" as having twofold activity on condition that they can exactly determine, thanks to adequate bookkeeping, their operations which relate to their activities as producers and those as handlers. Conversely, where the account books do not allow the distinction between the two activities, these "mixed businesses" would in principle be considered as producers over the whole range of their operations unless, should occasion arise, other means could be found to distinguish between these activities.

As for dealers who sell to producers and who can voluntarily take on the state of producer, the same solutions could be adopted as those for producer-handlers.

For these two categories of "mixed businesses", different technical problems arise in order to determine the part of tax they can deduct as having paid on their purchases. The problems are analysed later under point 6-b "Extent and limits of deductions", page 56.

2. Taxable operations.

Under this system, all deliveries made by producers would be taxable. A common definition of delivery would require consideration (see Part III, chapter D, page 26).

3. Taxable goods.

Deliveries of all movable goods would be taxable, except for exemptions for special reasons (see Part III, chapter C, page 26).

4. System applicable to investment goods and to general costs 1)

Under this system producers can deduct from the tax they must pay on their sales, the tax which they have paid for purchases of raw and similar materials (see chapter C-6, below). These deductions are currently called "physical deductions". If the deductions were admitted for other elements in costs, notably for investment goods, general costs and services, the system would be transformed into a tax on added value based on the production stage; a system analysed later by sub-group C.

5. System applicable to services.

Leaving aside the reasons that have led the sub-groups to prefer, in the case of a wholesalers tax and a single payment production tax, the taxation of services rendered to producers and, if occasion arises, to wholesalers, thus accepting certain cumulative tax affects, the non-deduction of tax imposed on these services arises - in the same way as in case of investment goods - from the actual character of this fractional payments tax which is not a tax on added value.

The other problems concerning taxation of services (possibility of deductions of tax affecting certain making-up of goods, cumulative effect due to taxation of deliveries for renderers of services and of services which are rendered to them; rates and exemptions to be established) arise no differently from those in chapter B-5, page 48.

6. System of deductions.

In principle each producer will only have to pay a part of the total tax, thanks to the mechanism of fractional payments which goes with the deduction of tax paid on purchase of certain materials.

Two questions must be analysed:
a) the methods of operating the deductions;
b) the extent and limits of the deductions.

a) Methods of operating the deductions.

The deductions can be considered either as "base on base", or as "tax on tax"; in the first case the sums paid for raw and secondary materials used in the manufacture of the same products, are deducted and the tax is levied on the difference. In the second case the tax is calculated on the gross turnover, and there is deducted from the sum thus obtained, the taxes paid at the purchase of raw and secondary materials.

The two procedures lead to the same results to the extent that the tax is levied at the same rate for all products at all stages. On the other hand, in the case of variety of rates (or of exemptions) applicable to different constituents of a certain product, the "base on base" deduction effects a certain equalisation of these rates, the final burden corresponding to a percentage of the final price which tends to relate to the rate which has affected the principal constituent of the product. It follows from this that the real tax burden of a particular product does not always correspond to the nominal rate for this product, which brings about certain disadvantages, notably for tax relief for exports and taxation of goods imported.

These disadvantages could be removed or reduced by refusing the purchaser of goods which are exempted or liable to a reduced rate, all or part of the "base on base" deduction for the purchase of these goods. But another disadvantage of the "base on base" deduction system can be quoted: a business man who manufactures goods affected by different rates will encounter great difficulties in distributing his deductible purchases over his sales.

The "tax on tax" deduction on the other hand, carries with it an effect of "recapture" when the rate applied to a certain stage is higher than that which has born at the preceding stage or by the constituents of the product. The real tax burden in principle corresponds to the tax rate affecting the product at the final stage. At each moment of production it is therefore possible to know the proportion of tax born by a certain product, and thus contains advantages for exports and imports.

If the "recapture effect" is eliminated by granting the possibility of fictitious "tax on tax" deductions to the purchase of goods exempted or affected by a reduced rate, it would not be possible to know the ultimate tax burden bearing on these products. From this there would occur difficulties for international trade.

1) For concept of "investment goods and "general costs", see Part III, chapter F, page 28.

After having considered the factors in favour and against these two methods of deduction, it has appeared useful to retain the principle of the "tax on tax" deduction.

b) Extent and Limits of the Deductions.

This taxation system only envisages "physical deductions", that is to say deduction of taxes which have been applied to raw and similar materials excluding investment goods, general costs and provision of services, which would bring a certain cumulative effect. (Remarks on the extent of the term "raw materials and similar materials" set out in chapter B-6, page 48, are also valid for production tax with fractional payments).

Commencing from the idea that deductions are only applied to avoid a cumulative tax on raw and similar materials used in the manufacture of finished products, it would only be necessary in principe, to allow these deductions for purchases of raw and auxiliary materials which go into the manufacture of taxable products. This is why in this hypothesis, when these materials have been used for the manufacture of tax exempted goods, it would not be appropriate to grant deductions. On the one hand it would occur from this that exempted goods would, nevertheless, bear a concealed tax burden (see chapter C-10, page 57) and, on the other hand, in the case where these materials would be used at the same time in the manufacture of taxable and exempted goods ("mixed production") the sum of tax which could be allowed in deduction would have to be proportional to the quantities employed in the manufacture of the taxable goods.

Difficulties can also arise in the calculation of deductions for "mixed businesses" (producer-handler and handler-producer).

However, two systems can be envisaged which require for these "mixed" cases the distinction in a very precise way of businesses subject to fractional payment tax and those which are not subject to it.

Under the first system the operation of the right for deduction would be deferred to the extent that the goods had been made the object of an operation giving right to deduction (sale subject to tax).

The "mixed businesses" which will have opted for this system would be able to apply this deduction of tax which has borne on their purchases of taxed materials, to the extent that they would make sales of goods subject to tax.

Under the second system the right of deduction of tax would, as under the system of law in common, be able to be applied to purchases of products but an adjustment would follow each time that these rights were not later confirmed by an operation subject to tax.

The "mixed" businesses which would have opted for this second system would be able to make deductions according to the normal system of the tax which will have borne on their purchases, but they would reimburse it each time that the products are not subject to taxation at sale. The sum of the reimbursement would be determined by reference to the exact or converted price.

On the other hand certain other technical problems must be borne in mind which are raised by reduced rates in a system of taxation by fractional payments with deductions by "tax on tax".

When a product affected by a reduced rate is manufactured with the assistance of materials taxed at normal rates, it can happen that the sum of tax to be deducted from this product exceeds the sum of the tax required at sale. This problem can also be produced in cases of sales loss, stealing, the destruction of goods or in the event of direct sale by a final producer to a consumer when going on to a lump sum reduction of the tax base.

In these cases, two possibilities arise, either to reimburse the surplus tax which cannot be assigned to the sales, or to leave it to the charge of the taxpayer. It is the second solution, in practice called the "buffer rule", which has been retained in the system of fractional payment taxation applied in France.

At this point, it is appropriate to underline the notable difference between a system of suspension and a system of fractional payments. Under the system of suspension, the tax burden on the finished product is always determined by the sale price (even if this price is found to be lower than the purchase price) and the rate applicable to the final stage.

On the other hand, with a system of fractional payments including a "buffer rule", the tax bearing on the sale being only deductible to the amount of tax due on the sale, the surplus definitely belongs to the tax authorities. This system is thus more severe than the preceding one.

This is why most of the delegations have expressed the opinion that although in certain cases the buffer rule may be necessary to avoid certain abuses, it would in practice be necessary to avoid as far as possible its application, either for example, by waiving it in case of destruction of goods, or by settling reduced rates at a level such that they will in most cases allow total deduction of tax paid previously.

7. Own consumption.

The same developments as those outlined for the single payment tax are applicable (cf. chapter B-7, page 48), mutatis mutandis, to taxation by fractional payment. Consequently it will be necessary to tax goods taken from stocks or current production by producers for private use, for the requirements of activities other than those of production or for the needs of production in the case where it concerns goods which would not have given right to deduction in the event of purchase.

8. Tax Base.

The tax rate will be applied to the prices of manufacturers throughout the manufacturing cycle. The tax will be levied in its entirety when the good comes into the trading stage.

In order to ensure equal taxation, it seemed suitable to the majority of delegations to go on to adjustments only in cases of direct sales of producers to private persons and not in the case of direct sales by producers to retailers or to final consumers other than private persons.

The developments mentioned in chapter B-8, on page 48, concerning the method to be employed to go on to adjustments within the framework of single payment production tax, namely either by correction of the tax base or by application of reduced tax rates, are equally valid for this system.

9. Inspection

The fractional payments system avoids suspension of tax and consequently registration of producers.

On the other hand, the temptation of fraud is generally less important in relation to a single tax on wholesalers or a tax levied at the last stage of production, because the weight of the tax is relatively light for each taxpayer, and also because the technique of deduction in linking the successive changes of the product makes tax evasion less useful and more easily proved by the tax authorities.

However, in order to prevent certain fraudulent practices it would be desirable that the deduction be dependent on the effective payment of tax by the first seller, but in practice this would seem very difficult to achieve. Nevertheless in case of collusion between seller and buyer it would be necessary to consider joint responsibility.

This sub-group has strongly emphasised that under this system, it will in particular be necessary in the realm of control, to approximate techniques in order to obtain similarly efficient results in all Member countries, since invoices play an essential role, seeing that it is in view of the tax on them referred to, that the purchaser can make deductions when the occasion arises. (See the considerations set out on the report of sub-group B, Part IV, end of chapter C-7, page 36, on the need to harmonize control. These considerations are also valid for this system of taxation).

10. Rates and exemptions.

It had been particularly envisaged by the Working Group No. I that as for the system of single phase taxation, the study would have to bear on a production tax by fractional payments, at a moderate and as far as possible, common rate, complemented according to requirements by an autonomous tax at the trading stage.

In relation to the adoption of a moderate and common rate, it is advisable to refer to chapter B-10, page 50.

a) In relation to the level of rates of a fractional payments production tax, it must be emphasised that one of the great advantages of such a taxation system over that of a single payment tax at the last stage of production, lies in the fact that, even if this first tax would be levied at a fairly high rate, it would in general be bearable. The payment of tax in effect is shared throughout the cycle of production, each producer bearing in the end a fraction of the tax.

b) In relation to exemptions, it must be stated that under this system (as elsewhere for most of the time under cumulative "cascade" systems), there often remains an invisible tax burden, called "residual tax" corresponding to the burden, inadmissible for deduction, which bears on raw and secondary materials used in manufacture (see point 6-b, second line, page 56).

This "residual" tax can carry with it a cumulative effect to the disadvantage of industry which, in using exempted products in manufacturing taxed products, cannot deduct from the tax bearing on their sales the "residual tax" incorporated in their purchases of exempted products.

These businesses would also be at a disadvantage in exporting since they will not be able to obtain refund of the total sum of taxes incorporated in the goods exported.

In order to obtain complete exemption, it would be necessary to exempt all raw materials and secondary materials comprised in the end-product which it was desired to exempt, but this seems difficult to achieve since materials must be followed through to their final destination so that they may not be used for other purposes.

So as to avoid the disadvantages, as well as for other budgetary and technical tax reasons, it would be desirable to limit to the greatest extent the number of exemptions and to replace them as far as possible by reduced rates calculated in such a way that deductions can be applied, and as a result abolish the "residual tax". A complete exemption would clearly not be achieved, but concealed taxation would be brought to light.

On the other hand, this would also allow the abolition of the quantitative proportion for the deduction of primary and auxiliary materials used, which exists because of the relationship between the weight of taxable products to the total production, if physical deductions were only admitted for taxable production (see point 6-b, second paragraph, page 56).

As has been done for single payment tax (see chapter B-10, page 50), the sub-group has considered it useful before going on to study the hypothesis of a common production tax complemented by an autonomous tax at the retail stage, to consider the possibility of introducing a production tax with fractional payments in the six countries with autonomous rates and exemptions, that is to say, differing from country to country.

It seems that such a hypothesis could not form a satisfactory solution for harmonization which would accompany the removal of tax frontiers, particularly because this system would mean the replacement of the suspension mechanism by one of fractional payments. In effect, within the framework of a system of suspension, it would be possible under certain conditions to conceive the removal of tax frontiers while leaving Member countries the freedom to set up rates and exemptions autonomously, notably in the case where deliveries to other countries have taken place before the point of impact of the tax and therefore under suspension of tax. On the other hand, under a system of fractional payments tax, all deliveries made by taxable persons are subject to tax, which implies that if the rates are different, some distortion will be produced in all cases and at all stages.

In relation to the hypothesis contained in the mandate, namely a common fractional payments production tax, the sub-group, in conformity with what has been done for single payment production tax, will analyse below the problems posed by the two possibilities of the mixed system (common production tax combined either with an autonomous tax on wholesalers, or with an autonomous tax on retailers). This analysis will be preceded by study of the machinery of fractional payments production tax in relation on the one hand, to trade with third countries, and on the other hand, to trade with Member countries.

11. Trade with third countries.

Under this system imports made by all persons are affected by the production tax and exports in order to obtain tax relief, benefit from refund of production tax paid at preceding stages.

The method of application will be rather simple; at exportation it will be sufficient to refund to the exporter the sum of the taxes he has borne at purchase which appears on the purchase invoices, or to allow him to apply them to those taxes he must pay for operations within the country, which comes to the same thing. It would also be possible to grant this exporter, should occasion arise, the possibility of purchasing materials and goods intended for export under provision of suspension of tax. For imports it will be sufficient to levy the tax according to the import value of the goods at the rate applied within the country for the same goods.

It is advisable to recall however, that this system only exists for "physical" deductions and that therefore it will be necessary if it is wished to take the cumulative taxation of investment goods, general costs and services into account, to levy at importation in addition to production tax, a certain compensatory duty and to grant a special refund at exportation in addition to normal refund (on this subject also see chapter B-11, page 51).
In relation to the question of settling whether refunds must be granted to exports made by retailers, it is advisable to refer to the considerations set out on this subject in Part IV, chapter C-9, page 38. A similar problem arises for wholesalers who in view of their exports, have not opted for the state of producer.

A particular problem will arise for exports of exempted goods which have been manufactured with the help of taxed constituents. Although these products appear untaxed since they are exempted, they are in fact affected by a "residual" tax corresponding to the tax paid at the purchase of constituents. The question arises whether it would not be appropriate to take into consideration a refund corresponding to this residual tax in order to completely relieve these exempted products from taxation and to make them more competitive in international markets. In the case where exemption would be replaced by taxation at low rates, allowing the absorption of the sum of deductible taxes paid at purchase of constituent items (see chapter C-10, page 57) the problem clearly does not arise.

12. Trade between Member countries.

a) On the assumption of the retention of tax frontiers between Member countries the techniques of application of production tax by fractional payments are identical with those studied in the preceding chapter concerned with trade with third countries.

b) On the assumption that tax frontiers between Member countries will be removed the following examples of trade between Member country A and another Member country B must be taken into consideration:

- Deliveries made by a producer in country A to a producer in country B. According to the normal rules of the system, the producer of country A would be subject in country A to production tax by fractional payments; the producer in country B would later be able to deduct from the tax required on sales in country B, the tax paid on purchases including those made in country A.
In this case no distortion would arise (the rates, systems of taxation of investment goods, general costs and services being identical in countries A and B) but it would occur from this that the tax yield would be proportionately attributable to each country according to the increase in the value of the product achieved within each country, so that for one part the principle of country of origin and for the other part the principle of country of destination would be applied.

On the other hand, if it was wished for these deliveries to assign to the country of destination the yield coming from products consumed within its territory, as has been judged necessary by the majority of the delegations (cf. Part III, chapter B, page 25), . the problem of deduction in the importing country of taxes paid in the exporting country would be solved among others, in the following way:

-- Granting of refunds by the country of origin. The purchaser in country B would not be able to make tax deductions of taxes paid in country A from the tax payable in his own country, but he would be able to apply for refund from the tax authorities of country A;

-- Establishing a clearing system between countries. The purchaser in country B would be able to make deductions of taxes paid in country A, but he should inform the tax authorities of his country B of the sum deducted. As a result the tax authorities of each country would enter into relations with one another to make compensatory payments.
These mechanisms will be studied more deeply in the part of the report dealing with the tax on added value (see chapter D-1, page 66).

- Deliveries made by a producer in country A to a person other than a producer in country B.

The application of the normal rules of the system to these transactions would bring about the collection of production tax in country A. In this instance it would not produce distortions (the rates in countries A and B being identical), but it would result from the application of the principle of taxation in the country of origin, that receipts coming from taxation of these deliveries would not be assigned to the country of destination (cf. see also the handling of this problem in Part VI, chapter C-10, page 39).

- Deliveries made by a dealer in country A to a producer in country B

If the trader in question wishes to avoid the goods being affected twice by production tax, he will be obliged in his country to opt for the state of producer. In this case, the situation described above arises.

- Deliveries made by a dealer in country A to a person other than a producer in country B

Production tax has already been levied at a prior stage (normally in country A) and will not in general benefit the consumer country.

13. Study of a combination of a common tax with fractional payments levied at the production stage together with an autonomous tax levied at the stage prior to that of retail trade.

The application of an autonomous tax at the wholesale stage implies as a single phase tax, the registration of persons liable to this tax; namely, producers and wholesalers insofar as they deliver to retailers or to consumers (also see methods of application of the tax to wholesalers studied by sub-group B, Part IV, chapter D, page 41). Producers who must already pay production tax on all sales that they make, without regard to the state of the purchaser, will be furthermore subject to the wholesaler's tax for their direct sales to retailers or to consumers.

The combination of a production tax with fractional payments with a single phase tax at the wholesale trade stage, thus has the consequence that the registration of producers, avoided when applying production tax by means of fractional payments, is made necessary for the application of the complementary tax. The abolition of registration of producers, which is the principle technical advantage of the fractional payments tax in relation to the single payment tax, is thus lost.

Leaving aside this technical aspect, the combination of a fractional payments production tax with a tax at the wholesale trade stage raises the same objections as those laid down for the combination of a single payment production tax with a tax at the wholesale trade stage (see chapter B-13, page 52), notably in relation to the technical complications of applying a mixed system to trade with third countries and Member countries.

The sub-group is therefore of the opinion that the combination of a common fractional payments production tax with an autonomous tax at the stage prior to that of retail trade could not form a satisfactory solution.

14. Study of a combination of a common tax with fractional payments levied at the production stage together with an autonomous tax levied at the retail stage.

It seems that a combination of a production tax with a tax on retailers presents, with small differences only, the same problems and the same advantages if the production tax is a single payment tax or if it is levied according to methods for fractional payments.

It is, therefore, appropriate to refer to the conclusions set forth for a combination of a single phase production tax with a tax at the retail stage (see chapter B-14, page 53). For a combination of a tax at the retailer's stage with a production tax with fractional payments however, these conclusions can be more favourable, since to some extent this system allows higher rates of tax and consequently a higher tax yield than a tax levied at the last stage of production.

D. Tax on added value (T.V.A.)

Tax on added value (T.V.A.) is a tax on turnover whose payment is split between all the economic stages that it covers, in the sense that at each of the stages that a product passes through, the tax is only levied on the value added to the product at that stage. Thus the T.V.A. - although its levying is spread over all stages - bears only once on the final price of a product and therefore has the same effect as a single phase tax levied at the final stage.

In principle, this taxation system avoids all cumulative effects and therefore acquires the greatest possible degree of neutrality in the economic field, while it also allows "physical deductions" (1) as well as "financial deductions", that is to say deductions of taxes which have been levied on purchases of investment goods or those which fall under the category of general costs, as well as of taxes bearing upon services which have been rendered.

The sub-group considered it preferable in the first place to study a T.V.A. system covering all stages of production and trade, also including the rendering of services and bringing in the least

1) Deduction of taxes affecting purchases of raw and similar materials provided for in a fractional payments production tax system (cf. chapter C-6-b, page 56).

possible number of exemptions. In this way the most widespread system possible would be obtained, which would have a very broad base with a similarly broad distribution of the tax burden and which would be able to gain large yields.

Granted that certain countries for technical, psychological and political reasons would not be able to adopt such a system, the sub-group has finally gone on to the analysis of less generalised systems of T.V.A. whose scope would cease either at the wholesale trade stage, or at the production stage, in eventual combination with an autonomous tax levied at the commercial trading stage.

1. T.V.A. covering retail trade stage.

a) Taxable persons

All producers, traders and all providers of services will be obliged to pay tax under as widespread a system as possible.

If all producers and traders are subject to T.V.A. the problems of definition of producer and of wholesale and retail trader could be avoided as well as the problems arising from "mixed businesses" (producer-handler, handler operating between producers and opting for the state of a producer). Given that renderers of services are included in the tax system, the difficulties of working out a definition between a renderer of services and a producer or trader are also avoided if the rates which are applied to services are the same as those applied to deliveries of goods (see chapter D-1-e, below). There would also be eliminated important cases of proportional payment whose mechanism is particularly delicate in a system which includes financial deductions (see chapter D-1-f, page 62).

However, the application of T.V.A. to certain categories of businesses, notably those conducted by small taxpayers (for example, artisans, small retail traders and small renderers of services) would run into difficulties either for psychological and political reasons, or for technical reasons (notably the application of a deductions system, cf. chapter D-1-f, page 62), since small taxpayers in general only have rudimentary bookkeeping and do not often have specialised staff.

In these circumstances it is necessary to look for means to facilitate the application of T.V.A. to small taxpayers while avoiding that such solutions give rise to important distortions on a national scale and in the realm of trade between Member countries.

b) Taxable operations.

All deliveries made up to the final stage, and in principle all services rendered, would be taxable (see chapter D-1-e, below). It will be necessary to work out common concepts concerning taxable operations.

c) Taxable goods.

Deliveries of all movable material goods, except for certain exemptions, will be taxable (see Part III, chapter C, page 26).

d) System applicable to investment goods and general costs (1)

The principle of this system is to avoid, as far as possible, a cumulative tax effect. This is why the granting of deductions for investment goods and general costs (financial deductions) is anticipated. Every person liable therefore, to T.V.A. can deduct from the tax he must pay on deliveries and other services, the taxes he has paid at purchase of goods and services necessary to manufacture or trade in the good he sells or the service he renders (see chapter D-1-f, page 62).

e) System applicable to services.

As has been indicated above, the grant of deductions for tax paid on services rendered to persons subject to T.V.A., the cost of which had been incorporated in the price of the goods, is anticipated. In relation to the question whether taxation of services whould be included under T.V.A. or be subjected to a special tax, it seems that the first alternative is the more desirable for reasons of technical policy, namely the reduction of the number of "mixed businesses" and therefore of cases of proportional adjustment cases. However, one would be able to leave outside the scope of the common T.V.A. system services "not influencing prices" (hairdressers, beauty

1) For concept of "investment goods" and "general costs" see Part III, chapter F, page 28.

parlours, etc.) for which Member countries would be able to apply an autonomous system if occasion arose (on this subject see Part III, chapter E-2, page 28).

If taxation of services is included in the T.V.A. system, renderers of services can deduct from the tax for which they are liable the tax which has been borne on their purchases of materials or goods and on services rendered to them which are necessary to the rendering of their services. Because of this, cumulative tax effects among renderers of services and the motive for concentration arising from these effects would be eliminated.

In relation to the rates applicable to services included under T.V.A., it would be preferable that the rate be the same as that settled for deliveries of goods, since it would no longer be necessary to set up a distinction between these two categories of taxable operations, which would make the application of the system more simple. But the possibility of having the same rate will depend on the level of the rate which will be set up for deliveries of goods, as well as the size of the deductions that renderers of services can make. However, in practice it seems hardly probable that in certain countries one would be able to tax services at the same rate as deliveries of goods.

f) System for deductions.

Although not levied on a single occasion, T.V.A. has the same effect as a single phase tax. At each stage it is levied on the sale price, with deduction of the T.V.A. borne within the purchase price of goods and services which have been brought together in the constitution of the sale price. In this way, the final price has in principle been affected only once by the total sum of the tax.

For this purpose the system provides for "financial deductions" as well as "physical deductions".

Before going on to study these two categories of deductions, in relation to the method of conducting the deductions, it is advisable to note the conclusion reached on this subject for production tax with fractional payments (see chapter C-6-a, page 55), which are also applicable to an added value tax; the deduction mentioned above would therefore be made on a "tax on tax" base:

- Physical deductions

The notes that have been made on this subject in chapter C-6-b, page 56, are also valid, *mutatis mutandis*, for this system.

It should be noted that since T.V.A. is applied to all operations, the problems of proportional adjustment posed by "mixed businesses" (producer-handler, handler-producer, etc.) no longer exists. However, to the extent that there will be exempted operations, a quantitative proportional adjustment will be necessary in order to settle the percentage of the deduction authorised.

Moreover, the extension of T.V.A. up to the retail trade stage removes one of the origins of the application of the "buffer" rule, since in such a system it is not necessary to go on to correction of the tax base (see point h, page 65). In effect, under a T.V.A. system halting at the production or wholesale trade stage - where certain adjustments on real prices are indispensable (for example, in the case of retail sales made by a producer or a wholesaler) - the application of the "buffer" rule results in lump sum adjustments applied to sale prices where they lead to a tax base below the level of the purchase price.

- Financial deductions

Solely physical deduction would leave in existence the cumulative tax effect arising from the absence of the possibility of deducting the tax which has affected investments, tools and services employed; factors which contribute to the formation of the cost price. This cumulative effect would clearly be the greater the higher the rate of the tax. The financial deduction regulations in the T.V.A. system are intended to remove this cumulative effect.

- Extent and limitations

Under this system the deductions should be as great as possible except for certain common limitations to avoid possible misuse, notably for certain goods which can be deflected from a trading or production purpose and applied to personal and private ends. Thus it will very clearly be necessary to exclude certain movable goods from the deduction provisions; such as carpets, some kinds of vehicles, etc. It should also be considered whether certain expenditures like travelling expenses should be deductible or not. It seems that deductions of taxes other than T.V.A. should be excluded (for example, excise duties, land tax and wages tax). In effect these taxes are independent of T.V.A. and cannot follow the regulations for T.V.A.; a certain cumulative effect

will exist but it will not be caused by T.V.A. which will retain its characteristic of only affecting the price of the good on a single occasion.
Starting from the idea that financial deductions have as their aim the avoidance of a cumulative taxation effect, in principle no deduction could be made by businesses which exclusively conduct activities which are exempted or outside the scope of T.V.A.

- Methods of financial deductions

The exercise of a right to deduction implies the effective application of T.V.A. and the sum of the deduction is settled in relation to the taxed turnover borne by each person liable to tax. It arises from this that while all the operations of a business are not subject to T.V.A., the deduction principle must be limited in extent. In another connection, the conditions for initial deductions are no longer sometimes linked with the alteration of business activities or with the distribution of taxable and non-taxable activities. In order to take these alterations into account, adjustments must be applied. For this reason the problem of specific deductions "in space" and deductions "in time" must be analysed.

It is appropriate to emphasise that this relates to the technical complications of the system which would be reduced in large measure if exemptions were kept to a minimum.

- Specific deductions "over space" (Déductions dans l'espace)

In order to calculate the sum of tax to be deducted in cases of mixed activity, that is to say taxed and exempted activity or activity outside the scope of the tax, two systems can be considered:

- The first taking into consideration the overall results of the business, relating taxable turnover to total turnover, which would lead to the setting up of a general proportion for all deductible goods purchased for business requirements; the business amalgamating its deductible goods, then applying the proportion according to its taxable activities. The calculation of deductible tax would be made provisionally in the course of a year on the base of the results of the preceding year with a final reckoning when the proportion for the year could be calculated. The system is simple but on the one hand involves the reduction of the deductions for goods exclusively related to taxed production, and on the other hand allows partial deduction for goods solely used in business activities not subject to T.V.A.

- The other system requires the differentiation of goods according to their actual employment. Goods related solely to taxed business activities benefit from total exemption; goods related to untaxed business activities cannot give rise to the right of deductions; while goods used in taxed and untaxed business activities only get a partial deduction. This partial deduction can be settled either by a general proportion of the business but here there arises the question of the precision of this method which for this purpose must be very exact, or by a special proportion for turnover calculated according to the relationship between taxed value and total value of similar business activities to that of these sole goods involved in mixed business activities. Such a system therefore involves the obligation to trace the goods individually and presents serious difficulties in granting partial deductions for goods related to mixed business activities. This is why in spite of a certain lack of precision, it seems preferable on practical grounds to adopt, should it so happen, the general proportion of turnover method based on the overall results of the business.

- Deductions "over time" (Déductions dans le temps)

For different reasons it can happen that an industrial or commercial business totally changes the direction of its business activities or modifies the spread of the value of its taxable and untaxable business activities. The alterations must be taken into account for deductions to be applied to amortizable assets (in principle, the problem does not arise for deductions to be made for general costs and services since deductions are actually made at the end of the operation during the course of which, these goods have been purchased or the services rendered).

In order to take these alterations into account, two methods can be used:

- Immediate deduction of the tax bearing on the investment goods; an initial deduction would be granted in relation to the general proportion for the results in the preceding year. In the case of new businesses, the deductions are calculated according to a provisional percentage considered in relation to the operations in view. In both cases the operation is finally reckoned up when the general proportion for the years has been calculated. If during the following years, during the period of the completion of the amortization of the goods which have been subject to immediate deductions, the initial proportion is modified as the result of the changes foreseen above, a new settlement of the financial deductions will be required.

In order to reduce the periods of settling up, a period of lump sum amortization for all goods, valid solely for the reckoning up and settling of financial deductions, can be considered. Furthermore, in order to avoid too numerous adjustments it can be allowed that the adjustments will only be brought into effect if the general proportion for a year has varied more or less than a certain number of points in relation to the original base proportion.
Through the immediate authorization of the deduction of T.V.A. this procedure favours investment and therefore productivity, while the goods are held tax free for the part which is still not used for business activities subject to T.V.A. It must, however, be underlined that deduction is limited by the possibility of relating it to each person subject to tax. In effect deduction is only possible to the extent that the business is liable to tax. If, for a determined period there exists a surplus of tax that cannot be attributed, this surplus will be carried forward to the time that the business will have enough tax to be paid. This system does not present notable difficulties from a practical point of view if the cases of possible proportional adjustments are avoided as far as possible.

- Annual deduction according to annual amortization instalments (proportional deduction over time): the investment goods are purchased taxed. An immediate deduction corresponding to the annual amortization instalment is authorized and calculated according to the general proportion arranged in the previous year. Each year a deduction will be made when applying the general proportion for the previous year until the complete amortization of the good. By this method it will no longer be necessary to go on to regulation of variations in the proportion over time.

This system appears logical while the deduction will only be authorized to the extent of the incorporation of the value of investment goods in the goods, that is to say at the point where a cumulative effect appears. Moreover, it does not contain any encouragement to invest and consequently it seems to be less discriminate in its effect on business activity than the system of immediate deduction in the same year as the acquisition of the investment goods. In effect, with this last method, during periods when the economy is expanding, and thus at times of high investment activity, business men would pay proportionately less tax on their turnover, which would still further encourage their initiative and consequently would accentuate the tendency toward a high level of activity. On the other hand during periods of depression, where only essential investments would be made, the possibilities for deductions for businesses would be more restricted so that liquidity would be reduced by this fact, thus making their economic position worse and reinforcing the tendency toward recession.

From the point of view of practical application, the system of proportional deductions over time seems to carry with it more technical difficulties, notably for small businesses, than the system of immediate deductions, to the extent that this latter system does not bring with it adjustments. A method of amortization in common must also be considered either by adopting a standard period applicable to all investment goods without distinction, or by adopting standard periods differing according to the category of goods (buildings, machines, commercial vehicles, etc.), or by adopting rules for determining the tax base of direct taxes.
Finally, it is appropriate to note that if in the T.V.A. system the method of proportional deductions over time were adopted as the normal system, it seems nevertheless possible, if certain circumstances require it (for example, in order to stimulate investment so as to check a trend in business activity toward depression), to go on for a determined period to a system of immediate deductions.
The possibility of immediate deductions would give an incentive to persons subject to the tax to profit rapidly from the tax advantage, consisting in the reduction for a short period, of the payments due on their sales. This incentive to invest would create a demand for equipment which could be a possible means of reinvigorating the economic market.

g) Own consumption.

A person subject to tax can set aside in his business goods of all kinds from his current production or from stocks or his private use or for the needs of his business.

Setting aside for personal needs must be taxed because they are included with personal consumption.

For setting aside made for business needs, their not being taxed could be accepted at the time of their being set aside because they will be taxed later at the moment of their inclusion in the cost price of finished products, but there exists a risk of non-taxation when the goods set aside are devoted to exempted production or "mixed" activities (taxable or non-taxable). Therefore there should be considered adjustments-which are difficult to undertake because there would not

be any trace of this setting aside-made in practice under tax suspension. One of the possibilities of reducing this disadvantage would be to tax them and, if it concerns goods giving right to deductions, to authorize as in the case of purchase of these goods, the deduction of the tax having affected these goods set aside, from the tax which must be paid by the business on taxable sales.

h) Tax base.

Under the system considered, the price making up the final tax base of the good would be that corresponding to the value of the good at the moment of sale to a consumer. Thus it is the retail price which, in fact, most frequently constitutes the tax base.

Since the tax would be levied according to a system of fractional payments, they would be collected throughout the stages of manufacture and trading, each taxpayer applying the tax rate to his real sale price with the deduction of tax paid at prior stages.

Under the system extended to the retailer's stage, it does not seem necessary to go on as a general rule, to adjustments of the tax base, in the case of direct deliveries by a producer or wholesaler to a private consumer.

As for taxation of services, the tax base would also be formed by the real price applied.

i) Inspection

The considerations made above in chapter C-9, page 57, are also valid for this system, notably in relation to the essential role played by invoices on which there must be noted the tax paid, thus permitting the purchaser, if necessary, to make deductions.

The creation of invoices noting taxes not in fact paid, could be placed on the same footing as counterfeiting banknotes, since by interfering with the operation of deductions the purchaser has actually drawn a credit from the tax authorities. There must be taken into account very severe penalties in cases of infringement in order more or less to contain this risk of fraud.

j) Rates and exemptions.

- In relation to exemptions, the remarks made in chapter C-10, page 57, are valid and it would also be desirable under this system to limit to a maximum the number of exemptions and to replace them as far as possible, by reduced rates calculated in such a way that they can absorb the taxes paid previously.

If it could be arranged that there were no longer any exempted sector, the application of T.V.A. would be much simplified. In effect not only would the chain of deductions in the case of incorporation of exempted products not be broken, bringing about a residual tax in taxed production as they do, but all proportional adjustments applicable to financial deductions and to all purchases of raw materials for physical deductions would be avoided.

- In relation to the rate, it must be emphasised that a T.V.A. system whose collection is split throughout the cycle of production and trading, would permit consideration in comparison with a system of single phase payment tax, of rather higher rates while each person subject to tax would only pay a fraction of the tax. But it must on the other hand, be stated that the application of a higher rate could bring about a disadvantage of a psychological type.

It must also be noted that where the scope is very extended (production, trading, rendering of services) and the base is very broad, in general corresponding to the retail sale price, with lower rates there could be obtained receipts equivalent to those procured by a tax levied at a prior stage.

k) Trade with third countries.

Under a T.V.A. system, the regulation for imports and exports follows the same rules as those considered in chapter C-11, page 58 for the fractional payments tax: at importation, the goods would be taxed at the same rate as that applied within the country for similar goods and, at exportation, it will be sufficient to refund to the exporter the sum of taxes he has paid at purchase or to allow him to credit them against taxes he must pay on operations within the country. There could also be granted to exporters if occasion arose, the possibility of receiving materials and goods which are intended for export under suspension of T.V.A.

It is advisable to underline that under a T.V.A. system, there do not in principle exist any cumulative taxes on investment goods, general costs and services, and that it will not be necessary to take into account refunds or special compensatory duties as is the case notably for the fractional payments production tax.

In relation to the problem of the export of exempted goods manufactured with the help of taxed investment goods and constituents, the remarks made for the fractional payments tax are also applicable to a T.V.A. system, namely that the question arises whether it would not be advisable to go on to refund of tax paid at purchase. In the case where exemptions would be replaced by taxation at low rates sufficient to credit tax paid previously, the problem clearly would not arise.

1) Trade between Member countries.

As has been done for the other systems that have been studied, it is appropriate here to consider the application of T.V.A. to trade within the Community either in circumstances where tax frontiers between the Member countries are retained or where they are removed.

- It is clear that under the first alternative of the retention of tax frontiers, the machinery for the application of T.V.A. to trade between member countries is identical with that studied in the preceding chapter in relation to trade with third countries. In the case of the retention of tax frontiers and thus of the retention of a system of taxation for imports and tax relief for exports, differences of rates, exemption and should occasion arise, even of technical methods of the T.V.A. system would not seem to lead to distortions of competition.

- The alternative of the removal of tax frontiers implies, in principle, as the sub-group has emphasised in several references, the unification of rates and exemptions. It may be repeated here, that according to the opinion of two delegations, it seems that tax frontiers could also be removed if the rates and exemptions were very close to each other. Whatever they may be, it has also appeared interesting to study the alternative of the removal of tax frontiers with rates and exemptions which differ appreciably from one country to another in the circumstances where all the Member countries would have adopted a T.V.A. extending up to the retail trade stage. This study is only carried out within the outline of a T.V.A. collected up to and including the retail trade stage, which thus implies that most trade between Member countries would take place between persons subject to T.V.A. For this reason, within the outline of the hypothesis of the removal of tax frontiers two sub-hypotheses occur; namely the case where T.V.A. is applied with unified rates and exemptions by Member countries and the case where T.V.A. is applied with rates and exemptions that are not unified.

- Sub-hypothesis of T.V.A. applied with unified rates and exemptions.

When T.V.A. extends to the retail trade stage, only the two following cases of trade between Member country A and another Member country B should be considered:

- Deliveries made by a person in country A subject to T.V.A. to a person in country B subject to T.V.A.

If the same rules are applied to these deliveries beyond the frontiers as those applicable to deliveries within the country, the exporter of country A will be subject in country A to T.V.A.; the importer of country B will afterwards be able to deduct tax paid on purchases including those made in country A from the tax payable on sales in country B. (The application of possible fictitious deductions explained on page 67 under the second alternative would in this case lead to the same result where it is assumed that the two countries apply unified rates and exemptions). Since the rates and exemptions are identical in countries A and B, the foregoing procedure would not cause any distortions, but it would occur that each country would be assigned the receipts arising from the taxation of the value which has been added within its territory.
Thus, the tax would for one part be levied in the country of origin and for the other part in the country of destination. If it was on the other hand, desired to assign all receipts from these deliveries to the country of destination, it would be necessary to solve the problem of the deduction in the importing country, of taxes paid in the exporting country. Leaving aside other possible compensation mechanisms to correct the effects of diversion of receipts (for example, a common clearing house), there could be considered for example, discounts between the tax authorities of the different countries or a system according to which the refund of taxes paid in country A could be demanded of the tax authorities in country A directly by the importers in country B (cf. on this subject chapter C-12-a, page 59). To achieve the first solution indicated (discounts) it would suffice that the taxpayers indicate in a clear way in their declarations the taxes paid for purchases within the country and the taxes paid on purchases in other Member countries.
This apportionment of taxes paid on purchases according to the country where they have been paid would be necessary even within the framework of the application of the principle which consists of assigning to each country the receipts proportional to the value added within each country. In effect, also in this case it will be necessary to be able to distinguish the taxes paid

within the country from those paid in other Member countries in the taxpayers declarations, for reasons connected with inspection, among them the checking of the rate of exchange applied to convert taxes constituted in foreign currencies into national currency.
It is also appropriate to consider the case where the person subject to tax (producer of dealer) of country B afterwards exports to a third country goods originating in country A; in this case in order to achieve complete tax relief country B will have to grant a refund corresponding to all the taxes borne by the goods exported which implies that if the tax levied on value added in country A has been assigned to country A, country B will be obliged to give refunds greater than the receipts that it has gained from the tax in question. Such diversion of receipts could also be produced in the case where a product imported from a third country into a Member country A is, whether or not having been subject to the application of labour, exported into another country B.
It is appropriate to emphasise that if one of the foregoing solutions could be achieved (discounts between countries or refund by country A of taxes to the importer of country B), the receipts would be assigned in their entirety to the country of destination and this same country would thus completely relieve from tax the product when exported outside the EEC.

- Deliveries made by a person in country A subject to T.V.A. to a person in country B not subject to T.V.A.

The application of the normal rules of the system to these deliveries would bring about the collection of T.V.A. in country A; no distortion would be produced but taxation would have taken place in the country of origin.
On the other hand, if it was wished to assign the tax product from these deliveries to the country of destination, at least in the more important cases (for example, mail order houses) the collection of the tax could be organised in a way that the taxation brings about the same effects as in the case of taxation according to the principle of the country of destination.

Two solutions could be considered:

Subject the delivery to tax in the country of destination (for example with the assistance of a concept of the place of delivery). The payment of tax could be made either by periodic declaration or by means of tax stamps;
Levy the tax in country A with discount of receipts between country A and the country of destination. In this case, the seller could be obliged to show in his declaration the figures of his deliveries to different Member countries.

Several delegations have expressed serious reservations relating to the possibility of practical achievement of these solutions. They have in particular emphasised that the extent of these deliveries must not be underestimated. In effect, it concerns not only deliveries to private consumers, but also deliveries to businesses which are outside the scope of T.V.A. Furthermore, with these deliveries should be included deliveries of nondeductible goods to persons subject to T.V.A.

- Sub-hypothesis of T.V.A. applied with rates and exemptions that are not unified

The same cases as those considered under the sub-hypothesis of T.V.A. applied with unified rates and exemptions must be considered under this heading (see page 66).

- The deliveries of goods made by a person in country A subject to T.V.A. to a person in country B subject to T.V.A. would be subject to the T.V.A. of country A. When these goods would be re-sold afterwards in the same state or after alteration in country B, two methods could be considered to operate the deduction of tax payable at purchase, namely:

1) deduction of a fictitious sum calculated by the application of the rates of country B to the purchase price not including tax; or

2) deduction of the tax actually levied in country A.

The first method which corresponds to the application of the principle of taxation in the country of origin would bring about certain consequences, namely distortions of competition and budgetary diversions which do not seem acceptable for the majority of the sub-group.
With the second method, which is a special form of the application of the principle of taxation in the country of destination, distortions of competition would not be produced while under the effect of "drawing in the tax" at later stages, particularly typical for a T.V.A. system extended to retail trade with "tax on tax" deduction, the tax burden bearing on a certain product would correspond to the last tax which has affected the product in question, namely at the rate of the country of destination.

This effect, however, cannot be complete if the rate applied in the country of origin is higher than that in effect in the country of destination and if the taxable value added in this second country is not sufficient to compensate the difference of rates. In this case there would arise a type of "buffer" in country B which would allow there to continue to exist a residual tax in country A which would be the source of distortions.
Moreover, receipts of turnover tax would be attributed to each country not only in proportion to the value added in its territory, but also as a result of the rate at which the T.V.A. is applied.
If it is desired to attribute the total receipts coming from products consumed in its territory to the country of destination, there might be considered here the possibility of resolving the problem by one of the methods considered in page 66.

It can be emphasised that if taxation in the country of destination is achieved, for example by way of refund by country A to the importers of country B of taxes paid in country A, there would also be eliminated the "buffer" effect mentioned above and thus the distortions that arise from it.
If on the other hand, the system that consists of discounts between the countries was applied, country B would grant its taxpayers who had made purchases in country A, total deduction of tax paid in country A on sales made by taxpayers within country B and, if occasion arose, if tax paid in country A is higher than that levied in country B, would reimburse them the excess which could not be attributed. In this way, even in this case, the "buffer" effect and the distortions which can arise would be eliminated.

- In relation to deliveries of a person in country A subject to T.V.A. to a person in country B not subject to T.V.A., the taxation would take place, at the rate which is applicable in country A, which would be a source of distortion given that the rate differs from that applied in country B. Moreover, if the tax of the country of destination could be applied to most deliveries in this category (cf. solutions considered on page 67 of this chapter), the distortions in these cases would be avoided and the tax receipts assigned to the country of destination.
It is clear that the reservations set down on page 67 are also valid for this case.

In conclusion, it does not seem out of the question that in a T.V.A. system where rates are not yet unified, measures can be put in hand so as to avoid great distortions of competition, and so as in principle to assign almost all the receipts to the consumer country. These measures would be the lighter the greater that rates of the different countries would tend to be unified.

2. T.V.A. covering wholesale trade stage.

Certain delegations having expressed serious reservations on the practical possibility of adopting a generalised T.V.A. up to the retail stage in their countries for psychological, technical and political reasons, it appeared desirable to go on also to a study of a T.V.A. system which is halted at the stage prior to that of retail trade.

So as to avoid repetition, this study will only bear essentially on the difference which exists between these T.V.A. systems and which arise from the fact that their financial points of impact are different, the other methods of the system (for example, in relation to taxable goods, the system for investment goods, general costs and services, etc.) being in general the same.

a) Taxable persons

Under this system all producers, all wholesalers and providers of services are obliged to pay tax.

The setting up of distinction between the taxed sector and the sector outside the scope of the tax should be given attention with the assistance of definitions, notably that of retail sale.

The problem will arise of deciding whether it will be necessary to grant retailers the possibility of opting voluntarily for the T.V.A. system, notably because they sell to other persons subject to tax or for export.

On the other hand, it will be necessary to study the problem of eventual obligatory subjection to taxation of large retail houses which is some measure have taken up the function of wholesalers.

The limitation of the scope of the tax will be the source of cases of proportional adjustment because of businesses which at the same time exercise taxable business activities (for example, those of a producer) and business activity which is placed outside the field of application of taxation (for example, that of retailer).

This type of mixed business clearly does not exist under the hypothesis of T.V.A. levied up to and including the retail stage whose scope includes in principle the whole of professional activities.

However, it should be noted that these disadvantages carry with them the advantage of fewer taxpayers to be inspected by the tax authorities.

b) Taxable operations.

All deliveries made by producers and wholesalers will be taxable, as well as in principle, services rendered.

c) System of deductions.

The account set out above in chapter D-1-f, page 62 relating to this field, is also valid mutatis mutandis, in the hypothesis of T.V.A. halting at the wholesale trade stage. However, it must be emphasised in this instance that cases of proportional adjustment will be more numerous and will complicate the application of the system because of the existence of mixed businesses of the type mentioned under point a) above.

These businesses which have activities falling within and also outside the scope of the tax - under the system in question that of a retailing reseller - would only be permitted to make deductions for their operations which are subject to tax.

d) Tax base.

In the system under consideration, the price of the product forming the base for final taxation would be the one corresponding to the normal wholesale price. Because the tax is levied according to the system of fractional payments, it is levied subsequently in all production and wholesale trade stages.

Thus, there arises the problem of settling the method of taxation in cases of direct delivery by a producer to a retailer and of a producer or a wholesaler to a private person or a final consumer other than a private person.

So as to ensure equal taxation, the majority of the delegations considered that it would only be necessary to go on to corrections in the case of direct sale by a producer or a wholesaler to a private person.

In relation to the method to be used making corrections, opinions were divided between the possibility of applying rebates to actual sale prices and the application of reduced tax rates.

It must be emphasised that the practice of these corrective measures could give rise to a "buffer" effect" for physical deductions. In effect, it could happen that after a rebate the tax to be paid at sale would be less than that paid at purchase.

e) Rates and exemptions.

What has been described above (see chapter D-1-j, page 65), on the opportunity to limit exemptions as far as possible is also valid for this system.

In relation to rates, it must be noted that in order to obtain a tax yield equivalent to those gained by a generalised T.V.A. system, it would be necessary under this system to envisage a higher rate.

f) Trade with third countries.

In general, the method of working described in chapter D-1-k, page 65, is also valid, mutatis mutandis, in this hypothesis.

Nevertheless, there arises under the system the question of considering the granting of refunds on exports made by retailers; on this subject it is advisable to refer to the conclusions reached in the report of the sub-group B (see Part IV, chapter C-9, page 38).

g) Trade between Member countries.

- In the hypothesis of the retention of tax frontiers, the machinery for the application of the tax is the same as that relating to trade with third countries.

- In the hypothesis of the removal of tax frontiers, in addition to the cases considered within the framework of T.V.A. extending up to the retail trade stage (deliveries between persons subject to T.V.A. among different Member countries and deliveries of a person in country A subject to T.V.A. to a person in country B not subject to T.V.A. - cf. chapter D-1-l, page 66) it is appropriate to consider under this system which leaves retail trade outside its scope, deliveries made by retailers in country A to persons in country B.

If the importer of country B is not subject to T.V.A., there are no distortions, but the technical methods outlined in chapter D-1-l, page 67, could not in all cases be used in order to assign the products of the tax to the country of destination while the tax has been levied at a stage prior to that of the delivery in question. When, on the other hand, the retailer in country A occasionally makes deliveries to persons subject to tax in country B, there would arise moreover, a cumulative effect from taxation in this latter country.

It is evident that if the retailer who makes sales in another Member country has opted to be treated as a taxpayer voluntarily, the situation under one of the hypotheses described above, which arise within the framework of T.V.A. levied up to the retail trade stage, occurs once more.

h) Combination of T.V.A. extending to the wholesale trade stage with a tax levied at the retail trade stage.

The same considerations as those raised in connection with a single phase general tax levied at the stage prior to retail trade with a tax on retailers, are also valid in the case of a combination of T.V.A. collected up to the wholesale stage with a tax levied at the retail trade stage. It is advisable to refer to the study quoted on Part IV, chapter D, page 41 et seq.

3. T.V.A. covering final stage of production.

So as to complete the study of the different possibilities which arise in relation to the stage at which it is advisable to set the final point of impact of T.V.A., it is now appropriate to go on to a study of a T.V.A. system whose levy would cease at the final production stage.

The problems arising from such a tax have in general, already been dealt with in other parts of this report, namely either when studying some other hypothesis for T.V.A., or when studying production tax with fractional payments.

This latter tax in the manner that it is envisaged in chapter C, page 54, only differs in effect from a T.V.A. system ceasing at the final production stage to the extent of the deductions made. In effect, physical deductions are made as well as financial deductions under a T.V.A. system. Moreover, services which are subject to a special tax within the framework of production tax (see chapter C-5, page 55), would be brought within the general system of T.V.A. (see chapter D-1-e, page 61).

For this reason it seemed appropriate to set a limit by bringing to light only the leading differences that exist when the final point of impact of the wholesale trade tax is carried forward to that of production; the other stipulations of the system (for example, the system for investment goods, general costs and services) in general remaining the same.

In the first place there must be indicated that under the system in question, "persons taxable" are producers and providers of services. There occurs a reduction in the number of taxpayers but on the other hand, because of the limitation of the scope of the tax, an increase in the number of mixed businesses. In effect, under this system, in addition to cases of producers who also have business activities as dealers, it may frequently arise that traders sell to producers and from this fact it will be necessary to allow them voluntarily to take on the status of being subject to the tax. These traders selling sometimes to persons subject to tax, and sometimes to persons not subject to tax, form "mixed" businesses. Technical solutions to the problem of mixed businesses have been set out elsewhere, in relation to physical deductions in chapter C-6-b, page 56, and in relation to financial deductions in chapter D-1-f, page 62.

The final tax base of the product will be made up by the price corresponding to the value of the goods when they leave the manufacturing cycle.
The tax is levied throughout the manufacturing cycle under application of the system of deductions. It is advisable to refer to chapter C-8, page 57 above, for other aspects of the tax base problem (cases where the base must be adjusted, method to be used, etc.).

The base under this system being lower than that of T.V.A. collected up to the wholesale trade stage, an equivalent tax yield could clearly only be obtained with a higher rate.

The machinery for applying T.V.A. to production and to trade with third countries and with Member countries, is the same as that described for fractional payments production tax (see chapter C, points 11 and 12, page 58 et seq) with the difference only that in the case of a T.V.A. it will not be necessary to consider special compensatory rights to take account of the cumulative tax effect of the taxation of investment goods, general costs and services.

It is also advisable to refer to the fractional payments production tax (chapter C, points 13 and 14, page 60 et seq), in relation to the eventual combination of a T.V.A. levied up to the final production stage with a tax levied at the wholesale trade stage or that of retail trade.

E. Conclusions

Among the possibilities of introducing taxes in the six Member countries there has been studied:

1. a common single production tax levied only once at the final production stage;

2. a common production tax levied according to a system of fractional payments;

3. a tax on added value.

ad. 1. Common single production tax levied only once at the final production stage.

In large measure, this system of taxation is comparable to the system of a tax levied at the stage prior to that of retail trade (1), studied by the sub-group B with the difference only that this system applies to producers.

The following considerations set out in greater detail in Part IV, chapter E, page 42 et seq, are also valid for a single phase tax levied at the final production stage.

So as to set up the system in as neutral manner as possible, the cumulative effects of the tax should be eliminated, taking into account that investment goods, similar goods and services to persons subject to the tax could be made under suspension of tax.

Under this hypothesis, this taxation system presents the following advantages:

- it is neutral from an international as well as a national aspect, and does not bring with it an incentive to business integration;

- it is favourable to the encouragement of technical progress;

- compared with the system of a tax on wholesalers, it limits the number of persons registered;

- it comprises a system of very simple compensatory provisions at importation and at exportation; the producers can make imports under provision of tax suspension and make exports without claim to refunds, for the remainder of international trade the application of taxes at importation and of refunds at exportation is simple and precise.

But conversely it represents an increased amount of work for the tax authorities because of the setting up and day to day running of a register of producers, as well as certain difficulties arising from the necessity of controlling deliveries between registered persons made under provision of tax suspension.

Furthermore, a wholesaler's tax through the necessity of retaining the level of the tax yield, requires a very high tax rate and the disadvantage arises more strongly for the system in question since, where the point of impact occurs at an earlier stage, the tax base is consequently more limited.

Working Group No. I, however, has considered levying a common production tax with common rates which could be set up at a moderate level.
This common tax would allow the coverage of the more or less greater part of the budgetary needs of Member countries which would in addition, have the option of adding to receipts coming from turnover tax by introducing a complementary autonomous tax at the trading stage.

The study of this hypothesis brings into strong relief:

- that a combination of a common tax levied at the production stage with an autonomous tax on wholesalers cannot form a satisfactory solution; and

- that a combination of a common tax levied at the production stage with an autonomous tax on retailers - leaving aside certain distortions which can arise from retail sales beyond frontiers within the Community - would encounter serious disadvantages in several countries where it would be for technical, psychological and political reasons extremely difficult, if not impossible, to introduce a tax on retailers, while in certain other countries it would be difficult to cover budgetary needs by a tax on retailers if the production tax were to be levied at a moderate common rate.

1) for reasons of simplification called henceforth: tax on wholesalers.

Having regard to the fact that the introduction of a production tax at a moderate rate combined with an autonomous tax at the trading stage does not seem realisable in all the six countries, the sub-group has believed it useful also study the possibility not contained in its mandate, of adopting in the six countries a single common tax levied at the final production stage.

On the other hand, it is appropriate to note that in principle there is no objection that a country in addition to a common production tax levies an autonomous gross turnover tax collected at the retail stage, which would, however, bring about certain distortions for these countries.

Thus as has been stated above, the production tax would have to be applied with high rates.

So as to reduce this disadvantage in some measure, the sub-group considered that the following means might be resorted to:

- either split the levying of the tax over all stages of production by applying the system of fractional payments;

- or give up the non-taxation of investment and similar goods, and of services made by persons subject to taxation.

The first possibility relates in fact to a system of added value tax which has been studied separately.

In the concept of a single phase tax levied at the final production stage, it is only the second possibility which has been considered.

Under this hypothesis, however, it must be stated that one advantage of the system would disappear; namely, complete neutral effect in the realm of business activity. Another disadvantage is that if it is wished to achieve complete relief from taxation for exports made by producers, refunds must be granted and if it is wished to ensure equivalent taxation of goods imported by other persons, compensatory duties must be levied; these refunds and compensatory duties could only be fixed according to a lump sum method.

Starting out from the assumption that the foregoing disadvantages are accepted, that is to say a high rate of tax and a certain lack of neutrality in discrimination, study of the possibility of introducing a common tax levied at the final stage of production in the six countries has given rise to the following conclusions:

- If such a common system carried with it identical tax rates and exemptions (or, according to the opinion of certain delegations, rates and exemptions very close to each other), it would be possible to remove tax frontiers between Member countries without prejudice to the conditions of competition.
But, if it was wished to assign receipts from taxation in their entirety to the country of destination, it would be necessary to anticipate special technical measures or financial compensation between Member countries for taxable deliveries beyond Community frontiers (namely, for deliveries other than those made under provision of tax suspension between registered producers).

- If, on the other hand, such a common system was adopted with rates and exemptions which differed more or less from country to country, the same conclusions would arise relating to the removal of tax frontiers as those set forth at the close of Part IV, pages 43 et seq.

It is appropriate, however, to underline that the category of deliveries which causes the greatest difficulties - namely deliveries between registered persons and unregistered persons - is more extended under a tax system on wholesalers.

ad. 2. Common Tax on production levied according to a system of fractional payments.

This tax system does not differ from that of a tax levied at the final production stage, above all through its method of collection by the splitting of the payment of the tax over all stages of production.

This splitting of payment is achieved by means of a system of deductions: each taxpayer calculates the sum of the tax according to his sales which are liable to tax, but deducts from this sum the tax that he has paid at the time of his purchases of raw and similar materials. It seemed that this method of deduction, the so-called "tax on tax" deductions, is preferable to the method of "base on base" deductions, according to which the tax is levied on the difference between the sale prices of the goods and the purchase price of the deductible goods.

The deductions are limited to the tax having been borne at the purchase of raw and similar materials ("physical deductions").

In the same way as for a single tax levied only once at the final stage of production, it is also possible to allow so-called "financial" deductions for investment goods, similar goods and services under a fractional payments production tax system, but in this case the fractional payments production tax would in fact be transformed into a system of taxation on added value, which will be studied later under point ad. 3.

This is why the study of the fractional payments production tax system has only been made under the supposition of taxation of investment and simila. goods delivered to businesses and of services rendered to them.

From this system it arises that:

- it is not entirely neutral from a national viewpoint;

- it is also not entirely neutral from an international aspect, unless lump sum refunds at exportation and compensatory duties at importation to compensate for the tax burden arising from taxation of investment goods etc. are instituted;

- it does not encourage the growth of technical progress when investment goods are taxed.

On the other hand it must be underlined that his system carries with it, in comparison with that with a single payment production tax, the advantage that even if the tax must be levied at a high rate, it will in general be easily bearable since the tax is split up over the production cycle.

Although from the aspect of its technical application the method of deduction of tax paid at purchase contains certain complications, this system has the advantage in relation always to that of single payment, that it is not necessary to apply registration of producers.

In relation to the possibility of combining the fractional payments production tax with a complementary autonomous tax at the trading stage, the practical achievement of such a system would encounter the same difficulties as those raised under point 1, page 71, with the difference only that the method of fractional payments allows the application of the tax at a higher rate than that which can be adopted under a single payment system, and thus of obtaining a higher tax yield.

Under these conditions the sub-group has also taken into consideration the introduction in the six countries of a common fractional payments production tax not combined with a complementary tax at the trading stage.

This study has brought into relief that - leaving aside the disadvantage that the system will not be entirely neutral because of the non-deduction of investment and similar goods and of services - the removal of tax frontiers between Member countries will not be achievable if the rates and exemptions were fixed in an autonomous and differing manner from country to country. Certain delegations are nevertheless of the opinion that the adoption of this solution would constitute some progress over the present situation and could form a step toward a more developed and satisfactory harmonization.

The suppression of tax frontiers would not produce distortions of competition if the rates and exemptions were the same in different countries. According to the opinion of certain delegations, the risk of these distortions would be sufficiently reduced even if the rates and exemptions were not identical but rather similar in different countries. In the both cases, the country of destination would not benefit from the receipts from taxation in their entirety; these receipts would in effect be proportionately attributed to each country where the product had been subject to an act of production. It seems possible, however, to assign to the country of destination the total tax receipts from deliveries between producers, for example by means of the methods described in chapter C-12-b, page 59 and D-1-1, page 66. If it is wished to arrive at the same result for deliveries made by producers or persons not subject to the tax, rather complicated special technical measures or financial compensation between Member countries with the help of a common clearing house or other means should be anticipated.

ad. 3. Tax on added value

This system of turnover tax, which implies "physical deductions" (deduction of tax borne at the purchase of raw and similar materials) alongside "financial deductions" (deductions of tax borne at the purchase of investment goods, similar goods and services), appeared among the systems considered by the sub-group, to be the one which allows regard to the greatest extent to the

criteria set forth in Part III pages 23 et seq, and notably to that relating to neutrality in matters of competition.

From a national aspect, by avoiding all cumulative effects as much for raw and secondary materials as for investment and similar goods and for services, the tax on value added does not carry with it any encouragement for the integration of businesses, the goods bearing the burden to the same extent whatever the number of stages they have passed through in the process of manufacture and distribution.

On the other hand, it can be considered that in relation to a single phase payment tax, the method of levying T.V.A. by splitting the obligation to pay the tax over different phases, is such as to make the tax more easy to pass on, the disadvantages arising from the concentration of the tax burden at a single stage also being avoided.

From an international aspect, equality of treatment of domestic and imported goods as well as the relief of exports from taxation are achieved with precision, and without having resort to complicated technical methods.

In relation to the influence of this system of taxation on productivity, the deduction of taxes having affected investment goods is a factor favourable to the growth of technical progress. On this subject it also seems appropriate to recall the remarks made in chapter D-1-f, pages 63 et seq, on the differing degrees of neutrality from the point of view of business activity, that are presented by the two methods of making deductions - immediate or proportional over time - from the tax borne by investments.

In relation to problems of technical policy, it appeared that of the second of these two possible methods of operating deductions - namely, either the "base on base" or "tax on tax" method (see chapter C-6-a, page 55) - the second should be adopted. Nevertheless, in certain countries this system would appear to be more complicated for a greater or lesser number of taxpayers than the system of "cascade" taxes. In these countries its introduction would thus bring about a new tax coverage both in relation to certain taxpayers, as well as to the tax authorities, and there could arise certain difficulties particularly during the transition period.

Finally, it has been stated that particularly in the case of T.V.A., it would be eminently desirable in order to simplify the conditions of application of the system to admit the least possible number of exemptions and that there are no special provisions apart from the T.V.A. system. In other words, the scope of the tax must be as wide as possible, and consequently, on the one hand should include all stages of production and trading as well as the rendering of services, and on the other hand be extended over all products with the least possible number of exemptions, which moreover, would be in harmony with neutrality in relation to competition. Thus, it has been necessary to state that the good functioning of a T.V.A. system carries with it a limitation of the possibilities of applying special provisions and exemptions and therefore of restrictions on the freedom of governments to apply a fiscal policy taking into account economic and social requirements. But it must be noted that under a T.V.A. system, a similar result can be reached by substituting for exemptions, fixed reduced tax rates at a level likely to allow the operation of deduction of taxes paid at an earlier stage.

The possibility of applying a tax on retailers being hardly possible for all the Member countries, it seemed appropriate to study the following three alternatives:

- T.V.A. extending to the retail trade stage;
- T.V.A. extending to the wholesale trade stage;
- T.V.A. extending to the final production stage.

The first alternative is that which corresponds best to the requirement of a broad application set forth above. It brings about several advantages of technical policy, particularly the elimination of the necessity to set up definitions so as to limit the scope of application of the tax and of going on to corrections of the tax base in cases where the cycle is incomplete, and the reduction in the number of "mixed businesses"; that is to say of businesses which conduct a taxable business activity at the same time as an exempted activity or one outside the scope of the tax. On the other hand the equality of the tax burden is better assured for the consumer.

Moreover, the tax rate would be established at a level lower than that which would be necessary to obtain the same tax yield if the tax were levied up to the wholesale stage or up to the final production stage.

Nevertheless, it appeared that a T.V.A. system extended to the retail trade stage, even with certain arrangements tending to remove or simplify the taxation of the smallest taxpayers would not form a practical solution for certain countries which do not believe it possible or opportune to introduce taxation of retailers.

The other two alternatives which have been considered, allow a reduction in the number of persons subject to tax by limiting respectively the application of the tax to the producers and to the wholesalers, or solely to the producers; in the last case particularly, businesses which in general possess adequate accounts would remain subject to the tax. It should be noted nevertheless, that in the case of a T.V.A. levied up to the final production stage the exclusion of wholesalers will in practice only be partial, since a large part of these dealers make sales to producers and consequently would ask voluntarily to be subject to T.V.A.

Under these two alternatives, however, it would be necessary to set up definitions to outline the scope of the tax and to settle other technical problems. It will particularly concern establishing the sum of tax deductible in the cases of "mixed businesses"; these businesses whose number clearly varies in proportion to the scope of the tax, will only be able to deduct partially the tax paid at purchase according to a proportion which can be settled by different systems. In relation to investment goods, under the hypothesis where the tax which has been borne by them can be deducted immediately in its entirety, a system of adjustments will have to be anticipated to take into account the eventual variations in the proportion over time. On the other hand, where the tax is borne at an earlier stage it will be necessary in order to avoid distortions, to apply corrections to the tax base in the case of an incomplete cycle. These reductions, which according to the opinion of the majority of the delegations should only be made in the case of direct sale by a producer or wholesaler to a private person, would only be able in certain cases to give rise to cases of "buffer" effect. It is emphasised that the solutions to be adopted in these cases should in principle be more stringent the higher the tax rate may be.

The rates of T.V.A. applied by the Member countries should be relatively high. They should be increased or reduced according to whether the T.V.A. extends up to the final production stage, or up to the retail trade stage respectively, and according to whether the exemptions and other exceptional provisions can or cannot be maintained within narrow limits.

In relation to the possibility of reducing these rates, by means of introducing a complementary tax levied at the wholesale or retail trade stage, it is appropriate to refer to the notes made on this subject under point 1, page 71 and point 2, page 72, namely that a combination of a tax levied at the final production stage with a tax on wholesalers does not seem achievable and that the combination of a tax levied at the final production stage, or at that of wholesale trade with a tax on retailers does not seem to be able to form a general solution while different delegations consider that taxation of retailers is not achievable in their country. However, this does not exclude the possibility that certain countries can adopt a combination of a T.V.A. extending up to the production or wholesale trade stage with autonomous tax on sales levied at the retailers stage because this would not interfere with the good functioning of the Common Market.

From the preceding consideration it arises ultimately that, under the hypothesis where internal tax frontiers are retained, the adoption of a T.V.A. system by Member countries will have as a consequence, the elimination of three of the four disadvantages existing at the present time, and raised in the general introduction to the reports of the sub-groups A, B and C, namely:

- the difficulty of applying the average rates anticipated in article 97 of the Treaty of Rome;
- the encouragement of vertical concentration (integration) of business inherent in a cumulative "cascade" tax system;
- the complications which arise from a multiplicity of systems for international trade.

On the other hand it seems also according to the experience of Member countries which practice a T.V.A. system that the technical application of this form of taxation would not in general, encounter insurmountable difficulties particularly if it is considered that each country could choose between the different alternatives of T.V.A. which have been considered that which it believes to be best adapted to its internal situation and could bring within its system all desirable and possible simplifications.

Within the field of the hypothesis of the removal of tax frontiers between Member countries, it has appeared opportune to study two sub-hypotheses, namely:

a) The case where T.V.A. is applied with the same rates and unified exemptions in Member countries.

- If in this case the scope of T.V.A. in the six countries is the same, no distortion can normally be produced. But the removal of tax frontiers between Member countries would have the result that each country would be attributed with the receipts arising from the taxation of the value which is added within its territory. If, on the other hand, it is wished to assign receipts in their entirety to the country of destination, special measures must be considered, and are indicated in chapter D-1-1, page 66 et seq. Several delegations have expressed serious reservations concerning the possibility of a practical achievement of the measures considered for deliveries made by a person subject to tax to a person not subject to tax. For these last cases, which would clearly be the more numerous when T.V.A. only extends up to the final production stage or to wholesale trade, the sole solution would seem to be a procedure of financial compensation through a common clearing house or by other means.

- If, on the other hand, the scope of application of T.V.A. in the six countries is not identical (for example, one country extending T.V.A. up to the retail trade stage and another country up to the wholesalers or producers stage) distortions can arise, since although the rates may be common under the hypothesis, it is in general applied to differing tax bases. It must be noted that the size of the distortions is clearly greater in relation to deliveries within the Community by producers and wholesalers than in relation to those less numerous deliveries made by retailers.

b) The case where T.V.A. is applied in Member countries with rates and exemptions which are not unified.

Under this hypothesis, removal of tax frontiers does not appear possible if the scope of T.V.A. does not extend in the six countries up to the retail trade stage.

In the case where the scope extends in all the countries up to the retail trade stage, it does not appear to be excluded that such a T.V.A. could allow consideration of the possibility of removing internal tax frontiers without previously going on to unification of rates and exemptions. The putting into effect of this solution would be subject to the application of special measures intended to avoid distortions and to assign receipts in their entirety to the consumer country, this would return in a special form to the application of the principle of taxation on the country of destination (see chapter D-1-1, page 67 and 68).

Moreover, appropriate measures - which have, however, encountered certain reservations on the part of several delegations - should be taken for deliveries made beyond the frontiers to persons not subject to tax (private persons, businesses beyond the scope of the application of T.V.A.) to which must be added deliveries of non-deductible goods made to persons subject to T.V.A.

PART VI

COMPARISON OF THE MOST IMPORTANT FACTORS OF THE DIFFERENT SYSTEMS STUDIED BY THE SUB-GROUPS B and C

It has appeared useful to bring together in a single comparative Table the more important data of the taxation systems taken into consideration for the harmonization of the turnover taxes in the six countries of the Common Market, studied by the sub-groups B and C.

On the other hand, it did not appear necessary to mention in the Table the studies undertaken by sub-group A because these studies in practice, do not lead to harmonization, but to a replacement of physical controls at the frontier by controls on account books within the Member States, while maintaining the different taxation systems currently in operation in each of the six countries.

COMPARATIVE TABLE OF THE TURNOVER TAX SYSTEMS STUDIED

	Tax at wholesaler's stage (Part IV)	Tax at last stage of production (Part V; chapter B)	Production tax with fractional payments (Part V; chapter C)	Tax on added value (T.V.A.) (Part V; chapter D) Extended to retailer's stage	Extended to wholesaler's stage	Extended to the last producer's stage
	I	II	III	IV-a	IV-b	IV-c
A. Nature of the tax and regulations applicable to deliveries of goods.	General tax (1), levied on a single occasion. Point of impact: delivery by a registered person (producer or wholesaler) to an unregistered person (retailer or final consumer). Suspension (2) of tax for deliveries between registered persons.	General tax (1), levied on a single occasion. Point of impact: delivery by the registered producer to an unregistered person (wholesaler, retailer, final consumer). Suspension (2) of tax for deliveries between registered producers.	General tax (1) levied on all stages of production but which in principle only affects the price of goods once, since at each stage the tax affecting purchases and imports of raw and similar materials is deducted from the tax liable on sales. ("physical" deduction).	General tax (1) levied on all production and trading stages but which only affects the final price of goods once since at each stage tax on purchases and imports of raw and similar materials as well as investment goods, and the tax borne by general costs and services employed, are deducted from the tax liable on sales "physical and financial" deductions).	General tax (1) levied on all production and wholesale trade stages but which affects the normal wholesale price only once, owing to the "physical and financial" deduction method (see IV-a)	General tax (1) levied on all stages of production but which affects the final price of the production cycle only once, owing to the "physical and financial" deduction method (see IV-a)
	(1) By "general tax" must be understood a tax applying in principle to all products and not to certain categories of goods. (2) Although certain Delegations prefer in this case to speak of "tax exemption" ("exonération de la taxe", "Steuerbefreiung") the sub-groups have agreed in their reports to use the term "suspension of tax" ("suspension de la taxe", "Steueraufschub").					
B. Regulation applicable to investment and similar goods bought by a person liable to tax.	Investment and similar goods even if purchased by a registered person should be taxed.	As under I	Investment and similar goods even if purchased by a producer should be taxed.	Taxpayers can deduct tax on purchases of investment and similar goods ("financial" deductions).	As under IV-a	As under IV-a
C. Regulation applicable to services: 1. Not influencing the price of goods	Each Member country could apply an autonomous regulation.	As under I	As under I	As under I	As under I	As under I
2. Influencing the price of goods.	Taxation according to harmonized regulation. Services, even those rendered to registered persons or to providers of services, should be taxed, except for certain services (making-up goods) comparable to delivery of raw materials. So as to reduce the cumulative effect arising from this regulation, in certain cases lower rates or even exemption could be considered.	As under I (mutatis mutandis)	As under I (mutatis mutandis, thus no deductions for services rendered to producers).	Included in the T.V.A. system. Taxation bearing on services rendered to taxpayers subject to T.V.A. is deductible ("financial" deductions). For technical reasons it would be preferable that the rates applied to services are the same as those fixed for deliveries of goods.	As under IV-a	As under IV-a
D. Regulation applicable to imports of goods coming from third countries	No compensatory tax (1) for goods, other than investment and similar goods, imported by producers and wholesalers (registered persons). Simple compensatory tax (normal rate applied) (2) for other imports: investment and similar goods imported by registered persons as well as all imports made by unregistered persons.	No compensatory tax (1) for goods other than investment and similar goods, imported by producers (registered persons). Simple compensatory tax (normal rate applied) (2) for other imports; investment and similar goods imported by registered persons as well as all imports made by unregistered persons.	Simple compensatory tax (normal rate applied) (2) for all imports.	Simple compensatory tax (normal rate applied) for all imports.	As under IV-a	As under IV-a
	(1) If it is considered to achieve taxation entirely equal to that borne by similar national goods, it would be necessary to levy a compensatory duty according to an average rate to compensate for the tax burden arising from the taxation of investment and similar goods and of services (see points under B and C-2) (2) Under the same conditions as those mentioned above (1), it would be necessary to raise the normal rate by the average rate afore mentioned.	(1) As under I (2) As under I	(2) As under I			

	Tax at wholesaler's stage (Part IV)	Tax at last stage of production (Part V; chapter B)	Production tax with fractional payments (Part V; chapter C)	Tax on added value (T.V.A.) (Part V, chapter D)		
				Extended to retailer's stage	Extended to wholesaler's stage	Extended to the last producer's stage
	I	II	III	IV-a	IV-b	IV-c
E. Regulation applicable to exports to third countries.	Exports made by producers and wholesalers (registered persons): tax relief by simple exemption (1) Exports made by retailers (unregistered persons): tax relief (eventual) either by means of a simple or by means of a system of untaxed purchases (2). (1) If it is desired to achieve complete tax relief, it would be necessary to grant a special refund calculated according to an average rate so as to compensate for the burden arising from taxation of investment and similar goods and of services. (2) Under the same conditions as those mentioned under (1) it would also be necessary in this case to apply the special refund mentioned under (1).	Exports made by producers (registered persons): tax relief by simple exemption (1). Exports made by traders (unregistered persons): As under I (2). (1) As under I (2) As under I	Exports made by producers: tax relief by exemption together with a deduction or a simple refund of tax paid at purchase of raw and similar materials (1). Exports made by traders: As under I (2). (1) As under I (2) As under I	Exports made by persons liable to T.V.A.: Complete tax relief by exemption together with a deduction or a simple refund of the tax borne at all purchases of goods or services.	Exports made by persons liable to T.V.A.: As under IV-a. Exports made by retailers: tax relief (eventual) either by simple refund of T.V.A. paid at purchase, or by a system of untaxed purchase.	Exports made by persons liable to T.V.A.: As under IV-a. Exports made by traders: As under IV-b.
F. Neutrality (1) from a national viewpoint.	Incomplete neutrality because of cumulative effect arising from taxation of investment and similar goods and of services.	As under I	As under I	Neutrality is, as far as possible, complete.	As under IV-a	As under IV-a
	(1) Neutrality is, in general, the more complete the fewer the possible exemptions there may be.					
G. Incentive to business integration.	Relatively slight (see point F above).	As under I	As under I	Nil	Nil	Nil
H. Effect on the development of technical progress.	A certain hindrance because of taxation of investment goods, etc.	As under I	As under I	Favourable, above all in the case of total and immediate deductions of investment goods.	As under IV-a	As under IV-a
I. Eventual combination with tax levied at another stage.	Combination with autonomous tax on retailers would encounter difficulties of a practical, psychological and political nature in several countries.	Combination with an autonomous tax on wholesalers cannot form a satisfactory solution. In relation to combination with a tax on retailers: As under I.	As under II	Nil	As under I	As under II
J. Regulation applicable to trade between Member countries in the assumption of the retention of internal tax frontiers.	As under D and E above. If it is wished to waive compensation of the tax burden arising from taxation of investment and similar goods, and of services, the present difficulties in applying average rates (Art. 97) would be eliminated. If, nevertheless, it is desired to institute as complete compensation as possible, these difficulties would be considerably limited.	As under D and E above. Comments under I are also valid for this system.	As under D and E above. Comments made under I are also valid for this system.	As under D and E above. Present difficulties of applying average rates are dissipated.	As under D and E above. As under IV-a.	As under D and E above. As under IV-a.

	Tax at wholesaler's stage (Part IV)	Tax at last stage of production (Part V; chapter B)	Production tax with fractional payments (Part V; chapter C)	Tax on added value (T.V.A.) (Part V; chapter D) Extended to retailer's stage	Tax on added value (T.V.A.) (Part V; chapter D) Extended to wholesaler's stage	Tax on added value (T.V.A.) (Part V; chapter D) Extended to the last producer's stage
	I	II	III	IV-a	IV-b	IV-c
K. Consequences of the removal of internal tax frontiers (1) (2), if all the countries have adopted the same taxation system with identical scope (3), and if: 1. the rates and exemptions are identical (4).	No distortions of competition. Budgetary problems for deliveries other than those made between registered persons (producers, wholesalers; voluntarily registered retailers). The resolution of the problem by technical measures and if occasion arises, financial compensation, does not seem to be excluded.	No distortions of competition. Budgetary problems for deliveries other than those made between registered persons (producers; voluntarily registered dealers). This category of deliveries being more extended than under the system dealt with under I, the possibility of resolving this problem by technical measures will be more limited so that it will also be more necessary to fall back on financial compensation.	No distortions of competition. But the budgetary problem arises for all deliveries within the community. For deliveries between persons liable to tax (producers and dealers having opted to be producers) two possible solutions should be considered: - either through refunds granted by the country of origin (5) - or through "clearing" measures. For other deliveries the same situation arises as for those noted under II.	No distortions of competition. But the budgetary problem arises for all deliveries within the Community. For deliveries between persons subject to the tax (the great majority of exchanges between countries) the same solutions occur as those shown under III. So as to resolve the problem for other deliveries (deliveries to private persons or to businesses not subject to tax and deliveries of non-deductible goods to taxpayers), technical measures (5) could be envisaged for a part, and as occasion arises, financial compensation for the rest.	As under IV-a, with the difference that the category of deliveries other than those between persons liable to tax - which raise the greatest difficulties, is more extended.	As under IV-a, but the category of deliveries under IV-b is still larger.
2. the rates and exemptions are different (4)	Some distortions and a budgetary problem exist for which a solution could not be found.	As under I	As under I	It seems possible to avoid distortions of competition by adopting special measures and to solve the budgetary problem arising for deliveries between persons subject to the tax (the great majority of intra-community deliveries) through "clearing" measures in such a way that the principle of the country of destination would be maintained. For other deliveries technical measures could be envisaged for a part, and as occasion arises, financial compensation for the rest (5).	As under I	As under I

(1) By the removal of tax frontiers is understood the elimination of refunds on exports and of compensatory duties on imports, as well as the removal of physical controls at internal frontiers.

(2) The majority of the delegations consider that also after the removal of tax frontiers the tax yield must benefit the consumer country. This question is shown in the Table by the term "budgetary problem". To resolve this problem, there must be considered among other matters:
- either certain technical measures whereby taxation, which according to the machinery of the system should take place in the country of origin, is shifted to the country of destination (indicated in the Table by the term "technical measures");
- or measures of financial compensation between Member countries through a common clearing house or by other means (indicated in the Table by the term "financial compensation");
- or under the systems including "tax on tax" deductions (III and IV):
  a) a procedure whereby deductions of taxes paid in other countries are restored by reimbursement by this other country; or
  b) a clearing procedure between Member countries of deductions granted by a Member country for taxes paid in another Member country (system shown in the Table by the term "clearing measures").

(3) If all the countries adopted a tax on added value (T.V.A.) with identical rates and exemptions but with differing scope (for example, one country extending T.V.A. up to the retail stage, and another country up to the wholesale stage or to producers), the removal of tax frontiers would bring about distortions of competition.

(4) Some delegations are of the opinion that if the rates and exemptions in Member countries are not identical, but very close, solutions identical with case (1) could be taken into consideration without running the risk of causing serious distortions.

(5) Several delegations have raised reservations about the possibility of achieving these measures in practice.

	I	II	III	IV-a	IV-b	IV-c
L. Obligations and formalities relating to the application of the systems from the point of view of fiscal technique: 1. For tax authorities	- Keeping registers. - Stronger inspection service (systematic control of deliveries made under suspension of tax). - Limited number of persons paying tax.	As under I	Systematic control of sums of physical deductions.	As under III (control of physical and financial deductions).	As under IV-a	As under IV-a
2. For tax payers	- Making sure that the purchaser is a registered person.	As under I	Systematic fixing of deductible sums.	- Systematic fixing of deductible sums, also for financial deductions. - No difficulties concerning distinction between different taxpayers (1).	As under IV-a	As under IV-a

(1) In systems with a more limited scope there are certain difficulties of delimitation.

PART VII

CONSEQUENCES OF THE CHANGE FROM ONE TAXATION SYSTEM TO ANOTHER

All substantial reform of a turnover tax system is likely to bring about repercussions of an economic, budgetary or technical character which can cause more or less serious disturbances in the order existing at the time of the introduction of the new system.

It is clear that each government in taking into consideration the possibilities of adopting a new system within the framework of the harmonization of turnover taxes, will insist on being able to foresee as far as possible, the more important economic, financial and administrative changes which arise from a change from the current system to a new system.

Therefore, the sub-groups have considered it indispensable to draw attention to this problem that they have not studied deeply, however. The difficulties in question moreover, arise in very different ways from country to country, so that it does not seem suitable to study the details within a multilateral framework. On the other hand, it seems premature at the moment to study all the implications which could arise during the change from each system current in each of the six countries to one of the systems studied by the sub-groups.

For these reasons the sub-groups considered they could limit in a general way some of the more notably repercussions which can be expected in certain circumstances from a reform of the system, while proposing to reserve to a later stage the study for each country, of some difficulties arising from the change from the current system to the system under consideration within the aim of harmonization.

The consequence of a change of system can in particular bear on:

A. The structure of prices and, under certain conditions, the general level of prices;

B. The effects of cyclical conditions;

C. Transitional difficulties in the field of the technical application of the new system;

D. Yield from the new tax.

A. Structure and level of prices

Each change in the system is likely to bring shifts in the obligation to pay tax, and consequently, commencing from the idea that the tax is shifted on as part of the prices, to bring modifications in the structure of prices.

Let us take as a first example the case of the replacement of a cumulative cascade tax system, bearing on all stages of the production and distribution cycles, at the same rates, by a tax system levied at the last production stage. Let us still further suppose that the rate of production tax is set at a level such that the final tax burden borne by a certain product is equal to the average tax burden supported by the same product under the cascade system (the average tax burden being settled by a product passing through a normal number of stages to which normal profit margins are applied).

A first indication shows that the tax will not be levied in the stages prior to and after the stage of the last producer. From this it arises that at earlier stages there will be occasion to reduce prices; the size of these reductions will increase at each stage. The last producer on the other hand, will have to apply an increase in his sale price to the extent that the increase in tax to be paid by him is higher than the reduction in his purchase price. At stages following that of the last producer, an increase in price will be produced, whose size decreases at each stage to become nil at the last stage of distribution.

For products whose production and distribution cycle and profit margins correspond to those of an average product, there will, therefore, be no modification of the final tax burden, but only a shift of the obligation to pay tax and consequently, a modification of the structure of prices in the cycle passed through.

However, for products which have borne a tax burden under a cumulative cascade tax system lower or higher than that arising from the single phase production tax, increases or reductions in the general level of prices may appear.

These modifications arise exactly from the greater neutrality characteristic to a single phase production tax which in general will eliminate discrimination between products passing through short production cycles and those passing through long cycles.

Influences on the level of prices can in effect be different according to the extent of integration attained in a certain economic sector.

In a sector where integrated and unintegrated businesses conduct their affairs at the same time, it may be that prices are settled by the unintegrated businesses. In this case a reduction in the level of prices may be expected, inasmuch as the burden occurring from the production tax would be lower than that borne under a cumulative cascade system by unintegrated businesses, and the integrated enterprises would see their tax advantage which they enjoyed priviously, disappear. If on the other hand, the prices are settled previously by integrated businesses at a determined level, the change of system could lead to a general rise in the price level of the sector in question.

The change-over from a cumulative cascade tax to a single phase tax can also bring about price movements on international markets, with possible repercussions on the trade balance for countries where the refunds at exportation have been lower than the real tax burden borne by the exported goods and the compensatory duties too slight to tax imported goods to the same extent as similar domestic products. The single phase production tax in effect allows fairly exact compensation at importation and exportation.

It appears useful to take into consideration the case where a cumulative cascade tax system is replaced by a system of added value tax as a second example.

The following Table conveys an impression of the modifications at each stage in the event of a change to an added value tax (T.V.A.), if this latter tax were applied at a rate of 10% (nominal rate = 11.111% real rate).
Additions (+) and subtractions (-) from the tax sums shown in the Table are expressed as a percentage of gross turnover not including tax.

Value added as percentage of gross turnover not including tax	Addition (+) or subtraction (-) at each stage if the current rate at this stage is:						
	0%	1%	2%	3%	4%	5%	6%
5	+ 0,55	- 0,45	- 1,49	- 2,54	- 3,61	- 4,71	- 5,83
10	+ 1,11	+ 0,10	- 0,93	- 1,98	- 3,06	- 4,15	- 5,27
20	+ 2,22	+ 1,21	+ 0,18	- 0,87	- 1,94	- 3,04	- 4,16
30	+ 3,33	+ 2,32	+ 1,29	+ 0,24	- 0,83	- 1,93	- 3,05
40	+ 4.44	+ 3,43	+ 2,40	+ 1,35	+ 0,28	- 0,82	- 1,94
50	+ 5,55	+ 4,55	+ 3,51	+ 2,46	+ 1,39	+ 0,29	- 0,83
60	+ 6,67	+ 5,66	+ 4,63	+ 3,57	+ 2,50	+ 1,40	+ 0,28
70	+ 7,78	+ 6,77	+ 5,74	+ 4,68	+ 3,61	+ 2,51	+ 1,39
80	+ 8,89	+ 7,88	+ 6,85	+ 5,80	+ 4,72	+ 3,63	+ 2,51

The foregoing considerations are based on the entirely theoretical supposition that the tax paid by a business is reflected to its full extent in the sale price. But in terms of economic reality, the possibility of passing on the tax depends in large measure on the condition and elasticity of the market.

In certains market situations the secondary effects on the calculation of prices brought about by the tax must be considered as well. These secondary effects are notably likely to arise in economic sectors where profit margins are calculated as a percentage of the purchase price in-

cluding tax. The same situation arises in all businesses where general costs and depreciation are calculated according to a percentage of the purchase price of certain materials, including tax. Thus, if the sale price at a certain stage is increased because of a rise in the tax effecting this stage, the base for the calculation of profit margin, for general costs, etc. of the following economic stage, will also be increased. Consequently, the rise in the tax at a certain stage results in rises in price at later stages which are higher than the rise in tax which caused those rises in price. Correspondingly, reductions in taxation which result in price reductions at a certain stage can, for the same reasons, lead to price reductions at following stages which exceed the original tax reduction.

It must be noted that the earlier price modifications are brought into the production and distribution process, the more numerous the stages will be where the secondary effects of price calculation and consequently the supplementary price increases, can arise and accumulate.

However, there can be no doubt that the effects on the price level from a change of taxation systems will depend in large part on the economic situation existing at the moment of the change of the system. In effect, the more the market favours sellers, the less their goodwill can be counted upon to pass on an equivalent reduction in prices. Moreover, in such market conditions it is possible, for instance through the rounding off of figures, that certain increases in prices exceed the real rise in the tax burden. But it is not excluded that measures for intervention taken by governments could contain within reasonable limits the effects on prices arising from a change in the taxation system.

B. Effects of cyclical conditions

Leaving aside the effects on the economic cycle which can emanate from any change of tax system if this leads to a modification of the general price level, it is appropriate to give some account of the cyclical effects that can occur from the introduction of an added value tax.

The cyclical effects particular to the adoption of a T.V.A. system, arise from the fact that with this system there is introduced by the expedient of "financial" deductions (cf. Part V, chapter D-1-f, page 62) the non-taxation of purchases of investment goods.

It can be expected in effect, that the putting into effect of a T.V.A. system with provision for total and immediate deductions brings a growth of investment. This happening would clearly not be unwelcome if the economy was in a depressed state at that time. If on the other hand, the introduction of T.V.A. coincides with an expansion of the economy and a high level of investment, the incentive to invest would nevertheless be stimulated and this would bring an accelerated boom which would be against economic requirements. These effects would naturally be diminished if the method of proportional deductions "over time" were applied (cf. Part V, chapter D-1-f, page 63).

C. Transitional difficulties in the field of the technical application of the new system

Each change of system carries with it the application of new concepts and regulations, which will inevitably raise a number of problems of interpretation, which can only be resolved after a lengthy period of transition during which the administration, legal authorities and fiscal science will be called upon to clarify doubtful points and to apply or suggest certain improvements to imperfections which appear during the practical application of the new system. In any case, it must be expected that a fundamental reform of the system, at least during the transitional period, brings about difficulties in relation to the technical application of the system by businesses and tax authorities and that certain legal uncertainties will exist during this period. The tax authorities will only be able to face these difficulties arising from the change to a more complicated system by an increase in qualified staff.

The change from one system to another moreover, raises the question whether certain technical arrangements for the transitional period should be considered; among them can be listed: measures for adapting, by means of reimbursements or back duties, the tax burden on stocks of goods, because these stocks at the time of the change-over bore a higher or lower tax burden than that which is contained in the new system. On the assumption of a change to a system granting "tax on tax" deductions (production tax with fractional payments or T.V.A.) a particular problem arises concerning the deduction of taxes borne by stocks of deductible materials, as well as - in the case of T.V.A. - investment goods not yet written off.

D. Yield from the new tax

The change from an existing system to another, risks to a greater or lesser degree causing differences in the yield coming from the new system in relation to that from the current system. In the first place it is extremely difficult to settle the rates and exemptions for the new system so as to guarantee the same yield as with the existing system. On the other hand, it is hardly possible to foresee the possible changes in the customs and structure of production and trade which can result from a new system.

APPENDICES

Appendix A

A. List of persons present at the meetings of the sub-groups A, B and C

A. At the meetings of the three sub-groups A, B and C, the following took part as permanent delegates: -

- For the European Economic Community:

Mr. Jansen	Chairman - Head of the "Indirect Taxes" Department
Mr. Lang	Member of the "Indirect Taxes" Department
Mr. Guieu	Member of the "Indirect Taxes" Department
Mr. Oudshoorn	Draftsman of the "Indirect Taxes" Department
Mr. Rivano	Draftsman of the "Indirect Taxes" Department

- For the German Federal Republic:

Mr. Juretzek	Ministerialdirigent - Ministry of Finance
Mr. Mesenberg	Regierungsrat - Ministry of Economic Affairs

- For Belgium:

Mr. Robert (until 30.11.1961)	
	Inspecteur Général - Ministry of Finance
Mr. Fonson (from 1.12.1961)	
	Inspecteur Général - Ministry of Finance
Mr. Ceulemans	Chef de Bureau - Ministry of Finance

- For France:

Mr. Frapsauce	Sous-Directeur - Ministry of Finance
Mr. Mespoulhès	Administrateur civil - Ministry of Finance

- For Italy:

Mr. Spalletta	Inspecteur Général - Ministry of Finance
Mr. d'Ovidio	Directeur de Section - Ministry of Finance

- For Luxembourg:

Mr. Wirtgen	Directeur - Ministry of Finance
Mr. Als	Inspecteur de Direction - Ministry of Finance

- For the Netherlands:

Mr. Millenaar	Director - Ministry of Finance
Mr. Os	Chief-Inspector - Ministry of Finance

B. At certain meetings of the sub-groups the following took part as representatives: -

- For the European Economic Commission:

Mr. Schulze - Brachmann	Head of the "Direct Taxes" Department
Mr. Campet	Reporter
Mr. Vandamme	Member of the "Direct Taxes" Department
Mr. Heerkens	Member of the "Direct Taxes" Department
Mr. Mongelli	Member of the "Special Cases" Department
Mr. Van Leeuwen	"Direct Taxes" Department

- For the German Federal Republic:

Mr. Mersmann	Ministerialdirector - Ministry of Finance
Mr. Frank	Ministerialrat - Ministry of Finance
Mr. Hahnfeld	Ministerialrat - Ministry of Finance
Mr. Hörner	Oberregierungsrat - Ministry of Finance
Mr. Adami	Permanent Mission of the German Federal Republic

Appendix A

- For Belgium:

Mr. Van Aken	Directeur - Ministry of Finance
Mr. Matthijs	Chef de Division - Ministry of Finance

- For France:

Mr. Coucoureux	Permanent Mission of France
Mr. Dessaux	Permanent Mission of France
Mr. Maymard	Ministry of Finance - Direction Générale des Douanes

- For Italy:

Mr. Formica	Directeur de Section - Ministry of Finance
Mr. Tamburro	Inspecteur Supérieur - Ministry of Finance
Mr. Pressich	Conseiller - Ministry of Finance
Mr. Liguori	Expert - Ministry of Foreign Affairs
Mr. Bormioli	Expert - Ministry of Finance

- For the Netherlands:

Mr. Tuk	Director General - Ministry of Finance
Mr. Van Alphen	Permanent Mission of the Netherlands
Mr. Smulders	Referendaris - Ministry of Economic Affairs

Appendix B

B. List of meetings of the sub-groups

Sub-Group A

1st Meeting	10.11.1960	Report IV/6942/60
2nd Meeting	24. 2.1961	Report IV/2045/61
3rd Meeting	4.12.1961	Report IV/ 163/62

Sub-Group B

1st Meeting	26/27. 4.1960	Report IV/2723/60
2nd Meeting	5/6. 7.1960	Report IV/4298/60
3rd Meeting	20/21. 9.1960	Report IV/5501/60
4th Meeting	10/11. 1.1961	Report IV/ 529/61
5th Meeting	22/23. 2.1961	Report IV/2092/61
6th Meeting	14. 4.1961	Report IV/3017/61
7th Meeting	9/10. 5.1961	Report IV/3446/61
8th Meeting	14/15. 6.1961	Report IV/4787/61
9th Meeting	5.12.1961	Report IV/ 164/62

Sub-Group C

1st Meeting	28/29. 4.1960	Report IV/2722/60
2nd Meeting	7/8. 7.1960	Report IV/4609/60
3rd Meeting	22/23. 9.1960	Report IV/5326/60
4th Meeting	8/9.11.1960	Report IV/6230/60
5th Meeting	21/22. 9.1961	Report IV/6778/61
6th Meeting	from 26 to 31.10.1961	Report IV/8318/61
7th Meeting	7.12.1961	Report IV/ 165/62

The Sub-Groups held their final meeting on 15.1.1962.

C. Outline of British Purchase Tax and Swiss Federal Turnover Tax

Appendix C

British Purchase Tax

1. Taxable goods

Certain goods laid down in 35 groups.

2. Taxpayers

Registered producers and wholesalers (all traders having gross annual sales exceeding £ 500 are obliged to register).

3. Taxable operations

a) Sales made by registered persons to unregistered persons.

b) Deliveries made by wholesalers to their own sales offices.

c) Imports and purchases of taxable goods by unregistered persons.

d) Imports and purchases of taxable goods by registered producers or wholesalers, not destined to be used as raw materials or to form stocks.

e) Own consumption of taxable goods by registered producers or wholesalers.

4. Tax base

The tax base is the wholesale value. (If the buyer has for whatever reason profited from a privileged price, the price paid will be increased for the application of the tax - uplift system).

5. Rates

There are four rates: 5,15,30,60%, according to the type of goods.

6. Exports

Exports are exempt from purchase tax.

7. Investment goods

In principle, investment goods are not affected by purchase tax. Thus the cumulative tax effect is avoided.

Swiss Federal Turnover Tax

1. Taxable Goods

All goods except for certain exemptions.

2. Taxpayers

Registered producers and wholesalers. Registration is obligatory.

3. Taxable operations

a) Sales made by registered producers or wholesalers to unregistered persons (retailers or consumers).

b) Sales of machines and tools to those liable to tax who use them in businesses (the industrial purchaser is thus taxed in the same way as the final consumer).

c) Own consumption (use for private ends and in certain cases also for professional ends, of things bought by a registered person under exemption provision or manufactured by him).

d) Imports made by unregistered persons.

4. Tax base

The tax base is the charged or agreed price. In cases of own consumption, the tax is levied on a fictitious wholesale price.

5. Rates

General rates are fixed: 5.4% on sales to retailers; 3.6% on sales to consumers. Certain consumption goods are exempted.

6. Exports

Exports are exempt. No refund is granted for exported products.

7. Investment goods.

Machines and tools are taxed. The cumulative tax effects resulting from this are not compensated by refunds at exportation.

Appendix D

MEMORANDUM

D. Memorandum concerning the effect of the taxation of investment goods on prices and rates under a turnover tax system levied at the wholesale stage

For employment in the discussions of sub-group B on the consequences of the taxation of investment goods within the framework of a taxation system at the stage prior to that of retail trade, the study in question contains:

I. Calculations of the incidence of amortization on the total turnover of the producer's and wholesaler's group;
II. Calculations in order to settle the differences of rates of such a tax in the two cases where investment goods are or are not taxed, assuming that the tax must achieve the same yield.

I.

By means of input-output analysis it is possible to calculate the incidence of amortization on total turnover for the producer's and wholesaler's group in its entirety, as well as for individual business branches. Input-output analysis shows the structure of costs, (raw materials, wages, amortization, profits, etc.) by branch of business activity and for the economy as a whole, as well as the structure of final demand (consumption, exports, investment, etc.) and sales by each branch of business activity in relation to this final demand. Moreover, these analyses show all intermediate deliveries between one branch of business activity and another. For this reason, in this study it was possible to isolate internal deliveries in the producer's and wholesaler's group.

Such studies exist for 1953 for Germany, Belgium, and Italy, and for the Netherlands for the years 1948-56. For this reason, 1953 has been taken as the base year for calculations. For reasons of comparison, the year 1956 has been added to the calculations for the Netherlands.

The studies consulted are as follows:
- Analyse Input-Output de l'Economie Belge en 1953 du Département d'économie appliquée de l'Université Libre de Bruxelles, 1958.
- Volkswirtschaftliche Gesamtrechnung, einschliesslich input-output-Analyse mit Zahlen für die Bundesrepublik Deutschland von Prof. Dr. Wilhelm Krelle, 1959.
- Notes introductives à l'étude et à l'application de la méthode "input-output" de Vera Cao-Pinna avec un tableau input-output pour l'année 1953.
- De productie-structuur van de Nederlandse volkshuishouding Deel I. Input-Output tabellen 1948-1956. Publikatie van het Centraal Bureau voor de Statistiek, 1960.

It must be noted that input-output analyses always have a more or less approximate character because the statistics on which they are based are often incomplete. These studies are made by organizations managed by private persons and without any official capacity, except for the study relating to the Netherlands which was conducted by the Central Statistical Bureau (C.B.S.). The information relating to France has been supplied by the French Delegation.

Overall incidence of amortization

In calculating the overall percentage in the total turnover of a group of producers and retailers represented by amortization, the group has been considered as including: industrial businesses, mining, production of gas, water and electricity, agriculture and wholesalers; in other words all entrepreneurs except retailers and providers of services.

The total turnover in question includes all deliveries abroad (exports), to the retail trade or directly to consumers, to providers of services, to public authorities (except public businesses of an industrial nature) as well as deliveries of investment goods within the producer's and wholesaler's group. Intermediate deliveries of the producer's and wholesaler's group, except those relating to investment goods, are not included. It is necessary to include exports since it must be allowed that amortization of investment goods is also reflected in the prices of goods exported.

The sum of amortization is thus composed of:

- all amortization of the producer's and wholesaler's group, without distinguishing the destination of the goods (deliveries inside as well as outside the group). By this method amortization reflected in the prices of semi-finished produc sold by one branch of business activity to another is taken into consideration.
- amortization reflected in the prices of services rendered to the producer's and wholesaler's group by unregistered businesses.

From this it was possible to prepare Table 1 in the Appendix.

It must be noted that the size of the percentage of amortization in relation to turnover has no significance whatsoever for the calculation of rates of tax for the two cases where investment goods are or are not included in the taxable sum, because this amortization relates to investments made in the past. To obtain the same tax yield for the two types of taxation mentioned, consideration must be given to investments made in the course of a certain year which are only reflected in the prices of goods during the following years during the course of which they are amortized. It must be noted moreover that in a dynamic economy investments are always much higher than amortization, but also that inflation makes the nominal sum of investment more important than that for amortization.

Incidence of amortization according to branch of business activities.

Finally the incidence of amortization in relation to turnover has been calculated for selected business sectors. In this instance, the total turnover of each sector in question has been considered, be it in relation to other sectors of industry or destined for consumption, export, etc. Such a method was necessary because amortization is clearly reflected in the prices of all sales made in the sector concerned.

In the same way of reckoning, amortization belonging to each sector had to be increased by the amortization included in purchases coming from other sectors. For practical reasons, the overall percentage of amortization outlined above has been applied to the semi-finished products and services coming from other sectors.

Table 2 gives the results of calculations based on this method. It must be noted that the extent of each sector is not the same for each country considered, but it appears that the inaccuracies arising from these differences are not such as to impair comparison of the results. On the contrary, in considering the aim of the study, the results are little influenced by these differences.

It appeared useful to include the transport sector because amortization is rather important in this sector.

Conclusions concerning the cumulative effect of double taxation of investment goods.

It results from Table 1 that the effect of double taxation of investment goods amounts to:
- from 0.57 - 0.82% of the overall turnover of the producer's and wholesaler's group if the tax rate is 10%.
- from 0.85 - 1.23% if the rate is 15%.
- from 1.14 - 1.64% if the rate is 20%.

In relation to the different sectors, it can be deduced from Table 2 that double taxation has the following effect:

1. with a tax rate of 10%:
   - from 0.42 - 0.86% for metal industry;
   - from 0.53 - 0.92% for chemical industry;
   - from 1.34 - 2.60% for electricity, gas and waterworks.

2. with a tax rate of 15%:
   - from 0.63 - 1.29% for metal industry;
   - from 0.80 - 1.38% for chemical industry;
   - from 2.01 - 3.90% for electricity, gas and waterworks.

Appendix D

II

The second part of the study is intended to give an estimate of the difference of the tax rates at the wholesaler's stage which it would be necessary to apply in order to obtain the same total tax yield whether or not it is desired respectively to grant exemption for investment goods within the producer's and wholesaler's group. In order to reach the conclusions in view, it is sufficient to settle the relationship of the total taxable turnover for the two alternatives.

This total taxable turnover is made up as follows:

1. All the deliveries (investment goods and other goods) of the producer's and wholesaler's group:
   a) to the retail trade and to consumers;
   b) to providers of services (except air and sea transport);
   c) to public authorities.
2. All imports destined for the purchasers mentioned under 1.
3. Under the assumption that deliveries of investment goods within the producer's and wholesaler's group will be taxed: all these deliveries as well as investment goods imported by this group.

The relationship of the rates to be applied under the regulations of the two systems will be the inverse of the relationship between the total taxable turnovers.

The sums which make up the total taxalbe turnovers can be found by referring to the publications mentioned above. But the distribution of the overall sum of investment goods cannot be traced through to their destination, that is to say investment goods intended for the producer's and wholesaler's group or for others.

For this reason the distribution has been arbitrarily settled.

The distribution of amortization between the two groups has been calculated for a particular year and this distribution has been applied to the total of deliveries of investment goods to find their destination.

In this way the results of the calculations are set out in Table 3. On line (4) the relationship between the total taxable turnovers is set down. On line (5), there is the same relationship but inversely stated and on the hypothesis that the rate of tax will be 20% and that investment goods destined for the producer's and wholesaler's group are not taxed. This table makes it evident that if investment goods are taxed, the rate could be lowered by 2.5 to 3.5 points.

TABLE I

	Germany 1953	Belgium 1953	France 1953	France 1956	Italy 1953	Netherlands 1953	Netherlands 1956
	Million D.M.	Milliard Fr.B.	Milliard NF		Milliard L.	Million Fl.	
a) Deliveries by: - industry, mining, gas, water and electricity works, - farmers, - wholesalers, for: - export, - retail trade, - consumers, - renderers of services, - public authorities, - investment.	118.611	352.82	132,2	168,4	11.216	23.742	32.020
b) Amortization by businesses listed under a), increased by amortization included in services rendered to these businesses.	9.913	25.51	10,1	11.5	788	1.482	1.809
c) Overall incidence of amortization in percentage in relation to total turnover of businesses listed under a).	8.3	7.2	7.6	6.8	7.0	6.25	5.7

TABLE II

	Germany 1953	Belgium 1953	Italy 1953	Netherlands 1953	Netherlands 1956
1. Coal	11,2	8	-	9	8.9
2. Textiles	8.1	6	6.8	5.2	4.8
3. Paper	-	6,9	7.25	7.7	6.4
4. Chemicals	9.2	5.7	7,8	6	5.3
5. Metals	9.8	8,7	9.2	5.6	5.5
6. a) metal working industry	8.6	5.6	6.7	4,7	4.2
b) electro-technical	6.9			6.4	4.9
7. Electricity, gas and water	16.8	19.1	13.4	26	22,4
8. Transport	14.7	17,4	13.3	15.6	13.3
Overall percentage	8.3	7.2	7.0	6.25	5.7

TABLE III

	Germany 1953	Belgium 1953	France 1953	France 1956	Italy 1953	Netherlands 1953	Netherlands 1956
	Million D.M.	Milliard Fr.B.	Milliard NF		Milliard L.	Million Fl.	
1. Deliveries within the country by producer-wholesalers group outside that group and imports by unregistered persons (= taxable total turnover under the first hypothesis) (a).	81.662	251.17	99,3	124,4	8.654	14.901	21.797
2. Investments made by the producers-wholesalers group.	15.038	33.73	16.2	24.6	1.687	2.943	4.767
3. Taxable total turnover under the second hypothesis (a) (= 1 + 2).	96.700	284.90	115,5	149	10.341	17.844	26.564
4. Relationship of taxable total turnovers under the two hypotheses.	84,4/100	88,2/100	86/100	83.5/100	84/100	83,5/100	82,5/100
5. Relationship of tax rates, fixing the percentage rate under the first hypothesis at 20%.	20/16.9	20/17.6	20/17.2	20/16.7	20/16.8	20/16.7	20/16.5

(a) First hypothesis: exemption of investment goods delivered to registered businesses;

Second hypothesis: investment goods are taxed.

BOOK II

REPORT OF

THE FISCAL AND FINANCIAL COMMITTEE

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REPORT OF THE FISCAL AND FINANCIAL COMMITTEE

I. COMPOSITION, FUNCTIONING AND COMPETENCE OF THE FISCAL AND FINANCIAL COMMITTEE. GUIDING CONCEPTS AND FUNDAMENTAL ASSUMPTIONS OF THE PRESENT REPORT

A. Composition and functioning of the Committee

1. Establishment of the committee

The Fiscal and Financial Committee (hereafter called the FFC) was set up by a decision of the Commission of the European Economic Community of 5th April, 1960. Its competence is laid down in the Mandate and Commentary which accompanies it [Appendix A] (1). It is clear that the specific provisions of the Treaty of Rome [Appendix B] (2) also constitutes a parallel determinant factor. The Committee's concept of the work which has been assigned to it, is set forth in the considerations mentioned under 1, B, 2 (page 98).

2. Composition of the FFC

The Committee was made up of the following persons:

Chairman:
Prof. Dr. Dr. h.c. Dr. h.c. Fritz Neumark, Frankfurt am Main

Members:
Prof. Dr. Willy Albers, Kiel
Prof. Alain Barrère, Paris
Prof. Cesare Cosciani, Rome
Dr. Joseph Kauffman, Member of the State Council, Luxembourg
Prof. Maurice Masoin, Brussels
Prof. Dr. Bernard Schendstok, The Hague
Prof. Carl S. Shoup, New York
Prof. Gaetano Stammati, Rome
Prof. Georges Vedel, Paris

Additionally taking part in the meetings of the Committee, either regularly or occasionally, were:

Mr. Hans von der Groeben, Member of the Commission of the European Economic Community
Mr. E. Wirsing, Deputy Chief of the Cabinet of Mr. von der Groeben
Prof. Dr. Hans Möller, Counseler of the Commission of the EEC
Dr. P. Verloren van Themaat, Director General for Competition
Mr. P. Nasini, Director, Directorate of Fiscal Affairs
Mr. Ch. Campet, Chief of a Division in the Directorate "Harmonization of laws"
Mr. C. Pietra, Chief of a Division in the Directorate General of Economic and Financial Affairs
Mr. D.C. Breedveld, Division Member, Directorate General of Economic and Financial Affairs
Mr. G. Heerkens, Secretary of the Committee, Division Member of the Directorate of Fiscal Affairs
Mr. A. Romani, Secretary of the Committee, Division Member of the Directorate of Fiscal Affairs
Mr. E. Barral, Secretary of the Committee, Division Member of the Directorate of Fiscal Affairs

During the first meeting the Committee elected Professor Dr. Dr. h.c. Dr. h.c. Fritz Neumark of Frankfurt am/M, as Chairman. In accordance with the decision taken during the third meeting (2 and 3 December, 1960), the Chairman was additionally charged with the functions of General Reporter. While drafting the Report on the basis of the results of the meetings held, the General Reporter has benefited - especially as regards the elaboration of some parts of the Report - from the precious assistance of all the members of the FFC as well as of some of the members of the Commission mentioned above.

3. The FFC met as follows:

21 and 22 July 1960
26 and 27 August 1960
2 and 3 December 1960
14 and 15 September 1961
14 and 15 December 1961
8 June 1962
7 and 8 July 1962

(1) See page 161.
(2) See page 164.

Furthermore there was both written and verbal contact between Members of the Committee, between Members of the Committee and Members of the Commission or of the Secretariat.

4. The present version of the report was adopted at the meeting of 7th and 8th July 1962 in Paris after detailed discussion.

5. The Report in its entirety has been agreed by all members of the FFC. This does not exclude the fact that a more or less large minority of the Committee may not be in agreement with certain judgements, conclusions and propositions that are contained in the Report. The ideas of this minority in this Report have been brought together in the form of alternatives where they concern the most important questions. The minority, which moreover did not always consist of the same persons, considered however, that its opinions opposing those contained in certain chapters were not sufficiently important to hinder agreement on the entire Report.

6. As well as in the preparation of meetings and of the Report, the Commission has given outstanding support to the Committee by providing material, by making valuable suggestions and by assisting it with the task of organisation, for which things the Committee is deeply grateful. The members of the Committee are particularly grateful to Messrs. Nasini, Campet, Heerkens, Barral and Romani.

B. Competence of the FFC

1. Questions studied in the report of FFC under the Mandate granted and the commentary accompanying it:

The questions that the FFC must study in the first instance in conformity with the mandate which was granted and with the commentary that accompanies it, are as follows:

a) "Study if and to what extent the differences currently existing in the finances of Member States partly or even entirely hinder the establishment of the Common Market bringing into being and guaranteeing conditions analagous to these of an internal market."

b) "Study to what extent it is possible to eliminate these differences which more considerably hinder the development and functioning of the Common Market".

The fundamental idea that the Committee should take into account consequently derives from the expression "establishment of a Common Market bringing into being and guaranteeing conditions analagous to those of an internal market".
This formula has been the leading idea for the Committee for the preparation of the Report; the fulfillment of this formula even if it must be step by step, must in every way be the result of the general evolution of the E E C.

The complete final fulfillment of this objective would be achieved when the characteristics of the Common Market of the Member States coincide with those pertaining to the internal market of a country. The economic and social aspects pursued from a national standpoint would therefore be transposed to the Common Market level. These objectives are expressed in the Preamble to the Treaty of Rome, which states:

". . Decided to ensure the economic and social progress of their countries by common action;

Directing their efforts to the essential purpose of constantly improving the living and working conditions of their peoples;

Recognising that the removal of existing obstacles calls for concerted action in order to guarantee a steady expansion, a balanced trade and fair competition.

Anxious to strengthen the unity of their economies and to ensure their harmonious development by reducing the differences existing between the various regions and by mitigating the backwardness of the less favoured . ."

When the mandate given to the FFC mentions "the differences currently existing in the finances of Member States", it is in principle advisable to distinguish three levels at which these play a role.

a) Firstly, they concern the objectives assigned in a general way to economic and social policy. In this regard, it seems that there already exists a broad agreement between the Member States, so that the Preamble to the Treaty refers in effect to objectives already accepted by different States from a national standpoint.

b) Next, it is a matter of specifying the role assigned to the financial policy of public authorities in the achievement of the objectives quoted and in the setting up of an order of priorities for these objectives. It is here that the main disparities appear. They occur from the nature of the various countries and of their population, from peculiarities of a historical, psychological and sociological type which arise with respect to those countries and populations. They appear in the overall tax burden, in its composition (for example, the relation between direct and indirect taxes), in the degree of re-distribution of income and wealth desired or achieved through taxation, as well as in the way in which taxing power is shared between the State and other authorities, i.e. between the Central Government, States and Provinces and local authorities (equalization of finance).

The commentary on the Mandate of the FFC sides with the opinion according to which the objective of the financial policy is to a large extent a function of the national peculiarities of each Member State; the following phrase illustrates this well: "Regional differences in public policy in relation to revenue and expenditure resulting from regional differentiation ordered by nature or consolidated by history, are in no way necessarily undesirable and the aim of the EEC is not to favour the uniformity or central regulation of economic and social conditions" (1).

Consequently one of the most important tasks of the FFC - at the same time one of the most delicate - consisted of finding solutions of fiscal and financial policy which represent a kind of rational compromise between the necessity of eliminating or at least strongly reducing, in the interest of the optimum functioning of the Common Market, the fiscal or financial disparities hindering the free play of competition between the Member States on the one hand, and the expediency of not interfering in the policy of Member States anxious to maintain national peculiarities arising from natural conditions and/or historical evolution on the other hand. If these peculiarities give rise to distortions of competition they must be counterbalanced by measures other than measures of financial policy. After all, it must be assumed that they will automatically lose their importance to the extent that the Common Market will become a reality.

c) Thirdly, account must be taken of the instruments of national economic and financial policy. These instruments cause the major part of the financial disparities and the most serious of them. In this matter it is a question of concrete legal dispositions and provisions which, because they have been applied for many years, are embedded in the minds of citizens who consider them as immutable provisions, although they are in part not justified or are no longer justified as a result of objective necessities. Let us take as examples borrowed from the direct taxation field, analytical taxation (the schedule system) and the synthetic taxation of income, as well as the differing taxation of earned income as compared to income from capital (discrimination) and in the field of indirect taxation, the contrast between cumulative cascade taxes and single phase taxes bearing on turnover, the differences in nature and level between consumption taxes as well as the different methods according to which they are levied (State Monopolies as opposed to Excise Duties).

Although as indicated, historical circumstances or national peculiarities of each country largely explain all these differences, the necessity of maintaining them is most often entirely relative, so that Member States possess a more or less considerable liberty of action in this respect. This situation should be made use of to eliminate such of these disparities which risk hindering or falsifying the interplay of competition.

In short, it can be said that the three levels thus defined contain the possibilities as well as the limitations of a gradual alignment of the fiscal and financial policies of Member States.

It is from this outlook that the Committee believed it should take up its studies and fulfill the Mandate that the Commission has given to it.

The Competence of the Committee can be set forth as follows:

1. Establish if, and should the occasion arise, in what manner and to what point, the disparities existing in public finance (2) of Member States hinder or make completely impossible:

a) The creation of a common market which brings about conditions analagous to those of an internal market (3) and does not contain tax frontiers, as well as

(1) See page 161.

(2) The concept of "public finance" includes receipts and expenditure at all levels including "para-fiscal" operations such as social insurance.

(3) The bringing into being of "conditions analagous to those of an internal market" implies freedom of movement for businesses, investment capital and labour.

b) The achievement of other objectives of the Community, such as the encouragement of competition and of economic growth.

2. Study to what extent it is possible to eliminate or to compensate the greatest of the disparities referred to, above all without affecting certain local differentiations perfectly compatible with the achievement of the Common Market and with other objectives of the Treaty which have been brought into public expenditure policy and taxation policy as the result of regional dissimilarities conditioned by natural attributes and/or historical evolution and, on the other hand, without applying frequent alterations in the rates of exchange.

3. Show which financial policy it is appropriate to apply if it is not wished to disturb or distort competition between Member countries; leaving aside all measures disturbing competition or producing distortion of competition other than measures of financial policy.

4. Study under what conditions tax frontiers can be eliminated within the Common Market or at least, reduced to an indispensable minimum.

The "disparities existing in public finance" mentioned under 1) that the present report proposes to study bear on:

a) the overall total of public receipts (taxes) and expenditure in relation to the National Product,

b) the relationship of direct to indirect taxes,

c) the nature and level of indirect taxes, as general taxes (taxes on turnover) as well as special taxes (Excise Duties),

d) the nature and level of direct taxes, including incentives, special treatments and measures taken for the avoidance of double taxation,

e) the taxation of transport (in connection with the financing of infrastructure costs),

f) other taxes (on wealth, inheritance, the movement of capital, etc.),

g) the structure of public expenditure, particularly the absolute and relative level of the expenditure of public administration in the narrow sense and of defence expenditure on the one hand, and on the other hand public consumption expenditures, investments and transfer of income prompted by social policy (subdivided into transfers of income and subsidies).

2. Remarks on the terms of reference.

a) Object of the report.

1) The purpose of the Committee is not to rough out a sort of "ideal taxation system", anticipating for each Member State from the aspect of the objects of integration, a combination of taxes of a particular type. Such a task, even supposing that it could have a satisfactory theoretical solution and not greatly exceed the scope of the work of the Committee would just simply not be considered because the factors and motives for integration only constitute one aspect in the complex of factors and motives which determine each national taxation system, and because the objective of the Common Market is not uniformity but solely harmonization of the tax systems of the Member States (cf. page 102).
A fortiori, it is not possible to provide the basic principles for an "ideal system for expenditure".

2) The Report is rather concerned with the disparities arising from the tax systems of the Member countries, namely: disparities bearing on the overall level of taxes, the composition of the tax burden with regard to the relative weight of different component parts of the system, the form (type) particular taxes take in the different countries on the one hand; disparities bearing on the level of significant particular taxes, including discrimination arising therefrom, on the other hand. The importance of such disparities can be accentuated by the psychological reactions that they can cause in interested circles; nevertheless, these disparities fall within the framework of this Report solely to the extent that it is assumed that they are a hindrance over short or long term to the objectives envisaged by integration.

3) If the tax legislation of the sic countries contains provisions that are similar in many essentials but nevertheless have effects likely to distort the interplay of competition, they come altogether within the scope of the study.

4) In relation to public expenditure, there must also be considered as a matter of first importance within the framework of the present Report, those expenditures which by their nature or differing level might interfere with the achievement of the objectives of integration.

5) The financial policy of the public authorities (budgetary policy), considered as arising from measures taken in relation to revenue and expenditure policy will be mentioned only to the extent that disparities of this type can hinder the approximate synchronisation of short and long term economic growth of Member States and thus upset the equilibrium in the balance of payments.

b) Objectives of integration assigned to financial policy

As brought out in the terms of reference and as later explained in detail, harmonization of the taxation systems and financial policies of the Member States must finally lead to the conclusion that measures of financial policy should no longer have any effects running contrary to the bringing into being of conditions analogous to those of an interior market for trading operations among the Six. It must particularly be studied if, how, and to what extent the abolition of Customs frontiers could also lead to the abolition of "tax frontiers".

Another clear objective of integration is the avoidance of all taxation and other discrimination based on nationality or "tax domicile". It should moreover, be managed so that no kind of obstacle of financial policy hinders the free movement of workers, of capital and of business enterprises. Care must, on the contrary, be taken that such movement can be achieved to the greatest extent possible just as when it concerned the movement of factors of production within a unified economic area. Nevertheless, this objective will be limited to a certain degree for the reasons already mentioned, reasons which make a complete unification of the taxation systems impossible and undesirable. In relation to the encouragement of competition, mentioned in the terms of reference, it is hardly possible to think of positive measures in the field of financial policy; rather is it sufficient to eliminate all measures curbing or distorting competition.

To sum up, it can be said that the objective must above all be to establish conditions of taxation and public expenditure similar to those that would exist within a unified economy, with the reservation of certain measures of regional policy (in part of a provisional nature) which could be taken in such an economic area.

Within this range of ideas, it must be considered that in a completely integrated State certain differences in the tax treatment of inhabitants can be accepted. On the other hand, as long as there does not exist an adequately developed solidarity within the E E C, such differences will give rise to psychological and political opposition to the Common Market. This could make the creation of the Common Market more difficult even when these differences in tax treatment do not result in a location of industries in places which are badly chosen from an economic point of view.

c) Some hypotheses for work and basic thoughts on which the present Report is based

1) The Report deals with the problems submitted from an essentially economic viewpoint, even though the Report does not lose sight of the legal framework of the Treaty. The Report reaches conclusions on several points which probably imply a modification of national and/or supranational juridical standards. The members of the Committee have nevertheless abstained from formulating precise juridical proposals for modifications of this type. They start from the assumption that the competent services will in time work out the legal and treaty provisions as they become necessary to achieve economic reforms recommended in the Report in relation to taxation and financial policy in the interests of realising the objectives of integration anticipated by the Treaty.

2) The FFC thinks that the indispensable measures for adaptation cannot be achieved in one step. Rather, it proposes a plan with steps or stages; the bringing into effect of measures at the different stages will be ordered by, the urgency of the measures on the one hand, and on the other hand, the political possibilities for their being put into operation.

The details are contained in the time table ("calendrier") which is placed at the end of the Report, page 153 et seq.

3) Certain proposals relate essentially to the achievement of intermediate objectives; they must attend to and/or assist the transition toward the ultimately desired solution. Other proposals concern the institution of relatively durable machinery. Belonging to them for example, are those which derive from the principle that for certain Member States or certain of their regions there remain considerable structural differences in relation to economic potential and to financial potential, differences that can be accentuated at least partially, by the free movement of factors of production when the final objective of integration will be attained. A supra-national equalization of finances will consequently prove to be necessary.

It seems clear that a real internal market such as it is hoped to achieve between the Six countries could only be made through Community finances organized within a more or less comprehensive framework.

4) As already mentioned (see page 100), the aim under consideration is not uniformity, but solely harmonization of tax systems and of financial policy. At heart, this is merely an intermediate objective whose achievement will serve to eliminate or prevent all financial measures taken in Member States which would be likely to hinder or distort competition within the E E C.

5) Even if it is assumed that the integration process will lead to a structure analagous to that of a Federal State, the tax systems and expenditures of the various States of this Federation will continue to reveal certain quantitative and/or qualitative disparities (cf. page 108). Such disparities are acceptable to the extent that they do not carry with them effects curbing or distorting competition. They express differences of economic structure and economic potential between one country and another, varied concepts of economic, social and public health policies etc., and as such would continue to exist for political reasons, namely to take into convenient account material, ideological and cultural peculiarities of the different countries, which, in large part founded upon history and tradition, will continue to exist when integration will be complete.

In relation to financial policy differences of this type can be explained in particular by the fact that:

i) Consumption habits vary from one nation to another, which can lead to a diversified structure of the consumption tax system;

ii) The viewpoints of countries on the desirability of influencing consumption of certain goods for reasons of health (for example alcohol) differ;

iii) Opinions differ on the extent of the redistribution of income and/or wealth that must be attained; this affects the distribution of the tax burden as a function of the categories of taxes, the degree of progressiveness of the taxes, and the absolute and relative importance of expenditures of a social character, etc.;

iv) All countries do not have the same ideas on the relationship considered desirable between public and private investment, and similarly, in a general way on the volume and nature of State intervention, even if in principle they are in agreement on the maintenance of a market economy;

v) Taxation ethics show local variations, similarly the ability or willingness of the Government and tax authorities to counter deficient tax morality of tax-payers by appropriate means varies.

6) Furthermore, complete unification of the tax systems of the Member States - even if it is held ad inconcessum that it's politically achievable - would not be considered as necessary from the aspect of integration policy, since experience proves that on many grounds moderate differences limited to the nature (structure) and to the rate of taxes do not hinder the free play of competition.

7) It must be assumed that in the course of the gradual achievement of integration as envisaged under the Treaty of Rome, the Common Market itself will bring into being strong forces which will press Member States to a certain extent towards harmonizing their tax and financial policy. However, the FFC is convinced that if it is wished to forestall friction and to shorten the period during which these adaptation difficulties will give rise to the continuance of current taxation "disharmonies", it will be appropriate not to wait, but on the contrary to take the initiative and conclude at least an agreement guaranteeing that henceforth no Member States will take new financial measures likely to complicate still further free play of competition.

8) As indicated (cf. page 100, point 2), the studies and proposals of the FFC must be based on the assumption that frequent changes of exchange rates will not be applied. This excludes the possibility of setting up a system of variable exchange rates. If a monetary system which assures integral convertibility at least among all the Member States, is considered as an ideal state for a common market containing conditions analogous to those of an internal market, the rates must in every way remain constant in relationship among the countries of the E E C. In order to avoid changes in the flow of trade with third countries, this system

however, implies the stability of the external parity of all the national currencies within the Community, even in respect of the outside world; if not, in effect the result might be irregular rates which would cause changes in trade flows with their economic disadvantages. On the other hand, invariability of currency relationships within the E E C does not exclude identically proportioned changes in exchange rates, changes which would be applied in common and in the same direction for all Common Market currencies in relation to third countries.

Such changes in the international parity of all the currencies of the E E C States could result from a common currency exchange policy, in the sense of Article 107 of the Treaty. The present Report concedes by supposition that these manipulations will be appropriate if required by a fundamental disequilibrium of the Community balance of payments, since such a disequilibrium is also an influence on conditions of competition within the Common Market. Thus, in the Report it is assumed generally that the Common Market viewed in its entirety, possesses in relation to third countries, a balance of payments which is in equilibrium.

For the FFC it is nevertheless clear that the tax and financial measures recommended by this Report will to a certain extent influence trade between Member States and third countries; this can lead to deficiencies or surplus in the balance of payments in certain Member States taken solely in connection with their relations with third countries and thus to deficiencies or surplus in the overall balance of payments of such States, even if the balance of payments of the Common Market considered as a whole is in equilibrium. On the one hand it can indeed, be imagined that the level of prices in the different Member States will be so aligned in relation to each other that internal disequilibria of this type will disappear in time, without it being necessary to modify exchange rates. On the other hand it can not be excluded that during the implementation of the tax measures proposed in the present Report, adaptation or several adaptations of exchange rates within the Common Market will appear to be opportune or indispensable.

The FFC has abstained from taking a position on these problems. In what follows - unless otherwise stated - the judgement it makes on the effects of taxes bearing on production, trade and consumption within the framework of the Common Market assumes as a hypothesis that there are no internal disequilibria in the balances of payments, that each Member State can on the contrary maintain its balance of payments with other Member States and third countries in equilibrium. This implies therefore an equilibrium of the balance of payments of the Common Market considered as a whole with third countries.

II. STATISTICAL DATA RELATING TO THE CURRENT ECONOMIC AND FINANCIAL SITUATION OF THE MEMBER STATES OF THE EEC

The statistics mentioned below are contained in Appendix C (1); they concern the economic situation of the Member countries of the E E C:

Table I - Product of State and local authority taxation together with social security contributions.

Table II - Breakdown of total public expenditure, including social security, by category of expenditure in the E E C countries in 1950, 1955 and 1959.

Table III - Index (1960) of Gross National Product, principal categories of expenditure and of contributions of certain sectors of the economy.

Table IV - Origin of Gross Domestic Product at factor cost per economic sector (percentages) (1960).

Table V - Distribution of National Income in 1950 and 1960 (percentages).

Table VI - Employment of Gross National Product in 1950 and 1960 at current prices (percentages).

Table VII - Importance of some categories of private consumption expenditure (as a percentage of total private consumption).

Table VIII - Gross National Product per capita and National Income per capita in Member countries of the Community.

Table IX - Relative importance of foreign trade in 1956 and 1960.

(1) See page 168 infra.

Table X - Total exports in 1957 and 1960 broken down as a percentage according to destination.

Table XI - Total imports in 1957 and 1960 broken down as a percentage according to origin.

Table XII - Composition of imports as a percentage of total imports in 1957 and 1960, according to groups of products.

Table XIII - Composition of exports as a percentage of total exports in 1957 and 1960, according to groups of products.

III. FUNDAMENTAL GENERAL CONSIDERATIONS

A. The fundamental aims sought by the establishment of the common market which are of particular importance for the intended financial policy

1. Achievement of a common market with conditions analogous to those of an internal market

It is agreed that the common market to be established within the E E C must contain the same characteristics as an internal market. Let us assume in principle that among others the characteristics of an internal market are: the free circulation of persons, the free circulation of goods and capital (customs duties and quotas being abolished), a unified currency, relatively uniform transport tariffs, uniform economic and social policy, in general uniform judicial standards and a high degree of security in the supply of durable goods and spare parts. To complement this, let us emphasize that an internal market does not entirely exclude all local (regional) disparities in relation to institutions and to financial measures, but that these disparities must not be of a type and size so as to hinder particularly the free movement of factors of production. Finally, under ideal conditions it would be unnessessary to retain "tax frontiers" which it might not be possible to abolish in those cases where in the field of indirect taxes major quantitative and qualitative disparities would arise. The question as to whether it is possible to abolish the "tax frontiers" within the E E C, and if so, how this should be done, will be discussed later on, see page 145.

It is apparent that such an elimination is, in principle, desirable, even though it should be accomplished only in the final stage of the integration, if there is evidence of a genuine wish to achieve conditions analogous to those of an internal market. In dealing with this question, it is necessary to consider as well the possible negative psychological reactions on the part of entrepreneurs, which may be evoked in the event that tax frontiers should be further maintained.

2. Elimination of influences and factors which give rise to distortions of the conditions of competition

It is assumed that in relation to internal economic policy, all the Member States are under a fundamental obligation to apply the principle of competition as widely as possible. Under this assumption, it is clear that they must also take measures in their mutual relationships to eliminate or to neutralize hindrances and distortion of competition.

In relation to financial policy, it arises from this that it is necessary to eliminate disparities of a tax policy or an expenditure policy between Member States, disparities which lead businesses and in the end, capital, manpower and business men to choose other places for establishment than those which would naturally or technically be the most favourable. Among other measures this implies the abolition of tax havens as well as those tax discriminations based upon criteria of nationality and often of tax domicile.

Beyond this it would be necessary to eliminate those tax measures which, although they do not restrain or distort international competition, rather have an effect on internal competition. Thus, apart from those effects which the current turnover tax of the type which exists among others in Germany, has on trade with abroad, its recasting is to be recommended because this tax distorts vertical competition in the countries where it is applied. Even if this basically concerns only simply eliminating regulations which distort conditions of competition (see above, page 101), there can be seen in such reforms a means of affecting competition in a positive sense as required under the Treaty and the Committee's mandate.

The FFC wishes to call attention to the fact that currently the word "competition" as it occurs in the economies of the type found in the Member States cannot be identified with "atomistic competition", but that it often and more and more is found between oligopolist businesses which practise an administered prices policy.

3. Other economic objectives

Beyond the achievement of a common market whose circumstances will be analogous to those of an internal market on the one hand, and the elimination of effects and factors likely to distort or disturb competition on the other hand, several other objectives of economic policy must not be lost from view in the efforts made to harmonize the financial policy of Member States. They must however not be considered as specific objectives of a common market under the same heading as those just mentioned. More precisely it concerns the occurrence of:

a) economic and monetary stability;

b) continuing economic growth, as vigorous as possible;

c) maintenance of the equilibrium of the balance of payments, through a market economy;

d) a more regular distribution of income and wealth.

The Preamble of the Treaty of Rome expressly mentions most of these objectives, all of them recognized in principle by the Member States within the framework of their internal economic policy as stated above (see page 98). However the FFC believes it should be explicitly emphasized that a rational financial harmonization policy can greatly facilitate and indeed expedite the achievement of the foregoing objectives. An important consequence of the acceptance of these objectives as an aim belonging to financial policy is that the Member States would in this way undertake to practise an anti-cyclical budgetary and tax policy, and that they would recognize the extreme importance of tax measures for the neutralization or elimination of inflationary or deflationary factors which disturb economic equilibrium.

B. Quantitative and qualitative disparities existing in the financial systems of Member States as factors capable of jeopardizing the achievement of the objectives of the Common Market

1. Disparities in the so-called overall tax burden

a) General preliminary remarks on the concept of "tax burden"

Each taxpayer is inclined to consider all the taxes that he pays as a burden. Similarly certain persons in parliamentary and published written discussions see taxes in a general way as a burden for the economy concerned. This may be countered by the following remarks:

It must be noted from a micro-economic aspect that the fact of imposing tax obligations of every type certainly constitutes from a simply psychological point of view a "burden" since this limits the ability of the individual to freely dispose of his resources and that this psychical "tax pressure" probably grows, all things being equal, with the size of the tax burden. This fact can be reflected in a depressing influence on the propensity to produce and invest. On the one hand it should not be overlooked however, that only part of the tax obligations that an individual cannot shift on, bears on him in an economic sense and that, on the other hand, all taxpayers benefit to a certain extent - an extent difficult indeed to measure exactly and which is without constant relationship with the tax burden that he bears and that he could bear - from public services financed by the State from taxes and whose proportional utility should thus theoretically be brought into account against the obligation to pay tax. If the limited case where the advantages and burdens compensate each other for certain taxpayers is passed by, it must be mentioned that the "current account" of the tax authorities provides many tax bearers with a credit balance and others with a debit balance and that in a strict sense, one may speak of a real (net) tax "burden" only in relation to this second group. This contrast between the two groups gives rise to the partly knowingly sought and partly unforseen achievement through taxation of the redistribution of income and wealth.

From the macro-economic aspect, it is similarly impossible to identify tax receipts with a "burden" imposed on the national economy. There is, on the contrary, a real effect weighing on the economy only to the extent that taxation engenders a net effect which hinders or reduces growth, taking into account the use of receipts from taxes, that is to say public services financed by taxation. Undoubtedly the friction resulting from this tax obligation must also be considered as a depressing factor. Other effects felt as a burden can be produced if there is a staggering over time (and according to the size of this shift) between the effects of the collection of tax and the effects arising from its re-expenditure. Analogous effects of a micro-economic type can also be imagined, to the extent that tax obligations that are immediately felt as depressing by tax bearers relate to the advantages drawn from public expenditures, advantages which only reach them with a more or less considerable time-lag.

The most important effects of the tax burden from the point of view of competition result not so much from the level of the overall sums paid in settlement of the taxes as from their differential distribution among individuals, (households), or among businesses. It is above all special taxes which have an influence on costs and prices or differentiated rates within the framework of a general tax on consumption (turnover tax) which distort competition as much for internal trade as for foreign trade. But even in relationship to the taxation of income or wealth, differentiated treatment of identical cases can, through its effect on incentives, distort the optimum distribution of resources.

Basing itself on general theoretical considerations, the FFC has finally reached the conclusion that a limitation of competition between Member States of the E E C must generally be feared not so much through the variation of the level of overall tax burdens but because certain taxes or certain groups of taxes contain qualitative and quantitative disparities.

To expand this there will follow a general summary of the size of the current so-called tax burden in Member States.

b) Size of national tax contributions

1. Taxes in relation to Gross National Product

According to data brought together in connection with national budgets by experts of the six Member countries, total tax receipts of the States and of local authorities, receipts of a "para-fiscal" type, taxes and social insurance contributions account for the following percentages in 1959:

	Gross National Product	Taxes	Taxes + Social Insurance Contributions
Germany (Fed. R.)	247.9 mld. DM	24.6 %	34.3 %
France	259.9 mld. NF	23.8 %	33.4 %
Belgium	572.4 mld. Bfr.	17.6 %	24.4 %
Netherlands	38.6 mld. Fl.	22.0 %	30.0 %
Italy	18,290.0 mld. Lire	19.9 %	28.5 %
Luxembourg	22.5 mld. Lfr.	20.4 %	29.1 %

The following remarks should be noted before drawing conclusions from these figures:

In spite of all the improvements during the last ten or twenty years in the calculation of National Product, it cannot be claimed that it completely represents reality and even less so that these figures are entirely comparable for one country with another. Moreover, there are great difficulties if it is wished to compare the overall mass of taxes in relation to Gross National Product resulting from the fact that this Product includes indirect taxes while the ratio between direct and indirect taxes varies according to the country. Taking into account these difficulties, no great significance can be attached to the differences in the table, a divergence which is in general small.

2. Taxes and income per capita

(a) In public discussion on the tax burden figures expressed per capita are often used. For Member States of the E E C the figures for 1959 appear (in $ US) as follows (1959 exchange rates):

	Income per capita (in $)	Taxes per capita (in $)	Taxes + Social Security Contribution per capita (in $)
Germany (Fed.R.)	1,140	280	388
France	1,176	280	393
Belgium	1,258	222	306
Netherlands	896	197	266
Italy	598	119	169
Luxembourg	1,441	295	420

(b) As simple per capita figures are of only slight value, they are often combined with income per capita usually in comparing these incomes before and after taxation.

As shown in the following Table, the sometimes considerable differences of net income per capita arise less from the disparities of tax burdens than from the disparity of incomes.

	Income per capita (Income per capita less tax) (in $)
Germany (Fed.R.)	860
France	896
Belgium	1,036
Netherlands	699
Italy	479
Luxembourg	1,146

Even when it is agreed that neither from a micro-economic or macro-economic viewpoint can overall tax payments be automatically considered as a "burden" (particularly because on this point the services that the State provides through the tax must be taken into account), it is advisable to emphasize that a relatively small income per capita generally indicates that anyhow direct taxation can only be increased in a proportion which would be less than that acceptable for relatively higher incomes.

(c) All things being equal, the fact that the concentration of income has varied effects in relation to the burden imposed shows how necessary it is to guard against hasty conclusions on figures relating to overall tax contributions.

A schematic example serves as an illustration:

Income group ($)	No. of tax-payers in each Group (in millions)	Average income per Group ($)	Total income per Group (Million $)	(%)	Average taxation per Group (%)	Tax Product per Group (Million $)	(%)
Country A							
less than 1,000	10	600	6,000	72.3	5	300	46.2
1,000 - 5,000	1	1,500	1,500	18.1	10	150	23.1
5,000 and over	0.1	8,000	800	9.6	25	200	30.7
Total:	11.1	748	8,300	100.-	7.8	650	100.-
Country B							
less than 1,000	8	600	4,800	42.1	4	192	18.2
1,000 - 5,000	2.8	1,500	4,200	36.8	8	336	31.8
5,000 and over	0.3	8,000	2,400	21.1	22	528	50.-
Total:	11.1	1,027	11,400	100.-	9.3	1,056	100.-

From this example, the following arises: although in both cases the total number of income earners of the two countries as well as the average income in each of the three groups are equal, the fact that in country B the concentration of income is greater in the middle and high income groups has the consequence that in this country, total income and average income of all income earners are higher than in country A. It arises from this that in country B the total tax burden, which represents 9.3% of total income, is appreciably higher than in country A (7.8% of total income), although in each case, the average tax burden according to income groups is lower in country B than in A.

c) Reasons for the disparities in tax burdens

Although the absolute and relative growth of State expenditure and the correlated growth in the absolute and relative volume of tax payments tend to be widely observed phenomena, the level of the tax burden in different countries always shows more or less important differences. These differences are explained (cf. page 102) to a large extent by the fact that political and ideological concepts of an appropriate relationship between private economic activity and that of the State vary in place and time. Moreover, differences of economic structure, particularly those bearing on the level and structure of National Income also seem bound to play a role in this matter so that all things being equal, countries with a comparatively low income (for a good part derived from agriculture) do not possess the same tax contributory power as those which have a higher level of income and an income coming mainly from the product of industrial or trading activities. To the extent that overall figures allow conclusions to be drawn, it can be held that if in two countries whose average incomes are in the ratio 100:200, and if the taxes constitute the same percentage of income, the country with the lower income in fact bears a higher burden, above all if the after tax incomes of the two countries are compared.

The fact that in similar cases relatively poor countries cannot purely and simply be satisfied with tax returns so low that the relationship between the tax product and national product is (appreciably) lower than that of richer countries, also arises from the fact that each State which considers itself politically, economically and socially developed, must offer a determined minimum of goods and public services, a minimum, however, that can make up a relatively important section of National Income given that the level of National Income is inadequate. Conversely, wealthy economies can often offer ample public services while their relative tax burden is correspondingly comparatively low.

d) Do (important) differences in the level of overall tax receipts constitute an obstacle to the bringing into being of a common market?

Differences in the level of the total tax burden (including social security contributions) in relation to National Product between the countries of the Community are not very considerable, with the exception of Belgium (1); meanwhile, matters are little different if taxes in their strict sense or the sum of taxes and social insurance contributions are considered. In contrast, the relative size of taxes and still more of the sum of taxes and of social insurance contributions is far less in Belgium than in other Member States. The difference is particularly noticeable between Belgium on the one hand, and France and the Federal Republic on the other. In Belgium, the tax burden nevertheless recently shows signs of a certain tendency to rise.

As emphasized above, the diversity of overall taxes reflects in large measure, apart from differences of economic structure, differences of concept held in the various countries of the tasks that public authorities must assume, as well as of the way, and of the extent to which these tasks must be performed. If the citizens of a country give recognition to relatively wide State economic activity and if they are consequently disposed to support higher taxes, clearly it should not be assumed that the difference of tax burden existing in comparison with other countries will bring about shifts of capital and persons. In relation to the migration of people across frontiers it must also be borne in mind that numerous factors of a non-tax kind have application in a reverse sense, and that in these matters tax factors only play a limited role.

But once set loose, such a movement caused by tax factors tends to be gradually accentuated, since to the extent that human beings or capital leave a place under high tax pressure for a place of lower pressure, these shifts tend to accentuate further local disparities of financial potential. The movement of persons and capital leaving a country with high taxation pressure and relatively low national income, reduces the tax base there, while on the other hand enlarging it in the country to which they move. In the first country this means either a reduction in the quantity

(1) For Member Countries this relationship is on average 31% (except for Belgium); positive or negative differences are more or less within 10% of the figure mentioned.

and/or the quality of public services, or an attempt to compensate pari passu lower tax yields by raising the tariff. The difference with respect to the second country increases, particularly if it becomes richer and reduces the tax burden and/or improves public services. In theory, an end to these movements cannot be expected before an equilibrium between the countries in question is achieved and after which there will only remain in the poorer countries those economic subjects, in relation to which migration of capital and labour are essentially a feature beyond the tax field, unless a supra-national body has intervened previously through measures for financial equalization.

The conditions under which a considerable fluidity of labour and capital could be expected, set in train by the overall differences of taxation described above, hardly seem to be in existence currently in the six countries of the Community. On the one hand, as indicated, relatively higher tax burdens are linked in general with relatively higher or better services on the part of the State, so that these differences cannot be simply considered as being a burden. On the other hand, differences between relative overall tax returns are not too considerable between most of the countries. Finally and in the third place, in a country where these differences are very marked and where a relatively small National Income is matched by a comparatively high tax burden, while this burden is less in the richer countries (taking into consideration for example, Italy on the one hand and Belgium on the other), there could in fact be hardly any disquieting consequences, since migration of people and transfers of capital are related by important non-tax considerations. But if this assumption is shown to be too optimistic the Community, as indicated above, would have to resort to measures for financial equalization, which at any rate will probably be necessary (cf. page 150 et seq.) up to a certain point and which would hinder or appreciably reduce the appearance of the occurrence mentioned which could in some ways be considered as a "perverse" development.

So as to avoid all misunderstanding, it is advisable to emphasize once more that the foregoing considerations relate exclusively to disparities existing from an international aspect in relation to the level of the total tax burden. On the other hand, it can obviously not be denied that there can be larger or smaller differences from one country to another in the tax burden between different sectors, types of businesses, groups of income and wealth, etc. even where the total sum of the relative tax burden is the same but shared in different ways over these sectors, types of businesses, etc. Such specific disparities between the national tax burdens, above all if they are relatively sizeable, are likely to bring about distortions of competition as much from an internal aspect as on an international scale.

2. Disparities in the composition of public expenditure

a) Preliminary general remarks

As already emphasized (cf. page 105), to understand exactly the net effect of taxes, there must be considered apart from the reduction in purchasing power as a result of taxation, the effects which occur from the re-employment of tax receipts by the State. This aspect of taxation has in the past often been neglected. Even when not limited to the analysis of the effects of taxation as to diminish the purchasing power these taxes were considered as a burden on the national economy; public expenditure financed by the taxes being considered with only a few exceptions, as "unproductive" because it was claimed that from the point of view of the general economy, they reduce the possibility of employing national resources in a profitable and beneficial manner by private economic subjects.

If this opinion were correct, the "pressure" exercised on economic activity by measures taken by the public authorities could be measured, either through the total sum of taxes or according to State expenditure, provided that financial expenditure by other than tax means were eliminated. However, in reality all public expenditure - or at least for the larger part - has effects that can be considered stimulating to the general economy. Empirical confirmation of this is given by the fact that the active growth observed during the last fifty or sixty years in developed national economies has gone hand in hand with a greater than proportional rise of public expenditure in relation to the trend of growth.

The effects of taxation as diminishing the purchasing power appear just like those of the re-employment of tax receipts in the form of public expenditure, through shifts and quantitative variations in production, consumption, prices, incomes, etc. But these two sorts of effect are not always harmonious. Consequently, although it may as indicated, in principle be necessary to study public receipts and expenditure at the same time if it is desired to analyse the net effect of State activity on the economy, it must be nevertheless noted that on the one hand, the effects of an

expenditure budget of determined level and composition differ according to the structure of the tax system allowing the coverage of the expenditures, and that on the other hand, the effects of a tax yield of determined level and composition differ according to the structure of public expenditure that it finances.

While it is difficult to establish with some exactness if a particular expenditure (taken in isolation) - taking into account effects resulting from its financing (taxation) - presents in fact and in volume the character of a burden or a stimulant where a particular tax (taken in isolation) covers this expenditure, another difficulty of method comes from the principle according to which nowadays - as opposed to the principle formerly adhered to - a tax is no longer attributed to a special expenditure. In conformity with this principle, the entirety of public receipts serve without distinction to finance the entirety of public expenditures. Consequently it must be recognized that it is advisable to ascribe each particular tax such a fraction of a particular expenditure as relates to its share in the overall tax mass and that conversely each particular expenditure is financed by all taxes in the proportion by which it is linked to the sum of expenditures. This assumption is in any event necessary when it is desired to compare international tax systems or expenditures which relate to budget figures over a short given period. Rather more precise statements can be made if it is considered that supplementary expenditures are decided upon and that for those expenditures supplementary tax resources are engaged, so that it can be assumed that there is a direct relationship between the two measures and their effects.

b) Effects of the differences of structure of national expenditure, with the same composition of tax receipts.

Just as the economic and social effects of each particular category of expenditure are different, the differences of structure contained in national budgets must with all things being equal, have different effects, even if the general level of expenditure is identical.

As already stated, the fact that there are differences in the overall level of tax receipts does not constitute a vital obstacle to the setting up of a common market. In effect, in most cases these differences are not very great. Moreover, tax burdens are in general higher where services by the States are greater.

The same remarks can be made for the overall sum of public expenditure, given that the counterpart of the tax burden is made up by expenditures. Notably it concerns establishing in what way international disparities of structure that exist in the composition of public expenditure are such as to hinder competition. It cannot be denied that such disparities can in principle bring to bear influence on the state of competition between Member countries, particularly if they are relatively large. Public expenditure in effect influences the cost prices of businesses, the overall level and composition of investments and consumption, and lastly the growth of the economy. It is, however, impossible to evaluate these effects quantitatively.

Certain expenditures, for example those which are made for research or those intended to stimulate exports, have a very great macro-economic significance. Expenditures relating to education (general and professional) also certainly influence long term economic growth, but the degree of effectiveness of these expenditures can vary from one country to another, even if they are of equal importance depending on the teaching and professional ability of the teachers, etc.

On the other hand public expenditures are closely linked with the fact that these or such expenditures have or have not been made in the past. In this connection the case of a well kept up or a neglected highway system, the provision of pensions etc., can be quoted. Wars and catastrophes can also influence public expenditure over the long-term. Credits and voluntary gifts granted to developing countries as well as expenditures destined for the improvement of underdeveloped regions in the country itself, are today of considerable importance but this importance varies from one country to another.

Finally, defence expenditure which is very high in Member countries affects - mostly in a negative sense - the extent of competitivity in the economy. If there are great differences in this category of expenditure, competition between countries is necessarily influenced.

It seems for the rest, that the structure of public expenditure depends on certain factors, for example demographic situation (number and density of population), the level of National Income, and finally on certain natural conditions (climate, natural routes of communication, dangers of flooding or erosion, etc.)

Even if the different categories of expenditures can be broken down and compared according to the same criteria from one country to another, it hardly seems possible to draw precise conclusions from this in relation to the incidence of one or of the other on competition (cf. Table reproduced below).

Breakdown of public expenditure, including social security, by categories of expenditure in the E E C countries for 1959 (1)

(in percentage of Gross National Product)

	Germany	France	Italy	Netherlands	Belgium	Luxembourg
1. Public consumption expenditure (of which defence)	13.6 (3.2)	14.9 (5.9)	14.5	13.3 (3.9)	11.7 (3.2)	11.6 (1.3)
a. Salaries	6.6	9,5	9,3	8,6	8.3	8,1
b. Rent and Amortization	0.6	0.1	0,3	0,9	0.6	2,4
c. Current purchases of goods and services	8.3	6.2	4,9	4.3	3,1	3.4
d. less: current sales of goods and services	1.9	0.9		0.5	0.3	2.3
2. Internal current transfers	14.2	13,9	14,9	13.8	14.3	16.6
a. Interest on public debt	0.6	1,4	1,9	2.7	2.2	1.1
b. Business subsidies	0.5	1,2	1,3	1,3	1.6	3.2
c. Social Security Services	10.1	9,7	7,3	7.3	8.7	10,2
d. Other current transfers to households	3.0	1,6	4,4	2,4	1.7	2.0
3. Current transfers abroad	2.3	1,2	0,1	0.1	0.03	0,07
4. Current expenditure of public administration (= 1. to 3.)	30,1	30,1	29.5	27.2	26.1	28,2
5. Gross capital formation	3.1	2,2	2.8	4.1	1.8	7.5
a. Purchases of new capital goods	3,0	-	-	-	-	-
b. Purchases of sites and used capital goods	0,2	-	-	-	-	-
c. less: sales of capital goods	0.04	-	-	-	-	-
6. Internal capital transfers	1.2	2,2	2,2	1.3	-	-
a. to private households	0.5	0,9	-	0,3	-	-
b. to businesses	0.8	1,2	-	1.0	-	-
7. Capital transfers abroad	-	-	-	0.2	-	-
8. Total public administration expenditure (= 4 to 7)	34.5	34,5	34.6	32,8	-	-
9. Gross national product at market prices (Milliards, national currency)	247.9	259.9	18,290	38.6	572.4	22,5

(1) See Appendix C, Table II, page 169.

It is not possible to settle the effective net burden for certain individuals or categories of income from effects derived on the one hand from taxes, and on the other hand from services provided by the State and financed through taxes, unless the incidence of all taxes affecting these individuals or groups and the incidence of public expenditures from which they profit are fairly accurately known at the same time. Several American and English writers have recently attempted to calculate these net burdens starting from different hypotheses either for the United States or for the United Kingdom. To the extent that these studies can be considered as more or less corresponding to reality, they give a picture of the way in which the measures taken within the framework of financial policy of the authorities (expenditure and taxes), influence the state of income or wealth of individuals or groups. The Fiscal and Financial Committee has not been able to make such research for the E E C countries, but such a study would be very desirable.

It follows that the only thing that remains to be done is a study of a micro-economic character with the intention of establishing the absolute and relative importance of expenditures which are intended to subsidise this or that sector or group of businesses.

The FFC considers that a detailed study of this type exceeds the outline of the work passed to it in its mandate. Anyhow, the sums in question and the differences between them are not very large if subsidies to agriculture, agricultural products and rents are disregarded. Where these subsidies are granted to a particular sector of the economy, the question whether they are compatible with the principles of competition is in particular dealt with by Articles 92 to 94 of the Treaty.

The FFC nevertheless considers that it is advisable to draw attention to two distinct problems:

On the one hand, expenditure relating to agriculture and that intended to maintain prices of farm products have reached a level where they inevitably influence the cost price and prices of other sectors of the economy. The common agricultural policy will therefore have an impact on the expenditure policy of the Member States and consequently on the competitive position of other economic sectors.

On the other hand, certain countries, notably Italy, make fairly considerable expenditures intended to improve the economic situation of certain insufficiently developed regions. The supplementary burden which results from this weighs on the entire economy of the country and such expenditures can only be profitable over the long term. In the short term these supplementary burdens can influence the competitive ability of businesses as well as the purchasing power of consumers and thus influence the direction of trade and of competition between Member countries. Several aspects of this problem will be examined in the paragraph relating to international financial equalization, see page 150.

It is appropriate finally, to emphasize the following:

The FFC is conscious that the foregoing brief considerations which relate to public expenditures only give some indications on certain aspects and certain problems. It has not been possible for it to treat these questions in detail at present, the more so as it believes that problems of taxation policy show the greatest urgency from a practical point of view, and it has given them its closest attention.

However, it deems necessary once again to emphasize briefly that there is reason to take into account not only the effects of taxation, but also the effects arising from the employment of the tax receipts if it is wished to estimate the disturbance to competition that can result from measures taken in relation to finances by public authorities in the matter of the flow of trade between States. In other words, it must take into account the effects of expenditures by the States financed by means of taxes and which reinforce, reduce or compensate the effects indicated above.

3. Disparities in the composition of tax systems

a) Structure of tax systems of the E E.C countries

Even under the hypothesis - hardly tenable - that the level (in relation to National Product), and the structure of public expenditure as well as the total mass of taxes are in harmony in two countries, a structural difference in the tax systems can sometimes have effects likely to influence conditions of competition, since the various types of taxes do not have identical effects (cf. page 113 et seq.). This concerns modifications of competition which are of a general type and/ or modifications of conditions of competition limited to particular products, services, transactions,

etc. The appropriateness or necessity of getting rid of such distortions derived from taxation in a Common Market clearly depends to a large extent on their size.

Even if limited to making a description of the tax systems and only dealing with the principal types of taxes or the larger categories of taxes, serious difficulties of method are encountered. This is explained particularly by the fact that

a) in theory and in practice the most widespread classification of taxes into "direct" and "indirect" taxes always remain controversial;

b) certain taxes are not levied in all the countries of the E E C ;

c) even taxes levied in all the States studied are more or less different and this has differing economic effects.

At the same time as the reservations arising from these considerations, there is set out below a survey of the structure of the tax systems of Member States, a survey that we wish to preface with the following note:

In place of the distinction between "direct" and "indirect" taxes, the classification into "taxes on income (or taxes on the formation of income) and on wealth" and into "taxes on the employment of income (including taxes on the factors of production)" is adopted. By analogy with the formerly customary distinction "direct taxes" and "indirect taxes", it is accepted that taxes on income and wealth are only partly and with difficulty passed on - if at all - while it is accepted that the passing on of taxes in the employment of income is desired by legislators, and that it is achieved as a general rule. But independently from the fact that these hypotheses are not entirely free from debate, it must be emphasized that taxes described as "on returns" (taxes on land and buildings, commercial and industrial taxes on professions and possibly independent taxes on income from capital), most frequently classified among "taxes on income and wealth", should not be lumped together with income taxes proper. On the contrary, they must above all be considered as factors in the cost price and to a large extent capable of being passed on. On the other hand, taxes on capital gains and particularly on movements of capital in the widest sense, cannot be included in a systematic classification.

As shown in the Table on page 114, structural differences on the various tax systems compared are often considerable. In Germany, the Netherlands and Luxembourg, "direct" taxes play a far greater role than in the other Member States - particularly in Italy. This is explained above all by the relative importance of the taxation of income (including the taxes "on return" - Ertragsteuer). Conversely, France, and even more Italy, have a leading place with "indirect" taxes among which, in France, turnover tax is the most important, while in Italy special consumption taxes take up a comparable important position.

The Table on page 114 contains only indications of taxes in a narrow sense. It does not therefore include obligatory social security contributions made by employers and workers. According to the data available to the Committee, these contributions - which are in material respects assimilable with taxes - contain considerable differences between one Member State and another. But as in the estimates of social security contributions - which are at least in part in connection with social security services - essential importance must be assigned to the services rendered and as the comparison assumes detailed enquiries which the FFC is not prepared to undertake, it has abstained from describing the financial structure of social security arrangements. Without doubt however, sizeable disparities in the matter of services and/or the financing of social security could have consequences for competition, as well as for businesses and for international movements in man-power (cf. page 134 et seq.) when conditions of free competition exist within the E E C.

b) Effects of structural disparities of the tax systems

For the present Report certain structural disparities only matter to the extent that they have an effect over the short and/or long term on the conditions of competition in the Common Market. The essential point in the matter is clearly to know whether - and if the occasion arises in what way - the different types of tax cause different effects on the relationship of costs, prices and incomes.

Although as indicated under a) above, agreement may not be unanimous on the possibilities of passing on various taxes, it can be assumed that there exists a direct relationship between taxation and the structure of costs and of prices for taxation on the employment of income (in a strict sense taxes on consumption), and for taxes on the factors of production, in any event to the ex-

Structure of Taxes levied by the State, (or by the Federation, as the case may be) and other public authorities in the countries of the E E C (1959).

(in percentage of overall tax returns)

Type of taxes	Germany Fed. R.	France	Belgium	Netherlands	Italy	Luxembourg
I. Taxes on Income and Wealth:	50.6	34,8	41.2	56.2	27.4	62.8
of which:						
1. Taxes on Income	(23.0)	(13.7)	(34.2)	(38.8)	(20.0)	(30.5)
2. Taxes on companies	(8.4)	(9.7)		(13,5)	(3.0)	(15.8)
3. Taxes on land and buildings	(2.6)	(5.1)	(4.3)	(2.2)	(3.8)	(2.4)
4. Taxes on professions	(10.7)		(0.4)	(0,0)	-	(8.3)
5. Taxes on Wealth	(1.9)	-	-	(1.52)	-	(2.8)
II. Taxes on the growth of Wealth and on movements of capital	2.8	5.5	6.0	3.8	7.0	2.3
III. Taxes on the employment of Income:	46.6	59.7	52.8	40.0	65.6	34.9
of which:						
1. Taxes on turnover and on transport	(25.3)	(34.7)	(29.1)	(19.0)	(20.4)	(16.2)
2. Taxes on food products and beverages, alcohol, tobacco, etc.	(10.9)	(9.0)	(7.5)	(9.1)	(23.3)	(11,3)[1]
3. Taxes on vehicles and mineral oils	(5.5)	(10.1)	(8.9)	(3.9)	(11.5)	(1.8)[2]
4. Other taxes on consumption and luxury articles	(0.8)	(3.6)	(1.8)	(0.3)	(4.9)	(1.8)
5. Customs duties	(4.1)	(2.3)	(5.3)	(7.7)	(5.5)	(3.9)

1) The taxes on mineral oils is included in this figure.

2) This figure only includes vehicle licences.

tent that they are, as is generally the rule, charged to producers. Such a direct relationship does not exist for taxes on the formation of income. The fact that businessmen try to compensate their reduction in profit under taxation pressure by price increases, has nevertheless a certain effect on prices. For various reasons however, for example, because the net taxable profit can never be exactly calculated except ex post and because of the progressive nature of the tax schedules, the allowances, etc., the tax burden that it is wished to pass on is only known ex ante, it is far from likely that taxes on the formation of income are transposed by increases in prices, like those which affect the employment of income and which themselves represent real cost factors. Effects of this character must be expected even less in the case of taxes on capital gains and on inheritance.

Even if consequently the existence of differences not of nature but only of degree between the effects of different types of taxes on costs and prices is assumed, structural disparities of the tax systems can, all things being equal, set in train differing economic effects. These are particularly clear and important when certain goods (for example, coffee) are affected by a special tax in a country and remain exempt from this tax in other countries where these products have great importance in the household budget. These differing economic effects also result in analogous disparities in the tax applicable to certain income (for example: capital gains, company profits, distributed dividends).

c) Determinant factors in structural disparities of tax systems

Structural disparities of national tax systems are explained on the one hand, by the diversity of types of taxes or objects chosen for taxation and, on the other hand, by the diversity of receipts drawn from each tax when in each State the variable proportions represented by differing taxes are measured in relation to the total product of the tax. These two factors are interdependent. They result in part from decisions based on economic, social, etc. considerations, (cf. last paragraph on this page), and they result in part from factors of economic and/or political-sociological structures; tradition can also play a certain role.

As for disparities relating to the qualitative composition of tax systems, it seems that they currently play a certain role within the E E C, but not an essential role in the diversity of tax structures measured according to the returns from taxes. Thus, different taxes like the tax on wealth on the one hand, the tax on coffee on the other hand, do not exist in all Member States; it can be thought - for example, for the tax on wealth - that other taxes assume the same functions in large measure. Whatever they may be, certain special effects likely to disturb the interplay of competition can arise from the fact that all things being equal, various taxes are not levied similarly in all the countries of the Common Market - notably in relation to taxes on consumption and on the circulation of capital.

But in a general way, structural disparities of the taxation systems result less from a different combination of differing taxes than from differences of relative return from the elements of the tax system. This diversity arises from the fact that the rates of one or several taxes vary from one country to another. A series of factors of economic structure play a further important role, in particular the level and distribution of National Income, the relative importance of economic sectors (notably the relationship between industry and agriculture), the form of organization of businesses (for example, the proportion of joint-stock companies in the total number of businesses), consumption habits (tastes) which in part derive from climate and natural conditions and also depend on the level of income, etc. Finally there must also be mentioned on this subject, the taxation mentality of the population as well as the abilities (in quantity and quality) of the tax administration, since different types of tax imply different duties on the part of individuals and the administration - determining the willingness of the individual to fulfill his obligations and the capacity of the tax administration to assess taxes precisely and to settle them in as rapid and efficient a manner as possible.

For the reasons shown, governments will have to make the following choice: either apply nearly the same rates as other countries, and in this case the taxes in question will produce differing receipts because of differing economic structures or social policies, or try to obtain nearly the same receipts as abroad by means of different rates. This dilemma appears with particular clarity for certain consumption taxes. If for example, country A which is a small consumer of beer but a large consumer of wine, wishes to derive from taxation of these articles the same relative product as country B where tastes are in the inverse proportion to country A, it should, all things being equal, lead in country A to a rate of tax on wine well below that of the rate applied in country B and raise the rate applied to beer above that of country B. Yet the conse-

quences are analogous for "direct" taxes which, for example affect income and wealth. Moreover, it must be recalled in connection with these taxes, that even with formal equality of the rates in different countries, an actual disparity in the tax burden (and consequently in the product of the tax) can result from the diversity of the effective importance of the rates, diversity due to differences derived from allowances, principles of assessment, basic rules of amortization, etc. but also from difference of the tax morality of taxpayers, from the efficiency of the tax inspectors in applying the tax, etc. If, for example, it is accepted that in relation to these last disparities mentioned, in one country tax evasion on income reaches about a third as against only 5% in another country, there will result from identical rates a difference in burden which can represent nearly 50% (calculated on the base of the lowest effective tax burden), even if the progressive character of the tax is left out of account. The illegal advantage for taxpayers under the larger evasion percentage would increase still more in certain cases if, in order to compensate difference in State contributions (differences which arise from the situation described), an equalization fund granted subsidies which would be to the charge of the country where the action of the tax authorities on incomes is more effective.

International disparities in the size of various taxes or categories of taxes can also be caused in the end through the pursuit of divergent objectives in economic and social policy; according to whether the government of a country will wish to give more or less scope to its policy for redistribution by taxes, it will grant greater or lesser importance to strongly progressive taxes on income and inheritance, or will maintain or suppress taxes with regressive effects on consumer goods of prime necessity. The fact that a government considers that it is easier or more appropriate for it than for another to act upon business activity and on economic growth by measures of tax policy can be determinant in the make-up of taxation systems, since various taxes and levies do not lend themselves in the same way to the pursuit of such objectives.

d) Compensation by means of variable exchange rates?

Monetary regulation is of the greatest importance for the effects of structural disparities of taxation systems on international competition. Although the present Report by hypothesis accepts that the Member States of the E E C retain the current system of fixed parities (see page 102 et seq.), it will now be studied whether variable exchange rates constitute a valid means for compensating differences of the effective burden resulting from structural disparities of the taxation systems.

To the extent that these differences lead solely to differences of price levels without price relationships between different goods being affected, they can be compensated through a system of varying exchange rates. Such compensation is also conceivable theoretically when price relationships between different goods are definitely modified by taxation measures, provided these modifications take place in all the E E C States in an identical way; for example, by means of a general turnover tax with exemption everywhere of the same goods or with taxation at moderate rates. In reality, differences of tax burden nevertheless exist for goods or particular sectors of the economy in national tax systems. Differentiated tax treatment, for the most part knowingly conducted, similarly causes distortions of competition in each country and moreover, alters the conditions of competition within the Common Market. This is the more true the more there are differences in the tax burden from one country to another. A system of variable exchange rates could evidently not correct such relative inequalities of the burden.

e) To what extent is an adaptation of the structure of tax systems necessary and possible in order to neutralize effects disturbing competition?

To the extent that, as in this Report, the structure of a taxation system is determined by the relative size of the returns procured by different taxes, one can speak of a harmonized structure of tax systems of two countries if -

a) the tax system includes the same types of taxes; or

b) each tax takes up the same proportion of the overall tax product.

In this respect no account will be taken of whether the total tax burden in relation to the individual or in relation to National Income is identical or not.

Even if the two conditions just mentioned were fulfilled (which in reality is by no means the case for (b) in particular), such an overall viewpoint does not allow valid conclusions to be drawn automatically for the neutrality of the structure of tax systems in relation to competition. For, on the one hand, relatively identical returns from a tax can among other things, be the conse-

quence of disparities of economic structure and/or of more or less strongly differentiated rates which can in their turn disturb competition, on the other hand, a same name (for example, income tax or turnover tax) often hides taxes which are very different in their nature and economic effects (see page 118 et seq.).

Given the multiplicity of factors primarily responsible for structural disparities of taxation systems (see page 115 et seq.) on the one hand, but also for the general reasons mentioned on page 102 on the other hand, any attempt to unify completely the structure of taxation systems of Member States of the Community is a priori likely to be frustrated because on the one hand, it would not be achievable politically, and on the other hand, because its success could not of itself alone remove all disturbance to competition due to national taxation policies. But as, all things being equal, important structural disparities of the tax systems must be considered undesirable because of the varied effects mentioned of the separate taxes, a certain approximation of taxation structures seems among other things to be desirable. In this connection it is advisable to distinguish between general taxes and special taxes.

Among the former must, above all, be included taxes on income, wealth, inheritance, turnover, while (single) taxes on consumption, capital transactions etc. are considered as special taxes.

In many respects taxes on companies and taxes withheld at source on dividends are situated halfway between taxes on income and taxes on turnover; their effects resemble those of taxes on capital transactions. To the extent that securities issued in the various Member States will find a far larger common market in the E E C, it will be appropriate to pay more attention to the tax burden applied to them by way of taxes on corporations, dividends and capital transactions.

It seems clear that the total absence of one of the leading present taxes on income on the one hand, and on the other hand of a general turnover tax cannot but lead to structural disparities of the taxation system in one country, which are so large in relation to another country, that from this there would necessarily result effects distorting competition. In fact however, all the States of the E E C possess such taxes although their structure and relative and absolute yield currently differ very much. For several reasons that will be later explained in the Report, it would be desirable to reduce gradually if not to suppress the disparities just mentioned. Notably it will be necessary to use about the same type of tax, without differentiating the effective burden too much, and more particularly while agreeing on those provisions that affect the overall nature of the tax - such as exceptions to objective and/or subjective tax liability, allowances, differentiated rates, etc. (see page 118 et seq.).

Even when these conditions will have been satisfied, there will still remain from one country to another a certain inequality in the tax burden imposed by each of the taxes, and in the part made up by each tax in the total tax product of each country. The extent to which the firstmentioned disparities in general "direct" taxes have the effect of disturbing competition will be studied later (cf. page 134 et seq.).

Identical considerations to those which will be described later on in relation to special consumption taxes, remain valid in principle for determining the size of such disparities in the general taxation of turnover.

In relation to the former (and to taxes on capital transactions which must to a large exent be included in this respect) the differences which currently exist between them in the taxation systems of Member States are greater in general and more alarming than those to be observed with respect to general taxes on income and wealth. Disparities in the relative size of taxes on expenditure and taxes on capital transactions - considered overall - fundamentally only reflect differences existing in the situation of taxes on income and wealth. The disparities shown by factors of social-economic structure, taxation mentality, the efficiency of the taxation administration, etc. play a special role in this matter. Exactly as with regard to the special taxes studied here, differences of burden can considerably complicate international exchange of taxed goods, services and capital, the achievement of a perfect Common Market would imply in principle that they become progressively harmonized. Thus, on the one hand this should imply that no product is subject to consumption tax in a country when it is not taxed in other Member States or when it is taxed only within the framework of a general consumption tax - and on the other hand, that differences in effective tax burdens borne by identical or similar goods would be as slight as possible from one country to another.

Limits exist nevertheless, for these attempts, for reasons already indicated several times. In relation notably to tobacco and beer, it is appropriate to comment that it would hardly be possible to reduce appreciably in the foreseeable future, the disparity currently existing between the countries of the Community in the field of burdens and tax receipts. This is particularly impossible because tax burdens which bear exactly on these goods play an important role in the balancing of budgets.

Nevertheless it is advisable to recall that these disparities would only cause disturbance to competition in cases where the principle of country of origin would be applied to all taxes, thus including special taxes on consumption. If, on the contrary, the principle of the country of destination were maintained, no disturbance to conditions of competition would be produced.

Thus, one arrives at the question of tax frontiers which, having regard to the very considerable importance that they possess, are made the subject below (see page 145 et seq.) of a systemic and separate study. Taxes on companies and dividends will themselves also be the subject of a separate analysis (cf. page 139 et seq.).

IV. PROPOSALS FOR THE QUALITATIVE AND QUANTITATIVE HARMONIZATION OF CERTAIN PARTICULAR TAXES

A. Differences of structure of certain particular taxes and proposals to reduce these differences as desirable from the point of view of integration policy

1. Preliminary general remarks

As indicated above (page 115 et seq.), a common description of a tax often conceals varied structures which can be very different as to their economic and social effects. Moreover, when two countries apply the same type of tax (for example, income tax), large disparities can result from the fact that the objective and/or subjective tax liability, the base, etc. are different, and from the fact that the tax is combined in one country with some, and in another country with other taxes, etc.

In what follows, the disparities of form and structure just mentioned will be studied in detail by tracing the possible effects of some taxes on competition. In this connection, there will for the time being left aside differences of rates, which will be studied later (cf. page 128 et seq.). It must be borne in mind that for the effective level of the burden, which is the ultimate influence on the conditions of competition to the extent that they are of a tax origin, the factors studied in this part of the Report as well as the relative variations in the tax rates often have a decisive influence.

It is obvious, with respect to the problems raised in this Report, that if distortions of competition are caused by differences in the types of taxes, those differences must be removed first, which interfere with trade between Member States; so for example, the fact that in one country taxation on income and corporations may be levied according to different rates can distort the interplay of competition between businesses of a different legal form; if however, the relationship between taxes on income and taxes on corporations are for the most part similar in all the Member countries, there would follow no alteration in the conditions of competition in trade (leaving aside the possible influence of disparities in the tax burden on international capital movements). This applies also to a cumulative multi-stage turnover tax which, as is known, encourages concentration and has similar distorting effects on competition, but which does not affect international competition if the same system with approximately the same rates is applied in all the E E C countries and if the degree of vertical concentration in these countries is the same.

2. Taxation on the formation of income (income and company taxation)

a) Dual or single system

Formerly in theory there was a distinction between the "analytical" and "synthetic" taxation of income. This distinction is vague because all real taxation of income by its own character, can only be synthetic; that is to say, it affects the overall income of a person. The separate taxation of different types of income by means of special taxes always works in the sense of a (more or less perfect) system of taxation on "returns", which are in essence "real" taxes, even if in practice they often have the character of "semi-personal taxes". This is true for German taxes on returns (Ertragsteuern) which fall under this description, as well as for "scheduled taxes" of the Belgian and Italian types.

On the other hand, the dual system and the single tax system have been considered as being two distinct types of taxation. Under the first, which existed in France up to 1948 and still continues

to exist in Italy and Belgium (1), different types of income are firstly subject to a series of scheduled taxes (in principle proportional), and a complementary tax (progressive) is furthermore levied on the income in its entirety. In the case of a sole tax on income, the sum of the income of a person is in contrast held as subject and base for the tax and is assessed on a single occasion. The argument advanced lately in support of a dual system, namely that this system is in effect the best example of "tax discrimination of income", is in fact shown as false for several reasons (for example, differing base for taxation, varying efficiency of the method of determining and inspecting different categories of income, etc.).

Even when the single type tax on income has application, it can appear in various forms in matters of detail. Fundamentally, overall income, whatever its level, is subject to a single rate, or as in England to a schedule split into a normal tax - proportional in principle but slightly degressive - and into a surtax which is progressive from a formal and material point of view, the former affecting all income, the latter on the other hand, affecting all income exceeding a certain determined level and levied in addition to the normal tax.

Finally, it must not be forgotten that, in the case where it exists, such as the Federal Republic of Germany for example, with a single tax on income with a uniform schedule, the parallel collection of business taxes to the account of the local authorities can engender in many respects effects analogous to those produced by the juxtaposition of taxes on income and scheduled taxes.

In considering the single tax on income (synthetic tax) as a prototype of tax, it can be maintained that it contains certain advantages in comparison with a system of scheduled taxes; these advantages have a certain bearing on the taxation policy of the Common Market. The assimilation of all the income of a person into an overall income allows wide account to be made of the particular conditions of this person and the rational application of the principle of progressivity which can only be effected by scheduled systems in an irrational and unjust way. On the other hand, a single tax on income leads to the achievement of a greater "transparency" of the taxes which is of special importance for taxpayers who wish to extend their activities to other countries of the E E C. Finally, the tax discrimination of income intended by scheduled taxation but unachievable in practice as indicated above can also be achieved by setting up a general tax on wealth with a complementary character, like that which the FFC has commended for all the Member countries of the E E C (see page 127 et seq.). In the opinion of the FFC a certain alignment of the Belgian "taxe professionnelle" and the Italian "ricchezza mobile" toward a system analogous to that which exists in other Member States would be achievable without causing great difficulty. Whether within the framework of a single income tax, there is levied a proportional (normal) tax and a separate progressive surtax, or all incomes are subject to tax without regard to level through a single tariff, is of secondary importance. Since Germany reformed the tax scale (1958) within the framework for a new tax system for joint incomes of husband and wife, the disparity with this type of tax in France has become still less significant than it was before.

The FFC considers that it would be desirable that the same type of single tax on income, with the same structure of scales, even if the rates are different, be levied in all the countries of the E E C. The Committee is unanimous in considering that in theory this solution is the best, and the majority of its Members believe that it will also in practice be achievable, although certain transitional difficulties will have to be overcome. However, it will be necessary to watch that the removal of real (scheduled) taxes does not lead to injustices resulting from differences or shifts in the tax burden derived from different methods of assessing and levying taxes for various groups of income recipients (funded versus unfunded income).

Independently of the question whether - and if occasion arises how - a harmonization of taxes on income will be operated, the question of the retention of certain taxes affecting "returns" (Ertragsteuern), such as are levied in certain countries (mostly by local authorities), should be studied carefully. The existence within a country of two sorts of dissimilar taxes whose effects however, are analogous, in effect gives rise to certain discrimination which also affects competition on an international scale, since they are differentiated according to the case in question. This question is closely linked with national regulations on financial equalization. A detailed study of this matter would go far beyond the scope of the present Report.

(1) In Belgium it was considerably mitigated by the Tax Reform of November 1962 (Publisher's note).

b) Personal allowances and deductions

The size of allowances and the way of calculating them for the taxpayer himself and for members of his family etc. settle on the one hand, the extent and consequently the return of income tax, and on the other hand and particularly for lower incomes, the effective burden. Clearly no judgement can be made on the size of allowances given apart from the rates; moreover, the level and distribution of National Income, considerations of social policy (redistribution policy), etc., have an influence in this field. The burden borne for social security contributions can also not be ignored when taking account of these allowances.

A widespread harmonization of the systems applicable to allowances must not be expected, at least without some delay, for the reasons just mentioned which vary from country to country. The reduction of existing differences should be attempted however, to the extent that this seems desirable, so as to avoid too large a difference of the effective burden borne by income derived from work. An attempt must be made to find a compromise between the requirements of competition on the one hand, and special national interest and aims in this realm, on the other hand.

But the FFC would like to make the following point quite clear: in each country of the Community, workers who have their tax domicile in another Community country should each have the right to the same allowances for dependents and to the same personal deductions (for example, because of payment of alimony) to which they would have had right if, as well as their family, they had their tax domicile in the country where they are occupied professionally and as if they had no other income than that which they would have earned in that country.

c) Taxation of households (joint incomes)

Different taxation on income of married couples and children can bring about very large disparities of burdens, even if the rates are very closely identical. While, in the E E C countries - with the exception of France which has for a long time applied a method similar in its effects to the American splitting of incomes by setting up a figure for a family quotient (quotient familial) - the system of taxing together the joint incomes of spouses with fixed allowances was in force up to 1958, the German reform (adoption of splitting incomes) has made an alignment of regulations in this matter more urgent. It is not necessary to unify all the structural details. The FFC however, considers that, following from more recent economic and social progress and because of the systems in force in France and the Federal Republic of Germany, it appears to be indicated to adopt a general method of taxing incomes of spouses and households together and/or to adopt a rate structure in order to ensure that the joint assessment of spouses does not lead to a tax burden which, because of progressivity, is higher than that on similar total incomes of single taxpayers. In this realm of ideas, an analogous solution should also be found to the problem of the taxation of the income of minors who are still a responsibility of the taxpayer. In general the tendency to add this income to that of the parents is observed unless it concerns income acquired by the children themselves (income from work). In other words, the income of minors added to those of the parents is limited to "funded income" (interest, etc.).

d) Extent of objective tax liability

In our time, all important categories of income are subject to taxation of income. Disparities continue to exist however, for certain exceptional income or income at irregular intervals. This is particularly the case for capital gains although this may be less a matter of principle than of the technique of tax collection.

It seems desirable to place these incomes under an identical system in order to achieve free international employment of capital and freedom of establishment within the E E C. This necessity for a uniform system clearly covers capital losses.

e) Differentiation of tax burdens

Almost all legislation regulating income tax and taxation of companies at present contains numerous special provisions, applied to special types of income or particular employment of income and which derive their origin from considerations of social and economic policy, and are often dirigistic in character. They are the prime cause of internal distortion of competition of tax origin. Since these special provisions differ from one country to another in nature and size, it is unfortunate that they frequently also have a depressing effect on international competition.

Sometimes these special provisions take the form of differential rates, sometimes they are more or less concealed within the dispositions relating to the principles for evaluation and

amortization, as well as, last but not least, to the rules relating to the computation and taxation of income.

It is in this field that a widespread harmonization is required so as to avoid distortions in the realm of international competition. Such a measure clearly assumes, among other things, an agreement of the Member States on principles for a policy encouraging investment or on growth policy, in relation to which concepts and interests can vary from one country to another.

In general, cases where differential tax treatment is held to be necessary for reasons of structural peculiarities of a country can be conceived without giving rise to distortion in trade between Member countries. In similar cases, it will however be useful to learn the opinion of the Commission so as to know if such measures are compatible or not with the functioning of the Common Market.

But even if an agreement on the extent of differentiation of the tax burden cannot be reached, there must at least be an attempt to unify the methods employed, particularly because unification would above all increase "transparency" of taxation.

f) Differentiation of methods of assessment and/or collection according to categories of income or according to the level of income

In fact a particularly important differentiation of the tax burden arises in many countries - partly deliberately and partly involuntary - from the application of different methods of collection and assessment of taxes affecting different categories of income and/or income of the same type but of a different level.

Such differences result for example, from the application of lump sum assessments either on the partial or total tax base, or on the tax itself. Such lump sum evaluations are in principle incompatible with the character of a true modern tax on income. For reasons of tax technique however, they cannot to a certain extent be dispensed with. But a comparative study shows that there are considerable differences between the Member States in the field of application, notably in the realm of the taxation of industrial and commercial income, and of income derived from the liberal professions, and also partly for farmers' incomes for which the tax burden borne in various countries under the heading of income tax and land tax would be worth a special study. Since lump sum taxation has always tended to provide those who benefit from them, more or less important advantages in comparison with taxpayers who are taxed according to real income, distortions of competition of a tax origin result from this within countries; given the considerable differences in fact existing from one country to another in the relative extent of the field of application of lump sum payments, this therefore causes disturbances in international trade. Thus, it is particularly urgent to seek an agreement between Member States on the nature and extent of the lump sum evaluations which should everywhere be reduced over time to an absolutely indispensable level from a technical point of view.

Together with the question of lump sum taxation, the nature and significance of withholding at the source are of great importance from the technical point of view of the assessment and collection of taxes.

The FFC is convinced that this method of taxation should be applied in the same way in all the Member countries, and that all interest and all dividends should be subject to it.

To the extent that the withholding process could not be applied immediately everywhere integrally - for example because of the non-taxation of public borrowing - the States concerned should also undertake steps to counter within a short time, the imperfections of their systems of withholding at source. Elsewhere are contained details on the method of withholding at source on dividends commended by the FFC (page 139 et seq.).

g) The method of taxation of company profits, particularly with regard to share companies

aa) The problem of a special tax on companies

In most industrialized countries, the taxation of profits of share companies etc. is at present made by a tax on companies, different in form from the taxation of income of individuals. This is also valid for the E E C countries, with the exception of Belgium (1); thus harmonization of the tax systems for industrial and commercial profits would be relatively easy to achieve in all the principal countries by levying a special tax for companies.

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(1) The Tax Reform of November 1962 introduced a special company tax (Publisher's note).

However, it must not be forgotten that a formal separate tax on companies is not of itself important in relation to the material treatment of company profits, whether these profits are placed to reserve or distributed. In relation to the real tax burden on these profits, it is rather a matter of considering if, or in what way, the tax on income and the tax on companies are related with one another (integrated), for example, with respect to the methods used for the computation of these profits and the possibility to credit one tax against another tax, etc.

In this respect, even in those E E C countries where there is already a formally separate company tax, the situation is different from one country to another. Without any further detailing of the dispositions of national tax legislation, the FFC states that these differences, which currently also concern the methods of collection of taxes, gravely prejudice the "transparency" of taxation and thus the possibility of comparing the tax burden affecting industrial and commercial profits, and dividends. These differences also make the agreement of conventions intended to avoid double taxation more difficult. Beyond these considerations it must be emphasized that a net difference in the tax burden on dividends is a handicap to the free employment of capital and freedom of establishment within the Common Market.

Where conditions of taxation of industrial and commercial profits used for self-financing are different from one country to another, this state of affairs also has unfortunate consequences. In this range of ideas the systems must be reasonably aligned as rapidly as possible, if not there will exist the danger that reserves put aside in the form of reserves for self-financing by integrated companies belonging to international groups, would be concentrated in the countries having lower taxes. This will perhaps not arise if (European) tax legislation envisages discriminatory measures in respect of foreign parent companies and/or in respect of foreign subsidiaries, but such legislation would be imcompatible with the concept of the Common Market.

Indeed, some theoretical arguments could be advanced in favour of regulations by which company profits would be taxed within the framework of a tax on income equally applicable to individuals and legal entities, in which case the current profits of companies would be considered as profits realized by shareholders, and for which the shareholders would be taxed whatever the form and in totality, thus including the non-distributive part of profits. Given however, that, as has been said, for some time and according to all the evidence, there has been a move toward a special tax on share companies, it could be easier to go on to a harmonization that would work in this sense.

Consequently, the FFC recommend that there be levied in all Member States, in addition to income tax, a special tax on companies. As long as the scheduled system of taxes shall remain in Belgium and Italy, scheduled taxes borne by share companies should be considered as forming advances toward the tax on companies.

This special tax would bear on all income of a share company (professional income, interest, etc.) as constituent factors of the income subject to company tax, which would not moreover, exclude measures tending to prevent the double taxation of income that a company draws from dividends and similar income originating from participations in another company (cf. page 123).

The structure of the rate should, according to the opinion of the FFC, be uniform in all the Member countries and it is proposed that for practical reasons, the tax be varied in such a way - although certain considerations of a theoretical character militate in favour of the application of a uniform rate for all profits without taking into account the method of other employment - that the part of the profits retained for self-financing be taxed more heavily than that which is distributed. Precise detail on the level of the various rates applied in relation to company taxation will be found further on (see page 139). However, the FFC wishes to emphasize at this point that in its opinion there should be no prohibition for a Member State to go on - be it for reasons of structural policy - to provisional modifications which seem desirable to it in relation to the difference between the rates applicable to the non-distributive part of profits and those applicable to the distributive part of profits, except if such a modification would bring about a disparity exceeding that recommended in the present Report.

The FFC believes that in the immediate future the practice which currently envisages levying taxation proportionately to the absolute sum of profits should be abided by. It is advisable to devote a special study to the question whether, as encountered for example in Switzerland, the tax should in part be progressive, that is to say, calculated in relation to the earning capacity of the company's capital, or in other words according to the relative level of profits.

For all the countries of the Common Market, the fact of adopting an independent tax on companies implies the necessity of being in agreement on the nature and importance of the relationship

(integration) between the tax on companies and the tax on personal income. The most important problem which arises in this respect deals with the tax system applicable to dividends paid to individuals. The two possible extreme solutions consist on the one hand, in total double taxation of dividends by means of the tax on the company and the tax on income and, on the other hand, in the collection of company tax on only non-distributed profits. The FFC, as already stated, has expressed an opinion for a compromise solution consisting of a differentiation of company tax in favour of distributions. The details on the problems concerned will be found later in the framework of the study of the technique of withholding at source (see page 139 et seq.).

bb) Taxation of parent companies; problem of participations

In countries where there exists a distinct tax on companies, the problem of the tax treatment of dividends drawn from participations has received a broad number of solutions (cf. appendix D on holding companies and investment companies (1)). On the one hand, there are solutions which start from the idea that there must be avoided as far as possible, within the broad field of the taxation of share companies, the principle of "bis in idem", an idea which has led to special systems through which certain countries assist share companies. On the other hand, there exists the concept according to which it is sufficient to apply to parent companies a tax system analogous to that for businesses having branches.

Where legislators grant - in certain cases where economic evolution demands it - the privilege applied to parent and subsidiary companies for participations of less than 50%, it is always possible that businesses seek to arrange their affairs by interposing in the line of relationship one or several holding companies.

From the point of view of simplicity, the principle of "non bis idem" is clearly to be preferred. But the FFC recognizes that desire for simplification must not always outweigh others when it concerns the solution of tax problems.

For this reason, it proposes a graded solution which is described later with explanations relating to the withholding of tax on dividends at source (cf. page 139 et seq.).

3. Turnover tax

In relation to turnover tax, there exists a series of more or less differing possibilities which can in part be also combined one with another.

Firstly turnover tax can be levied in the form of a single phase tax, a tax on several stages, or in the form of a tax on all stages. The two latter types may be cumulative cascade taxes or not.

In the first case, it could take the form of a tax on production, at the wholesale stage, or at the retail stage. In theory, the tax could in this case as well as in the two other cases, be imposed on gross turnover or net turnover. However, in fact the only reasonable possibility to limit it to one phase exists in the case of gross turnover tax given that if a tax is levied on net turnover, there will be considerable differences between the different products or branches of production in relation to net turnover or as regards the relationship between this and the gross turnover at a particular stage. This is why for net turnover tax only the non-cumulative levy at several stages can be envisaged, contrary to gross turnover tax which is capable of being levied according to both alternatives, i.e. a single phase tax or a tax levied at several or all stages.

Given the considerable significance of turnover tax - which significance varies in a not unimportant way from country to country - and the direct influence of this tax on the formation of prices and consequently on the conditions of competition, it can be understood that the problem of harmonization of this sort of tax has played a major role in discussions up to now. Since a special Committee of the E E C concerns itself with questions of turnover tax, the FFC believes that it can and must limit itself to sketching certain basic problems (2).

Harmonization of turnover taxation does not seem to be required at first sight, at least as long as differences in the level of taxation are made "inoffensive" by the application of the principle of the country of destination through the well-known compensatory measures that are already in being (compensatory levies at importation, refunds at exportation). But in reality these compensatory measures cannot prevent there arising from this, less in the average case than in numerous special cases, tax advantages and disadvantages in international trade in certain goods,

(1) See page 178 et seq.

(2) See the Reports of the Sub-Groups A, B and C, page 1 et seq.

precisely because there are various types of turnover taxes. Beyond this, certain distortions of competition arise from the fact that the number and nature of goods exempted from turnover tax are different from country to country.

Quite apart from differences in the level of effective burden, it is therefore absolutely urgent to go on to a broad harmonization of turnover tax systems, even if the principle of country of destination should be maintained.

The Members of the FFC, with only one exception, are persuaded that in any case it is advisable, in the interests of harmonization which especially in this field is necessary, that none of the Member States of the E E C maintains a cascade system of gross turnover tax. This type of tax primarily presents the disadvantage of causing distortions of competition within national economies where it is applied, and of artificially encouraging the concentration of businesses. Moreover this tax distorts international trade through the impossibility of exactly calculating the overall charge of turnover tax for a good and consequently, in the case of the application of the principle of the country of destination, the sum of compensatory duties and refunds corresponding to this charge.

(1) After the abolition of gross all-stage turnover tax, the choice between the other turnover tax systems as well as their form largely depends on the question whether it is wished in relation to this essential tax to retain the current practice of the principle of the country of destination, or that this must be replaced by the principle of the country of origin (cf. page 148). If the principle of the country of destination is maintained and at the same time tax frontiers are abolished, there can only be taken into consideration as a turnover tax system, a tax levied at the retail stage which in no case requires tax frontiers with the exception, should the occasion arise, of cases where there is applied what is termed "use taxes". If on the other hand, the principle of the country of origin is supported, any kind of net turnover tax can be employed that may be levied either at the production stage or at the wholesale trade stage. In this case there must not be any, or very small, differences between countries in the different rates if it is wished to abolish tax frontiers.

Some of the Members of the Committee are of the opinion that one could and should give greater or smaller discretion to the various States in the choice of turnover tax systems (leaving aside gross cascade turnover tax). The majority of them are, on the other hand, of the opinion that the application of the same system is desirable, at least over the long term, and more exactly the application of a system allowing achievement of the principle of the country of origin and consequently the abolition of tax frontiers.

As a tax at the retail stage is on practical technical grounds over the long term unachievable as the sole form of turnover tax (given particularly the large number of small retailers of whom the majority are unable to maintain precise book keeping), a decision in favour of the application of the principle of the country of origin (see page 126) theoretically has the meaning of a decision in favour of a net turnover tax on all stages (net value added tax, taxe sur la valeur ajoutée). At the moment such a tax exists solely in one of the Member States, France, but it has been attempted for some time in other countries and notably the Federal Republic of Germany, to achieve a reform in the sense of adoption of net turnover tax.

Such a tax can be managed in different ways. The first possibility consists in not admitting any deductions for investment goods purchased, as was the case in France before the "Lauré reform". However such a tax cannot be considered from an economic point of view as a true net turnover tax, because it affects many more factors than simple value added. It does not have a neutral effect because it also affects the income from capital.

Consequently there can only be taken into consideration a tax on added value or a properly termed consumption tax as a rational economic form of turnover tax. The first affects the value added by businesses, but allows deduction for investments according to annual amortization (therefore called an "income type net turnover tax"). On the other hand, the form of a properly termed consumption tax ("consumption type net turnover tax"), through total deduction of expenditure on investments in the year of purchase, leads to taxing in each year only the difference between the added value and net investments, that is to say consumption proper. Only this latter type of net turnover tax can be termed economically neutral, since from a tax point of view it does not reduce the income coming from the use of capital; moreover it is more attractive from the point of view of economic growth.

These two forms of taxes can nevertheless be managed differently in detail. This problem will not be examined here. It is sufficient to emphasize that to the extent that one is limited to considering

the so-called method of deduction, there can in principle be employed either the "base on base" method, or the "tax on tax" method. These two methods contain advantages and disadvantages. From the point of view of trade between the countries of the E E C, these differences do not play a considerable role if the principle of the country of destination is applied, since it is then possible in the two cases to apply precise compensation in tax between the States on condition that there are no (differences of) exemptions or differences of rates. In the event of adopting the principle of the country of origin, on the other hand, the "base on base" method of deduction would alone enter into consideration; this implies naturally that differentiation of rates of tax based on the nature of the goods taxed is abandoned (see however page 148, and the arguments there of one of the Members of the Committee in favour of "tax on tax" deduction).

(2) At the moment there exist exemptions and differentiations in all laws relating to turnover tax.

As already mentioned elsewhere, tax exemptions (when they differ according to the countries) cause important distortions in the conditions of international trade. If rational functioning of the system in connection with the objectives of the E E C is desired, it is essential that the different countries consult one another on the categories of goods to be exonerated from turnover tax. It seems appropriate to restrain to the greatest extent possible the number of these exempted goods, that is to say, to restrict exemption to goods which are in general of prime necessity. Such a regulation would considerably reduce the regressive effect of turnover tax on the one hand, and on the other hand, would prevent Member States with a weaker financial and economic situation from seeing their tax receipts reduced by proportions that they could not bear.

In relation to differentiation of tax burden within the framework of net turnover tax, experience has shown that to the extent that those differentiations are a function of the types of goods, which is itself in conformity with the system, they make administrative management extraordinarily complicated because of the difficulties that such a system inevitably brings with it. Moreover, the existence of different rates gives rise to groups of interested parties who claim the lowest rates for goods that they produce by invoking arguments which are not always objectively based. Thus it seems right on the one hand, (apart from total exemption of turnover tax for a limited number of goods of prime necessity) to envisage a uniform rate and on the other hand, to subject certain luxury products to special taxes on consumption (tobacco, alcohol, etc.) in cases where this appears desirable for reasons of social, health or tax policies.

In relation to differentiation of turnover tax as a function of the turnover of businesses, it must be emphasized that perhaps this is defensible within the framework of a gross cascade turnover tax (notably because of effects of encouraging concentration of businesses). But it must be rejected for net turnover tax since it is inequitable, it goes far beyond the outline of the system, and raises objections from a taxation point of view. Naturally this does not exclude that for reasons of tax technique, there could be anticipated a certain general exemption (not too high) comprising subjective freedom from taxation until the statutory limit is reached, and complete taxation of total turnover if turnover exceeds the limit.

Finally it must be asked whether it is materially right or politically possible to expand net turnover tax to all branches of the economy or to all professional groups.

This question arises mainly for agriculture considered as a branch of the economy. Since here it concerns a very delicate and very complex realm, which is moreover the object of studies made by special committees of the E E C, the FFC considered that it should neither deal with this problem to any extent nor had it the necessary competence to do this. However, it felt it should draw attention to the fact that whatever the regulation adopted in this respect, it should be uniform for all the Member States.

In relation to the liberal professions they are also characterized by a range of peculiarities which seem to indicate continuation of their subjection to a gross turnover tax, as is the case in several countries at the present moment. A more detailed study would be necessary to know whether such a regulation or a similar regulation is also desirable for craftsmen considered as a branch of the economy. However the FFC is in principle of the opinion that it is hardly justified to exclude craftsmen from the application of net turnover tax or even to grant them simply a right of option, notably because of the extraordinary technical difficulties which would be raised by clear delimitation between craft and non-craft businesses.

(3) For various reasons, notably because of the differing budgetary needs of Member States, it is doubtful that the application of a uniform type of turnover tax, that is to say in fact of a net

turnover tax levied on all stages, according to an (approximately) identical rate would be politically achievable and could be considered as a generally satisfactory solution. Therefore the FFC considers the following scheme as the best compromise possible:

A system of net turnover tax of the type indicated is introduced in all the countries of the E E C as a base tax with the same or almost the same rate. In addition, there could be imposed, as a complementary tax, a retail tax that Member countries can administer - notably in relation to the rate - to a large extent prompted by their particular budgetary needs. It has already been shown that a retail tax is not practicable as the sole form of turnover tax and it has also been shown why this is not so. However, levied as a complementary tax at moderate rates it would not give rise to the same objections and difficulties. Even if there are relatively marked differences of rates between the countries, the character of a retail tax is such that it does not bring about notable distortions in trade between States, given that the goods subject to the tax at the retail trade stage are not exported (with only a few exceptions, relating for example, to certain durable consumer goods for which there could be envisaged the application of use taxes according to the American model).

(4) It is possible to summarize the views of the majority of the FFC as follows:

It is desirable to abolish in all the E E C Member States gross turnover tax levied at all stages. In place of gross turnover tax, there should be applied a net turnover tax covering all stages up to that of retail trade, the latter itself being excluded. So as to allow application of the principle of country of origin, it would be advisable that this tax be of the same type and that the rates be nearly the same. Because of differences existing between the budgetary needs of Member States, harmonization of details must take place by stages. But at the end of the process, there must be a unanimous agreement with regard to the system, the exemptions from subjective and objective tax liability, the rate of tax, etc.

The aforementioned net turnover tax might eventually be complemented by a tax on retail trade, whose rate can be different according to the country without causing any distortions of competition.

The reform of turnover tax like that which has been sketched out, could be achieved over time in the following way:
first of all Member countries agree on the fundamental principles which must serve as the basis for methods of net turnover taxation that they wish to install after the abolition of gross turnover tax at all stages (where it exists). This agreement reached, the new system is applied in all countries, with the reservation of as few and small differences as possible from one country to another in the level of the tax, tax exemptions, etc. Whatever the result might be, these differences could still remain sufficiently important during a certain time for it to be necessary to consider the maintenance of the principle of the country of destination. This reform, should occasion arise, is matched by the setting up of a complementary tax on retail trade, a tax whose rate is low and can vary from one country to another.

Next, there is a progressive harmonization of net turnover tax notably in respect of rates, exemptions, etc. The application of the principle of the country of origin could make its appearance at the end of this harmonization process.

In relation to Italy, it is probable that it will be necessary to apply the reform in three and not two stages. First of all, Italy would adopt the same type of net turnover tax as other Member States, without however levying then and there a complementary tax on retail trade. Next Italy would attempt to adapt gradually in detail the rules of net turnover tax to the dispositions in force in the other Member countries. The possibility of setting up a moderate tax on retail trade will be studied. Finally Italy will adapt itself entirely to the arrangements applied by the other States, as much in relation to net turnover tax as for tax on retail trade.

4. Consumption taxes

(1) Concerning excise duties - in any case if taxation according to the principle of the country of origin were considered - a very large measure of harmonization would be unavoidable, as already mentioned (cf. page 118). Firstly and above all harmonization should be aimed at the level of the taxes. In order to guarantee (approximate) uniformity of this level, an alignement of consumption tax systems would not indeed be absolutely indispensible, however, it would without doubt facilitate effective harmonization in many cases.

As will be seen later (cf. pages 129 and 148), the Committee is of the opinion that for a long

time still it will be necessary to apply to special consumption taxes, the principle currently in force, that is to say, the principle of the country of destination. For this reason it seems that the problem of harmonization of these taxes will not arise in the near future.

In order to improve the "transparency" of taxation, it would however, be desirable to seek an agreement among the Member States for the same taxable goods, on the method of assessment (ad valorem taxes or specific taxes). It seems doubtful if a similar agreement on the question of "monopolies or consumption taxes in a strict sense?" might be politically possible. In our opinion uniformity with respect to the form of the taxes should not at any cost be sought, especially since the countries where there are monopolies (recalling for example, the tobacco monopoly in France and Italy) have valuable experience of them and would not, rightly, wish to abandon them.

(2) A particular problem arises with respect to those excise duties which in part have the character of a tax on manufacture, given that they bear on goods utilized at the same time for direct consumption and - either as raw materials or as secondary materials - in the production processes of businesses (sugar, alcohol, etc.). If the rates applied in Member States of the E E C for these taxes are different, there arise from this distortions of competition in the trade between these States for the products concerned, because of differences in the costs of production and consequently of differences in prices. Contrary to what happens for turnover taxes that are levied at the last stage of production or on "added value", this disadvantage cannot be compensated in relation to special excise duties by the application of the principle of the country of destination, given that it is not possible to calculate in a precise way the burden of these special taxes affecting raw and secondary materials and that the Treaty of Rome expressly forbids taking this burden into account on a lump-sum basis.

Consequently, it seems that there exist, in theory only two possibilities: either incorporate with turnover tax those consumption taxes which continue to be levied after changing to the second phase of tax harmonization - then it would be necessary to increase in corresponding measure the rate of net turnover tax for the products in question - or to abolish them as special duties, in which case the loss of tax receipts should be compensated by a general rise in the rate of net turnover tax. To the extent that such a procedure would be impossible or inopportune for taxes which by their nature affect mainly true consumption (cf. the objections that have been formulated in respect of differentiation of turnover tax related to different categories of goods, objections which are described above, page 125), it should be allowed that businesses that buy products to which these taxes apply can deduct these special taxes from the net turnover tax that they must pay.

Finally, it is once more appropriate to note that if all consumption taxes are conceived so as to affect solely consumption proper, it is not necessary to go on to harmonization of these taxes with a view to avoiding distortions of competition, insofar as the principle of the country of destination is applied to the taxes in question. However, to the extent that it is considered that total abolition of tax frontiers between Member States of the E E C is ultimately desirable and that consequently it would be also advisable to apply the principle of country of origin for consumption taxes, it will be indispensible at that time to go on, from a qualitative and quantitative point of view, to a broad harmonization for these taxes.

5. Taxes on wealth and on inheritances

Since this part of the Report deals exclusively with questions concerning the structural forms of one and the same tax, the problem of whether a tax bearing on wealth must be considered as an element necessary to all the tax systems of the Member countries, will be ignored here. It is appropriate to note, however, that the majority of the FFC is of the opinion that it would be expedient to levy a tax on wealth at low rates since this would be a means of operating tax discrimination of income. Furthermore, such a tax would have the advantage of improving or correcting the inspection of declarations of income and inheritance. In order not to bear too heavily on small or medium sized fortunes, fairly large allowances should be considered and settled by reference to the situation of the family and the age of the taxpayers.

Although the FFC is conscious of the difficulties brought about by an exact and concrete evaluation of the factors comprising an inheritance, it considers that because of experience in this realm in Switzerland, the Netherlands, the Federal Republic of Germany, the Scandinavian countries, etc. these difficulties are not insurmountable.

To the extent that taxes are levied on wealth, a broad alignment would be desirable. This align-

ment relates particularly to the question whether the wealth of natural persons is alone subject to tax or if that of legal entities is also subject; furthermore harmonization of the relationship between income tax and tax on wealth must be recommended (for example: deduction of wealth tax from the base for assessment of income tax), on the one hand, the relationship between the tax on wealth and the tax on profits (particularly taxes on developed and undeveloped property), on the other hand.

Finally, the FFC considers that it is important not to apply the wealth tax to legal entities in order to avoid double taxation. Such a regulation seems above all necessary in order to prevent distortions of competition of a tax origin, because the importance of a tax on wealth differs under conditions otherwise equal, according to whether the principal (or secondary) role is played in the country or in a branch of industry by businesses employing primarily capital, or labour.

For the taxes on inheritance, their fiscal importance measured as the proportion they represent in the overall tax product, is to-day everywhere restricted. It is however, often - at least for large inheritances or estates - so high that gross inequalities between countries can lead to transferences of domicile and to movements of capital for tax reasons. Certainly, this argument concerns the nature and the types of tax on inheritance less than their level. But if "tax transparency" is desired to be as great as possible, a certain formal harmonization of the system of taxes on inheritances (tax affecting either devolvement of part of the inherited estate or the estate as such, or a certain combination of the two) would also be desirable.

Furthermore, obstacles to the free movement of capital could and should be eliminated by means of conventions for the avoidance of double taxation to the extent that these obstacles result from great differences in the tax burden on inheritances and estates. In this respect it would be very desirable that in future all Member States apply the same criteria in the matter of subjective tax liability (nationality or situs).

B. Disparities existing in the rates of various particular taxes and proposals to reduce these differences as desirable from the point of view of integration policy

1. Preliminary general remarks

If, as explained (see page 105 et seq.) disparities in the relative overall level of taxes do not in general interfere with competition, above all when the expenditure structures which relate to them are clearly the same, disparities in the level of certain particular taxes can hinder international movement of persons, goods and capital, and indeed divert them from their "natural" route. In a general way it cannot be said what the importance of this difference must be so as to bring about such effects, since in this respect, things vary according to the type of tax. In addition to transport costs, which play a primary role in commerce, their must, on the one hand, be brought into account non-tax effects (particularly for movement of persons), and on the other hand, particularly for the establishment or movement of businesses, natural, technical, etc. factors of establishment and whose weight is often sufficiently large to compensate for tax factors.

In evaluating the effects that certain differences of tax rates can have on competition, it should be kept in mind, as already mentioned in the foregoing, that for many taxes these effects are not solely linked to the rates of tax but to the effective (real) tax burden which results from the simultaneous interplay of several factors, the rate being only one of these factors. Thus for example - leaving aside the possibility of varying use of the tax product - it is in relation to the taxation of industrial and commercial profits or of wages, that the effective burden of income tax in a given country A where rates are nominally higher than in a country B, can be less than in country B, if in country A there exist larger allowances and exemptions, and more advantageous principles of valuation and assessment or amortization for taxpayers. Furthermore, account should be taken of the practical efficiency of the legal provisions concerning the rates, an element the importance of which depends upon the tax morality of the taxpayers on the one hand, and upon the capacity and determination of the tax administration in the struggle against attempts at tax evasion on the other hand. In relation to the two points just mentioned, the technique applied for assessing and/or collecting the tax clearly play an essential role. With regard to progressive taxes (taxes on income and on inheritance) the effective tax burden does not only depend upon the rates as such, but rather upon the rate structure, that is to say the differences of level and extent and other factors which also interpose themselves in settling the course of progressivity.

In addition, the following is pointed out: certain taxes have particularly close relationships with others in the functions assigned to them by the tax system and in their micro-economic effects,

so that by considering them in isolation erroneous conclusions can be reached. Such a relationship exists for example, between the tax on personal income and the tax on companies, especially in respect of the tax burden on profits distributed by companies. Another example is that of the relationships between the tax on wealth on the one hand, and the tax on income, companies and inheritances on the other hand. To the extent that the tax on wealth represents a supplementary taxation of what is called "funded" income, it must be considered in addition to income tax and tax on companies, where the taxation of income from capital or of company profits is concerned. Moreover the existence and the rate of tax on wealth plays a role in the evaluation of the comparative level of taxation of inheritances, since this can take, at least in part, the function of a tax bearing on wealth, particularly if it takes the form of an estate tax.

If it is assumed that a country must collect a certain overall tax product, the relative weakness of its National Income can have the result that income tax can only cover a small part of its financial needs. Thus, such a country will have to resort strongly to other taxes - particularly indirect taxes - and this is especially so if such a country is very attractive for tourists. Within the framework of indirect taxes, and more particularly of consumption taxes, the level of the rates will especially be a function of the consumption habits of the population, which in turn are partly connected with the level of income. There can be mentioned as an example of this, the consumption of sugar per capita which is nearly equivalent in France, Germany, Belgium and Luxembourg; lower in Italy by about 40% and higher in the Netherlands by about 50% in comparison with the first-mentioned countries. The relatively high level of a special consumption tax - such as tax on alcohol and particularly on brandy - can furthermore result from the objectives of health policy pursued by the country in question. Progressivity of tax on income and inheritances likewise to a large extent transpose considerations relating not to budgetary and taxation policy but to economic and social policy; this is illustrated for example, by the fact that in the United States, of the 41 milliard dollars personal taxes, about 2 per cent only come from taxation of income subject to a rate higher than 50%, although the rate can reach up to 91%, as is well known.

2. Particular taxes whose rates show large differences likely to jeopardize seriously the aims sought by the establishment of a common market

a) Special excise duties

Leaving aside the sometimes considerable differences of form and technique in taxes which affect certain consumer goods (see page 126 et seq.), differences which more or less complicate the exact comparison of the effective burden, it must be said that in many cases this burden nowadays varies more or less from one country to another. Certain goods are not subject in several Member countries to any special tax (for example, coffee, tea, salt, wine, matches, lighting equipment, meat, playing cards, saccharine), whereas they are in other countries.

If the problem of consumption taxes which bear on goods likely to be used not only for consumption but also - as raw or auxiliary materials - for primary and secondary production (cf. page 127), is left aside, the question of a quantitative harmonization of excise duties proper only arises, as has been previously said in this Report, in the case where with respect to these excise duties the principle of the country of destination is replaced by the principle of the country of origin. In this case it would be obviously indispensible, given that excise duties are true taxes increasing the cost price, to go on to a very broad harmonization of effective burdens. In relation to certain products like cigarettes and coffee, it may be assumed that the size of disparities in tax burden diminishes to a certain extent through differences of taste from one country to another, but for other products such differences do not play any role or only a very slight role. Experience shows furthermore, that even for the first group of products, it is possible that consumption orientates to a rather large extent in other directions when there are considerable disparities in taxes and consequently in prices, leaving aside the fact that producers will in the circumstances, adapt their exports to the differing tastes of foreign consumers.

Even if one does not go on to complete unification of the tax rates, but is content to align them - which alignment should, it is true, go so far as to make it possible to abolish "tax frontiers" - important disparities in the repercussions that such a measure would have on the budget receipts of the different Member States are to be expected. In this range of ideas, it is appropriate to emphasize for example, that the proportion of total tax receipts of excise on beer is 0.3 per cent in Italy, 1 per cent in Luxembourg and 1.2 per cent in the Federal Republic and that the corresponding percentages for tobacco are respectively 12.7 per cent, 2.6 per cent and 6.2 per cent. Moreover, in several cases there arise problems of financial equalization given, for example,

that contrary to what happens in other Member States, part of the Dutch tax receipts coming from excise duties and turnover tax is assigned to the Provinces and to the Municipalities. A similar situation exists for excise on beer, which in Germany is levied by the Länder, while in other countries it is levied by the central government.

To the extent that the differences in the relative fiscal importance of special excise duties are due to differences in tax rates, it could not be required of those countries which, particularly for reasons of structural policy, rely to a large extent on what are called indirect taxes, to apply a reduction of tax rates for the purpose of harmonization, unless they were granted compensation within the framework of supra-national financial equalization, during a fairly long transitional period during which the progress of economic integration would allow little by little the reduction of the disparities which at present still exist in the national economic and tax power of the Member States.

The problems and difficulties which have been alluded to above have led the FFC to abandon the idea of presenting a recommendation in relation to particular consumption taxes to apply in the near future, the principle of the country of origin and thus to abolish "tax frontiers" completely. If consequently, it is not necessary provisionally to harmonize tax rates, the maintenance of the principle of the country of destination does not completely exclude certain reforms for consumption taxes in the near future. In this respect some possibilities have been indicated above (see page 127). In particular, it would have to be seriously examined whether it is not possible in the very near future, to completely abolish excise duties which are only found in certain Member States of the E E C (cf. 1st paragraph of the present section). Such a measure would not only be desirable for reasons of simplification or because of the regressive and therefore anti-social character of the taxes in question, but it would also lead to a certain harmonization of the structures of national tax systems. It would be facilitated by the fact that the relative fiscal importance of these taxes is small; thus, overall receipts coming from taxes on salt, matches, lighting equipment, playing cards and saccharine represent in total at the moment in the Federal Republic 0.2 per cent and even in Italy only 1 per cent of the total of tax receipts.

Finally, it should be mentioned in this connection that, when a domestic commodity competes with a commodity produced in an other Member State which can be largely substituted for the former (domestic) commodity, any higher tax affecting the substitute product must be abolished since it materially has the character of indirect protection of the domestic product. This type of protection is forbidden by the Treaty. If such a situation is suspected, the two taxes must be compared with the price of the commodities less the tax.

b) General turnover tax

Starting from the assumption that the same type of turnover tax is adopted as a basic tax in all the Member States, that is to say a net turnover tax at all stages, this would, in the event of the maintenance of the principle of the country of destination, allow precise calculation and compensation of differences in the tax burden arising from any differences in the tax rates. On the other hand, it could be questioned whether differences in rates would complicate or hinder the application of the principle of the country of origin.

To the extent that it is assumed that a net turnover tax at all stages is levied under conditions that are otherwise identical (tax exemptions, etc.), it can be considered that even with equal rates the credit for taxes levied on added value in the exporting country against taxes levied on value added in the importing country, can have psychological reactions. Of course, in fact there would arise no distortions of competition under these circumstances. It would be otherwise if the system of "tax on tax" deduction would be applied and if there would exist considerable differences between the tax rates of two Member States. Such differences can possibly have the result that the tax levied on net value added in the importing country (in the case of a low rate) is less in absolute amount than that (in the case of appreciably higher rates) calculated in the exporting country for the net value produced in that country; theoretically the importing country would then have the right of demanding a partial refund from the exporting country. This difficulty would be done away with if instead of applying the "tax on tax" method of deduction, the "base on base" method were applied.

Therefore, insofar as it would be decided -

a) to adopt in a general manner a net turnover tax, and
b) to replace the principle of the country of destination by that of the country or origin, such a

decision would be at the same time in favour of the system of "base on base" deduction. 1)

Even under these conditions differences in the rates of tax - meaning fairly important differences - would affect the principle of equal conditions of competition. Although a country with a relatively high turnover tax is usually a country which has at the same time relatively low direct taxes and vice versa, repercussions of this latter category of taxes on prices are as has been indicated, uncertain and difficult to calculate precisely in particular cases. This is why it is necessary to achieve complete equality of rates of net turnover tax, considered as a basic tax, (but not of a tax on retail trade levied as a complementary tax), if it is wished to avoid distortions of competition caused by turnover tax.

c) Taxes on the transfer of capital

Even under the hypothesis that through the establishment or maintenance of total convertibility of currencies of the Member States or through the creation of a unitary E E C-currency, no hindrance in the matter of foreign exchange regulations will any longer exist with respect to the international movement of capital, factors of a tax nature can hinder or make impossible movement of capital which otherwise would have occurred because of more attractive conditions of interest rates or better possibilities of making profits.

Among the tax factors which, as a general rule, seem to be the relatively most important for investment decisions - at least over the long term - are those which relate to "direct" taxes on income, on industrial and commercial profits and on wealth, but indirect taxes on transfers of capital can also play a certain role.

These levies which together with taxes taken in the strict sense, arise in part in the form of stamp duty and registration duty, affect in the first place the formation and the increase of capital of companies, in the second place the issuing of stocks and shares, and finally Stock Exchange transactions. Currently the systems of these taxes are very different by nature and level in the individual Member States. Moreover there can arise many cases of double taxation in this respect which can only very rarely be avoided by double tax agreements.

When the question is considered whether the present inequality of tax burdens affecting capital transactions leads to restriction of the free international movement of capital, it must above all be emphasized that decisive considerations for the formation of companies or the increase of their capital do not seem for the most part, to be of a taxation type. The existence of sizeable differences between taxes on capital transactions nevertheless exerts a marginal influence which can be related to both the formation of a company or the increase of capital as well as, should circumstances arise, the legal form of the business to be set up abroad. The FFC is of the opinion that in the Common Market the choice between the establishment of a branch or a subsidiary of a corporation should not be influenced by tax factors.

Since net returns expected from investments that bring investors to take decisions ordinarily have greater importance for bonds than for shares, it must be presumed that considerable differences of tax burden for fixed income securities hinder the movement of international capital relatively more than when those differences of tax burden bear on dividend-producing securities. This statement applies as much to taxes on Stock Exchange transactions as to taxes on securities. (------) 2)

Considering the foregoing, very broad harmonization seems indicated or even indispensible for taxation of capital transactions in order to create, as much for businesses as for savers, uniform tax conditions in the Member States with regard to direct investment as well as investment in securities. Harmonization in its ideal form must tend to unify all the taxes considered, as

1) One member of the Committee is, however, of the opinion that in the case where there would be important differences in the rates applied for turnover tax by Member States, conditions of competition for exports to third countries would be severely affected if the method of "base on base" deduction were applied instead of the "tax on tax" method, above all in cases where the exporting country fulfills purely a trade function and where consequently, the value added in that country is very small. This member is also of the opinion that even with equality of rates of the value added tax, taken as a basic tax, it will be necessary to study the preference for and justification of the "base on base" deduction method more thoroughly (cf. page 148).

2) In the French text - but not in the Dutch, German and Italian texts - this paragraph ends as follows: "But it is above all necessary that withholding taxes with respect to income from securities should be made uniform, at least if they cannot be credited by beneficiaries who have their tax domicile in another country of the Community. This question will be treated below."

much in their type as in relation to their level. However, there could also be conceived, at least for a transitional period, a solution under which approximate equalization of the real burden affecting the same capital transactions would at least be achieved by partial reforms. Moreover, it is advisable to abolish all kinds of double taxation of international movement of capital. Finally it should be studied at the same time, whether there exist in the framework of taxes to be harmonized, regulations which, because of tax discrimination of certain forms of capital or investment - irrespective of whether they concern domestic or foreign capital transactions - infringe upon the principle of fair competition and which consequently should be abolished.

Meanwhile, the FFC is of the opinion that taxes affecting movement of capital do not in general represent factors in a rational tax system in accordance with present modern conditions. Their absolute and notably relative budgetary importance is constantly diminishing. This is why the FFC recommends to consider the question as to how these taxes could be reduced, and finally entirely abolished, by way of a reform to be achieved in stages. To the extent that registration of legal deeds must be considered as useful or necessary, present taxes on capital transactions should be replaced by moderate duties having the character of a fee.

In another part of this report (see pages 136 et seq. and 140 et seq.), there will be studied to what extent harmonization of indirect taxes affecting capital transactions must be complemented by a harmonization of direct taxation, and in particular by a regulation, in conformity with the spirit of a common market, for withholding at source applied to income from movable capital.

d) Motor vehicle taxes and tax on transport

Motor vehicles essentially bear two taxes: the tax on vehicles in the narrow sense for which the taxable event is most frequently the possession of a vehicle, and taxes on mineral oils. When calculating the total level of all these taxes (1), one often thinks of the relationship between their yield and the costs of construction and maintenance of roads even when there exists no explicit (formal) assignment of the product of the tax (earmarking). Consequently it can be assumed that all things being equal, there is a correlation between the level of the tax and the extent and quality of the road network for motor traffic.

aa) First of all, for motor vehicle tax proper, any inequalities of tax burden should hardly give rise as a general rule to effects capable of disturbing competition. It is solely if, all things being equal, these inequalities are considerable that it could be conceived that they would influence persons buying cars and trucks in their purchases. If moreover, the origin of vehicles or the domicile of the owners should henceforth no longer play a role in the matter of international traffic, a difference of tax burden could give rise to a type of tax evasion, particularly for vehicles belonging to businesses, because vehicles would then be registered to a large extent in countries where the tax is lower. Thus in this case, it would hardly be possible to avoid a broad alignment of the effective tax burdens.

bb) The tax on mineral oils. More than any other duty, the tax on mineral oils is made use of for very many ends of financial and economic policy which partly contradict one another. This explains why nearly everywhere taxes on mineral oils have become a heterogeneous group which consists of mixture of taxes, exemptions or subsidies and of a series of measures which arise in part from considerations of transport policy, in part from considerations of production or of consumption policy. From a financial aspect, it must be emphasized that taxes on mineral oils for structural reasons, have acquired a greater and greater budgetary importance.

The FFC does not feel itself to be in the position to make detailed proposals on this matter, given the complexity of nature and effects of this type of tax. The Committee limits itself to asserting that a very broad qualitative as well as quantitative harmonization of duties and taxes on mineral oils in the Member countries is urgently needed. To the extent that - as may be assumed - the States would wish to retain the differentiation of rates as is customary at present, according to the nature of the taxable goods or the employment of these goods, care must be taken that the Member States are not only in agreement on tax exemptions or subsidies, but also at least on the nature and possibly also on the extent of this differentiation.

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(1) In international traffic, it is not in the first place the overall burden of all the taxes mentioned which is important, but their composition. If in a Common Market country the level of motor vehicle tax proper is relatively high while that of duties on mineral oil is relatively low, or vice versa, fairly serious distortions can arise when cars which are registered in this country perform transport services within the territory of another country where they have to pay an excise duty on the fuel they need at a level which is higher or lower than the corresponding duty in the country of registration.

More particularly in relation to the tax rates for heating oil, petrol and heavy oils, there should be agreement on gradual harmonization of these rates within the E E C within the framework of a plan to be settled soon.

The FFC recommends the study by a special working group of the entire complex of problems raised by the taxation of mineral oils. This would not solely have the task of studying the above-mentioned different aspects of this tax, but also its relationship with other taxes on transport as well as the problem whether, or to what degree, international harmonization of the taxes on mineral oils could imply a change of the policy that Member States followed until now for the financing of road works.

cc) Apart from tax on vehicles and mineral oils, a tax on transport affects traffic, as well as certain other transport sectors.

From an organic point of view, the tax on transport forms part of the general turnover tax, from which has been separated - either for reasons of a tax technique or for motives related to transport policies - taxation of the price of transport. In a general way, the same conclusions as those relating to the disparities of turnover tax can be drawn from international disparities existing in the tax charges on manufactured products and resulting from differences of structure of the tax on transport.

When disparities in the rates of two taxes are the same, the degree of distortions of competition is far less in the case of transport tax than for turnover tax, since the cost of transport represents only a relatively slight part of costs and consequently of the factors determining the price of goods. Thus, even when the part represented by transport costs in the total cost price of a good is 25% - which is high and occurs only rarely - and when the disparity of charges is as high as 10 points in the scale, rising from 0% (no transport tax) to 10% of the price of transport (this is a rate which is applied in the Federal Republic of Germany only in some cases) the price difference that results is only about 2%. Meanwhile, the relatively slight importance of transport tax is emphasized by the small part it represents in relation to the total tax receipts of Member countries, a part which varies between 0.3 and 1.1% of all tax receipts.

On the other hand, harmonization of transport policy forms a difficult task which should not be made more difficult by disparities in taxation. Furthermore, disparities in the rates of transport taxes necessarily bring about price differences which directly influence the state of competition. It seems desirable therefore to include transport tax, and primarily taxation of goods transport, in a harmonization programme.

Interference with competition arising from disparities of taxation of transport services can above all arise:

(a) from disparities in the price of goods produced in different countries, goods which are in competition with one another at the same particular place of consumption, although the price of the goods in the place of production in country A and country B and the cost of transport (without tax) from the place of production to the place of consumption are the same. These disparities can bring about shifts in the pattern of demand between goods manufactured in different countries and because of this, cause shifts in the location of production;

(b) from disparities in the costs of transport, which bring about a diversion of traffic toward the country where transport costs are less because of lower rates or the absence of transport tax; when, for example, goods must be moved overland between the Benelux countries and Italy or vice versa, it would be sufficient to divert traffic to the country where transport costs are lower, that disparities of a tax origin in transport costs between France and the Federal Republic of Germany are relatively slight; in this case the decisive factor from the point of view of distortion of competition is not disparity in transport tax in relation to the sale price of goods but the same disparity in relation to the transport costs in connection with which disparities of transport taxation have naturally to a more substantial impact; of course there must be taken into account in the framework of this process, also taxation of fuel by means of a tax on mineral oils as well as possible taxation of the motor vehicle by means of the motor vehicle tax.

(c) from multiple taxation of transport services extended over several countries by means of transport tax. As a result of such double taxation products originating from other countries are made the object of discrimination in relation to products manufactured in the consumer country. This multiple taxation arises, for example, when the tax is calculated in relation to the number of tons transported or the total price of transport, or when it is levied as a stamp duty on trans-

port documents. It would be advisable to abolish or reduce these distortions of competition by taking the following measures:

(1) Determine the basis of assessment of transport tax in such a way - for example, by calculating it in relation to the number of ton/kilometers travelled within the particular country or in relation to the part of the transport price which is related to the different countries - that double taxation is avoided;

(2) Subject transport services made by different transport media (road, rail, transport by air and by water) in the various interested countries to the same tax. For this, it is necessary not only that the Member countries are in agreement as to taxing or exempting transport services by a particular transport medium (for example transport of goods by road), but also that transport services made by a competing transport medium, for example, inland waterway transport, are subject to the same treatment, since otherwise when the transport possibilities for a good manufactured outside or within a country are different, (non-taxed transport by water for imported products to a place close to their place of consumption, taxed road or rail transport for a good manufactured within the country), there arise distortions of competition of tax origin;

(3) Reduce disparities in the bases of assessment, in exemptions and rates.

c) Income tax

The choice which must be made between country of origin and country of destination for the leading indirect taxes has as its equivalent in the realm of income tax, the choice between the country of the source of the income and the country of domicile of the taxpayer (cf. pages 146 et seq. and 149 et seq.).

Normally it is the principle of the country of origin (the country of source of the income) which is applied for income tax or company tax. There are several explanations of this: the taxes in question or the income subject to these taxes - particularly industrial, commercial or farming and similar profits - can be more effectively and easily checked by the tax authorities whose officials know exactly and from experience the situation in the country where the activity in question is performed. It is moreover, good psychology to anticipate possible tendencies toward xenophobia by making taxpayers pay their taxes in the country where their gainful business activity is exercised; finally, the application of the principle of the country of destination to income taxes and to tax on companies, often used for indirect taxes, seems impossible because there exists no practical possibility to calculate for each product the sum that a "compensatory tax" should represent as a proportion - in percentage of the purchase price - levied at importation or as a refund made at exportation, even under the hypothesis where passing on of these taxes to the profits is achievable.

Nevertheless, it can hardly be denied that in the field of taxation of income and profits, considerable inequalities in the tax burden can also be injurious to the establishment of conditions equivalent to those of an internal market. There is a double implication: on the one hand, the existence of slight disparities of burden, as financial history also shows, do not as a general rule bring about artificial disturbance of competition or, as a result thereof, international migrations, given the weight of other than tax considerations concerning the location of businesses, the domicile of beneficiaries of income, the place of work and residence of workers, employees or members of the liberal professions, etc.; on the other hand, in many cases even considerable differences of tax burden do not necessarily hinder competition.

However, it must be recognized, particularly when it concerns large companies, that disparities in taxation can influence the choice of country in which a new company (parent or subsidiary) or a new branch will be set up, and also the choice of country where the profits made by a subsidiary company are held in reserve. Furthermore it is possible that even fairly insignificant differences in the charge falling under the head of income tax or company tax on pure income from capital leads to a misallocation of capital.

For income tax, the remark made above (page 128 et seq.) is particularly valid, namely that the rates are themselves of little importance for the effective and decisive charge, and that in addition to the tax on income and companies, supplementary charges must be considered with an analogous function, like taxes on wealth and business taxes. Finally, on the one hand, the level of morality and intelligence of taxpayers and on the other hand, the capacity and determination of the tax authorities to apply the statutory provisions as completely as possible, determine to a large extent the relationship between the nominal or legal burden and the effective burden. If the clause of all things being equal was in fact applied to this matter, it would probably be possible

in many cases to reduce considerably the present difference between the rates of several States.

It must, however, be recognized that the level and progressivity of income tax rates are also to a large extent a function of economic potential, particularly of the level and distribution of national income which reflect this potential, and that, besides, the concepts which differ from country to country on the redistribution of income that is desirable also play a part. Thus, in order to obtain through taxation a (relatively) identical sum in a poorer country, there must be higher effective tax charges than in a richer country, and the same can be said with respect to a more or less sizeable concentration of income (on this subject see page 107). For this reason, the attempt made by a comparatively poor country to obtain by high income tax rates, returns corresponding to those of richer countries would be self defeating, that is to say they would lead over the long term to accentuation of differences of economic and tax potential (see page 108 et seq.).

If on the contrary it is assumed that there are relatively higher charges for income tax and/or company tax in the richer economies, and lower charges in the poorer economies, it could be assumed particularly for businesses that they consider the differences in non-fiscal circumstances (including the use of tax receipts) as at least partial compensation for differences of tax burden.

There will now be studied with respect to specific categories of income to what extent differences of effective tax burden for income tax and/or company tax can influence certain groups of recipients of such income in the decisions that they take for their residence, their place of activity or the investment of their capital.

1) Income from employment

To the extent that migrations of wage-earners are the consequences of variations in the possibilities for earning, nowadays these seem to be considered above all according to the nominal amounts of the wage or salary (so-called "take-home" pay). The difference between these amounts and gross wages and salaries derives from income (wage) tax, on the one hand, from social security contributions on the other (experience proves that usually no attention or at least less than it merits, is given to differences of purchasing power of identical net nominal wages - without regard as to whether and to what extent these differences arise from consumption taxes).

With the same nominal size of wages and salaries which are considered as being at an average level according to the standards of West-European industrialized countries, the sum withheld at source on account of wage tax and workers' contributions to social security do not seem at the moment to differ considerably in Belgium, France and Germany, while they are appreciably less in Luxembourg and appreciably higher in Italy. However, there cannot be drawn from these differences conclusions on the incentive to possible migrations because of the taxes. In the first place, it must in effect be presumed that differences of wages derived from fairly similar activities are often sufficiently great for inequalities of social and tax burdens to be largely compensated, if not over-compensated. Assuming for example, that with the same purchasing power of money and the same consumption structure, a particular work was remunerated in Germany by a gross salary of 8,000 DM (6,400 DM net) (tax burden and social security contributions equivalent to 20%, while in the Netherlands the corresponding figures would be 7,000 DM and 5,800 DM (tax burden and social security equivalent to about 17%), it is clear that the net German salary would attract the Dutch in spite of the fact that is has been subject to a higher burden. In the second place it must be borne in mind that employers share in the costs of social security to an extent that varies from country to country. If these sums are considered as "invisible additional wages", the ranking of wages by country is, in many cases, almost inverted. Thirdly it may be for psychological reasons that, all other things being equal, the workers in one country prefer a broad social security system which is granted to them compulsorily by law, and which implies a corresponding reduction of their disposable income, to a system which with fewer compulsory social services, leaves them a higher disposable income and which allows them to deal themselves (partially) with matters of sickness, etc., while in other countries the opposite attitude is to be seen. Fourthly and finally, it must be borne in mind that non-tax or non-economic factors (difference of language and surroundings) can be so important that they run counter to international migrations, even if it appears that such migrations could be caused by considerable differences in net salaries which are due to taxation.

Considering the foregoing, it seems that an alignment of tax rates on income from employment, although it may perhaps appear desirable in principle, is not particularly urgent. A final decision in the matter would require more precise knowledge of the relevant factors than is possible at

present. Since it would be much easier to obtain such information if the systems of wage taxes were harmonized - apart from the rates - an alignment of these systems would for this reason be highly desirable. Differences in the taxation of earnings will at any rate acquire importance the more that gross wages will be aligned with one another in Member States during the course of integration and that psychological and legal hindrances to the free movement of man-power are abolished.

2) Income from independent activities (liberal professions)

Apart from income tax, the type and level of taxation applicable to turnover and, should circumstances arise, to wealth, determine the overall tax situation of persons performing independent activities (doctors, lawyers, artists, etc.). However, of the total tax burden that they support, income tax has a primary importance in all the States of the E E C. In certain countries such as the Federal Republic of Germany and to a slight extent in Luxembourg, taxes on wealth and turnover have an importance that should not be ignored but only when the turnover and/or size of wealth are very high, income drawn from liberal professions being also relatively high. For the greater part of the taxpayers considered here, it can be assumed, however, that since their total tax payments consist for 90% and more of income tax, this tax alone has an influence in the transfer of establishment beyond frontiers which is motivated by tax reasons so far as these play a role.

Differences of "formal" income taxes, that is to say taxes calculated according to the statutory provisions with respect to liberal professions are slight or considerable according to the country. In this matter, the family situation of taxpayers plays a particular role, all things being equal (minimal in Italy, maximum in France). The difference between the burdens expressed as a percentage varies moreover, according to the size of the incomes compared, because of the differing progressivity of national tax rates.

If the factors indicated make an overall judgement of the possible effects of differences of tax burden difficult - particularly in the framework of a dynamic analysis - it must be added that the importance of identical differences of this type can well vary from one profession to another. But even if it is assumed that at the final integration stage the exercise of a professional occupation should be entirely free, it is no less true for many people exercising a liberal profession - but not for all - differences of language, surroundings, legal systems, etc. and to a large extent differences in the possibility of gross earnings, would play in the event of doubt, a greater role than the differences currently apparent in tax burden. The size of the latter could moreover, in fact be smaller than appears from simple comparisons of tax law, since these cannot express the sometimes very considerable differences of method of assessment (for example, in France frequent recourse to lump sum assessment), tax morality, etc.

For the vast majority of persons exercising a liberal profession the question of the necessity of the alignment of tax systems thus arises in roughly the same way as for wage earners. However, it must not be lost from view that for members of certain liberal professions, for whom difficulties of language, differences of legal system, etc. hardly play a role in the choice of place of occupation (for example, consultant engineers, architects, artists, etc.), current differences of tax burden can constitute a not unimportant obstacle to the free movement of persons.

3) Income from movable capital

For income from movable capital, differences in the effective tax burden clearly play a very important role in relation to free circulation of capital. Taxes which come into account at this point are income tax, company tax, withholding taxes on income from movable capital, taxes on the capital transactions and, in some instances, tax on wealth.

If particular questions raised by taxation of dividends are left aside (cf. page 139 et seq.) the following remarks should be made:
In cases where income from movable capital forms together with other income the total income which is subject as such to a general (synthetic) income tax (these cases would everywhere be the most numerous), the income tax burden relating to income from capital can only be calculated hypothetically (for instance as a marginal charge). In spite of this, important differences existing between these tax burdens will often influence decisions taken for investments by holders of capital. This forms another argument in favour of a certain harmonization of income tax rates and of the other factors that determine the effective tax burden.

On this matter the FFC considers that it is advisable to lay fundamental importance on the nature an level of withholding taxes rather than on the structure of the income tax rates. This is par-

ticularly valid for withholding taxes applicable to income in the form of interest and dividends paid to persons who do not make known their identity to the bodies charged with applying withholding and of whom there is reason to suppose that they do not declare the income in question for the purpose of income tax, and that they do not use the withholding as a credit against income tax, but consider and accept it as final taxation of their income from movable capital. Consequently, at least in these cases, it is appropriate to arrange that the tax treatment applied in Member States is absolutely identical. This is why it is proposed later (page 139 et seq.) to apply uniform and relatively high withholding taxes to this interest and these dividends. Obviously, this does not exclude the possibility for the beneficiary of the income to declare it and to be reimbursed, should question arise, for part of the tax withheld by way of a credit against his income tax.

Regulations relating to taxation of capital gains merit particular attention. If, as is the case at the present time, a very different tax system is applied to these gains in the different countries, this could considerably hinder the free circulation of capital. The abolition or at least considerable reduction of these differences, thus seems urgently necessary.

4) Industrial and commercial income

These incomes are subject, according to the legal form of the business, to income tax or to company tax; to this is sometimes added - as for example, in the Federal Republic of Germany - a "business" tax which has more or less the character of a "real" tax (Realsteuer); finally it is necessary to take into account the tax burden formed by the land tax on developed and undeveloped sites as well as, in some cases, a general tax on wealth.

As already emphasised (cf. page 113-115), opinion is split on whether and to what extent, the taxes considered, and notably income tax, can be and are effectively shifted on; everyone is, however, largely in agreement on two points, namely that, at least in part, it is probable that these taxes are shifted on, above all for land and business taxes and to a lesser degree for taxes on companies and on wealth and on the other hand it must also be considered as probable that general income tax also exerts a certain influence on prices. Under these conditions it could be argued that under the assumption (nevertheless hardly realistic for income tax) of complete shifting on of the tax, disparities of tax burdens existing between the States would not have great importance for businesses since, hypothetically they do not cause differences in profits. It must however, be observed that even in the case that the taxes considered would be completely shifted on, that is to say that there would be a corresponding rise in prices, the net profit will be reduced and, all other things being equal, will be reduced the more the elasticity of demand for goods offered by the individual businesses is greater. From a realistic point of view it will on the other hand be necessary to assume that a progressive tax on industrial and commercial incomes cannot be shifted on, or only partially, notably if there is a buyers' market.

Let us now examine, under the hypothesis that has been made, if and possibly to what extent, more or less sizeable disparities between the national tax burdens levied on businesses can influence competitive positions and their freedom of establishment.

Firstly, with regard to the question of freedom of establishment between States, tax considerations do not in general play a decisive role in the choice of the location of businesses, but solely a secondary role as shown in empirical studies. In any case, it is the custom to take into account in this type of decision - on a State level as well as in particular on a municipal level - not only the tax burdens, but also the public services financed by local authorities from tax receipts. If this applies to the situation existing within a particular national economy, it is a fortiori valid if a comparison is made between various national economies with a view to choosing a place to set up or transfer a business. This it can be said that only under the assumption, that considerable international differences exist with regard to the total net tax burden on industrial and commercial income, such differences, because of their incidence on expected business profits, cause transfers of business establishments which are not justified by purely economic considerations.

This assumption certainly applies more to small or medium-sized businesses than to large businesses. These latter are, first of all, more mobile, secondly they make their decisions without taking into account non-rational factors which on the contrary play a certain role for the smaller businesses, and finally, they are subject not to a (progressive) tax on income, but to a (proportional or only lightly degressive) tax on companies for which there are relatively greater chances to shift on the tax. Even if it were not possible consequently to prove empirically that disparities of tax burden currently existing for big companies between the different countries, are so large that it could be prima facie considered probable, for transfers of businesses to be

motivated by such disparities, it would be desirable that the taxation of companies and the withholding on dividends (and also should occasion arise, the other taxes listed above) be harmonized, in form as well as in substance, in the Member States.

In the considerations described above, the possible incidence of disparities of tax charges affecting industrial and commercial incomes has been taken as the starting point, with regard to their direct and indirect effects on expected profits. It remains to study if from this there occur hindrances to international competition to the extent that various "direct" taxes to which businesses are subject can be shifted on by them in their costs and prices. Such a possibility cannot in principle be denied; it must however, be emphasized that two factors can reduce it: on the one hand, taxes on income and on companies constitute general charges for which there is good reason to assume that their international disparities balance one another out through exchange rates; on the other hand it is also important for the aspect of the problem considered whether, and to what extent, differences of tax burdens are compensated by differences in government services which are important for businesses.

Taking into account the fact that certain differences of tax burden on state (cantonal) and/or municipal level have not, or only slightly, brought about effective hindrance to competition in federal countries such as Switzerland and the United States or even (business tax) in the Federal Republic of Germany - the following assertion could be formulated: differences in the taxation of industrial and commercial income will only have an unfavourable influence on freedom of movement and/or the competitive situation in trade between Member States of the E E C if they reach a notable extent, taking into account the public services financed by tax receipts.

Particularly for large businesses subject to company tax, there would be good reason, however, to accept that a broad harmonization of effective tax burdens is desirable and indeed necessary.

It is appropriate to recall in this context once more (cf. above, pages 128 et seq.) that for the questions studied here - independently of the psychological effects that may result from considerable international disparities relating to progressivity or to marginal rates - it is less a matter of formal tax rates than of the real charges for which, in addition to the tax rates, inter alia the provisions concerning the computation of profits, the methods of collection, etc., play an important role. The international disparities existing at present in this realm have the consequence that the "transparency" of taxation is greatly reduced. It is much more important that within a country the rules of assessment and amortization for example, but also those regarding the carry over of losses, even if they are formally only of a general character, lead in fact to a differentiated tax treatment for certain branches of the economy or certain businesses, or - indirectly - of goods manufactured by them, because such favourable possibilities cannot always be used by all those taxpayers who are meant to benefit from them. To the extent that this leads to any form of tax discrimination in a particular country, discriminations which do not exist in other countries, or which do not exist in the same direction and/or to the same extent, there must arise from this distortions of competition between the Member States. The FFC is therefore of the opinion that it is urgent either to abolish these discriminations or to harmonize them in order to avoid such distortions. It has already been emphasized (see above page 121 et seq.) that a broad harmonization of the provisions relating to the methods of assessment (taxation of actual profits vs. lump sum assessment) and collection (type and pace of payment of provisional instalments and balances of tax) is again desirable.

5) Income from agriculture

If agricultural income were subject to income tax and, if at all, to wealth tax in nearly the same way as industrial and commercial income, this could lead for such income to the same conclusions as those developed above. In reality, however, the situation is that most farmers and the major part of agricultural income, even when they are subject in principle to general taxes, benefit in fact from preferential treatment for other than economic reasons (political, social and other reasons). Furthermore, on the one hand, agriculture brings relatively slight tax receipts and on the other hand, benefits from considerable subsidies which in general greatly exceed these receipts.

The calculation of net financial burdens imposed on agriculture would be entirely beyond the possibilities which the FFC has at its disposal. Therefore, the FFC confines itself to stating that it is hardly possible under present circumstances to indicate to what extent, if any, income taxes cause distortions of competition in international trade in agricultural products (a different situation probably exists with respect to land tax). However, it can be assumed that within the different

countries the policy for taxes and subsidies for certain enterprises and certain agricultural products has discriminatory effects which distort conditions of competition in external trade as well as in internal trade.

The abolition of such regulations will have to form an urgent task when conditions of competition envisaged for trade in industrial goods will also be applied in principle to trade in agricultural products between the E E C-countries.

f) Problems of the size of company taxation and withholding taxes on dividend

While for the tax on personal incomes it is sufficient, but also desirable, in the interest of the good functioning of a common market, to anticipate a certain alignment of rates or of effective charges, company taxation must in the opinion of the FFC, be levied at equal (or almost equal) rates, at least for the taxation of undistributed profits. The necessity of this arises from the fact that company tax above all affects large businesses whose activities extend across the frontiers of a country and for which, when considering the choice of the place where to locate or to transfer their seat, the anticipated net profits - which are precisely the profits for which these taxes come into account - play a more important role than for most of the businesses subject to personal income tax (see page 137 et seq.).

aa) The rates of company tax

As has been stated above (page.122 et seq.), the FFC is in favour of a differentiation of the tax on companies according to the attribution of profits.

For the tax to be imposed on undistributed profits of companies, the FFC is of the opinion that its level must in general not be too different from the maximum rate of personal income tax, so as to avoid that businesses for which, because of their nature and size, the legal form of a share company or a limited liability company would be the most appropriate, choose solely for tax reasons another form through which they would be subject to personal income tax. Taking into account the great majority of current rates of personal income tax in the E E C, a rate of about 50 per cent could be considered for company tax with respect to undistributed profits.

The majority of members of the FFC consider that the company tax affecting the distributed part of the profits in the form of dividends should represent about half the tax applicable to undistributed profits and by no means less than 15 per cent. (1)
Within the framework of the limits thus indicated the States have freedom, for reasons of economic growth and notably for reasons of business cycle policy, to vary, should this be necessary, the difference between the tax on undistributed profits and that imposed on distributed profits (cf. above page 122). However, this proposal should not preclude the possibility of applying other solutions of tax technique allowing the attainment of the same end in an other way.

bb) Problems raised by withholding taxes

As has already been emphasized, the FFC is of the opinion that for distributed profits (like the tax affecting interest of all types) income tax should be levied in the form of withholding at source, since this method constitutes a far-reaching protection against tax fraud.

1) However, withholding at source on dividends in principle forms only a sort of advance payment on the income tax of shareholders in sofar as these are natural persons. Consequently, the tax withheld must be entirely credited against this income tax; a condition for such a credit is of course, that shareholders declare their dividend income for its full amount as part of their total income. This condition is not always met in practice and this is why the FFC has sought a realistic solution which on the one hand should avoid the risk that the withholding tax by being too slight will only imperfectly attain its objective which is the avoidance of tax fraud, and which on the other hand, would not compel the tax authorities, because the tax withheld would be too high for many recipients of dividends, to provide for detailed measures for refunds on income tax.

Therefore, the FFC makes the following proposal: in all the Member States withholding tax shall be imposed on the basis of two rates: a relatively low rate - which could, for example, fluctuate between 10 and 20 per cent - would be applied to profits distributed to persons having their domicile in the E E C and who own either registered shares or bearer shares, but who at the time

(1) See appendix F which gives a description of the advantaged and disadvantages of the various possible solutions, page 193 infra.

of collecting the dividends provide information on their identity. For all other persons, withholding tax would be imposed at a far higher rate - 25 per cent minimum - which contrary to the first-mentioned rate would be the same in all Member States.
So as to ensure equality of treatment, it would be appropriate to apply a corresponding differentiation for withholding tax on interest of all types.

If one day the E E C should be extended to all Western countries, this system could be replaced by other methods, such as, for example, the French system of accounts ("bordereau"-system) or a system according to which each taxpayer is given a code number after a system has been introduced to ensure an extensive exchange of important tax information through a supra-national body. For the time being it seems that such methods, which most probably would lead to the creation of "tax haven" countries, can not yet be applied.

2) To the extent that the shareholders are companies possessing their own legal personality, the FFC has reached the following conclusions for the procedure applicable to withholding: the considerations set forth in other parts of the present Report on the tax treatment of parent and subsidiary companies (cf. above page 123 and below page 140 et seq.) have led the great majority of the FFC to the opinion that dividends received by one company from another company should, in principle, not be subject to a withholding tax, given that otherwise the tax exemption necessary to avoid double taxation would not be complete. However, this principle must be applied with shaded differentiations if it is wished to avoid abuses, and the FFC proposes to consider for the withholding tax different rates according to the identity and seat or domicile of the shareholders:

a) If the distributing company does not know whether the shareholder is a natural person or a company, the maximum rate shall be applied.

b) It shall be the same - without prejudice to provisions of agreements for the avoidance of double taxation - where the recipient of the dividends is a company whose seat is established outside the E E C.

c) If the shareholder is a company whose seat is established within the E E C - whether in the country where the seat of the distributing company is established or in another Member State - no withholding tax shall be applied. (1)

In general, exemption from withholding tax should not depend in the latter case, on an immediate redistribution of dividends by the parent company to its own shareholders, given that such a condition would bring about complications and would form a hindrance to the policy of the companies. However, in order to counter certain possible abuses, it would be opportune to apply a withholding tax at the minimum rates envisaged for individual shareholders whose identity is known and who have their domicile within the E E C insofar as the company which receives the dividends retains all or the larger part of the profits which it draws from its participation in other companies, and that it benefits systematically from the system applied to parent and subsidiary companies in order during a fairly long period, to keep the larger part of its income in the form of reserves. In this respect, the FFC refers to considerations such as those appearing in No. 34 of the commentaries of the Fiscal Committee of the OECD (2) dealing with Article XX on the taxation of dividends (4th Report of the Fiscal Committee, 1961, page 44-45).
However, the foregoing recommendation not to impose a withholding tax (except in the cases of abuse indicated) on dividends paid by one company to another, only constitute one of the aspects of the system applicable to parent and subsidiary companies. This system also includes tax exemption for these dividends in cases where a company participates in another company.

The question is as follows: in the case where a subsidiary company has been taxed, as far as its own company tax is concerned, at a reduced rate for distributed profits and at a higher rate for profits retained by it, and where the dividends paid by it to another company have not been subject to a withholding tax, must the company which receives the dividends be subject to a supplementary tax the purpose of which would be to compensate for the tax reduction from which the subsidiary company has benefited?

In the opinion of the FFC, the tax exemption for the company which receives the dividends is fully justified if it does itself distribute the dividends in question to its own shareholders, given that these shareholders are then subject to personal income tax with regard to the dividends that

(1) However, see Appendix F where another technical solution is described, page 193.

(2) OECD = Organization for Economic and Cultural Development (Publishers' note).

have been distributed to them. On the other hand, dividends that a company receives from another company and which it does not re-distribute to its own shareholders, should bear a supplementary tax to be paid by the first company. For practical reasons, however, tax exemption of dividends should not be dependent on the condition that the dividends be re-distributed during the year in which they have been received. On the contrary, it should suffice for the tax exemption to apply, that the re-distribution to the receiving company's own shareholders be made within two to four years counting from the moment that the dividends are received.

Finally, it is appropriate also to raise the question whether, in case (c) supra, the application of the tax system anticipated for parent and subsidiary companies should be dependent on the fact that the company receiving the dividends owns a particular part of the capital of the distributing company, and/or on a minimum duration of such participation.

The FFC answers this question in the affirmative, given that otherwise the system in question could be diverted from its proper economic objective. Without formulating in this respect detailed proposals, the FFC expresses the opinion that the provisions relative to the favourable treatment of intercorporate dividends ("Schachtelprivileg") should be limited to participations forming at least 15 - 20 per cent of the capital of the distributing company and which have been held at least one or two years before distribution of the dividend. In this respect, conditions relative to the percentage and duration of participations should be the same in all Member States of the E E C (see page 144 and Appendix D, page 178).

3) A last point relating to withholding tax on dividends concerns the question as to which State should be entitled to receive the product of this withholding tax.

The FFC is of the opinion, as has been said, that withholding taxes normally constitute a sort of tax instalment or advance payment on the shareholders' personal income tax. Consequently it seems equitable that the State by which the tax is withheld reimbuse the State in which the shareholder has his domicile. Clearly such a reimbursement can only be made in cases where the beneficiaries of the dividends belong to the first or second category mentioned above (holders of registered shares or holders of bearer shares, who provide information on their identity). Even if such a solution for technical reasons cannot be applied in the immediate future, it would be advisable to consider it as the ultimate objective to be attained as soon as possible.

C. The problem of double taxation

Article 220 of the Treaty of Rome provides that Member States will undertake among each other, as far as may be necessary, negotiations with a view to ensuring for their nationals the elimination of double taxation within the Community.

This provision relates primarily, if not exclusively, to double (or multiple) international taxation which arises to the charge of the same taxpayer, when the same legal or factual situation leads to the application of tax in two (or several) countries, on the same or a similar legal basis. In other words, Article 220 is directed against direct international double taxation.

However, the provision of Article 220 does not necessarily seem to exclude from its field of application the so-called indirect international double taxation. This arises when the debtor of a part of income or wealth cannot deduct from his taxable income a payment or a debt, while the creditor who has his tax domicile in another State, is taxed there on the sum which has been paid to him or which is owed to him, it being understood that this situation would not have arisen if the debtor and the creditor were domiciled in the same State.

Such indirect international double taxation occurs fairly often in the case of maintenance payments between natural persons and in that of intercorporate dividend distributions. In the first case, the tax influences the choice of country of domicile or work of at least one interested person; in the second, the tax can influence the choice of the seat of the parent company or of a subsidiary company, and in any case, it affects the conditions of competition of a group of related companies.

The cause of double taxation resides in the application of two or several sets of tax legislation, of different or similar structure, to the same object and the same taxpayer (direct double taxation) or to one and the same object solely (indirect double taxation).

On the other hand, differences of structure presented by conflicting tax legislations can impede or complicate the introduction of measures for the avoidance of double taxation and affect the effectiveness of such measures.

It follows from this that the search for specific solutions for the elimination of double taxation,

and the application of such solutions in practice are, in large measure, conditioned by the alignment of national legal provisions in the areas where this alignment is recommended in this Report (for example: taxes on company profits, taxes on dividends, withholding taxes on interest).

Such an alignment would, for double taxation, have the following advantages:

The "transparency" of tax legislation would be increased, which would make it easier to recognize cases of double taxation;

The homogenity of systems that would occur from it would make easier the conclusion of bilateral conventions with a view to introducing converging measures to attain the objective desired.

The alignment of legislation seems clearly to be a prerequisite for the conclusion of a multilateral tax convention between Member States.

It is undoubtedly possible to counter indirect double taxation by conventions, as is shown in certain conventions concluded by the United Kingdom and by certain recommendations of the Fiscal Committee of the OECD. However, the most certain method to eliminate this form of double taxation is a harmonization of national legislation in the areas where this double taxation arises. It is even conceivable that a multilateral convention relating to harmonization of one or two taxes (notably company tax and tax on dividends) also contains measures for the avoidance of international double taxation in the field of these taxes 1); it is even conceivable that such a convention envisages a mutual participation in the yield of a certain tax (notably that on dividends).

After this general observation relating to the alignment of national legislations it is appropriate to examine more specific measures which can be recommended to eliminate double taxation.

1) It is possible to take the position that the method most appropriate to the requirements of a real common market would be one which would consist of centralizing the operations relating to the assessment of the tax, that is to say that the computation of total taxable income for taxes on overall income and on company profits should take place within a <u>single</u> State, which would normally be that of the tax domicile or that where the greater part of the business activities are performed. Such a system, conducted according to uniform rules of assessment of the taxable object, would have the advantage of radically eliminating double taxation within the Common Market. So as not to favour too much the States of domicile of the beneficiary of the income, the single operation of the computation of the taxable income would have to be followed by an allocation of the bases of assessment among the different interested States. In short, such a system could function among the Member States in a way analogous to that of the German business tax ("Gewerbesteuer"), where in relevant instances several municipalities share in the yield of this tax. Meanwhile, this would not necessarily exclude withholding at source where judged opportune.

However, the FFC is conscious of the fact that the introduction of such a system requires at the start a very broad alignment of national legislations and a very developed degree of collaboration between the tax authorities of the Member States. A proposal recommending centralization of assessment operations would be far too different from traditional methods followed in the field of double taxation. The FFC is, therefore, of the opinion that, even if the concept of a single assessment must not be lost from sight for the distant future, the present situation demands rather the search for a solution to the problem in improving existing techniques and adopting these to the particular needs of the Common Market.

2) Alongside unilateral measures provided for in certain legislations with a view to avoiding or reducing double taxation, and the coordination of which depends on the efforts to align these measures, the principal instrument for resolving problems of double taxation is the <u>tax convention.</u>

The OEEC, which is now OECD, is at present working out a model convention for the OECD countries, to which the E E C countries belong, intended to replace the model conventions of Mexico and London. The first four Reports of the Fiscal Committee of the OECD already cover almost all the matters usually treated in conventions of this type.

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(1) From the terminology used in the (original) German text it clearly appears that the FFC especially refers to the double taxation of company profits by company tax and dividend (or income) tax rather than to double company tax and double dividend tax as such - Publisher's note.

Before appraising the articles prepared by the OECD, it is appropriate to study the present situation with respect to double taxation between the Member States of the E E C.

It appears from the Table published in the fourth Report of the Fiscal Committee of the OECD (page 11) that the network of bilateral conventions between the six States is complete, except for conventions between Germany and Belgium, Italy and Luxembourg, and between the Netherlands and Luxembourg. This same Table shows that a certain number of bilateral conventions concluded between these States are undergoing revision.

Furthermore, the conventions concluded or revised since the publication of the second and third Reports of the Fiscal Committee of the OECD are different in form and substance from certain texts recommended by the OECD.

In a general way it must be stated, unfortunately, that the rules adopted in the different conventions in force are far from being homogeneous, and that many of these divergences must give rise, in relation to the economic interests of the six countries, to differences of treatment which are incompatible with the full and perfect functioning of the Common Market.

3) The FFC is convinced that, in the interest of the Community, the problem of double taxation must be solved by harmonized if not uniform, rules in the relations between each of the Member States and its five partners and thus over the entire territory of the Common Market.

To arrive at this aim, the FFC recommends, that in principle, as the basis for such rules, the solutions proposed by the Fiscal Committee of the OECD be adopted, insofar as the coordination of certain taxes does not justify a different solution (cf. No. 4 infra). Furthermore, these solutions should be amended and supplemented in such a way that they respond more adequately to the specific needs of the Common Market (cf. No. 5). Finally, the FFC proposes that the existing network of bilateral conventions be replaced, as soon as possible, by a multilateral convention (cf. No. 6), so long as it is not held to be preferable for certain taxes to combine an agreement for the alignment of such taxes with a convention for the avoidance of double taxation within the Community, or even with a convention for mutual sharing in the yield from certain taxes.

4) The suggestion of basing a convention for the solution of double taxation problems on the recommendations of the OECD implies several consequences:

a) The bilateral regulation to be completed or the multilateral regulation to be instituted must not differ, either in substance or in form, from the model solutions, except on the points on which all the Member States are in agreement to depart from such model solutions.

b) The reservations formulated by certain Member States with respect to some of the articles prepared by the OECD, notably for taxation of dividends and interest, should be abandoned.

Several of these reservations, prompted by the particular set-up of certain national laws, with respect to the taxation of company profits and dividends, would at any rate become without object if legislation on these matters could be aligned.

c) With respect to the methods to be applied for the avoidance of double taxation, the Fiscal Committee of the OECD, placed in front of insurmountably divergent points of view, has had to prepare two alternative texts, forming Articles XXIII and XIV, respectively (4th Report, page 31). The Fiscal Committee of the OECD considered that in a bilateral convention, one of the States could bind itself by Article XXIII and the other by article XXIV. The limitations arising from such an option in the case of a multilateral convention will be described below under (6).

Article XXIII sanctions in paragraph 1, the method of exemption with a progressivity clause and in paragraph 2, the credit methods with respect to a limited proportional withholding tax on dividends and interest. Article XXIV follows the general credit method, limited to the sum of the corresponding tax in the country of tax domicile. The FFC will not expound on the merits and disadvantages of the various methods. The reason for this abstention will be shown under (6).

5) In order to answer better the requirements of the Common Market, the rules prepared by the OECD could be amended and complemented at certain points:

It seems neither necessary nor desirable to develop within the Common Market, the principle of taxation in the country of the source of income as broadly as in the relationship with third countries. The further one progresses from the principle of taxation in the place of tax domicile, the more the multiplicity of various taxes within the Community risks creating situations contrary to those of an internal market and deviating from overall taxation at progressive rates applicable according to the legislation of the country of domicile.

a) This is the case for artists and professional sportsmen who, contrary to Article XI of the model convention (2nd Report, page 28), could more opportunely be taxed on their professional income in the country of their tax domicile. This however, presupposes the mutual obligation of tax administrations to exchange information.

b) The definition of permanent establishment, according to Article II of the model convention, can lead to an unfortunate parcelling of the income of a business.

Even if the OECD definition is acceptable in its broad concepts, the FFC wonders whether it would not be desirable to abolish, for the territory of the Common Market, the provision of paragraph 4 of Article II, which includes in the permanent establishment, a permanent respresentative who is authorized to conclude contracts. The reason that the FFC poses this question is that the application of this provision depends on the extent of the power assigned to the representative, an extent which the parties concerned can constantly change according to their needs. In computing the profit attributable to the representative, this situation leads to serious difficulties.

In a general way and over the long term, the FFC recommends a narrow interpretation of the concept of permanent establishment in respect of businesses which have, in the countries of the Common Market, either their seat or a permanent central establishment, understood in the sense of an establishment which serves, among others, the country in whose territory it is located.

c) According to Article XX, which in the model convention deals with the taxation of dividends, the State of the seat of the distributing company retains the right to tax up to 15 per cent the dividends paid to shareholders having their tax domicile in another contracting State, but this maximum of 15 per cent is reduced to 5% for dividends paid to companies having their seat in another State and possessing at least 25 per cent of the capital of the distributing company.

This provision, which recognizes the necessity of a special system for parent and subsidiary companies from an international aspect, is also favourable for the economy of the Community, but it should be accepted without reservations and be supplemented in a sensible and logical way.

On the one hand, abandoning the reservations expressed, the Member States should agree on a maximum rate for withholding taxes and on the proportion of the participation required to benefit from the system. The State of tax domicile of the subsidiary will have to apply the special system even when the parent company will not pay, to the State of its tax domicile, any company tax on dividends obtained through its participation ("Schachtelprivileg").

On the other hand, this Article calls for a complement, in the sense that it does not cover the exemption that the State of the seat of the parent company must consent to. Now, it seems normal that if the model convention requires the State in which the subsidiary company has its seat, to limit its levy to 5 per cent of the dividends, it is not in order that the State in which the seat of the parent company is located can deny the parent company the special system that would be applicable if the subsidiary company were a domestic company for this State.

The real purpose which is at the bottom of the model provision is to extend the special system for parent and subsidiary companies ("Schachtelprivileg") to international relationships.

In any case the FFC recommends that this point be worked out in a clear way in the relations between the Member States of the E E C.

6) The best means of ensuring uniformity of rules relating to the problem of double taxation is certainly a multilateral convention to be concluded by the E E C Member States. It is not excluded, moreover, that the OECD will present the result of the work of its Fiscal Committee when completed, as a model for a multilateral convention.

The FFC draws attention to the fact that in a multilateral convention concluded by Members of the E E C, the possibility of an option between Articles XXIII and XXIV envisaged above, can only exist as a sole option for each State, that is to say each State should always apply either Article XXIII or Article XXIV in its relations with all its partners. The FFC accepts that this freedom of option will facilitate the conclusion of a multilateral convention which should even allow the contracting States to choose one of the Articles for natural persons and the other for other taxpayers.

The FFC is in any case of the opinion that the efforts directed against double taxation within the E E C should ultimately lead to the conclusion of a multilateral convention, based on the OECD

model, if necessary amended according to the suggestions mentioned under (5) above. The FFC recalls the general remark made at the end of (3) above for conventions concerning the alignment of taxes.
The period during which a similar objective could be achieved will depend on the tempo at which alignment of national legislations will be operated and at which the adjustment of bilateral conventions will be completed.

However, it will not merely be sufficient to have a multilateral convention; it will still be necessary to ensure its uniform application and interpretation.

For the time being, the settlement of disputes arising under bilateral conventions, is made by an amicable procedure based on negotiations between the administrations of the States concerned (Art. XXV of the model convention 4th Report, page 33) or through the competent national courts.

For the application of a multilateral convention, these procedures will be insufficient to ensure uniformity of practice and court decisions in the field of double taxation. At the final stage, it will be necessary to envisage the setting up of a common system of amicable procedure and of a common tax court for double taxation litigation.

But even for the present it is certain that the tax conventions in force between Member States contain many provisions which are basically similar or analogous. The FFC recommends therefore, that as soon as possible an agency be attached to the European Commission which would have the task of advising Member States on the conclusion or revision of tax conventions, as well as the competent administration, on the operation of the amicable procedures intended to settle disputes arising from the application of these conventions. This agency would thus take up the functions of a body within which there could be developed a joint amicable procedure.

7) If the FFC has noted, sub (1) above, a preference of doctrine and principle for a single system of assessment and if it proposes in the introduction to (5) above to extend the principle of taxation in the country of tax domicile, it is among other things because of its desire to ensure taxation at a progressive rate applicable according to the law of the country of tax domicile.

It is just that double taxation should be completely avoided, but on the other hand each taxpayer should be ultimately taxed according to his taxpaying capacity in accordance with the provisions of his country of domicile.
In principle, such an objective is more or less reached through the application of the method laid down in Article XXIII (exemption with progressivity) as well as that of Article XXIV (ordinary credit) of the OECD model convention.

In practice however, it seems clear that a "just" tax system could only be set up following an alignment of national legislations and only on condition of a good and efficient exchange of information.

V. PRINCIPLE OF THE COUNTRY OF ORIGIN vs PRINCIPLE OF THE COUNTRY OF DESTINATION

1. Preliminary remarks

The question of the choice between the principle of the country of destination and the principle of the country or origin is of the utmost importance for all the proposals and measures intended for a harmonization of taxes within a common market. As is well known, discussion of this matter had its origin in turnover taxation within the European Coal and Steel Community. However, it has application currently to a wider framework, without any agreement having yet been reached.

The dispute concerning these two principles has considerable importance from a political-psychological point of view for the future development of the EEC, above all because the decision that will be taken in this respect will also constitute a decision on the question whether it will be possible, and possibly how and when, to remove the so-called tax frontiers existing at the present time.

This is why it appeared advisable to the FFC to subject this problem to systematic and detailed study.

2. Meaning and significance of the principle of the country of destination and the principle of the country of origin.

a) The principle of the country of destination

1) In relation to goods and services, the principle of the country of destination means that they

are subject to the taxes in force in the country where they are ultimately consumed, whatever the country in which they were produced. It follows from this that although a particular good has been entirely produced in country A or imported in its entirety from countries B or C or manufactured in country A with the help of raw materials, machinery, etc. imported from B or from C, it is subject in country B, in all three cases, to the same special and/or general consumption taxes. Thus, the application of the principle of the country of destination consists in taxing a good or a service not in the country where it is produced, but in that where it is consumed or used. In relation to services, the country of destination is that in which the service is rendered.

2) The discussions which have been held up to now, have been limited in their essentials to studying the general tax on turnover and the special taxes on consumption. However, it is possible to consider this problem in relation to other taxes as well.

The principle of the country of destination can not apply to personal income, company and wealth taxes (cf. above page 134). This often leads to the conclusion that the principle of the country of origin is applied for these taxes. But this way of presenting things is not altogether correct. In relation to taxes on income, companies and wealth, there must rather be a distinction between taxation in the country of domicile or establishment on the one hand, and the country of source (where the profits and other income arise) or of the country of situs (country where the factors providing the income are located) on the other hand.

The distinction between the country of destination and that of the country of origin is also not applicable rationally in relation to taxes on inheritance and gifts since no questions of import or export arise directly for these taxes. Here it is more properly the question of the possible choice between the principle of domicile or residence and that of the country of situs. This also applies to taxes on wealth.

3) It is endeavoured to take into account the principle of the country of destination by utilising a series of compensatory measures to the extent that the principle of the country of destination is applicable in the realm of general and special consumption taxes, and where taxes of this type as levied by the various countries differ as to type of tax and/or level of tax:
On the one hand, endeavours are made to compensate disparities of tax burdens of this type by exemptions and/or refunds at exportation, while on the other hand, there are levied so-called compensatory taxes at importation. Thus, it is sought to make all goods in the final consumer market bear the taxes which are applied to a corresponding good entirely produced in the country where the market in question is situated.

One tries to insure by means of such a compensation policy that the consumer of country A always pays a price comprising the same amounts of tax whatever the country where the good has been produced. As long as there will subsist differences in the level of consumption taxes in force in the various Member States, the application of the principle of the country of destination will not, however, have the result that each good is subject in each country to the same rate of tax.

4) Except in the case of a tax at the retail trade stage (not including "use taxes") the principle of destination, assumes the retention of so-called tax frontiers. These frontiers exist because of the fact that a good crossing them requires inspection and measures which are necessary because exports are subject to exemptions or refunds, and imports to a compensatory tax.

If the system for exports and imports could function in such a way that each good was completely exempted from the tax of the exporting country that it in fact bears, and be subject precisely to the tax charge of the importing country that a good manufactured in its entirety in that country, must support there, this could clearly not result in any disturbance in trade between the States. However, these conditions do not, or not completely, in reality exist. This is notably the case when one of the Member States applies a turnover tax system which does not allow the exact calculation of the tax burden affecting a particular product. Distortions of competition are necessarily the result when tax exemptions or refunds in an exporting country are higher or lower than the amount of the consumption tax effectively borne by a product and, in the same way, when compensatory taxes levied in the importing country are higher or lower than the tax burden borne by a product of the same type entirely manufactured in the country of importation.

5) It is often considered as an advantage of the principle of the country of destination that a consumer, on the one hand does not have the possibility of avoiding his contribution to public expenditure in his own country by buying a good abroad and, on the other hand does not have the need to contribute to the financing of public expenditure of a foreign country.

b) The principle of the country of origin

1) In the application of the principle of the country of origin, goods and services bear tax burdens applicable in the country where they have been produced, whatever the country where these goods and services are consumed. In the case of a good whose raw materials come from country A, while its manufacture has been partly effected in country B and partly in country C, the overall tax burden of this good will be made up of the sum of taxes relating to raw materials in country A and the value added during manufacture in countries B and C. It arises from this, that a particular good in a particular country is quite definitely subject to the same overall tax burden, whether consumed in that country or another; but this overall tax burden is on the contrary different (assuming that the tax rates for this good are not everywhere identical) according to whether actual items of the same type of good have been manufactured in their entirety in the consumer country or have been manufactured in their entirety or partially in other countries.

2) To the extent that the principle of the country of origin is applied, there is no need of tax frontiers. There are no tax exemptions or refunds at exportation and there are no compensatory taxes at importation.

3) Under the assumption that the level of special and general consumption taxes varies from country to country, the application of the country of origin can bring about artificial distortions, that is to say distortions due to tax reasons, in international trade. These distortions would only be acceptable if such disparities in tax burden were insignificant.

3. Consequences for the E E C

a) Current practice

Various types of tax are at present subject to a differing system - which is permitted by the Treaty: the principle of the country of destination is applied to turnover taxes and to taxes on consumption; to what are termed direct taxes there is applied on the contrary, the principle of taxation according to the country of domicile or seat or the country of source or situs.

One of the consequences of this is that the question of the harmonization of the main so-called indirect taxes does not seem to arise, at least not in principle. Compensation of disparities of tax burdens does not however, in fact exclude protectionist use of refunds and compensatory taxes, given that in practice this compensation shows often deficiencies. There would occur other disadvantages in the form of disturbances of competition to the extent that it would happen that taxes affecting the formation of income are shifted on, at least partially, that is to say, lead to increases in prices. In this case disparities in relation to the respective importance in the different national tax systems of taxes based on the principle of the country of origin or on the principle of the country of domicile or of source, and of those based on the principle of the country of destination would bring about advantages or disadvantages to competition, based on tax reasons inherent in the variety of the tax systems on the one hand, and the variety of methods of application of different taxes in foreign trade on the other hand. Although such distortions of competition may be very likely, it is impossible to measure their size even approximately, notably because all hypotheses in relation to shifting on income tax and tax on wealth are arbitrary by nature and because remote effect of these taxes on production, growth, etc. does not lend itself to quantitative evaluation.

b) Proposals for reform

As has been emphasized above a general application of the principle of the country of destination to all types of taxes is not possible, and the present combination of applying the principle of the country of domicile or of source on the so-called direct taxes with applying the principle of the country of destination to the leading indirect taxes brings disadvantages that have just been mentioned. The question then arises whether, and under what conditions, the principle of the country of origin, or of the country of domicile or of source can be applied to all relevant types of tax, without causing distortions of competition that would follow, at the present moment, from the existence of appreciable disparities in the structure of national tax systems and in the level of taxation in relation to general and special taxes on consumption.

1) Such a solution, if it could be found, would notably present the great advantage of allowing the abolition of the so-called tax frontiers. Occasionally it is said that for statistical purposes and for reasons of public health etc. certain frontier inspections would have to be maintained, even if the principle of the country of destination were completely abolished, and that these tax frontiers exist technically and in appearance, but that they are not "real". In relation to this, however, it must be emphasized, that the free movement of goods and capital sought and gained

through the abolition of customs frontiers can only have the result of the establishment of a common market having the character of an internal market if it is complemented by the abolition of tax frontiers. Such a measure also seems necessary to the FFC for psychological and political reasons. Thus it is advisable never to lose sight of such an abolition, in the perspective of the ultimate objective of economic integration policy, even if it is only achievable slowly.

The FFC meanwhile has gained the conviction that the application of the principle of the country of origin is not possible in the forseeable future in relation to excise duties. In effect, national systems for excise duties will be characterized by a different composition and level as long as the economic and financial strength of the different Member States will themselves differ, and that consequently a country will have to adopt this form of taxation in a heavier or lighter degree than other countries; that differences of tastes from one country to another or of habits of consumers have importance in this respect has already been emphasized.

In relation to excise duties, the FFC pronounces itself in favour of the maintenance of current practice (principle of the country of destination).
The fact that tax frontiers must be maintained is regrettable, particularly for reasons of psychology etc. as mentioned above, but it affects only slightly the statements of the FFC concerning the desirability in principle of removing tax frontiers. In effect, goods subject to special excise duties only play a modest role as much for their part on the range of exports and imports as for their absolute and relative importance in the flow of international trade.

2) Just as it is uncontested that it is impossible to apply the principle of the country of destination to direct taxes, the problem leads back in the last analysis to the question whether, and if so how, turnover tax can be shaped in such a way in Member States that the principle of the country of destination which is currently applied to it can be replaced by the principle of the country of origin.

It is clear that such a change-over is inconceivable as long as national turnover tax systems will differ considerably and/or sizeable differences continue to exist in relation to the level of the tax burden. Broad harmonization of turnover tax consequently forms an absolute necessity. The sense in which it could or should be achieved has been described above (see page 123 et seq, page 131 et seq.).
It is appropriate to recall at this point that all attempts at harmonization in this field must start from the necessity of abolishing gross turnover tax at all stages, and that the general application of a net turnover tax system to all stages in the Common Market requires the adoption of a "base on base" deduction (1). Complete unification of tax rates is not perhaps absolutely necessary, but it would be very desirable (cf. below, page 148/9). Indeed, it is firstly necessary that the differences in tax rates be very small, and secondly, that the provisions relating to exemptions and to allowances be similar in all the Member States.

The differences that result in fact from such measures, are generally far more important than those which arise from different tax rates. As an example: if under the same net turnover tax system, the turnover tax which affects the price of a good at the final consumption stage is at 10% in country A, at 12% in country B, the relatively higher charge of country B in comparison with country A is 20% although it represents only 2% of the final sales price of the good. Such a difference does not in the majority of cases, gravely prejudice conditions of trade between Member States. If on the other hand, a particular good is made the object of turnover tax exemption in country A, while it is subject to this tax in country B, the difference in the final sales price of these goods reaches 12%, if conditions are otherwise identical; it is thus six times higher than in the first case and of importance in terms of absolute value so that it will result in considerable distortion of competition.

Although the broadest possible harmonization of the systems and level of turnover tax is desirable, it cannot be denied that considerable practical difficulties stem from the fact that the various States have different budgetary needs and, that as described above (page 115 et seq.), the structure of their tax systems is not simply a matter of chance, arbitrary acts or of tradition,

(1) One member of the Committee has expressed a very clear preference for the "tax on tax" deduction system, as much for technical reasons (flexibility, without influence on the tax yield) as for reasons inspired by the desire for "tax transparency", since the other system is not without a cumulative effect. Furthermore, this member draws attention to the fact the method preferred by him automatically absorbs in the industrial stages, the exemptions envisaged for technical reasons for example in the agricultural sector. (cf. page 131).

but generally the result of socio-economic conditions. A (nearly) complete harmonization of turnover tax would lead in numerous cases to considerable changes in the tax yield of Member States. These changes would in turn make it necessary to proceed to a reform of other factors of the tax system in question. If, for example, in a country which cannot, or does not wish to increase direct taxation, harmonization of turnover tax brings about a reduction of the yield from this tax source, this country will then have to deal with difficult if not insoluble budgetary problems. In this case, only the proposal sketched out above can provide a solution, namely a combination comprised of a net turnover tax at all stages with an (approximately) identical rate on the one hand, and a moderate tax at the retail trade stage on the other hand, the rate of which could be more or less different according to the Member States and which thus could match their budgetary needs, without causing disturbance in international competition.

4. Questions connected with the problem of trade with third countries

Even if, in trade between the Member States, the application of the principle of country of origin and consequently, the removal of tax frontiers is possible if the proposals sketched out above are adopted, the principle of the country of destination currently practiced in a general way must naturally be maintained in trade between the E E C countries. Two technical difficulties, however, arise in the case of a harmonized net turnover tax in relation to trade with third countries:

1) To the extent that the rates of net turnover taxes at all stages are not strictly identical in all the Member States of the E E C, the question arises as to how the refunds and compensatory taxes necessary in trade with third countries must be calculated and possibly shared among the interested countries in the case where a good exported from a third country has in part been produced in the exporting country and in part in other Member States of the E E C, or in the cases where a good imported from a third country is made the object of added value as the result of processing, etc. performed in more than one Member State of the E E C. The difficulties resulting from this situation constitute an important argument in favour of complete equality of rates relating to net turnover tax. On the other hand, the tax to be levied, according to the present Report, at the retail trade stage at differing rates would, because of its character, hardly raise the problem of sharing as indicated above.

2) Even when the level of turnover tax is the same, it can be asked how refunds to be paid or compensatory taxes to be levied in trade with third countries must be calculated and to which Member State they must be allocated. Clearly this is a problem of supranational financial equalization (see below page 150 et seq.).

5. The question of tax domicile or residence for so-called direct taxes

As emphasized on several occasions, the concept of the country of destination cannot be applied in a strict sense to these taxes. This does not imply, however, that some problems with respect to the place of taxation cannot also arise in this field.

In relation to income tax, in a strict sense, in principle there exists a possibility of choice between an exclusive taxation of overall income in the country of tax domicile of the taxpayers on the one hand, and a taxation of various income categories in the country of source or situs and of other income categories in the country of domicile or of residence, on the other hand. In relation to interest from mortgages, the country of domicile of the debtor must always be considered as the State where the source of income is situated; the country where the property is situated does not come into consideration in relation to interest from mortgages, at least not when the procedure of a withholding tax is followed. The problem is similar for company taxation; here the question arises in addition, where dividends must be taxed which are distributed by a company established in a country A to shareholders domiciled or resident in countries B or C, that is to say in a country other than that in which the company has its tax domicile (cf. page 140 et seq.).

The tax on wealth can either be levied in its entirety by the country of tax domicile of the owner, or be shared among the countries of tax domicile on the one hand and the country of situs (for example, for real estate) on the other hand. Only the country of situs enters into account for the tax on transfers of real estate as well as for taxes on developed or undeveloped property; for the taxes on capital transfers it is solely the country of establishment of the company which counts; for the part of the general tax on wealth relating to securities it is only the country of tax domicile of the owner which is the determinant factor.

VI. GENERAL PROBLEMS OF FINANCIAL POLICY

1. Supranational financial compensation

a) General Remarks

As already emphasized on several occasions in the present Report, the FFC is convinced that harmonization of fiscal and financial policies cannot be achieved without the adoption of compensatory measures if it is wished to avoid distortion of competition between the States and to establish in general in the E E C, conditions analogous to those of an internal market.

Above all this derives from the fact that economic structure and economic strength (closely linked to it) of the six States differ in a not unimportant way at the present time. These differences which are reflected, to a certain extent but not entirely, in the rate of real income per capita, bring disparities of financial power. These disparities in turn notably have the following consequences:

A relatively weak country from an economic and financial point of view cannot obtain, all things otherwise being equal, tax receipts as large as those of richer countries through direct taxes (notably income taxes in the wider sense).

Essentially for the reason mentioned under (1) the country must rely to a relatively large extent, on "indirect" taxes, notably on general and special taxes on consumption which as compared with individual and corporate income taxes have a lower tax return and are less equitable from a social point of view.

Relatively poor economies are obliged to choose, under conditions that are otherwise equal, between the necessity of providing for public services that are important for the general economy, social and cultural policy, etc., on a reduced scale or of inferior quality in relation to rich countries, and the necessity of raising the rates of certain taxes to a point where it can eventually result in distortions in trade between countries.

Consequently to avoid distortions in competition of a tax origin in trade between the States, certain compensatory measures are necessary from a financial aspect; generally there has been recourse to such measures in varying degrees in all federated States, and even in unitary States in relation to local authorities. However, account must be taken of the following limitations:

To the extent that essential differences in relation to tax receipts are not in general, or for certain taxes, based on differences corresponding to economic and financial strength, but on a different efficient (intensive) use of the various tax sources, the form of supranational financial compensation must not have as a consequence that the countries applying less rational methods of assessment and collection are supported by tax authorities who work more rationally, and that thus for such countries there is no incentive to improve their methods.

The condition of all measures of financial compensation is that the country favoured is encouraged to achieve all possible and necessary reforms in the interest of harmonization of tax systems.

Financial compensation must not aim at completely abolishing all disparities in economic and financial strength; it is appropriate rather to reduce these differences to the extent that seems necessary in order to set up compatible conditions of competition within the Common Market.

Financial compensation must be supple: since as a consequence of the gradual integration of Member States economic and financial disparities currently in existence have a tendency to be reduced without disappearing completely, supranational financial compensation can and must adapt itself constantly to these modifications, that is to say that transfers to countries that are relatively weak financially must be in principle of a degressive nature.

b) Particular problems

The FFC cannot have as a task the discussion of numerous particular technical problems, even the most important, which are linked to the putting into operation of supranational financial compensation combining the conditions mentioned above. Rather it is advisable in this matter to make detailed studies which should be conducted by a special committee. It is appropriate nevertheless to briefly set forth below certain aspects and points of view which merit being taken into consideration:

1) Firstly, there must be considered the criteria for determining the economic and financial strength of the Member States (for example, real income per capita) and the level in relation to

which the economic and financial strength of a country is greater or less than the average strength of all the Member States and allows the crediting or debiting of a country under a system of general supranational compensation.

2) One of the essential objectives of financial compensation consists in allowing relatively weaker national economies to go on to a reform of their tax systems in view of better harmonization of tax systems within the E E C. This, for example, implies abandonment or reduction of taxation of movement of capital but also rational assessment and collection of income tax. In the granting of financial compensation subsidies, it is consequently advisable to guard that these payments are really used, at least in part, in the interests of the objective mentioned above.

3) All industrialized countries today participate in whatever form in assistance to countries undergoing development by making larger or smaller payments to such countries. The base of evaluation of an "adequate character" of the development assistance is generally taken as a determined part either of National Product or of the range of public expenditures of the donor country. The FFC completely recognizes the great ethical and humanitarian importance as well as the economic and political importance of this development assistance. However, it believes it is also legitimate to take into account in the future, obligations which certain of them have made as a result of supranational financial compensation within the Community in evaluating the participation of Member States of the E E C in assistance to countries undergoing development in a narrow sense; if such is not the case, for the States considered there would eventually arise an exaggerated burden from obligations which are primarily inherent objectives of international or supranational policy.

4) Certain particular measures will be considered, apart from general financial compensation measures. The measures will above all be necessary at the time of the reform of turnover tax proposed in the present Report.

In the circumstances it concerns trade in goods between E E C countries as well as trade between Member States of the E E C and third countries. The necessity of relying on certain compensation operations occurs from the fact that alteration or finishing of goods does not have the same relative importance in the various countries.

It would be incompatible with the spirit of the measures for reform proposed here and hardly achievable in practice, to subject transactions made in relation to imports and exports of goods brought about in part in one, and in part in another Member State, to a detailed inspection of all businesses concerned in all the countries in question. It can only concern finding a solution on the basis of lump sum taxation guaranteeing that it takes into account, at least to a certain extent, the idea that the consumer must bear the taxes which affect the goods considered and that the yield of these taxes goes to the country where the consumer is situated. The question of the form to give to partial financial compensation of this type, limited to turnover tax, exceeds the scope of the work of the Committee; the method to be adopted, for this problem as much for the analogous problem of trade with third countries, with a view to operating rational sharing of the taxes levied or of rebates to be paid, should rather be studied by the special committee referred to above.

5) Although in principle it may be possible to find elsewhere the necessary means for financial compensation, the FFC to this end recommends employing customs duty receipts of the Member States while waiting for the bringing into being of true Community finances, which can only be envisaged later. The customs duties would in this case be considered as revenue of the Community as such. There must be reserved to the special committee, which has already been referred to several times, the study of the problem, if - and should occasion arise in what way - the receipts drawn from customs sources of the Community should serve to fullfil funds required for particular aims.

2. Harmonization and co-ordination of guiding principles of general financial policy

We have already briefly underlined at the beginning of this Report (see pages 98 and 105) the economic and social objectives of general policy which have in principle been recognized as such by the Member States of the E E C, and for whose achievement financial policy measures can also be put into operation to differing degrees.

Experience shows that in spite of recognition of the principle of these objectives, political practice often partly hinders their achievement, that on the other hand, there can be conceived situations engendering conflicts of objectives and finally that the points of view concerning the priority to be granted to different objectives varies in time and space.

In relation to this last point, it can hardly be expected in the future - in any case as long as economic union of the E E C countries will not have become a political union - that the different States abandon their own conceptions of the relative importance of different social and economic objectives. This is equally valid for the level of redistribution of income and/or wealth considered as desirable. Under these conditions it will be necessary to give proof of realism and to fix certain minimum requirements in relation to harmonization and co-ordination of economic and social objectives, insofar as measures for tax policy and public expenditure are placed at the service of these objectives and that such measures give rise to hindrance to the free movement of persons, capital and goods between Member States situated under conditions analogous to those of an internal market.

The FFC considers that it would advisable to demand the two following conditions as minimum requirements:

1) Member States shall try to apply their general financial policy in such a way that is does not cause any hindrance to harmonious and continuing growth, as much for the national economy as for the economies of other Member States and that the level of employment remains high. This condition notably implies that the systems for taxation and expenditure contain the highest degree of built- in flexibility and that budgetary policy for surpluses and deficits be applied in such a way that in each case they reflect the necessities of the business cycle (cf. above page 105).

It seems desirable for the realization of this objective that the competent representatives of the Ministries of Finance and Economic Affairs remain in close and permanent contact, being informed in adequate time of the planned financial measures which are or can be important influences in this respect and consulting each other in order to harmonize these measures. Moreover, it is necessary that a regular exchange of information dealing with real development of finances during the budgetary year takes place.

2) The Member States shall work out their financial policy in such a way that the achievement of the objective mentioned under point (1) does not compromise internal or external financial stability. If a government thinks that the probable development of the budget will bring about inflationary or deflationary disturbances and if it believes that it cannot in time or adequately avoid these disturbances - for example, for reasons of internal politics - by its own means or through existing international organizations, it informs the governments of other Member States and with them studies the possibilities of mastering these difficulties by common effort. In this respect it must be emphasized that the E E C will only contain conditions analogous to an internal market if the same "monetary climate" persists in all Member States, that is to say if the financial policy of the States (naturally in close co-operation with monetary policy) does not cause or does not favour inflationary or deflationary processes, but at least guards that within the Common Market, differences considered as inevitable in relation to the assumption of stability are situated in the same direction and have approximately the same size.

3. Tax harmonization considered as a dynamic process; necessity of rational co-ordination between financial policy and monetary policy

As has appeared in certain paragraphs of the Report and the Appendices, the FFC considers that harmonization of financial systems being a long-term political matter to be achieved in stages, certain of its elements can neither be fixed in a permanent way, nor be decided now for an indeterminate period. Three main reasons explain why the present study can require alterations or even possible additions:

1) Tax harmonization will constitute a dynamic process in this sense that, divided into stages over time and put into effect in successive steps, the achievement of certain of the stages will have to be pursued in a political and economic context which could differ from the current context. Certain basic data necessarily taken into consideration for the working out of the present Report may have changed in the more or less distant future and from this fact call for changes in the proposals formulated at the present time.

2) The influence of economic structures on tax systems being - as has been noted - of great importance, there should be taken into account on putting into operation harmonization, structural changes likely to arise and which will influence the methods of harmonization themselves. This consideration is made still more imperative by the fact that economic growth created by the Common Market, by modifying the economic structures of Member States, will react on their tax structure and could raise in fresh terms certain methods for harmonization (cf. on this point Appendix E: The influence of economic growth of the Member States on problems of tax har-

monization, page 185). Here it is again made clear how much the action undertaken is liable to continuing adaptation in order to be effected in conformity with changes provoked by growth: development of regions, creation of new business activities, relative importance of various sectors, shifts of man-power, growth of production, modifications in the distribution of National Income, etc.

(3) To these medium and long term problems, are added those posed in the nearer and even immediate future, by cyclical requirements.

It has been shown in the present Report that the putting into operation of harmonization cannot be dissociated from financial policy, which is itself linked with monetary policy.

The FFC desires to stress the fundamental role played in the present period by financial policy owing to the considerable growth in the total sum of budgets and the greater and greater size of the volume of funds passing through the Exchequer. From this there occurs a series of immediate and direct consequences on the volume of liquidity and on the value of money; so that it is no longer possible to consider that an isolated or independent monetary policy is still sufficient to attain the objectives which have been traditionally assigned to it. Financial policy and monetary policy must not only be co-ordinated, but made compatible. Co-ordination will try to seek the attainment of an objective either simultaneously by the proper action of the two policies, or alternatively by such action as, having regard to the conditions of the moment, appears the most efficaceous. Thus a government desiring to influence the volume of liquidity will be able to find the management of tax rates more efficient than the management of Bank Rate. The compatibility of financial and monetary policy should be pursued in such a way that dispositions relative to credit or currency are not contradicted by measures of tax policy or vice versa. Thus, easy credit policy intended to develop investment must not be obliterated by a tax policy running counter to the formation of savings.

In these different realms, requirements of policy in relation to the business cycle are decisive. However, continuing and regular attention must be directed to the examination of conditions to be fulfilled in order that co-ordination and compatibility of financial and monetary policy may be achieved reasonably, having regard to the needs of the moment and to the permanent requirements of harmonization.

In particular attention must bear on the obstacles or delays that measures intended to achieve co-ordination and compatibility of financial and monetary policies can cause in the endeavour for harmonization of tax systems. Furthermore, it will also be advisable to determine the effect that a specific harmonization measure could exercise on the financial policy adopted and, by way of repercussions, on the monetary policy with which it is connected.

These considerations still emphasize the necessity of considering harmonization as a continuing endeavour whose principles and methods should be defined at an instant - as has been attempted in the present Report - but whose application must be followed with care in order to be adapted to the requirements of the business cycle and of financial and monetary policy of the Member States.

VII. TIME-TABLE FOR TAX HARMONIZATION MEASURES

Preliminary remarks

As experience gained up to the present within the E E C shows, notably in relation to the achievement of the customs union, common agricultural policy, etc., it is not always possible to guarantee the execution of a precise timetable. For tax reform, it may be expected that in certain cases the preparatory work which is required from a technical point of view, extends over a period that it is not possible to fix in an exact way. This is why in the passages that follow there has been abandoned any indication of the number of years foreseen for each phase or period during which this would last according to present ideas. The following distinction in three phases therefore basically indicates the relative degree of urgency of measures and preparatory work envisaged within the framework of the different phases.

Certain of the reforms recommended by the FFC are closely linked, from the point of view of their implementation over time, to progress which will be accomplished on particular fields, such as transport and energy policy. This is why the idea has been abandoned that such proposals should be put into operation in the framework of this or that phase; the proposals have rather been put together in groups for which it may be assumed that the achievement of the respective reforms should be settled by the time taken for putting into effect the general necessary measures for harmonization in the sectors affected.

I. First Phase

Preliminary remark

Leaving aside turnover tax, this phase will essentially only consist of measures needed to prepare the reforms that should be achieved in the later phases.

A. Measures to be taken

1. The reform of turnover tax on the basis of principles formulated in the Report must be considered as the most important and most urgent measure to be taken within the framework of tax harmonization.

During the first phase, there will have to take place the suppression of cumulative gross turnover tax levied at all stages (cascade tax) everywhere that it exists, and its replacement to the extent possible by a tax on added value, or eventually by a tax levied at a single stage. Each of the Member States can prepare - and if occasion arises put into effect - the tax on transactions at the retail trade stage, intended to complement the tax on added value. After the introduction of a tax on value added, tax frontiers will have to be abolished as soon as possible in relation to turnover tax. In this context, if occasion arises, the special excise duties mentioned under II B 3 b) will be incorporated in the tax on added value or the exemption rules for these excise duties will have to be unified in Member countries.

2. Provisions relative to the method and level of taxation of dividends and interest (withholding at source) should be harmonized.

3. Present treaties for the avoidance of double taxation between Member countries would have to be recast in the sense of the model treaty of the O.E.E.C., insofar as it is not already possible during the first phase to conclude a multilateral convention (see I B 4 and II A 3 of this timetable).

B. Preparatory measures

1. The details of company tax reform which are proposed in the Report, should be prepared.

2. All measures of alignment in the field of direct taxes, considered as necessary in the Report, that is to say, apart from those concerning income tax and company tax, those relating to real taxes and taxes included with them, so far as their economic effects are comparable with those of income tax or company tax, should be prepared. In this respect, it is appropriate that the method of taxation that should be applied by all the Member States is the synthetic overall taxation of income. In particular, care should be taken that provisions are worked out as uniformly as possible for valuation and amortization, as well as for other factors in assessment, which apart from the rate structure have importance from the point of view of the effective tax burden. Finally, in this range of ideas, it will be advisable to study in what way it will be possible to tax capital gains according to methods which are both efficient and uniform.

3. A detailed exchange of views should take place in relation to experience acquired and the possibilities of improvement for tax inspection.

4. It will be advisable to study the possibility of concluding a multilateral convention intended to avoid double taxation between Member States.

5. Preparations will have to take place with a view to creating, at the moment of ultimate achievement of customs union, a common fund assigned to the Community and maintained by means of receipts from the common external customs tariff and, if occasion arises, by means of other resources.

II. Second phase

Preliminary remark

Just as during the first phase, leaving aside the reform of turnover tax, the preparatory measures will be the focal point of work; there will have to be put into effect during the second phase the measures prepared during the first phase and moreover, some complementary reforms.

A. Measures to be taken

1. Reformed (harmonized) company taxation must be put into effect.

2. The necessary measures should be taken with a view to harmonization of personal income tax.

3. A multilateral convention for the avoidance of double taxation will have to be concluded.

4. Special consumption taxes which are not levied in all Member States and whose product is of relatively small importance will have to be abolished.

B. Preparatory measures

1. The study of methods of general taxation on wealth, which would be intended as the Report proposes, to complement personal income tax should be studied.

2. In relation to death duties currently applied in each of the Member States, it will be advisable to study to what extent it is desirable or necessary for the good functioning of the Common Market to go on to an alignment of the systems and rates.

3. It must be studied in what measure excise duties which it does not seem possible to abolish (cf. above II A, 4), should be harmonized. In this respect a distinction should be made between special consumption taxes in the proper sense of the term, and taxes on products which can at the same time be consumption goods and means of production.

a) As long as it is considered that the principle of the country of destination must be abided by, it will not be necessary to go on to a harmonization of special taxes on consumption in the narrow sense of the term (for example, taxes on tobacco). On the contrary, under this hypothesis it will be necessary so as to avoid distortion of competition, to maintain the traditional system of refunds and compensatory taxes. Conversely, it is clear that the complete abolition of tax frontiers would assume a very developed harmonization of these taxes.

b) Taxes affecting goods likely to be used either as consumer goods or as means of production will be of a nature likely to cause distortion after reform of turnover tax has been reached, since in the latter hypothesis these taxes will be incorporated in the cost price without there being a possibility of taking compensatory measures at the frontier. To put an end to such distortions, one of the two following solutions can be considered, whose advantages and disadvantages respectively it would be advisable to study: merging of these taxes with the new tax on added value or allowance to deduct the taxes in question from the tax on added value itself. In any case such a measure should be taken at the same time that the tax on added value is put into effect, that is to say during the first phase.

III. Third phase

Preliminary remark

In principle all the reforms proposed in the Report should, so far as this has not already taken place during one of the previous phases, be finally put into application during this phase. Moreover, the following measures should be taken:

1. To create a common information service with the end of ensuring efficient tax inspection.

2. In addition to the creation of a common fund maintained mainly by receipts from customs duties (see above I B 5), it will be advisable to take necessary measures with a view to ensuring financial compensation at a supranational level, as the Report recommends. In this range of ideas, it should be noted that certain financial compensation operations will perhaps be required at earlier stages. Such will notably be the case when the achievement of certain reforms depends on simultaneous execution of financial compensation measures.

3. For litigation which can not be resolved in a satisfactory way by national courts, there will have to be created a special court at European Community level with a view to setting up an appropriate appeal procedure.

IV. Tax measures for which the time-table depends on the achievement of general reforms in the sector to which such measures relate

1. To the extent that capital movements within the Common Market will be effectively freed, it will be necessary to abolish those taxes on capital transactions which are liable to bring about distortions. Insofar as this may be judged opportune for reasons other than tax reasons, certain of these taxes could be transformed into duties or fees. Taxes on capital transactions whose abolition or transformation into fees (of the remunerative type characterized by charges on the

conclusion of legal documents and their registration) will not be considered as necessary to the good functioning of the machinery of free movement of capital within the Community, should be unified.

2. Taxation of transport in the wide sense of the term should be harmonized on the basis of the general principles established for transport policy.

3. The same follows for the taxation of sources of energy.

BOOK III

APPENDICES TO THE REPORT OF THE FISCAL AND FINANCIAL COMMITTEE

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APPENDIX A

MANDATE ENTRUSTED TO A SCIENTIFIC COMMITTEE FOR THE STUDY OF FISCAL AND FINANCIAL PROBLEMS IN THE EEC

(Fiscal and Financial Committee = FFC)

1. The E E C Treaty only limits the financial and tax autonomy of Member States in Customs matters and matters concerning the tax treatment of trade between States. This does not prevent Member States of the E E C deciding to harmonize their financial and tax policies if it appears desirable or is required in the interest of the Common Market. The economic problems which arise for public revenue and expenditure policy with an economic community moving toward economic union, have not been sufficiently considered either in general economic publications or in literature on public finance. It therefore appeared appropriate to set up a fiscal and financial committee and to ask it to bring these problems to light and to suggest solutions.

2. The FFC should study:

a) If and in what measure the disparities of public finance currently existing between Member countries partly or even entirely hinder the establishment of a Common Market which brings into being and guarantees conditions analogous to those of an internal market;

b) To what extent it is possible to remove the disparities which considerably impede the formation and functioning of the Common Market.

3. The studies of the FFC must above all bear on public revenue and expenditure policy in those aspects which touch policy in relation to competition, and must show what form public financial policy should take if it is desired to avoid distortion of competition.

4. Undoubtedly questions of indirect taxation (particularly turnover tax) will constitute one of the principal problems demanding the attention of the FFC. Nevertheless, it is not intended that because of this the Working Group set up within the scope of the Directorate General IV to deal with harmonization of turnover tax should stop its work, it should on the contrary speed up its studies as much as possible. The FFC shall thus concern itself solely with questions of the principles of indirect taxation and shall show particularly under what conditions it is possible, thanks to the Common Market, to eliminate not only customs frontiers but also tax frontiers.

5. It is clear moreover, that questions of indirect taxation only form one of the groups of problems that the FFC will have to study. It will also have to be concerned with direct taxation, the economic effects of inequality of overall tax burdens, the varied composition of the tax revenues as well as with public expenditure (notably expenditure for social purposes and for investment).

6. It would be desirable that the FFC concerns itself in its field of studies with the particular problems raised by tax laws in the realm of transport (also in relation to coverage of overhead costs) as well as the effects of taxation and financial policy within the Common Market on relations with third countries.

7. The FFC will have to complete its studies within a relatively brief delay. Detailed studies are not expected from the FFC. It shall solely raise the principal problems in outline, clarify the possible solutions and sketch the possible steps in a move by stages toward an ideal solution.

Comments on the mandate entrusted to the FFC by the Commission

1. The FFC should bear in mind that regional differences in public policy relating to revenue and expenditure resulting from regional differentiation ordered by nature and consolidated by history, are in no way necessarily undesirable and that the aim of the E E C is not to favour the uniformity or central regulation of economic and social conditions. However, regional differences of public financial policy should not be so extreme that they complicate or hinder the formation of a Common Market, which implies over the entire area of the E E C, conditions analagous to those in an internal market. The existence of such disparities of financial policy should likewise not hinder the achievement of other fundamental objectives of the E E C, notably in relation to the cyclical development and to economic growth (Art. 103 and paragraph 5 of the Preamble).

2. It is in this sense that the FFC should see to what extent, and in what way, current disparities in the field of public finance should and could be counterbalanced or removed, and in which fields and in which forms regional differences of revenue and expenditure policy of Member States do not contain any disadvantages or are even desirable.

3. It would be appropriate for the FFC to start from the following hypotheses in their studies:

a) The Member States of the E E C have as their aim the setting up and maintenance over the entire territory of the E.E C., a Common Market with conditions similar to those in an internal market. The European Economic Community must therefore become as complete an economic union as possible.

b) Consequently, it is not desirable to balance shifts in general conditions of competition in each of the six Member States by recourse to frequent changes in rates of exchange. It would, on the contrary, be preferable to attempt to settle as soon as possible the relationship between the rates of exchange in the six countries which would also be a desirable move toward the eventual achievement of monetary union.

c) Furthermore, it is desirable to remove not only customs frontiers between Member countries, but also to reduce tax frontiers to a strict minimum.

d) All the other situations interfering with the interplay of competition will be gradually removed so that in the survey of financial policy, it is not necessary to take into account the fact that certain measures of financial policy in spite of the disturbances that they cause in competition, have favourable effects because they precisely balance out distortions which otherwise exist in the field of competition.

e) The creation of conditions proper to a Common Market also involves free movement of businesses, capital and labour. From this it results that taxes and public expenditure should not hinder movement of production units to favourable locations or cause such removals to be made to unfavourable locations.

4. The following directions are further given to the FFC:

a) Given that revenue and expenditure of different sections of the Civil Service appear in a widely differing degree in the budgets of Member States, it will hardly be possible to avoid that the enquiry does not also bear on the revenues and expenditure of subordinate local bodies and also on special budgets, for example, those of social insurance. Undoubtedly it will be necessary to review the revenue and expenditure of public authorities as a whole, because the burden of these revenues and expenditures on the Common Market does not at all depend on the type of regional body to which they must be attributed.

b) Given that it is continuously in public that the varying relationship among the different E E C countries between direct and indirect taxes causes a distortion of competition between the different countries of the E E C , it would be expedient to study this problem.

c) In relation to direct taxes, it would also be appropriate to study the differentiations within each national economy and even more so between these economies, which result from the fact that tax privileges and special provisions with regard to the determination of income and profits are numerous, and that tax systems (methods of assessment and of collection) differ very greatly from country to country in spite of a certain alignment which has already been achieved (the so-called taxes on returns are included here among direct taxes).

d) In relation to direct taxes it would be appropriate in addition to enquire in what way it would be possible to treat the problem of double taxation within the framework of the E E C, in other words, in what measure it appears opportune to modify existing double taxation agreements and to bridge the gaps they contain. It is clear that the approximation of methods of taxation also allows considerable simplifcation of the provisions for the avoidance of double taxation.

e) Although it might be tempting at first sight to limit the enquiry to the principal taxes in each country, it would be expedient that it should also bear on other taxes. Secondary taxes can have the effect of distorting competition and may have a considerable weight in limited sectors, even if the product of the tax is insignificant in comparison with the budget. Furthermore, taxes existing only in some countries could also serve as example for other countries. In this range of ideas it is for example, expedient to think about general taxes on net wealth as well as death duties.

f) To the extent that public expenditures must be included in the enquiry, it appears without doubt to be useful on the one hand, to make a distinction between public administration in the narrow sense of the term (justice, foreign affairs, etc.) and expenditures for national defence, as well as, on the other hand, public investment, public consumption expenditure (for example, education, social services), transfer of income (including social insurance contributions) and

subsidies. Contrary to the general services of public administration and to expenditure on national defence which can be admitted to profit nearly equally all consumers and producers in the same country and in proportion to their consumption and production, there is reason to expect that in relation to the latter expenditures different social classes derive benefit from them to differing degrees, so that these expenditures may foster distortions in competition.

APPENDIX B

THE PROVISIONS OF THE EEC TREATY WHICH ARE OF PARTICULAR IMPORTANCE FOR THE PROBLEMS EXAMINED BY THE FISCAL AND FINANCIAL COMMITTEE

Article 2

It shall be the aim of the Community, by establishing a Common Market and progressively approximating the economic policies of Member States, to promote throughout the Community a harmonious development of economic activities, a continuous and balanced expansion, an increased stability, an accelerated raising of the standard of living and closer relations between its Member States.

Article 3

For the purposes set out in the preceding Article, the activities of the Community shall include, under the conditions and with the timing provided for in this Treaty:

a) the elimination, as between Member States, of customs duties and of quantitative restrictions in regard to the importation and exportation of goods, as well as of all other measures with equivalent effect;

b) the establishment of a common customs tariff and a common commercial policy towards third countries;

c) the abolition, as between Member States, of the obstacles to the free movement of persons, services and capital;

d) the inauguration of a common agricultural policy;

e) the inauguration of a common transport policy;

f) the establishment of a system ensuring that competition shall not be distorted in the Common Market;

g) the application of procedures which shall make it possible to co-ordinate the economic policies of Member States and to remedy disequilibria in their balances of payments;

h) the approximation of their respective national law to the extent necessary for the functioning of the Common Market;

i) the creation of a European Social Fund in order to improve the possibilities of employment for workers and to contribute to the raising of their standard of living;

j) the establishment of a European Investment Bank intended to facilitate the economic expansion of the Community through the creation of new resources; and

k) the association of overseas countries and territories with the Community with a view to increasing trade and to pursuing jointly their effort towards economic and social development.

Article 7

Within the field of application of this Treaty and without prejudice to the special provisions mentioned therein, any discrimination on the grounds of nationality shall hereby be prohibited.

The Council may, acting by means of a qualified majority vote on a proposal of the Commission and after the Assembly has been consulted, lay down rules in regard to the prohibition of any such discrimination.

Article 17

1. The provisions of Article 9 to 15, paragraph 1, shall also apply to customs duties of a fiscal nature. Such duties shall not, however, be taken into consideration for the purpose of calculating either total customs receipts or the reduction in total duties referred to in Article 14, paragraphs 3 and 4.

Such duties shall, at each reduction, be lowered by not less than 10 per cent of the basic duty. Member States may reduce these more rapdily than is provided for in Article 14.

2. Member States shall, before the end of the first year after the entry into force of this Treaty, inform the Commission of their customs duties of a fiscal nature.

3. Member States shall retain the right to substitute for these duties an internal tax in accordance with the provisions of Article 95.

4. Where the Commission finds that in any Member State the substitution of such duty meets with serious difficulties, it shall authorise such State to retain the said duty provided that the State concerned shall abolish it not later than six years after the date of the entry into force of this Treaty. Such authorization shall be requested before the end of the first year after the date of the entry into force of this Treaty.

Article 92

1. Except where otherwise provided for in this Treaty, any aid granted by a Member State or granted by means of State resources, in any manner whatsoever, which distorts or threatens to distort competition by favouring certain enterprises or certain productions shall, to the extent to which it adversely affects trade between Member States, be deemed to be incompatible with the Common Market.

2. The following shall be deemed to be compatible with the Common Market:

a) aids of a social character granted to individual consumers, provided that such aids are granted without any discrimination based on the origin of the products concerned;

b) aids intended to remedy damage caused by natural calamities or other extraordinary events; of

c) aids granted to the economy of certain regions of the Federal Republic of Germany affected by the division of Germany, to the extent that such aids are necessary in order to compensate for the economic disadvantages caused by such division.

3. The following may be deemed to be compatible with the Common Market:

a) aids intended to promote the economic development of regions where the standard of living is abnormally low or where there exists serious under-employment;

b) aids intended to promote the execution of important projects of common European interest or to remedy a serious disturbance of the economy of a Member State;

c) aids intended to facilitate the development of certain economic regions, provided that such aids do not change trading conditions to such a degree as would be contrary to the common interest. Any aids to shipbuilding existing on 1 January 1957 shall, to the extent that such aids merely offset the absence of customs protection, be progressively reduced under the same consitions as apply to the abolition of customs duties, subject to the provisions of this Treaty relating to the common commercial policy in regard to third countries; and

d) such other categories of aids as may be specified by decision of the Council acting by means of a qualified majority vote on a proposal of the Commission.

Article 95

A Member State shall not impose, directly or indirectly, on the products of other Member States any internal charges of any kind in excess of those applied directly or indirectly to like domestic products.

Furthermore, a Member State shall not impose on the products of other Member States any internal charges of such a nature as to afford indirect protection to other productions.

Member States shall, not later than at the beginning of the second stage, abolish or amend any provisions existing at the date of the entry into force of this Treaty which are contrary to the above rules.

Article 96

Products exported to the territory of any Member State may not benefit from any refund of internal charges in excess of those charges imposed directly or indirectly on them.

Article 97

Any Member States which levy a turnover tax calculated by a cumulative multi-stage system may, in the case of internal charges imposed by them on imported products or of refunds granted by them on exported products, establish average rates for specific products or groups of products, provided that such States do not infringe the principles laid down in Articles 95 and 96.

Where the average rates established by a Member State do not conform with the above-mentioned principles, the Commission shall issue to the State concerned appropriate directives or decisions.

Article 98

With regard to charges other than turnover taxes, excise duties and other forms of indirect taxation, exemptions and refunds in respect of exports to other Member States may not be effected and compensatory charges in respect of imports coming from Member States may not be imposed, save to the extent that the measures contemplated have been previously approved for a limited period by the Council acting by means of a qualified majority vote on a proposal of the Commission.

Article 99

The Commission shall consider in what way the law of the various Member States concerning turnover taxes, excise duties and other forms of indirect taxation, including compensatory measures applying to exchanges between Member States, can be harmonized in the interest of the Common Market.

The Commission shall submit proposals to the Council which shall act by means of a unanimous vote, without prejudice to the provisions of Articles 100 and 101.

Article 100

The Council, acting by means of an unanimous vote on a proposal of the Commission, shall issue directives for the approximation of such legislative and administrative provisions of the Member States as have a direct incidence on the establishment or functioning of the Common Market.

The Assembly and the Economic and Social Committee shall be consulted concerning any directives whose implementation in one or more of the Member States would involve amendment of legislative provisions.

Article 101

Where the Commission finds that a disparity existing between the legislative or administrative provisions of the Member States distorts the conditions of competition in the Common Market and thereby causes a state of affairs which must be eliminated, it shall enter into consultation with the interested Member States.

In such consultation does not result in an agreement which eliminates the particular distortion, the Council, acting during the first stage by means of an unanimous vote and subsequently by means of a qualified majority vote on a proposal of the Commission, shall issue the directives necessary for this purpose. The Commission and the Council may take any other appropriate measures as provided for in this Treaty.

Article 102

1. Where there is reason to fear that the enactment or amendment of a legislative or administrative provision will cause a distortion within the meaning of the preceding Article, the Member State desiring to proceed therewith shall consult the Commission. After consulting the Member States, the Commission shall recommend to the States concerned such measures as may be appropriate to avoid the particular distortion.

2. If the State desiring to enact or amend its own provisions does not comply with the recommendation made to it by the Commission, other Member States may not be requested, in application of Article 101 to amend their own provisions in order to eliminate such distortion. If the Member State which has ignored the Commission's recommendation causes a distortion to its own detriment only, the provisions of Article 101 shall not apply.

Article 201

The Commission shall study the conditions under which the financial contributions of Member States provided for in Article 200 may be replaced by other resources of the Community itself, in particular, by revenue accruing from the common customs tariff when the latter has been definitely introduced.

For this purpose, the Commission shall submit proposals to the Council.

The Council, acting by means of an unanimous vote and after consulting the Assembly on such

proposals, may lay down the provisions whose adoption it shall recommend to the Member States in accordance with their respective constitutional rules.

Article 220

Member States shall, in so far as necessary, engage in negotiations with each other with a view to ensuring for the benefit of their nationals:

- the protection of persons as well as the enjoyment and protection of rights under the conditions granted by each State to its own nationals;
- the elimination of double taxation within the Cummunity;
- the mutual recognition of companies within the meaning of Article 58, second paragraph, the maintenance of their legal personality in cases where the registered office is transferred from one country to another, and the possibility for companies subject to the national law of different Member States to form mergers; and
- the simplification of the formalities governing the reciprocal recognition and execution of judicial decisions and of arbitral awards.

APPENDIX C

STATISTICAL DATA RELATING TO THE CURRENT ECONOMIC AND FINANCIAL SITUATION OF THE MEMBER STATES OF THE EEC

Table I Product of State and local authority taxation together with social security contributions (1)

		Taxes	Social Security	Total
Germany (F.R.) Milliard D.M.	1950	21,08	7,78	28,86
	1955	41,78	14,67	56,45
	1959	57,97	24,12	82,09
France Milliard F.	1950	21,1	7,4	28,5
	1955	36,9	15,3	52,2
	1959	62,0	25,0	87,0
Italy Milliard lires	1950	-	421	-
	1955	2501	1428	3529
	1959	3549	1561	5110
Netherlands Million florins	1950	4892	789	5681
	1955	6532	1368	7900
	1959	8360	2990	11350
Belgium Milliard Fr. B	1950	59,2	19,7	78,9
	1955	76,6	27,6	104,2
	1959	97,0	38,2	135,2
Luxembourg Million francs Luxembourgeois	1952	4436	1268	5704
	1955	4008	1526	5534
	1959	4583	1954	6537

1) Calculation based on the national accounting systems. Standard system of the United Nations and of the O.E.C.D.

a) Source: General Statistical Bulletin (E E C) 1961 No. 12.

Table II

Breakdown of the total public expenditure, including social security, by category of expenditure in the EEC countries in 1950, 1955, 1959 (a) (percentages of Gross National Product)

	Germany (F.R.) (not including Saar)			France			Italy			Netherlands			Belgium			Luxembourg		
	1950	1955	1959	1950	1955	1959	1950	1955	1959	1950	1955	1959	1950	1955	1959	1950	1955	1959
1. Public consumption expenditure (of which	14.4	13.3	13.6	12.9	13.0	14.9	11.2	12.9	14.5	12.5	14.3	13.3	9.8	11.0	11.7	12.4	13.2	11.6
Military)	(4.5)	(3.4)	(3.2)	(5.8)	(4.9)	(5.9)	-	-	-	(4.7)	(5.5)	(3.9)	(2.1)	(3.5)	(3.2)	(1.9)	(2.5)	(1.3)
a. Salaries (b)	7.2 (c)	6.7 (c)	6.6 (c)	8.6	8.8	9.5	8.4	8.9	9.3	4.9	8.2	8.6	6.8	7.5	8.3	6.9	8.0	8.1
b. Rent and Amortization	0.6	0.5	0.6	0.7	0.2	0.1	0.2	0.2	0.3	0.9	0.8	0.9	0.5	0.5	0.6	2.3	2.4	2.4
c. Current purchases of goods and services (d)	8.5 (c)	7.9 (c)	8.3 (c)	4.1	4.0	6.2	2.6	3.8	4.9	5.0	6.0	4.3	2.7	3.3	3.1	5.9	4.5	3.4
d. less: current sales of goods and services	1.9	1.8	1.9			0.9				1.3	0.7	0.5	0.2	0.3	0.3	2.7	1.8	2.3
2. Internal current transfers	13.4	12.2	14.2	11.5	14.2	13.9	-	12.3	14.9	10.7	10.4	13.8	12.7	11.7	14.3	10.3	14.4	16.6
a. Interest on public debt	0.4	0.5	0.5	1.1 (e)	1.2 (e)	1.4 (e)	-	1.8 (e)	1.9 (e)	2.8	2.3	2.7	1.9	1.7	2.2	0.9	0.9	1.1
b. Business subsidies	0.5	0.1	0.4	1.1	1.7	1.2	0.3	1.1	1.3	1.3	0.9	1.3	1.1	1.1	1.6	1.5	2.7	3.2
c. Social Security Services	7.6	7.9	10.1	7.9	9.4	9.7	-	-	7.3	3.9	4.1	7.3	7.2	7.1	8.7	6.8	9.2	10.2
d. Other current transfers to households	4.9	3.6	3.0	1.4	1.7	1.6	-	9.3	4.4	2.6	3.1	2.4	2.3	1.7	1.7	1.0	1.5	2.0
3. Current transfers abroad	1.1	1.6	2.3	0.4	0.7	1.2	-	0.2	0.1	0.5	0.2	0.1	0.1	0.1	0.03	0.3	0.2	0.07
4. (= 1 to 3) Current expenditure of public administration	28.9	27.2	30.1	24.8	28.0	30.1	-	25.4	29.5	23.7	24.9	27.2	22.7	23.0	26.1	23.1	27.7	28.2
5. Gross capital formation	2.5	2.8	3.1	1.6	2.2	2.2	2.0	2.6	2.8	3.2	3.6	4.1	1.9	1.7	1.8	4.0	6.7	7.5
a. Purchase of new capital goods	2.4	2.7	3.0	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
b. Purchases of sites and used capital goods	0.06	0.2	0.1	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
c. less: sales of capital goods	0.05	0.03	0.04	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
6. Internal capital transfers	0.6	0.8	1.2	-	3.2	2.2	-	2.2	2.2	2.1	3.0	1.3	-	-	-	-	-	-
a. to households	-	0.3	0.5	-	1.4	0.9	-	-	-	0.6 (f)	0.2 (f)	0.3 (f)	-	-	-	-	-	-
b. to businesses	0.6	0.5	0.7	-	1.7	1.2	-	-	-	1.5	2.7	1.0	-	-	-	-	-	-
7. Capital transfers abroad	-	-	-	-	-	-	-	-	-	0.04	0.2	0.2	-	-	-	-	-	-
8. Loans to other sectors (g)	0.9	4.9	2.4	-	2.0	-	-	-	2.9	11.0	2.1	0.6	-	-	-	-	-	-
9. (= 4 to 7) Total public administration expenditure	31.6	30.8	34.5	-	33.5	34.5	-	30.3	34.6	23.0	31.7	32.8	-	-	-	-	-	-
10. Gross national product at market prices (Milliards, national currency)	97.20	178.30	247.90	100.2	170.5	259.9	9.768	13.807	18.290	19.0	30.3	38.6	363.5	482.4	572.4	17.9	18.5	22.5

a) Calculated according to the outline of the national accounting standard system of the United Nations and of the O E C D.
b) including remuneration of armed services.
c) Clothing expenditure of armed services are included in the heading 1. c).
d) including equipment and military construction.
e) including interest on public debt remitted abroad.
f) including capital transfers to pension funds.
g) not included under heading 9.

Table III Index (1960) of Gross National Product, principal categories of expenditure and of contributions of certain sectors of the economy (1954 = 100) (a)

	Germany (F.R.)	France	Italy	Netherlands	Belgium	Luxembourg
1. Gross National product	150	130	142	132	116	119 (1)
ditto per capita	140	123	138	122	112	115 (1)
2. Private Consumption	150	127	129	129	119	127 (1)
3. Public Consumption Expenditure	140	125	141	106	96	104 (1)
4. Gross fixed capital formation	169	147	167	147	124	124 (1)
5. Exports of goods and services and factor income received from abroad	212	134	225	165	157	128 (1)
6. Imports of goods and services and factor income forwarded abroad	243	142	205	162	159	129 (1)
7. Contribution of economic sectors to the Gross National Product:						
a) agriculture, forestry and fisheries	115	103 (1)	115	129	97	107 (1)
b) manufacturing.	164	128 (1)	164	140 (2)	129	121 (1)

a) Source: General Statistical Bulletin (EEC) 1961 No. 12

1) 1959

2) including mining, building, electricity, gas and water.

Table IV

Origin of Gross Domestic Product at factor cost per economic sector, (percentages) (a)

	Germany (F.R.)	France	Italy	Netherlands	Belgium	Luxembourg
1. Agriculture, Forestry and Fisheries	7,2	-	17,1	10,6	6,8	8,6 (1)
2. Mining, Manufacturing, Building, Electricity, Gas and Water	51,5	-	43,1	42,0	49,2	52,3 (1)
3. Transport and Communications	7,3	-	6,9	9,0	7,8	7,2 (1)
4. Wholesale and Retail trade	12,6	-	9,2	13,0	6,5	11,9 (1)
5. Others	21,4	-	23,7	25,4	29,7	20,0 (1)
Gross domestic product at factor cost.	100	100	100	100	100	100

a) Source: General Statistical Bulletin (EEC) 1961 No. 12.

1) 1959

Table V

Distribution of National Income in 1950 and in 1960 (percentages) (a)

	Germany (F.R.)	France	Italy	Netherlands	Belgium	Luxembourg
1. Salaries:						
1950	59,1	52,7	49,0	55,0	48,3	52,4 (2)
1960	60,8	61,4	52,6	57,2	52,2 (1)	61,3 (1)
2. Other income accruing to households:						
1950	33,9	42,4	-	34,3	50,8	29,8 (2)
1960	30,7	33,9	-	33,7	46,9 (1)	33,4 (1)
3. Company Saving:						
1950	2	3,4	-	6,5	0,1	6,9 (2)
1960	2,7	2,3	-	5,7	0,1 (1)	0,5 (1)

a) Source: General Statistical Bulletin (EEC) 1961 No. 12

1) 1959

2) 1952

Table VI Employment of Gross National Product in 1950 and 1960 at current prices (percentages) (a)

	Year	Germany F.R.	France	Italy	Netherlands	Belgium	Luxembourg
1. Private Consumption expenditure	1950 1960	64.2 57.0	67.1 65.0	70.8 61.3	67.1 56.4	76.5 68.7	52.8 (1) 60.9 (2)
2. Public Consumption expenditure	1950 1960	14.4 13.7	12.9 14.6	11.1 14.5	12.5 13.5	9.8 11.9	12.4 (1) 11.6 (2)
3. Gross fixed capital formation	1950 1960	18.8 24.0	15.9 17.4	17.4 22.2	20.0 23.9	16.5 17.5	17.5 (1) 23.3 (2)
4. Changes in stocks	1950 1960	+3.8 +2.2	+3.4 +1.9	+1.4 +1.6	+6.3 +3.5	-0.0 +0.6	-1.0 (1) +2.0 (2)
5. Exports of goods and services and income received from abroad	1950 1960	12.2 25.7	16.4 16.0	11.1 17.3	43.5 53.7	26.7 36.5	97.8 (1) 82.2 (2)
6. Imports of goods and services and factor income sent abroad	1950 1960	13.4 22.7	15.7 14.9	11.8 16.9	49.4 51.0	29.5 35.2	79.5 (1) 80.0 (2)
7. Gross national product at market prices	(= 1 to 5-6	100	100	100	100	100	100
Ditto in national currency		Mrd DM	Mrd NF	Mrd Lire	Million Florins	Mrd FB	Million F. Lbg.
	1950 1960	97.20 276.60	100.2 288.0	8,768 19,888	19,044 42,340	363.5 608.0	17,945 (1) 24,000

a) Source: General Statistical Bulletin (E E C) 1961 No. 12.

1) 1952

2) 1959

Table VII Importance of some categories of private consumption expenditure (a) (as a percentage of total private consumption).

	Year	Germany F.R.	France	Italy	Netherlands	Belgium	Luxembourg
1. Foodstuffs	1950	-	38.2	48.6	32.7	29.7	34.3 (1)
	1960	-	30.6	43.0	30.5	28.1	35.2 (2)
2. Beverages	1950	-	9.7	5.6	2.0	5.8	5.9 (1)
	1960	-	7.8	5.5	2.4	5.0	6.0 (2)
3. Tobacco	1950	-	2.2	4.6	4.5	2.0	3.0 (1)
	1960	-	2.0	4.4	4.3	2.1	3.0 (2)
4. Clothing and other personal effects	1950	-	14.7	12.6	20.8	13.4	15.7 (1)
	1960	-	11.8	10.0	15.9	10.0	12.8 (2)
5. Rent, water, heating and lighting	1950	-	6.8	5.0	10.3	15.5	14.0 (1)
	1960	-	9.0	10.0	13.5	16.7	12.6 (2)
6. Furniture and household equipment	1950	-	3.4	1.9	5.9	7.4	6.3 (1)
	1960	-	5.0	2.3	9.5	8.9	7.6 (2)
7. Personal and medicinal care	1950	-	5.4	3.3	4.1	5.3	5.0 (1)
	1960	-	8.3	3.7	5.8	6.5	5.7 (2)
8. Transport and communications	1950	-	5.7	5.4	4.5	5.9	7.4 (1)
	1960	-	7.4	8.1	4.3	7.7	8.1 (2)
9. Leisure and entertainment	1950	-	6.1	7.3	7.5	7.5	5.4 (1)
	1960	-	8.2	7.8	6.2	7.5	5.2 (2)

a) Source: General Statistical Bulletin (E E C) 1961 No. 12.

1) 1952

2) 1959

Table VIII

Gross National Product per capita and National Income per capita in Member countries of the Community.

Year	Germany F.R.	France	Italy	Netherlands	Belgium	Luxembourg
A. Gross national product per capita at current market prices						
	D.M.	NF	Lire	Fl.	F.b.	F. lbg.
1950	2,072	2,401	188,100	1,883	42,100	60,630 (1)
1955	3,625	3,939	287,300	2,818	54,400	60,680
1959	4,790	5,763	373,700	3,404	62,900	72,060
B. National income per capita at current prices						
	D.M.	NF	Lire	Fl.	F.b.	F. lbg.
1950	1,589	1,831	148,300	1,478	35,600	48,160 (1)
1955	2,796	2,994	225,900	2,285	45,500	48,240
1959	3,713	4,328	292,900	2,794	52,000	55,470
C. Gross national product per capita at 1954 market prices in guilders converted at official rates of 1954						
1950	2,182	3,528	1,315	2,198	3,537	
1955	3,209	4,226	1,703	2,714	4,052	
1959	3,786	4,698	2,081	2,916	4,272	
D. Gross national product at 1954 market prices in guilders converted at official rates of 1960						
1950	2,189	2,905	1,233	2,198	3,402	
1955	3,220	3,479	1,596	2,714	3,897	
1959	3,798	3,876	1,951	2,916	4,109	

1) 1952

Table IX Relative importance of Foreign trade in 1956 and 1960 (a)

	imports				exports.			
	% of gross national product		per capita		% of gross national product		per capita	
	1956	1960	1956	1960	1956	1960	1956	1960
1. Germany (F.R.)	13.8	15.4	127,2	189,1	17,9	17.4	141.4	213.8
2. France	10,3	10.9	124.5	137,9	9,9	11.9	101.8	150.7
3. Italy	13,5	14,8	65,8	95,7	10,6	11.5	44,8	74.1
4. Belgium 5. Luxembourg	31,7	31,4	354,8	416,3	33,5	29,9	343,0	389,0
6. Netherlands	45,2	40.7	340,9	394,7	38,9	36,2	262,8	350,9
Community	--	--	136,6	174,8	--	--	122,8	175,7

a) Source: Basic Statistics for 15 European countries, Statistical Bureau of the European Communities.

Table X

Total exports in 1957 and 1960, broken down as a percentage according to destination (a)

Exporting countries		Total exports		destined to:			
		Mrd $	%	EEC	EFTA	U.S.A.	Rest of World
France	1957	5,047.4	100	25.3	14.2	4.8	55.7
	1960	6,863	100	29.8	14.5	5.8	49.9
Belgium - Luxembourg	1957	3,171.4	100	46.1	15.2	8.4	30.9
	1960	3,775	100	50.5	15.9	9.7	23.9
Netherlands	1957	3,097.4	100	41.6	23.8	5.2	29.4
	1960	4,028	100	45.9	23.7	4.9	25.5
Germany	1957	8,574.7	100	29.2	26.3	7.0	37.5
	1960	11,413	100	29.5	28.0	7.9	34.6
Italy	1957	2,540.6	100	25.0	21.5	9.1	44.4
	1960	3,650	100	29.6	20.8	10.6	39.0
Community	1957	22,431.5	100	31.9	21.1	6.7	40.3
	1960	29,729	100	34.4	21.9	7.5	36.2

a) Source: Basic Statistics for 15 European Countries.

Table XI

Total imports in 1957 and 1960 broken down as a percentage according to origin (a)

Importing countries		Total imports		coming from:			
		Mrd $	%	EEC	EFTA	U.S.A.	Rest of World
France	1957	6,116.8	100	21.4	9.1	13.5	56.0
	1960	6,280.0	100	29.4	8.8	11.9	49.9
Belgium - Luxembourg	1957	3,416.7	100	43.5	15.1	12.4	29.0
	1960	3,957.0	100	47.8	14.0	9.9	28.3
Netherlands	1957	4,104.5	100	41.1	15.2	13.2	30.5
	1960	4,531.0	100	45.8	14.0	13.2	27.0
Germany	1957	7,499.0	100	23.5	18.4	18	40.1
	1960	10,091.0	100	30.0	19.4	14.1	36.6
Italy	1957	3,626.0	100	21.6	16.3	18.8	43.3
	1960	4,715.0	100	27.8	16.2	14.2	41.8
Community	1957	24,763.0	100	28.4	14.8	15.4	41.4
	1960	29,574.0	100	34.3	15.1	12.9	37.7

a) Source: Basic Statistics for 15 European countries.

Table XII Composition of imports as a percentage of total imports in 1957 and 1960, according to groups of products (a)

Importing Country	Year	Total Imports	Foodstuffs Beverages & Tobacco	Mineral fuels, lubricants & similar products	Raw materials, oils, fats	Machinery and transport equipment	Other products
France	1957	100	21.7	20.6	28.5	11.4	17.8
	1960	100	20.1	17.0	24.3	14.4	24.2
Belgium - Luxembourg	1957	100	14.0	12.9	23.0	17.0	33.1
	1960	100	12.8	10.0	20.6	20.3	36.3
Netherlands	1957	100	14.1	16.9	16.5	19.2	33.3
	1960	100	13.9	13.1	15.0	21.7	36.3
Germany	1957	100	27.4	11.6	30.9	5.9	24.2
	1960	100	23.1	7.8	34.0	9.6	35.5
Italy	1957	100	14.1	20.8	34.0	11.2	19.9
	1960	100	15.8	14.1	30.3	13.0	26.8
Community	1957	100	20.0	16.2	27.3	11.8	24.7
	1960	100	18.5	11.8	23.3	14.4	32.0

a) Source: Basic Statistics for 15 European countries.

Table XIII Composition of exports as a percentage of total exports in 1957 and 1960 according to groups of products (a)

Exporting Country	Year	Total Exports	Foodstuffs Beverages & Tobacco	Mineral fuels, lubricants & similar products	Raw materials, oils, fats	Machinery and transport equipment	Other products
France	1957	100	14.9	5.8	8.9	19.6	50.8
	1960	100	13.1	3.9	8.4	24.7	49.9
Belgium Luxembourg	1957	100	3.8	6.5	7.5	12.1	70.1
	1960	100	4.3	4.3	7.4	12.9	71.1
Netherlands	1957	100	28.1	14.3	8.4	14.8	34.4
	1960	100	26.7	11.7	8.2	18.7	34.7
Germany	1957	100	2.1	7.2	3.3	41.5	45.9
	1960	100	1.9	5.9	2.9	43.4	45.9
Italy	1957	100	23.7	7.3	4.9	22.7	41.4
	1960	100	15.4	6.0	4.5	27.7	46.4
Community	1957	100	11.3	7.8	6.0	26.6	48.3
	1960	100	9.8	6.0	5.6	36.0	48.6

a) Source: Basic Statistics for 15 European countries.

APPENDIX D

TAX SYSTEM FOR HOLDING COMPANIES, INVESTMENT COMPANIES AND INVESTMENT FUNDS

(Dr. Joseph Kauffman)

I. Definitions

A Holding Company is a company whose object is to take holdings in other companies with a view to controlling them and to co-ordinating their activities (Management Trust).

Thus a holding company can only achieve its objective if the participation it has acquired in another company is sufficiently important to ensure the exercise of control.

Investment Companies and Investment Funds are institutions whose objective is the acquisition and management on behalf of a certain number of savers, of securities chosen according to different criteria, notably that of security through the spread of risk.

An Investment Company is a company with fixed or variable capital, shared among the savers, which itself becomes owner of the portfolio; under certain law systems ownership of the portfolio can take on the character of a trust.

An Investment Fund has as its objective the formation of a portfolio which belongs indivisibly in co-ownership to the savers, administered by a management company and deposited in a bank. The rights of joint owner-savers are inscribed in the form of certificates that the management company remits to them against accession to the rules which fix the rights and obligations of the parties and which forms the contractual basis of the mutual relationship.

II. General Aspects of Law

1) The aim of Holding Companies which consists of seeking control and management of a group of companies, is in principle, legal, with the reservation of the restrictions provided by the law of the European Communities and by certain national laws in relation to concentration, rules of competition and abuse of a dominant economic position.

It is appropriate to recall that according to company law of certain countries, the exercise of voting rights relating to important holdings undergoes limitation; in the general meetings of companies under Belgian or Luxembourg law for example no-one, either for himself or as proxy, can take part in the vote on behalf of shares which represent more than one fifth of the shares issued or two fifths of the shares represented at the general meeting. Under Luxembourg law, this limitation to the voting power does not apply, however, to extraordinary general meetings.

In connection with Holding Companies from a general law standpoint, it is thus clear that there are no problems other than the establishment of a barrier against use of excessive economic power.

2) Investment Companies and Investment Funds as collective savers call for measures of protection for savers.

The object of the present study does not lie in examining in detail the provisions already legislated in certain countries, or in determining the ideal regulations that it would be appropriate to set up. In this connection the following references may be consulted:

France: Ordinance No. 45-2710 of 2 November 1945, relating to investment companies, modified several times subsequently, regulates "sociétés nationales d'investissement" and "sociétés d'investissement"; these two types of companies are, in principle, Investment Companies with fixed capital.

Ordinance No. 57-1341 and No. 57-1342 of 28 December, 1957, apply to Investment Companies with variable capital and to Investment Funds respectively.

Decree No. 59-789 of 24 June, 1959, subjects title of shares in Investment Funds when these funds are subject to foreign law, to the previous authorization of the Minister of Finance when the shares are introduced on the French market.

Instruction No. 808 of 9 July, 1959 of the "Office des Changes" subjects to special authorization the purchase abroad by a French resident of shares in an Investment Fund regulated by foreign law.

Germany: The law of 16 April, 1957, entitled "Gesetz über Kapitalanlagegesellschaften".

Belgium: The law of 27 March, 1957, relating to investment funds; this law has become ineffective from 31 December, 1961.

The German law of 16 April, 1957, is the most homogeneous, the French ordinances of 1957 require complementary measures, the Belgian law of 1957 is provisional and its application depends on individual licences and authoritions granted by the Banking Commission.

According to the German law, the principle of security of investment and the spread of risk is ensured by the following regulations:

a) The Investment Fund can only acquire quoted securities.

b) The value of the securities issued by a single company acquired by the Investment Institution may not, in principle, exceed at the moment of acquisition and together with securities of the same company already included in the portfolio, 5% of the value of the total portfolio of the Investment Fund.

c) An Investment Fund may not possess more than 5% of the issued nominal share capital of a particular company.

From this it can be concluded that if Investment Companies and Investment Funds call forth measures to protect the saver, the question of abuse of economic power does not arise in connection with total holdings.

In the field of commercial law, Investment Companies operating as ordinary companies raise hardly any problems.

This cannot be said for Investment Funds whose creation requires particular legal provisions in certain countries.

An exception to this is the Netherlands, where civil law does not regulate the operations of investment funds, provided that the portfolio is made up of a large number of small parts of the same type. The Board of the Amsterdam Stock Exchange guards the interests of owners of certificates in Investment Funds quoted on the Exchange.

Among the questions which in certain countries need special regulation, the following examples can be quoted:

a) An amendment to Art. 815 of the French, Belgian and Luxembourg Civil Code, and if it so occurs, an analogous provision in other national legislation, intended to ensure the permanency of an Investment Fund and to place it under protection from an action for sharing out the assets;

b) measures organising the representation of Investment Funds at the general meeting of companies in which they hold shares.

According to Art. 2 of the Belgian Law of 27 March, 1957, all clauses in rules of management intended to give permanent power to a management company to represent the certificate holders of the Fund at general meetings of Belgian and Congolese companies whose shares are owned by the Fund, is declared null.

Even in the absence of such a provision, the validity of a similar authorization would have raised in Belgian law the same objections that it is likely to encounter in French and Luxembourg law; objections arising from the permanence and irrevocability of such an authority.

In the Netherlands holders of certificates have always had the right on showing a certain number of certificates, to require the titles represented by the certificates. This solution removes any irrevocability of a mandate without in practice making the Investment Fund too instable. Furthermore it sets down the principle that indivisability cannot be continued against the will of a co-owner.

III. Aspects of Tax Law

A. Holding Companies.

The incidence of taxation on the relationship between a Holding Company and its subsidiaries relates on the one hand to the income from the holding 1), and on the other hand the realisation of capital gains 2).

The solution of these problems can vary according to whether the Holding Company and its subsidiaries are regulated by the same tax laws (a) or are subject to differing tax systems (b).

1) a) In relation to the income, assigned by the subsidiary to the parent Holding Company, no particular difficulty arises where legislation provides for the single stage taxation of company profits. This is the case in current Belgian legislation (1). The Belgian subsidiary is liable to taxation on its distributed earnings while the shareholders of the parent company are liable to income tax on the distributed earnings of this company, but the mere existence of the Holding Company hardly alters the tax burden.

The situation is different in principle where there are two taxes; the one on the total earnings of a company and the second to be paid by the shareholder on the distributed earnings. The effect of such a cumulative tax system normally results in an increased tax burden. Certain systems of tax law relieve this situation by exempting from tax, under certain conditions, the earnings of Holding Companies from subsidiaries. In general this freedom from tax is subject to the holding of a minimum proportion of the capital of the subsidiary (20% in France, 25% in Germany and Luxembourg, no minimum in the Netherlands if the company is a statutory Holding Company, and 25% in the Netherlands if the company according to its articles can pursue purposes other than the acquisition, holding, etc., of securities).

Holdings in companies may be required to have some permanence in order to be privileged, namely to have been held for a predetermined period.

On the other hand relief from taxation can vary in scope and may be related to the total sum of the dividends distributed by the subsidiary, in this case often taking the form of relief of taxation at source (Germany, the Netherlands - for holdings of 25% or more -; Luxembourg) or may be applied to the net sum taking into account the tax paid at source by the subsidiary (France).

b) Relationships between Holding Companies and subsidiaries are receiving more and more attention in international affairs.

Thus the tax exemption set up in France and the Netherlands for Holding Companies established in one or other of these countries, is operated in relation to dividends collected from subsidiaries subject to national law, and to dividends collected from subsidiaries abroad.
(Netherlands: foreign subsidiaries which in their country of tax domicile are, in principle, subject to national tax on profits).

On the other hand, the introduction of a special system for subsidiaries (Schachtelprivileg) occurs in certain conventions for the prevention of double taxation. The State where the head office of the subsidiary is situated accepts a special limitation of its right to retain tax at source, and the domiciliary State of the parent company exempts the parent company entirely, or in part, from taxation on dividends that are distributed to it by the subsidiary.

2) a) The question of the tax treatment of capital gains realised in a portfolio is not peculiar to holdings retained by Holding Companies.

The solutions contained in various legislation on the tax treatment such capital gains are far too varied for it to be possible to give an account within the framework of this study.

Nevertheless, it can be stated that to the extent that exemptions exist in this matter, either under stipulation of the re-employment of the funds, or by means of writing up their book value, such exemptions apply to the holdings of Holding Companies which, because of their importance or long standing, are normally classed among goods described as "fixed assets".

b) According to German and Luxembourg legislation, profits realised through the transfer of all

(1) That is to say prior to the Tax Reform of November 1962 (Publisher's note).

or part of a holding exceeding 25% of the capital of the company concerned, is taxable even if the shareholder is resident abroad.

Dutch legislation only takes account of this situation in the case where the shareholder is an individual or a foundation resident abroad.

It is appropriate to note that the tax convention between Germany and Luxembourg reserves the right to tax such gains solely in the country of residence of the shareholders. This is the normal rule in cases where a tax convention exists between European countries.

B. Investment Companies and Investment Funds.

(This chapter is sub-divided in the same way as the preceding chapter relating to Holding Companies, see page 178 para. A).

1. a) Special provisions for tax exemption are required particularly for Investment Companies, because these companies do not by definition hold the proportion of shares necessary to benefit under the system for subsidiary companies. It is therefore the absence or insufficiency of similar provisions which in large measure explains the preference of originators of investment institutions for Investment Funds.

In relation to Investment Funds, special tax provisions appear unnecessary, while savers connected with Investment Funds are individual co-owners of the portfolio and as a result entitled to all rights relating to shareholding. Nevertheless particular provisions relating to the tax system for this type of institution have appeared appropriate to certain legislators.

The purpose of the German Law of 16 April 1957 from a tax standpoint is to neutralize the existence of Investment Companies ("Kapitalanlagegesellschaften"), whether as trustee owners of a portfolio or exercising administration on behalf of individual co-owner savers. This aim is achieved by the following measures:

- Tax withheld by the companies issuing the shares owned by the Fund, and relating to the dividends distributed to the Fund, are restored to this Fund.
- The administrating company is exempt from tax in relation to income derived from the common portfolio (Sondervermögen).
- The income distributed by the Fund or Investment Company is in principle, considered income from movable capital and is taxable as such. The Investment Company is only obliged to withhold tax at source on dividends distributed to residents abroad.

The Belgian Law of 27 March 1957, provides that Investment Funds are not subject to the "Taxe professionnelle"

Double taxation on distributions of profit is avoided by appropriate measures (Art. 10, No. 2).

In the Netherlands the income of Investment Funds is firstly shared among certificate holders as no tax is withheld at source on Dutch dividends received by Investment Funds. Then, the total of the withholding tax to which the fund is subject, is shared among the certificate holders and deducted from the gross income to which the coupons on the certificates give right. The holders alone have the right to make an appeal about the assignment of this withholding tax in relation to their tax liability (tax on personal incomes or tax on company profits).

b) The general problem of double taxation in relation to dividends raises particularly difficult problems. As long as no adequate or harmonious solution to this problem has been found, it will be difficult to deal with the still more intractable problem of an Investment Fund placed in a certain country, drawing income from another country and distributing this income to participating savers in a third country.

It seems clear that this problem, assuming that it is of sufficient importance could only be correctly solved within the framework of a multilateral tax convention.

2. a) In principle the operations of an Investment Fund should not make capital gains taxable which, without such operations, would have escaped taxation.

This is why German law does not make an Investment Company taxable, to the extent that distribution is derived from realised capital gains and is assigned to private holders of certificates.

At the same time, distribution to residents abroad which is in principle, it will be recalled, liable to the withholding of tax at source, is relieved of withholding tax to the extent that the distribution relates to realised capital gains.

Dutch law, not going as far as German law, allows all statutory investment companies (including statutory Holding Companies) to put all capital gains into reserves to offset any eventual capital losses, so that net capital gains are only taxed if distributed to shareholders.

b) Refer back to the explanation in 1) (b) above.

The problem of capital gains seems easier to solve than that of dividends, if the right of taxation is reserved solely to the country of domicile of the beneficiary.

C. Luxembourg Law of 31 July 1929 on the tax system for Holding Companies.

This system has been held over to a special chapter because it applies both to Holding Companies proper and also to Investment Companies.

Firstly, it is appropriate to record that these companies which enjoy a special tax system are in all other respects subject to common provisions of commercial law applied to trading companies in general.

According to Art. 1 paragraph 1, of the Law of 31 July 1929 "all Luxembourg Companies will be considered as Holding Companies if they have as an exclusive object the acquisition of holdings in whatever form, in other Luxembourg or foreign companies, and the administration as well as the improvement of such holdings, in such a way that the company has no industrial activity of its own and that it does not possess a trading establishment open to the public. The portfolio of Holding Companies can include Luxembourg or foreign public securities".

It is accepted that the object of a Holding Company includes possession of patents and their exploitation through the granting of licences, but excludes direct exploitation.

The competent public administration exercises strict surveillance on Holding Companies in order to check that they keep their activities within the limits set by the law. A Holding Company which engages in industrial or banking operations causes the loss of its special tax system and its subjection to the common system of taxation. In certain cases a loan granted to a shareholder is sufficient to produce this consequence.

The taxation system for Holding Companies under Luxembourg law has the following characteristics:

Direct Tax:

Holding Companies are exempt from direct taxation, namely: tax on company profits (Körperschaftsteuer), net worth tax (Vermögensteuer), municipal trade tax (Gewerbesteuer).

Nevertheless, dividends that are received from other Luxembourg companies are subject to the legal withholding tax of 15% which is not reimbursed.

Dividends received from abroad by a Luxembourg Holding Company remain subject to taxation in the country of origin without benefit from any alleviation that may be provided for under tax conventions.

Dividends distributed by Luxembourg Holding Companies are free from withholding tax of 15%; these dividends remain entirely taxable according to the personal liability of the Luxembourg shareholder just as they are taxable for foreigners according to the legislation which is applicable to them.

Indirect Taxes:

Holding companies take advantage of the following reductions in rates of tax:

	Common tax system	Holding company tax system.
Stamp duty on shares issued	0.10 %	0.10 %
Registration tax	0.50 %	0.32 %
Annual subscription duty on value of issued shares	0.30 %	0.16 %

Special reductions are granted Holding Companies which under special circumstances hold investments of at least 1,000 million Lux. frs.

In judging the benefit of the Luxembourg system for Holding Companies after a comparative study of tax law, it appears that it can be concluded that:

The reductions provided for indirect taxes and the alleviation available for certain large Holding Companies, does not seem to correspond to equivalent or analagous systems of other countries, where the existance of holding companies does not give rise to a reduction of indirect taxation.

On the other hand, it must be recognised that the reduction of rates reserved to Luxembourg Holding Companies hardly represents a substantial saving of taxes, given that the ordinary rates are not high.

In relation to direct taxes, it must be borne in mind that Luxembourg Holding Companies are partly controlling companies, that is to say real holding companies, and partly investment companies.

It appears from the study of other tax systems that profits which only pass through a company or an intermediate organization between the business which produces the profits and the final beneficiary, benefit from fairly extensive or complete tax exemption as far as that company or intermediate organization is concerned.

Such is the case for companies drawing benefit from a system for subsidiaries (Schachtelprivileg) and for certain Investment Companies or certain Investment Funds.

In setting up its special legislation for Holding Companies, the Grand-Duchy of Luxembourg has done in a more direct and categorical way, what other countries have done in similar or analogous situations.

The principles, applied through varying techniques, remain fundamentally the same:

- freedom from any additional tax burden for profits passing through the Holding Company or Investment Company;
- maintenance of taxation normally applicable, to the stage before and following that of a Holding or Investment Company.

IV. Conclusions

1) Important holdings belonging to Holding Companies which do not fall under the restrictions of the competent authorities in connection with an abuse of concentration, must benefit for economic reasons, from a system of exemption that has existed for some time already in most of the countries of the European Economic Community.

2) It would be desirable that these systems for exemption should be harmonized and given a general character within the Community, in order to extend their application in relationships between companies subject to different national legislation.

3) A general rule is particularly required to deal with the question of what share capital is required in order to obtain exemption, and also whether indirect holdings should be taken into account or not.

It has been illustrated that exemption systems set up by tax legislation in certain E.E.C. member countries for Company holdings, apply where the minimum participation is 20% or 25%. A law under consideration in the Netherlands foreshadows the application of exemption provisions to participations of at least 5%.

Leaving aside economic considerations, it appears that it would be convenient within the Common Market, to approximate the proportion of the holding at the lowest apparent rate in a comparison of national legislation provisions.

4) Investment Companies and Investment Funds appear destined to play a very useful economic role, at least if it is considered desirable to have a wide distribution of stock and shareholding among classes of people little accustomed to this form of saving, and badly placed themselves to make judicious investments.

5) For this reason it is appropriate to ensure that profits passing through the institution which gives legal form to the common portfolio, should not be taxable.

6) This system should be applied without distinction to Investment Companies and to Investment Funds, so that the latter are not favoured to the disadvantages of the former; on the other hand, the Investment Fund raises problems of commercial law which have not yet been fully solved (for example, representation at general meetings).

7) Exemptions settled under national law systems for Investment Companies and Investment Funds, should be brought within the framework of relations between the countries of the Community by means of a multilateral convention.

8) From the espect of direct taxation, the system applicable to Luxembourg Holding Companies does not appear to be inconsistent with the range of taxation provisions taken in other countries of the Community for analagous situations.

9) The possibilities open to a private shareholder of tax evasion on dividends from abroad, do not depend on the tax law system applicable to the distributing company; the temptation for the taxpayer and the risk for the Treasury arise from the possibility of anonymous encashment of a coupon detached from a bearer certificate.

APPENDIX E

THE INFLUENCE OF ECONOMIC GROWTH OF THE MEMBER STATES ON PROBLEMS OF TAX HARMONIZATION

(Prof. A. Barrère)

The Common Market is leading toward a situation that must resemble that of an internal market, which is not in itself sufficient definition since there exist several types of national market. Furthermore it is not sufficient in order to achieve a uniform, if not single, i.e. a common market, to shift the levying of custom duties to the outer border of the geographic area of the six countries, and to lower the tariffs which have become "internal" at the same time by making them uniform.
The drafters of the Treaty of Rome were not mistaken; the Common Market will be a gradual achievement obtained by integration of economies and harmonization of the juridical framework of economic activity. It will be necessary to overcome resistance arising not only from habits of thought, or settled positions threatened with change, but also from political, economic and social structures which are the product of a long historical evolution and little by little have been engrained into habits of production, saving and consumption. The alteration of these structures and particularly of tax structures, is always slow and requires time to become effective. To the extent that policies can hasten the process, it is expedient to settle common aims, sometimes to be reached by different routes.

I. The General Framework of Tax Harmonization

1. The integration of the six economies implied by the setting up of a Common Market, thus requires the voluntary harmonization of structures and policies directed to the ends which are spontaneously reached in an internal Market: optimum division and employment of resources, lowering of costs, raising prosperity.

For two reasons the establishment of competitive conditions within the wider geographic area cannot be considered as sufficient to reach the desired end. In the first place because these competitive conditions can only be established gradually, in several stages, whose sequence is extremely complicated: the lowering of tariffs, free movement of labour and capital, right of establishment, conditions of competition, approximation and then unification of cost factors, etc. These stages can be singled out in the abstract; in reality their elements are closely intertwined so that what appears to be a long term requirement is very often brought into question from the start. This is so for the standardization of prices which depends more on existing structures and the gradual growth of production, than on any regulatory legislation for stimulation or for protection.

In the second place, the system of competition which is desired - assuming that it is already operating - is not the perfect competition outlined in theory. The Common Market starts from a situation of reality, characterised in the six countries by markets where there are oligopolies and monopolies, by location of industries which brings about effects of economic domination, by patterns of trade which are already firmly established, by financial and economic groupings that are preponderant in some national economic sector, and by cartels already in existence. The putting into effect of a system of competition between these elements which are difficult to handle, will not take place spontaneously merely because there is an enlargement of the framework within which relationships between them already exist. Undoubtedly enlarged competition will have a resolvant effect, but it will be dangerous to be optimistic in this respect since behind the groups, cartels, and monopolies, for the support of dominant positions and forming the base of trade patterns, there are often deliberate or tacit policies and government consent. From this the need is evident for a common authority which would not have simple arbitration powers or an indistinct purpose. In practice they must and should facilitate, and even create, rules of competition which, without such a body, would most probably be imperfectly established. Therefore, given the structural evolution of the six economies, competition will not occur between small units of production but rather there will occur competition of an oligopolistic character, which already operates in each of the countries, be it only in an interconnected relationship with the public authorities which have accepted or shaped the conditions of its operation.

2. The structure of a Common Market is thus not ipso facto that of a natural market; it results from a group of connections existing between units of production and trade networks, until now of a national character, and required to be placed in a multi-national framework through the harmonization of legislation and the powers vested in a common authority. The modifications of economic, tax and juridical structures are indispensable for the same reasons as those which will affect the conduct of national policies. In this general structural modification there are apparent two types of competition; the one between branches of industry (for example, mineral fuels as against liquid fuels and gases), and the other between firms. The share of one or other in the national product could be affected in certain countries so that there were consequences for the volume and distribution of the labour force by occupation and for the level of profits. Arbitration, compromise, social measures for compensation, and transitional measures would become essential, as much as the prevention of national measures likely to hinder the necessary changes. It is simple to conceive the alterations caused by a sizeable lowering of tariffs in a situation where an industry is accustomed to protective duties, and the temptation that will arise from this to protect by means of indulgent taxation sectors of industries and marginal concerns so threatened. The Common Market will not spontaneously subject one or the other to the resolvent and equalizing effect of automatic measures; there is not only a case for regulating competition which has been subject to oligopolistic practices and protective tariffs and taxes over a long time (which history shows is not contradictory), but also for watching closely the effects of this competition and for preventing distortions arising from this.

3. Thus the Common Market will be a market in which competition will have to be regulated if it is to achieve integration of the six economies. Integration will not be the automatic consequence of competition between small units, but it will result from a regulated competition between the leading sectors of the economy where there are many oligopolistic situations.

In this regulated competition, measures of a tax nature are called upon to play a specially important role since they run the danger of appearing to governments as an easy substitute, because they are less apparent, for measures of tariff protection. Without denying taxation the role of a suppletory and tacit protection, the regulation of competition must be assumed to eliminate distortions of a tax nature which run contrary to free competition and ultimate integration. It therefore calls for harmonization which at first sight appears as an adaptation of tax policies and systems for the achievement of the aims of the Common Market. The first aspect, in great part negative, of tax harmonization therefore is to eliminate distortions, or in other words the disturbing effects contrary to the consequences expected from the interplay of competition, in fact the effects disturbing the modifications of national structures which should enable the achievement of an integrated market.

4. The problem arises of establishing if this general formula is realistic and embraces the full problem.

It could at a first attempt be thought that the problem is solved by a definition that tax harmonization is the absence of obstacles to the interplay of competition. This would only be the case if the data of economic integration of the six countries had been defined once and for all at the time of signature of the Treaty of Rome on the basis of conditions existing at that time. It is not possible, however, to hold on to a kind of unalterable concept of the evolution of structures, which would consist of believing that this is fulfilled according to approaches sketched out from existing structures, which will only change under the effect of the desired integration process. Other forces will influence that evolution, they result from the dynamism of economic activity since competition has not only the effect of ensuring the balance of supply and demand, but must also ensure the progress of the six economies. This progressive development therefore alters as such the structures themselves. After some months of a market directed to competition, the geographic structure of the European Economic Community will no longer be what it was at the time of the signature of the Treaty.

The Common Market does not have as its sole aim the achievement of an integrated market, and the drafters could hardly have wished otherwise. Following the Treaty's design, the Common Market must facilitate the raising of the real and gross product in each of the countries, the harmonization of economic growth and particularly the prevention and reduction of overall disequilibria on a national and multi-national scale, and a reduction of disequilibria between branches and sectors of industry, taking into account social consequences. The Common Market binds the six countries to harmonize development, and the harmonization of economic growth cannot be achieved without tax harmonization in the widest sense.

It would be dangerous to ignore this view of tax harmonization since it would lead to the following contradiction; tax changes made necessary by an integration conceivable on the basis of existing structures, would be included, but those made necessary by dynamic alterations occurring in the economies of the Member States would be rejected.

The latter are at least as important as the former because increasing competition accompanying the modifications of economic structures reacts on the structures and taxation policies with which the economic structures are partly linked and with which they have envolved. Tax harmonization is not solely a function of the establishment of a system of competition and of the process of integration. The context in which it is placed is essentially dynamic because the conditions of adaptation of tax policies and tax systems depend on this process under which competition, economic integration and harmonized growth are fundamentally associated. It is hardly possible to conceive the achievement of integration without the operation of competition and it is hardly acceptable that this would not be a factor in growth. But with regard to the harsher effects of integration, competition will exist only when it is being supported, organized and regulated; growth will only occur with the help of a harmonization policy without major disequilibrium and without serious tensions. Administration of competition with a view to integration, and harmonization of growth with a view to prosperity, are interrelated and complementary; while tax harmonization is linked to both. It will therefore not suffice to say that harmonization will be effected by stages, from phase to phase, as the economic (and political) integration of the six countries proceeds under the effect of competition; tax harmonization is a continuous process just as will be the dynamic development of the six economies. Integration and growth are both factors of change and require continuous adaptation of tax and financial policies and systems. Tax harmonization must therefore be tied to the interrelated processes of integration and growth.

II. Content and Principles of Tax Harmonization

It is not easy to give the tax harmonization a precise definition covering all details and particulars. Tax harmonization might be considered as resulting from a Treaty provision obliging each State to conform to a general requirement: not to hinder the working of the Market. Harmonization can also be considered as an ideal to be reached gradually and empirically, leaving to the governments a liberty of action that can only be restricted by possible observations of the common authorities. It might be considered to apply to the range of financial and taxation policies, leading to a gradual unification of legislation or more simply that it just relates to the elimination of distortions deriving their origin from taxation. It can also be held that tax harmonization can only move forward by rationally directed stages proceeding from the simple to the difficult, or on the contrary, that taxation as a whole should be from the start brought under consideration and that each opportunity must be taken in order to advance on all sectors at once. Let us then try to distinguish the different factors implied by tax harmonization in relation to integration and growth; it will be easier to set down in consequence the principles and points of application.

5. A beginning can be made by describing what appears to be outside the scope of tax harmonization.

This is not the unification of the tax systems of the six countries, being understood as the creation of an identical structure for the great categories of taxes and thereby an identical distribution of the tax burden over the different parts of the operations liable to tax: acquisition and expenditure of income, consumption, transactions, transfer of wealth etc. A tax system is in large measure the product of history, in this sense it is adopted to the psychology of taxpayers and their economic and social habits which have often required a long period of familiarization. The tax system is also a reflection of the economic structure of the country and of the distribution of national income. In other terms: the tax system is itself a structural factor, closely linked with sociological, economic and institutional situations, and is therefore not easily susceptible to rapid changes. Therefore the complete unification of tax systems would not only assume an identity of economic and social structures, but even a similarity of psychological and sociological conduct.

It could be considered at the furthest point, that the integration of the six Member countries by reducing the heterogenity of economic structures will reduce the heterogenety of the tax systems; but it appears rational to admit that real unification of one and the other will never be attained.

6. It can be wondered if this unification would be necessary; it certainly seems not to be so. What would be its object? The creation from a tax point of view of identical conditions for production and circulation of goods and services. Yet from an economic standpoint, these conditions are not already the same within the different countries. Why look for an identical situation in the tax field, when it does not exist elsewhere? Uniformity in the tax field can hardly be strived for when it does not exist in the economic field. So much the more would it be unrealistic to expect taxation to create, by means of compensation or equalization of burdens and advantages, a uniformity of the conditions of production and trade. It is the task of a competitive market to achieve the reconciliation of these conditions, and it would be pointless to require tax systems to establish them by institutional means.

7. What then, is the essential aim of tax harmonization? It is to encourage the interplay of competition in such a way that integration and economic growth of the six countries may be achieved simultaneously and gradually. It is therefore, not a problem of the structure of the tax systems, but a question of the effects and incidence of taxation operated in each country on the processes of integration and economic growth.

Thus to the degree that the dynamic process develops, it will be appropriate to adapt each tax system in such a way that the national product can continue to increase without competition being hindered. For this purpose nothing shows the system of taxation of corporations or the relief from tax of investments, must be according to the same regulation; it will merely be necessary that the ultimate incidence of the tax systems in each country will encourage dynamic development through competition; in one country this might be by taxation of company reserves, in another by tax relief for investments.

In this light the principles of tax harmonization can be conceived as a function of the growth and dynamic development of the economies of the six countries.

Tax harmonization can be achieved by the application of principles which all amount to the fundamental proposition according to which harmonization must be pursued more from the aspect of reactions to and the effects of tax systems, than from the aspect of their structures.

8. The principle of conformity of tax systems.

This first principle indicates that harmonization should not strive for an identity of tax systems, but a conformity of each of the systems to the aims of the Common Market. This leads to the following two requirements; one at the start, the other in the long run.

The tax systems must be in accord with the induction of the Market, based on a system of competition. Thus, it is necessary that at the start arrangements likely to hinder the interplay of competition should be altered: the removal of hindrances to the circulation of goods, capital and manpower; of tax protection of industries, abusive support for certain economic activities, artificial survival of marginal businesses, etc. It would even be appropriate to take positive measures encouraging the mobility of productive resources and the fluid working of economic mechanisms.

But it is also necessary that economic development and integration should be encouraged in the long run by rapid adaptation of the systems to changes of structure: the perfection of production processes, the renewal of existing branches of economic activity and the creation of new economic activities are set in train by growth. Demand for capital, investment activity, and transfer of manpower cannot fail to follow. These modifications which require suppleness and fluidity, must not be hindered by scleroses of a fiscal type. Thus it is of importance that conformity of tax systems be maintained by their rapid adaptation to the structural changes. Undoubtedly this adaptation will necessarily impose itself in the end, but it is preferable that it should be achieved without appreciable delay.

This requirement leads to the setting up of supple and sensitive tax systems where the tax base can easily be altered and where the object to be taxed can be easily held, determined and assessed.

9. The principle of similarity of reactions.

If the Common Market would be held within a stationary situation where care for stability would come before the aim for growth, the principle of similarity of reactions would not have great importance once the principle of conformity of the tax system was working. But it is not sufficient that tax systems should be adapted easily and rapidly to changes of structure in order to safeguard their fundamental conformity with the aims of the Common Market; it is necessary

that they react in a similar manner to new conditions of production and trade which are created by growth. This point is not without importance.

It has already been said that harmonization does not consist of the creation of conditions of production which from a tax point of view are identical; it is appropriate to specify that, on the contrary, harmonization must be conceived within the aim of bringing about within the Common Market similar reactions when changes occur in conditions of production or trade. With the help of a simple example, it can be illustrated what the problem is. A new durable consumer good makes its appearance on the market and profits from the consumers' approval; harmonization as regards this good will not consist of the same tax regulation (same base, same rate, same procedure for levy); it consists rather of establishing a form of taxation which places the consumers of each country under similar conditions, taking into account the fact that they are accustomed to their national tax system, their consumption habits, their income level. In one country a turnover tax can be used, in another a so-called tax on luxury consumption; the essential thing is that the reaction of purchasers should not be different by reasons of tax policy. If new industries make fresh calls on capital, that is not to say that each country need adopt the same measures in relation to the inflow of foreign capital; it is, on the contrary, appropriate that capital does not flow to one country rather than to another by reason of tax provisions applied in each to company profits. It is the perspective of the advantages drawn from the economic conditions of production and sale, which must govern the placing of capital and not the fear or expectation of the application of either a strict or a favourable tax system. Tax systems must leave the economic expectation of profit its natural character.

To sum up, the principle of similarity of reaction tends to preserve the mobility of resources, of factors of production and of demand, while guaranteeing mobility and refraining from channeling them or from creating obstacles to their orientation by economic dynamism.

10. The principle of similarity of incidence must ensure the competitivity of costs and prices. There is no question here of suppressing differences of taxation, but of differences in the effects of taxation. Undoubtedly, it is difficult to trace repercussions and the ultimate point of impact of a tax; but it would be daring to say that similarity of regulation in matters of base, rates and levy are sufficient to establish identical repercussion on costs and on prices. Harmonization will consist in seeking the approximation of effects that the costs and prices of identical products bear, so that demand may not be restricted or artificially directed toward a particular national product rather than toward its equivalent abroad.

11. The principle of non-distortion must lead to the elimination of measures of tax policy likely by their effects to disturb the interplay of competition. What is important here is not the elimination of disparities or of differences of system or of regulation, but of their disturbing influences, since distortion lies not in differences of measures but in the creation of effects that are harmful to the achievement of the aims of the Common Market.

Two methods of application of the principle of non-distortion can be distinguished. The disturbing effect can be appraised by reference to the ideally defined aims, that is to say the achievement of a market which through the interplay of competition promotes the integration and growth of the six economies. Distortion is thus not the tax measure but its effect contrary to the expected impulse of competition. Again, the principle does not concern systems or legislation but their consequences and their effects. Distortion must also be appraised as a function of new situations brought into being by economic growth, by taking into account that, although they did not exist initially they can appear after a structural change or in the course of changes in the volume or nature of production, trade or demand. Distortion must therefore be appraised in a dynamic perspective since an alteration in economic conditions of competition linked to the process of growth, can cause the appearance of a disturbing effect of tax origin which was not manifested until then or which remained unsuspected. It must not be forgotten in effect that the phenomena of growth can disclose effects which could not be revealed previously owing to their slight importance. Thus the effect of a tax measure could depend on the size of a firm, on the concentration of businesses, on the volume of capital or manpower employed, etc. Given the frequency of tax measures favourable to small businesses, such situations could easily occur. This dynamic perspective throws light on the concept of the threshold of distortion which indicates that the disturbing effect can only appear in certain conditions - or even disappear - under the pressure of dynamic changes.

These two methods of the appraisal of distortion - in connection with ideally defined aims and in connection with new situations caused by growth - also indicate that the disturbing effect can

manifest itself according to two different ways: through the structures which condition the interplay of competition; through the functioning of the economy directed toward growth and development.

III. The Points of Application of Harmonization

The points of application of harmonization can now be listed.

The question is to establish how conformity of the tax systems to the aims for integration and growth, the similarity of fiscal reactions to alterations of general conditions of economic activity, the similarity of tax incidence on costs and prices, and the removal of distortions of structure and functioning can be pursued. In the light of the economic growth of Member States the fields for application which are offered by growth itself, will be examined first.

In the field of structures there can be distinguished: businesses, branches of industry, the overall economy; and in the field of economic activity: competitivity, equilibrium of economic activity, harmonization of growth. The application of one or of several harmonization principles, relates to each field.

12. The structure of business can undergo different transformations during growth. The first concerns the changes of the combination of factors of production to make the production process more efficient. In general, the consequence is greater use of capital in relation to labour and thus an increase of investment. So there arises the need for a tax system which has regard for the distribution of capital between businesses and does not impose an order of preference in the satisfaction of the demands of businessmen, contrary to market forces. Obstacles to the growth of businesses and to the development of their economic activity must be abolished, as well as dispositions contrary to the development of production and the raising of productivity. A lack of harmonization between tax systems of the six countries would result from the maintenance of taxes which would set up important differences in the return on capital, from special tax reductions relating to the demand for credit emanating from particular categories of businesses, from differences with regard to the taxation of business incomes, the constitution of tax free reserves, self financing, etc. It would be possible to increase at will the effects which divergent tax systems would be likely to create in this matter by divergent reactions as to the extension, transformation or progress of productivity related to growth. Delicate questions can arise notably from government policy in relation to small businesses, if one country wishes to see them maintained, and the other to see them integrated. Likewise, systems favouring the survival of marginal businesses may create reactions which largely differ from the effects of competition on the improvement of old and inflexible economic structures sheltering behind various protective devices. Finally, the question arises of tax measures likely to favour or hinder the reform of businesses whose activity is declining toward expanding production.

13. The extension of new branches of economic activity, the improvement of traditional branches, competition set up between them, are classical signs of growth. It must be added that having regard to the oligopolistic and monopolistic character of certain national sectors, the competition of new and traditional branches will be established between countries at the level of the Common Market. This competition will bring reorientation of economic activity, formation and disappearences of businesses; certain branches will be seen to increase their share of the national product while that of others will diminish. The decisive effect of taxation in this field is evident. It is expected that governments will try to safeguard the interests of their nationals, as much for businessmen as for wage earners or suppliers of capital. Moreover, the lack of harmonization can show itself in different ways, as national legislation is able voluntarily or involuntarily to favour or to raise obstacles to these gradual changes whose social consequences can be very severe. The conformity of tax systems to the aim for growth is thus brought into question as much as their similarity of reaction to development requirements or to the incidence on costs and prices. It is also evident in this connection that harmonization is not to be pursued in the sense of a unification of systems, but rather in the sense of similarity of the effects of taxation and the equality of the period of time necessary for adaptation. Nothing indicates that the same type of tax on production or on sales will favour in the same manner the response of structures to the requirements of growth. Rather than the differences of base or of rate, it is the repercussion and incidence of taxes on investments, the taxation of new establishments and of subsidiaries, the reinvestment of profits, the shifting of taxes in the prices, the taxation of sales, which will be essential. Harmonization will be transposed by national tax systems which,

by reason of the attitude of businessmen, of the mobility of labour, the fluidity of capital, the degree of concentration, bank policy, etc. will achieve equally favourable conditions for innovations, and for the development of production, and will approximate costs and prices.

14. At the level of the overall economy, national tax systems will have to avoid all measures contrary to the growth of production and the raising of productivity. Without this there would be created obstacles to the benefits expected from the extension of the market and from integration. The problem of cumulative cascade taxes, the taxation of added value, and the taxation of energy are implied here. This is also valid for the proportion established between the yield of direct and indirect taxes; it is generally considered that the former in contrast to the latter cannot be shifted on in the prices. This is, furthermore, valid for the effect of tax on the volume of savings intended for investment.

This is a field which most directly touches the structure of tax systems and a historical adaptation of psychological and sociological conduct. The greater or smaller rigidity of these systems can be a decisive factor in their rapid or delayed adaptation to changes in the national economy brought about by growth.

15. Problems of working also form part of the process of harmonization.

The competitivity of economies depends to an appreciable extent on the incidence of taxation on costs and the appearance of distortions. Indirect taxes, excise duties and turnover taxes play a considerable role here. Often discussed and well known, the problems thus raised do not call for comment. Once again the necessity of considering essentially the similarity of incidence of taxes rather than the identity of the tax is emphasised.

16. On the other hand, conditions for the achievement of equilibrium of branches of industry and national economies, require more than a brief mention. It would in effect be wrong that the problem of equilibrium should be considered as being outside the realm of harmonization. Not only must the tax not interfere with the circulation of goods, capital and labour, not only must it also facilitate the distribution of resources within the economies undergoing integration, but it must by the way in which it is imposed and employed, further the general equilibrium of the economy.

Here arises what is called - using a disputed expression - the "weight of the tax burden". This expression as used in making international comparisons does not have great significance. In assuming equal efficiency of public services, differing tax burdens signify simply a difference in needs for finance and thereby in national budgets. Far from indicating that the national economies bear different real burdens, international comparison indicates that a different volume of goods and services is assigned to individuals - producers or consumers - through the operations of public authorities. It is appropriate to know if the volume of expenditure financed by the tax has equivalent efficacity and the same productivity. It is therefore the nature of expenditure rather than its volume which bears on economic equilibrium. The real faults of harmonization seen from the viewpoint of economic equilibrium will reside in appreciable differences in the matter of subsidies to unproductive or marginal businesses or failing branches of industry, in the volume of transfer payments, in the breadth of income redistribution, in the importance of defence expenditures, in public gifts outside the territory and without effect for national economic activity, etc. The incidence of the use of public funds can thus have different consequences on raising the real national product, on its level of equilibrium and ultimately on the ways and means of integration and of economic progress. In the long term there can result notable differences in the level of productivity and of average costs, and thus in the competitivity of economies undergoing integration. Delays of development can be accentuated for certain countries and provoke them to take measures for compensation or safeguard which would prolong the defects of harmonization existing in the field of expenditures within the field of taxation. This leads on to a more general problem.

17. The harmonization of growth assumes tax harmonization, but can be brought into question by the absence of insufficiency of tax harmonization. Harmonized growth assumes action by the public authorities against recessions, unemployment, inflation, and bottlenecks. Taxation plays an extremely important role in this field. Less than in other fields can uniformity of tax systems be demanded; the question is more simply to establish similar conditions of reaction and effect in order to provide for a range of measures equally effective in permitting common action within the integrated economies. For the growth of the Common Market will often pose problems common to the six countries, at least for what relates to recession and inflation, which are often of a general character or at least may spread generally.

In this field harmonization requires very great care in order to avoid conflicts between intervention measures favourable to growth and those which would be unfavourable to competition within the integrated economies. Thus, one moves little by little from problems of the structure of tax systems toward those of financial policy.

Is this too much to ask? This question must be studied in order to reach a conclusion.

The extent of harmonization.

18. Placed in a static framework, harmonization can be limited to problems belonging to the make-up of tax systems and the structure of taxes. Taking into account economic, institutional, psychological and sociological peculiarities belonging to each country, the adoption of a dynamic perspective leads to placing the accent on consideration of the similarity of the effects of taxes rather than the identity of tax structures. So, the nature of public expenditures has appeared more important than the weight of the tax burden. It seems indispensable to emphasise that fiscal policy cannot be excluded from the perspective of harmonization.

It would not suffice to deal with the questions raised by special temporary regulations for certain types of taxes having immediate influence on trade, costs and demand. Economic growth places the measures to be taken in long term perspective, which implies not only the effects of economic progress on tax structures, but also their effects on economic structures undergoing transformation. From here arises the need for continuous (current) effort for mutual adaptation. But equally there arises the problem of policies; that is to say in addition to short term measures, there must be the working out of forecasts, expectations and broad outlines. The adaptation of tax systems, the consideration of their effect and their incidence cannot be disassociated from a real forward looking attitude; they are closely connected, in the full sense of the term, with a financial policy making its choice and arrangements with an eye on the future. Anyway, is not the choice between several possibilities, between a flexible or rigid tax system which reacts in the way desired to expansion and recession, an act of financial policy? Is it any different for measures relating to investment, the investment of capital, the taxation of income or of consumption? Each question relating to tax harmonization favouring growth comes from a choice which is political in the choice of certain ends, like the decision which leads to the putting into effect of integration and of progress by means of regulated competition.

Thus tax harmonization is not a temporary work but a continuing action: it places financial policy in its entire range altogether beyond momentary legislation and regulation.

APPENDIX F

HARMONIZATION OF THE TAXES ON COMPANIES AND ON DIVIDENDS

(by Prof. B. Schendstok)

I. Some preliminary remarks.

II. Parts of the report to which the present appendix relates.

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I. Some preliminary remarks

The report of the Fiscal and Financial Committee only incidentally gives a description of tax legislation in force and of draft laws under consideration in the different countries. It appeared, during the meetings of the FFC - cf. the Report page 121 et seq. in relation to the problems raised by taxation of share companies and by deductions (in the form of withholding at source) from dividends, that the current situation is at such a point of confusion that an analysis in a systematic way is required. It goes without saying that harmonization will have to be achieved on the basis of uniform terminology, even if this terminology will have to be "translated" in each country according to customary concepts in relation to the particular needs of each one of them.

Within the different countries, unanimity is far from reigning in relation to the legal base and the function of certain factors of the aforementioned taxes. This requires harmonization to be looked for in the sense of a compromise between solutions which have been given or that it is proposed to give, within a national context, to problems of an international character.

Under these conditions the technique with regard to the taxes now under consideration plays a role in harmonization other than when it concerns turnover tax, where it is possible to arrive at agreement in broad lines without it being necessary to know all the technical details of the tax. Among harmonization problems, national interests clearly also play a role, notably in relation to the international sharing of the tax yield. But, once more, a worthwhile discussion is only possible on the basis of uniform terminology and one which, above all for taxes which have effects on one another, is closely linked to the different possibilities of taxation technique.

In various places the Report has already mentioned numerous requirements - often difficult to reconcile - which the proposals of the FFC should satisfy. Several of these requirements have not been recalled in the present Appendix because without doubt sufficient light has been thrown on them in the Report. For several others that the Report has dealt with more by implication, it could be considered that the proposals of the FFC do not attach importance to them that they have however, in reality. The present Appendix stresses these requirements, clearly in a positive way. But, above all an attempt is made to place partial solutions in a general framework. In the Report these partial solutions are often formulated along broad lines. The present Appendix should, under the sole responsibility of its author, provoke thought on the question: are partial solutions put into relief more clearly when they are more closely linked with one another than has been possible in the Report?

In conformity with the resolution of the FFC, the present Appendix also takes note, as far as the subject dealt with is concerned, of opinions expressed by certain more or less important minorities (see page 98) to the extent that the Committee considered it more desirable to explain these opinions in the present Appendix than in the Report itself. This has been done without specifing the size of these minorities.

In order on certain points, not to complicate the description more than necessary, the Italian tax structure has not always been analysed in comparison with that of other countries. In effect,

the Italian tax structure - ingenious through it may be - differs from the other to such an extent that a comparison is possible only in very exact cases. With the same purpose of simplification, the present Appendix only takes into account the following natural persons and legal entities:

a) ordinary share capital companies and particularly the large (or fairly large) joint stock companies whose profits are of the same order of magnitude, to the extent that it does not concern holding or investment companies;

b) holding companies (joint stock companies to the extent that they are made up of holdings);

c) investment companies;

d) natural persons as shareholders, to the extent that they possess shares in:

1) ordinary share capital companies;
2) holding companies;
3) investment companies.

As the position of entities mentioned under b), c), d 2) and d 3) has been studied in a fairly detailed way in Appendix D, points a) and d 1) will receive particular attention in this Appendix. We will, however, examine whether the solutions which seem possible and desirable could be adopted, if the other points are taken into consideration.

Each time a commencement will be made, by studying if in relation to taxation of companies and withholding tax on dividends the same treatment is obtained for companies and for shareholders who have their domicile in the different countries of the E E C and which are comparable.

As far as need be, the functioning of the various systems will be studied not only in the case where dividends do not cross over frontiers or only frontiers within the E E C, but also where they cross, in one sense or another, frontiers external to the E E C.

II. Parts of the Report to which the present Appendix relates

IV A.2.g) The method of taxation of company profits, particularly of large companies.

aa) The problem of a particular tax on companies

bb) The taxation of parent companies: the problem of participations.

IV B. Disparities existing in the rates of certain particular taxes and proposals to reduce these differences as desired from the point of view of integration policy

1. Preliminary general remarks
2. Taxes whose rates contain disparities of a character likely to jeopardize seriously the aims pursued by the Common Market

e) Income tax
3) Tax on income from capital
4) Tax on business income

f) Problems concerning the rate of taxation on companies and of the withholding tax on dividends

aa) The rates of the tax on companies
bb) Questions relating to withholding at source.

IV C. The problem of (international) double taxation.

III. Terminology, method of analysis (1)

Company taxation: all taxation levied to the charge of a share capital company and in proportion to its income, irrespective as to the name under which such tax is imposed and as to whether any part of the income that is distributed is taxed otherwise than the non-distributed part.

Real tax on companies: tax on companies to the extent that it is not treated (in relation to distributed profits) as an advance tax to be credited against the tax on the income of natural persons

(1) The present chapter appears under the sole responsibility of the author of the present Appendix.

who receive the sum distributed (reserves possibly attributed from a tax point of view to shareholders are included here with distributed profits).

Apparent tax on companies: company tax to the extent that it is treated (in relation to distributed or similar profits) as an advance tax to be credited against the tax on the income of natural persons who receive the sums distributed.

Tax credit (crédit d'impôt, toerekenbare belasting, anrechenbare Steuer, credito d'imposta): tax paid or retained and transmitted to the tax authorities, and which is deducted from the tax payable by the beneficiary of the profits.

Visible and non-discretionary tax on dividends (précompte mobilier non facultatif retenu sur les dividendes; zichtbare en niet facultatieve voorheffing op de dividenden; nichtfakultative Kapitalertragsteuer die auf Dividenden einbehalten wird; imposta d'acconto non-facoltativa ritenuta sui dividendi): tax withheld by the company which is credited against the tax for which shareholders are eventually liable

Invisible advance withholding on dividends: part of the company tax that can give rise to a tax credit for the shareholder.

Discretionary tax on dividends (précompte mobilier facultatif sur les dividendes; facultatieve controle-voorheffing op de dividenden; fakultativ einzubehaltene Kapitalertragsteuer auf Dividenden): tax withheld solely in the case where the beneficiary of the dividends, at the moment of their encashment, does not disclose facts or circumstances which entitle him to be exempt from withholding.

Net Dividend: sum constituting the dividend for the individual shareholder. Thus, this is the sum on which, if occasion arises, the visible withholding taxes on dividends are calculated.

Gross Dividend: amount of profit that the company must achieve to be able to distribute the corresponding net dividend. The difference between the gross and the net dividend is the company tax which corresponds with the dividend.

Net reserves: sum placed to reserve after payment of company tax.

Gross reserves: sum of the profit that the company must achieve in order to be able to arrive et the corresponding sum of net reserves. The difference between gross and net reserves is the tax on companies which corresponds to the sum placed to reserves.

Standard rate of tax on companies: percentage of tax levied on gross reserves.

Grossing up (in the case of company taxation): conversion of the net dividend or of net reserves into a corresponding gross sum.

Grossing up (in the case of the tax on income and advance levies): conversion of the sum received after deduction of (visible or invisible) withholding taxes, into the sum prior to this deduction.

The method of analysis is as follows: it is assumed that the company places in reserve everything that the profits allow, taking into account company taxation or that it distributes it. These two extreme cases clearly do not correspond to reality, but their combination according to whatever quantity determined, allows more realistic cases to be understood. However, it should not be forgotten that the beneficiaries of bonuses have been ignored. The question of the influence of bonuses on taxable profits has not been considered here, neither has that of investment allowances which question has also been deliberately left out of account.

IV. The real and the apparent tax on companies in relation to undistributed profits: current systems and the proposed Belgian system.

It is useful to include the British tax system in the comparative analysis, given that this is very illustrative in many respects.

Federal Republic of Germany: The business tax (Gewerbesteuer) which is only levied in varying proportions on profits, has not been taken into consideration here.
It is the same for tax on net worth due from companies. The "Körperschaftsteuer" is, in the cases considered here, at 51% of gross reserves equivalent to 104.08% of net reserves.

Belgium (legislation in force): The rate of professional tax varies between 25% and 40%. Moreover, since the professional tax paid in the previous year is deductible, the effective percentage levied on gross reserves is lower. It runs from 20% (equivalent to 25/125 of gross reserves) to 28.57% (equivalent to 40/140) of the part of gross reserves which is taxed at the highest rate. Although the 28.57 percentage, calculated on the total gross reserves, is never reached, it can be borne in mind throughout the present analysis, given that the marginal percentage is very often determinent in the decisions that businessmen are led to take and that gross reserves frequently comprise elements subject to taxes other than professional tax. On dividends received by the company, for example, 30% is withheld under the head of taxe mobilière. Thus the tax can be estimated, subject to some reservation, at 28.57% of gross reserves, equivalent to 40% of net reserves.

Belgium (projected law) (1): Company taxation levied on gross reserves is partly final (30%), partly provisional (5%), this last part being returned in the case where the sum put to reserve is later distributed.
For the purpose of this Appendix, the tax levied on gross reserves can be estimated at 35% of gross reserves, equivalent to 53.85% of net reserves. In the calculation of net reserves, here is not taken into account the fact that, at the time of a later distribution from reserves, a "tax credit" can be interposed (see point VI c following).

France: The annual tax of 1.5% on the sum of reserves has not been taken into consideration. The tax on companies is at 50%. Gross reserves are consequently taxed at 50%, net reserves at 100%.

Italy: Gross reserves are firstly affected by the "ricchezza mobile" tax (RM), in category B; the remaining part is subject to company tax (imposta sulle società). The rate for category B of the RM tax is at present 36.5%; the tax on companies is:

a) for profits which do not exceed 6% of the capital, at 0.75% of the capital;

b) to the extent that profits are higher, at 16.5% of the (excess) profits.

For the purposes of the present Appendix it is this latter percentage that has been used. The percentage of 16.5 on profits reduced by RM tax corresponds to nearly 10.5% of profits not reduced by this latter tax. Leaving aside the fact that profits could still comprise elements subject to other schedular taxes, we therefore arrive at marginal taxation of 36.5%, plus 10.5%, equivalent to 47% of gross reserves or 88.7% of net reserves.
If the (non-deductible) tax on companies of 5% levied on the interest of bonds issued by the company is also considered as a company tax, a slightly higher figure will be reached.

Luxembourg: As for the Federal Republic of Germany, the business tax (Gewerbesteuer) and the tax on net worth are not taken into consideration. In relation to company tax, gross reserves are taxed at 40% net reserves consequently at 66.67%.

Netherlands (current legislation): The standard normal rate has lately been fixed at 45% (from 1.1.63). Consequently, the tax on gross reserves amounts to 45%, equivalent to 81.81% of net reserves.
Netherlands (projected law): No change in the rate for profits placed to reserves has been proposed as yet.

Great Britain: Profits tax is a true tax on companies (15%); income tax is an apparent tax on companies (38.75%). When calculating profits subject to income tax, profits tax is not deducted; the total tax levied on reserves is thus 53.75% which corresponds to 116.51% of net reserves. In the calculation of net reserves, no account has been taken of the fact that when there is a later distribution from reserves, the company can pass on to its shareholders the income tax that it does not then have to pay a fresh time.

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(1) The projected law has been taken into account as it has been presented; it has not been possible to take into account eventual modifications brought about during parliamentary debates, which have not been completed at the moment of preparation of the present Appendix. (Meanwhile the Belgian project has become law-publisher's note).

Summary

	Taxation in relation to	
	gross reserves	net reserves
Federal Republic of Germany	51 %	104.08 %
Belgium (current system)	28.57 %	40 %
Belgium (projected law)	35 %	53.85 %
France	50 %	100 %
Italy	47 %	88.7 %
Luxembourg	40 %	66.67 %
Netherlands (1963)	45 %	81,81 %
Netherlands (projected law)	45 %	81,81 %
(Great Britain)	(53.75 %)	(116.51 %)

V. Real and apparent tax on companies in relation to non-distributed profits: concept of the FFC.

Having regard to the percentages underlined above, it is not surprising that the FFC proposes a uniform tax on reserves of 50%. If a weighted average is sought for, a somewhat lower percentage will be arrived at rather than a higher one.

In the calculations given hereafter as examples, the 50% figure will be adopted because it simplifies the calculations. It would be, however, misunderstanding the thoughts of the Committee to conclude from this that they would have a marked preference for a precise rate of 50%.

In relation to the prevention of international double taxation of companies which have their tax domicile in one of the E E C countries and which (also) conduct their activities in other E E C countries, one should refer to paragraph IVC of the Report and in particular to points (3), (5) and (6).

VI. Real and apparent taxation of companies in relation to distributed profits: national legislation in existence or envisaged for the immediate future.

In the systems of company taxation which are currently in force in France, Luxembourg and the Netherlands, the rate applied to gross reserves and gross dividends is identical.
All three countries have a genuine company tax at a uniform rate. Net dividends are considered as the income of shareholders (natural persons). On these net dividends, a visible withholding tax is applied which as an advance payment is credited against the shareholder's personal income tax. This withholding tax is a non-discretionary tax for resident shareholders, for non-resident shareholders it is often made discretionary according to a Tax Convention.

In Italy a uniform rate is also applied to company gross reserves and to the gross dividends that it distributes.
Net dividends are clearly not further subject to another schedular tax, but they come into account insofar as they are part of the income of natural persons, for the complementary tax on income (imposta complementare sul reddito delle persone fisiche). No creditable withholding tax is applied on dividends: in view of the rate of complementary tax this would in effect give rise in too many cases for a refund (1). Absence of a withholding tax, however, has had the result of subjecting non-resident shareholders to the complementary tax on income.

From the foregoing it can be concluded, on the one hand, that Italian company taxation is a true tax on companies, and on the other hand, that the Italian system is so unique in this way that a comparison with that of other countries has had to be abandoned in this Appendix.

In the system applied in the Federal Republic of Germany and Belgium, as well as under the Dutch projected legislation, company taxation levied on the gross dividend is lower than that which is levied on gross reserves. In Great Britain, this system has already been in existence for a long while. In the three Continental countries, the preferential system does not apply to all dividends but solely to normal dividends. In the present appendix the exceptions will not be taken into account.

If share companies are identified with their shareholders, the taxing of dividends in the company as well as with the shareholders implies a discrimination in respect of this legal form. But even if they are not considered as identical there is discrimination. Why should interest due from the

(1) Meanwile a withholding tax of 15% has been introduced in Italy -, Publisher's note.

company be allowed to be deducted from profits and why not the dividends which, according to this concept, are also paid to third parties?

The answer is that dividends from the point of view of the share company are considered as transferred profits and, from the point of view of shareholders, as income from capital.

Whatever it may be, this discrimination, given the current rates of company taxation and personal income taxes, in the opinion of many people has an unfortunate effect on economic growth, and this point rather than any argument of equity, has determined the attitude of legislators.

The fact that three Continental countries only wished to mitigate this discrimination after that has been introduced to a limited extent in Great Britain, where it did not exist previously, shows this clearly.

When it is wished to take account of the relative burden of company taxation in relation to gross dividends, it is advisable not to lose sight of the fact that reduction of the rate depends customarily on the sum of net dividends and not on that of gross dividends.
When the tax on the net dividend is fixed for example in the Federal Republic of Germany at 15%, this means that the tax on gross dividend is reduced by (51 - 15%) of the net dividend.

Federal Republic of Germany: calculation can be made in different ways. One of them is as follows: the percentage represented by company taxation in relation to gross dividend is calculated by starting from a particular net dividend that we will assume as equal to 100. In order to find the gross sum, this sum must be increased by 15%, equivalent to 15. On this latter sum, according to the standard rate, is due $\frac{51}{49}$ of 15 or 104.08% of 15, equivalent to 15.61.
Total tax: 15 + 15.61 = 30.61.
Gross dividend is thus: 100 + 30.61 + 130,61 and the tax of 30.61 is equal to 23.44% of the gross dividend.

Thus, a gross dividend of 100 can correspond to a net dividend of 76.56. The reduction amounts in this case to (51 - 15)%, or 36% of 76.56, equivalent to 27.56. Tax of 0.51 x 100, less 0.36 x 76.56 = 51 less 27.56, equivalent to 23.44 allows the distribution of a net dividend of 100 less 23.44, equivalent to 76.56.

In fact, in place of a standard rate of 51%, a rate of 23.44% equally calculated on the gross dividend is applied. This comes to the same thing as if the gross dividend had been reduced by 54.04% before applying the standard rate of 51%. The percentage 54.04 will hereafter be called percentage "A". It could also be called the degree of limitation of discrimination. The German "A" in a singular manner approaches that of Great Britain, and therefore we will first calculate the Britisch "A".

Great Britain: What, for the purpose of the present Appendix is called the standard rate of company taxation, is 53.75%, thus a gross dividend of 100 allows distribution of a dividend of 46.25, after deduction of income tax as (visible or invisible) advance payment of tax to be credited against the shareholders' income tax.

In order to find the real dividend, the sum of 46.25 must be grossed up by multiplying it by $\frac{100}{100-38.75}$ This produces a dividend (net for company tax, gross for income tax) of 75.51. The tax which remains to the charge of the company on a gross dividend of 100 thus reached: 100-75.51=24.49. If the gross dividend is reduced by 54.44% and the tax rate of 53.75% is applied to the difference, the same result occurs. Percentage "A" is thus 54.44, that is to say higher by only 0.4 than that in the Federal Republic of Germany.

In Great Britain on a dividend of 75.51 there is applied an invisible advance tax of 75.51 less 46.25, equivalent to 29.26 (or 38.75% of 75.51), which for all resident shareholders becomes a "tax credit". In the Federal Republic of Germany, the (visible) advance tax and the "tax credit" are very much lower (25% for the resident shareholder).

Belgium (current legislation): for a gross dividend of 100, the company is liable to 21.87 for professional tax and national crisis tax. With a standard rate of 28.57% therefore the percentage "A" is 23.44.

Belgium (projected law): for a gross dividend of 100, a "tax credit" of 15 is granted to the (resident) shareholder.
A tax of 30 is levied on the company. The shareholder thus receives 70 from the company and 15 from the tax authorities, equivalent to a total of 85. From the point of view of income tax (and visible withholding taxes), this is then the gross dividend. Company taxation equal to 30 and

levied on the gross dividend is thus composed of a tax of 15 on companies and an invisible advance withholding of 15.

As shown above (IV), the tax which corresponds to the gross reserve is equal to 35. If 57.14% is taken from 35, namely 20, there remains 15. Percentage "A" is thus 57.14.

Netherlands (projected law): the gross dividend is generally taxed at:

a) 45% of gross dividend, reduced by

b) 15% of the net dividend.

Calculations similar to that made for the Federal Republic of Germany show that for a gross dividend of 100, the tax consequently reaches 35.30 and the net dividend 64.70. Percentage "A" is thus 21.56, since 0.353 x 100 is equal to 0.45 x (100-21.56).

Summary

Country	Standard percentage of company taxation	Percentage "A"	Tax on companies as a percentage of gross dividend
Federal Republic of Germany	51	54.04	23.44
Belgium (current system)	28.57	23.44	21.87
Belgium (projected law)	35	57.14	15
France	50	0	50
(Italy)	(47) (1)	0	(47) (1)
Luxembourg	40	0	40
Netherlands (1963)	45	0	45
Netherlands (projected law)	45	21.56	35.30
(Great Britain)	(53.75)	(54.44)	(24.49)

(1) Of which about 10.5% under the head of a true company tax.

In its Report (see page 139), the FFC has proposed that the percentage of company tax levied on the gross dividend should be equal to half the percentage levied on gross reserves. As recalled above, the FFC has proposed in relation to gross reserves a rate of about 50%. The rate for the gross dividend would thus be about 25%. The proposal could be otherwise formulated by starting from a tax of 50% on gross reserves. The tax on gross dividends would thus be equal to:

a) the half of the gross dividend, less

b) a third of the net dividend.

Percentage "A" (limitation of discrimination) is thus 50%. In its proposal relating to the rate of company tax levied on the gross dividend, the FFC also supported a desirable minimum of 15%. This is clearly in relation to the percentage of 15 indicated in analysing the rates for the Federal Republic of Germany. In the light of the calculation made at the time of this analysis, this minimum, at a standard rate of 50% (also for a 48% standard rate) is equal to about 23% of the gross dividend.

The cogency of a proposal tending to reduce the standard rate of company taxation by a factor whose sum will depend on the net dividend, will relate to:

a) the sum of the non-discretionary withholding tax on the net dividend;

b) the question whether the yield of such a withholding tax will be and will remain paid to the country which imposes it, at least if a discretionary withholding tax as a simple control measure is applied. This point will be re-examined in the part devoted to withholding taxes.

VII. Tax on companies; visible and invisible withholdings on dividends: international sharing of the tax yield. Technical possibilities; choice of the FFC.

The FFC has proposed (in relation to company taxation):

a) a standard rate of "about 50%" (end of paragraph V of the present Appendix)

b) a factor A (= degree of limitation of discrimination) of 50 and consequently

c) a rate of "about 25%" on the gross dividend, which in view of the figures quoted under points a) and b) gives:

d) a rate of "about 33 1/3%" calculated on the net dividend, this latter being equivalent according to the figures quoted, to about three quarters of the gross dividend.

For the sake of simplification, it will be assumed in the following analysis that "about" can be considered as "exactly", this being designed for readers who do not like algebraic formulae. Since it is possible that it may be wished to understand the relationship of figures in the case where the percentages are not in such a simple relationship to one another as 50, 50, 25 and 33 1/3, some simple formulae have been set down. These formulae can if desired, be ignored, but the symbols should be noted because they will also appear in the non-algebraic section of the analysis which their use allows to be appreciably abridged.

Symbols

D = gross dividend (company tax); in the formulae it is always assumed to be equal to 100;

P = standard rate of company tax = rate applied to gross reserves;

d = net dividend for the company taxation (= dividend subject to income tax and to withholding taxes);

T = percentage of company tax levied on the gross dividend;

A = percentage of limitation of discrimination in respect of profits distributed in the form of dividend, in the sense that $P - \frac{A}{100} = T$;

p = percentage of net dividend (company tax), which represents the reduction of tax on distributed dividends.

Formulae

Various values for D

$$D = d + \frac{D}{100} P \left(1 - \frac{A}{100}\right)$$

$$A = \frac{P - T}{P} 100 = \frac{dp}{P} \cdot \frac{D}{100}$$

$$T = P \left(1 - \frac{A}{100}\right) = P \frac{100 - A}{100}$$

$$d = (100 - T) \frac{D}{100} = \frac{PA}{p} \cdot \frac{D}{100}$$

$$p = \frac{PA}{d} \cdot \frac{D}{100}$$

$$P = \frac{dp}{A}$$

$$\frac{p}{100} d = \frac{D}{100} (P - T)$$

Where D = 100

$$D = d + P \left(1 - \frac{A}{100}\right)$$

$$A = \frac{P - T}{P} 100 = \frac{p}{P} d$$

$$T = P \left(1 - \frac{A}{100}\right) = P \frac{100 - A}{100}$$

$$d = 100 - T = \frac{PA}{p}$$

$$p = \frac{PA}{d}$$

$$P = \frac{dp}{A}$$

$$\frac{p}{100} d = P - T$$

Note that the 50% proposed by the FFC for A only results in the formula

$$A = \frac{P - T}{P} 100 = \frac{50 - 25}{50} \cdot 100 = 50$$

Under the FFC proposal, the percentage p is thus equal to

$$\frac{P}{d} A = \frac{50}{100 - 25} \cdot 50 = 33\ 1/3$$

Given that the two percentages P and p summarize the entire rate structure, the proposal of the FFC can also be expressed as follows:

P = 50; p = 33 1/3

Would the FFC proposal be assumed to mean that P is equal to 48 and A to 50, these would be obtained:

$$T = P \frac{100 - A}{100} = \frac{48}{100} . 52 = 24,96$$

and if D was equal to 100:

$$d = 100 - T = 75,04$$

$$p = \frac{PA}{d} = \frac{48}{75,04} . 50 = 31,99$$

Bearing in mind the analysis that will be given later in the present Appendix, on the base of the formula $D = 100 = P - \frac{p}{100} . d + d$ the results of the formulae in two other cases are:

if $P = 50$ and $p = 16\ 2/3$ D being equal to 100, it results in:

$d = 60$ $T = 40$ and $A = 20$

if $P = 48$ and $p = 15$ D being equal to 100, it results in:

$d = 61,18$ $T = 38,82$ and $A = 19,12$

Withholding at source on dividends

So as to augment comprehension of the system, the FFC prefers non-discretionary visible withholding taxes on dividends rather than invisible withholdings. Nevertheless, it should be borne in mind that in the case of visible withholding, the tax credit depends exclusively on the dividend and that it does not correspond directly to company tax levied in the country where the company has its tax domicile.

This point is especially important when the company acquires its profits in other countries: in this case it often pays no company tax in the country where it has its tax domicile.
Tax credit from which shareholders benefit, is thus, in fact, a lump sum credit in relation to company tax due in other countries where the company has achieved its profits. It can be the same in the case of invisible withholdings, but not necessarily so. It will depend on legislation on the matter. This confirms the point of view of the FFC, at least if shareholders themselves are not subject to company tax.

The FFC proposes to combine a visible and non-discretionary withholding tax with another which would be optional (see page 139-140). The percentage sum of these withholding taxes would have to be identical in all the Common Market countries, but it would not be necessary that the elements of this sum, considered separately, be identical in all the Member countries.

This arises from the fact that nearly all non-discretionary withholding taxes are credited against the income tax of the shareholder, which must give rise, above all when income tax is low, to either numerous refunds (net negative taxation) or to a system which excludes these refunds, but which would then be capable of causing great dissatisfaction.

The discretionary withholding tax, applied as a control measure, indeed provides a mass of information; but the possibility of making use of this information by sampling considerably diminishes the disadvantage presented by a vast mass of data. Therefore, the country where income tax is low should have the possibility of settling the discretionary withholding tax at a higher rate (and the non-discretionary withholding tax at a lower rate) then other countries in the Common Market.

It seems logical that the yield of the non-discretionary withholding tax remains paid to the country where the withholding has been made, even if the shareholders who benefit from a credit against their income tax live in another country (1). It is in the nature of things that the discretionary withholding applied as a control measure should not bring in anything. Insofar there is a tax withheld to the charge of shareholders resident in other countries, the names and domiciles of

(1) The majority of members of the FFC have opted for a different solution (see page 140).

these shareholders are not known. The country where the withholding is operated thus collects a receipt to which it does not have right in reality. If the shareholder makes himself known after withholding has been made, but within the relevant time period, the country where withholding has been applied must cancel the discretionary withholding tax and restore it to the shareholder and at the same time advise the tax administration of the country of domicile of the shareholder. From a purely international point of view, the States thus have every interest that there exists a high non-discretionary withholding tax in their own country and a high discretionary withholding tax in other countries.

The FFC has also given its opinion, although in vague terms, on the rates of the two types of withholding taxes. It has, however, employed terminology other than that which has been employed in the present Appendix; in effect, it calls the sum of the two withholding taxes the maximum rate and the non-discretionary withholding tax the minimum withholding tax. In the opinion of the FFC this non-discretionary tax should vary "between 10 and 20%"; in another place where it is a question of internationally sharing the tax yield (see page 144), it agrees (except in relation to subsidiary companies and large participations) with a non-discretionary withholding tax of 15% which should be accompanied by a tax credit for an equal sum in the country where the shareholder has his residence. With regard to a discretionary withholding tax the FFC is of the opinion that the rate should be equal to at least the difference between 25% on the one hand, and 10% to 20% on the other. This can be interpreted as a rate of at least 10% to 15%. In relation to "at least", a rate of 15% may be considered as normal. Thus, one arrives at a non-discretionary withholding tax of 15% and a discretionary withholding tax, applied as a control measure, also of 15%, with perhaps a possibility for Italy of provisionally maintaining for administrative reasons, a non-discretionary tax of 10% and a discretionary withholding of 20%.

Relationship between non-discretionary tax withholding on dividends and reduction of company taxation for the distributed part of profits.

The most satisfactory regulation of reduction for the distribution of profits within the group of Member countries of the E E C, can only be reached if there is established a relationship between the non-discretionary withholding tax of 15% on dividends and the reduction for distribution of profits applied to the company tax. This reduction of tax should therefore be fixed at 15% of the net dividend, that is to say, of the dividend which forms an income for the shareholder and on which the visible withholding tax is applied.

Countries which until now have not yet applied tax reduction for distribution of profits would thus obtain, (direct or indirect) on the part of non-resident shareholders, a tax sum identical to that which it would receive if company tax was levied only according to the standard percentage P.

Various reasons have led the FFC, taken overall, to reject this concept.

In relation to company taxation, this system could in practice lead to a percentage P equal to 50, and a percentage p equal to 15. In this context, it should be noted that even a country where the percentage p is about 33 1/3 and the percentage P is about 50 would not be able to allow percentage p to be maintained at so high a level if the country would have to abolish the tax on net worth applied to share companies.

Visible withholding taxes on dividends, existing or already envisaged

Currently existing withholding taxes (except one type of withholding tax applied in Belgium which has not been dealt with above) are all applied as a non-discretionary tax to shareholders who are resident natural persons, but have often been changed by virtue of tax treaties into a discretionary withholding tax when the shareholder is a resident of a country party to such a tax treaty.

Regulations are so divergent that it is impossible to enumerate them all here. Within the framework of the Common Market, unification in relation to third countries is therefore necessary. Developments are clearly directed toward a non-discretionary withholding tax, for non-residents too, of the 15%, to the benefit of the country where the tax withholding is made. If all the States where the shareholders have their domicile decided to grant corresponding tax credit, an important form of international discrimination would have disappeared.

The FFC has proposed (see page 140) to replace non-discretionary withholding by discretionary withholding if the shareholder is a parent company or a share company with a large participation and which has its tax domicile in a Common Market country. The FFC would only like to envisage

a special system in cases where the dividends so received would remain for a long period in reserves within the receiving companies.

It is appropriate to point out, however, that in the proposed scheme, a State is at a disadvantage from a taxation point of view if a foreign share company exercises its business activity in that State in the form of a subsidiary and not in the form of a branch. Yet, that should not make a great difference. This is why it is desirable to apply a withholding tax (of 15%), even in this case, as much in international as in domestic relationships. The State where the company with a participation is domiciled should then, if the parent company in its turn has withheld tax on dividends, deduct from the sum due under this head the tax on dividends withheld previously on dividends collected by the company, without taking into account the fact that this withholding has taken place in the country itself or in another country of the Common Market.

The same system should also be applied to investment companies. They would thus be subject to the same conditions as investment trusts.