

EC: Tax Harmonization in the Community I

INFORMATION REPORT OF THE SECTION FOR ECONOMIC AND FINANCIAL QUESTIONS OF THE ECONOMIC AND SOCIAL COMMITTEE ON TAX HARMONIZATION ***

Rapporteur: Mr. Fredersdorf

1. Foreword

1.1. On 23 July 1975 the Commission published an Action Programme for Taxation in the form of a Communication to the Council (Doc. COM (75) 391 final). A talk on the Programme was given at the 24th meeting of the Economic and Social Committee's Section for Economic and Financial Questions on 22 October 1975 by Mr. Goergen of the Commission. At that meeting the Section was unable to agree on the setting up of a Study Group and the matter was deferred. After further discussion at the 27th and 28th Section meetings on 28 April 1976 and 1 June 1976, the existing Study Group dealing with tax matters was asked to consider whether there was a case for a Study on the subject. The Study Group's Chairman, Mr. Fredersdorf, submitted a memo at the Group's meeting on 13 July 1976, and after a full discussion the Study Group decided to recommend the Section to set up a Study Group to prepare a Study on the general question of fiscal harmonization in the EEC.

1.2. The memo was presented to the 29th Section meeting on 31 August 1976 in a revised form expressing general support for tax harmonization (Appendix 1), and after a thorough discussion was broadly approved. At its 176th meeting on 28 September 1976 the Committee's Bureau gave its permission for the Section to set up a Study Group and draw up a Study later to become an *Information Report*; see 1.4. below. Thereupon, at its 32nd meeting on 12 November 1976, the Section appointed the following Study Group:

Chairman: Mr. Rouzier

Rapporteur: Mr. Fredersdorf

Members: Mr. Garstens, Mr. Charpentie, Mr. Clark, Mr. Cremer, Mr. De Ridder, Mr. Germozzi, Mr. Van Greunsven, Mr. Hemmer, Mr. Merli Brandini, Mr. O'Ceallaigh, Mr. Peyromaure-Debord-Broca, Mr. Rolinger

Experts: Mr. Timbart (French Employers' Federation) and Mr. Braun (European Trade Union Confederation)

1.3. The Study Group began work on 10 January 1977 with discussion of a draft plan for the proposed Study prepared by the Rapporteur. It had a total of 8 meetings, the last one being held on 12 October 1977. The draft for the pro-

* Doc. CES 846/78 pk; Brussels, 12 July 1978.

** The appendices that have been referred to have not been reproduced.

posed Study produced by the Study Group was discussed at the Section's 38th, 41st, 42nd and 44th meetings on 8 November 1977, and 7 February, 4 April and 6 June 1978.

1.4. At its 161st Plenary Session on 12 July 1978, the Committee decided to consider the Section's Study as an Information Report.

1.5. The Information Report does not deal with matters relating to the Customs Union even when they are of a tax nature. The Commission has published a special memorandum on the Customs Union (Doc. COM (77) 210 final of 13 June 1977), and the Economic and Social Committee on 30 March 1978 gave a unanimous Opinion on this memorandum (Doc. CES 1276/77 fin), in which it advocated setting a target date of 1980 for completion of the Customs Union and emphasized the need for harmonization of taxation, particularly VAT. The Economic and Social Committee also expressed the view that tax harmonization was essential in its Opinion of 30 March 1978 on the proposed market regime for alcohol (Doc. CES 694/77 fin).

2. Basis of Tax Harmonization

2.1. The Need for Tax Harmonization

2.1.1. Tax Harmonization as an Element of European Integration

2.1.1.1. On its own, tax harmonization can be judged a good or a bad thing. In the context of the European Community, however, a minimum of tax harmonization is indispensable to the following purposes:

- a) to make possible the economic and monetary union which the European Council has continually, right through to its most recent meetings, declared to be its unwavering political aim;
- b) to create the lasting solidarity between all members of the Community in which lies our only chance of ever being able to solve the common problems of unemployment and inflation, of evening out regional and social disparities and obtaining similar standards of prosperity for all — problems which are proving more and more intractable for nations acting alone. The will which exists amongst all people of the Community to stand together, come what may, in tackling these problems must not be weakened or altogether frustrated by the continuance of differences in taxation. The European Community can only do these things if its institutions have the tools for the job, i.e. if certain powers now exercised by the national States are transferred to it, in full or in part. Harmonized taxation would facilitate this development, for taxation impinges, or can impinge, upon all spheres of human activity, and hence upon all government policies, a fact which was recognized more than 140 years ago by Alexis de Tocqueville. There is hardly a single public matter, he wrote, which does not derive from or end in a tax.

2.1.1.2. The Commission's Communication on the Prospect of Economic and Monetary Union of 17 November 1977 (Doc. COM (77) 620 final) rightly points out the importance of progress in the taxation field:

'A particular effort will have to be made in the tax area. There will be need for significant progress, especially though not exclusively with respect to indirect taxes. The recent completion of work on the harmonization of the basis of assessment for VAT makes further progress possible.

Firstly, examination of tax harmonization proposals already presented by the Commission should be speeded up so that they can be approved as far as possible during 1978. These proposals include the harmonization of excise duties, which are a source of numerous distortions of competition.

In the light of progress made, the Community should decide, by the end of the five-year period, on the measures to be taken to achieve the abolition of fiscal frontiers.'

Progress of this kind in the harmonization of taxation will facilitate solution of the abovementioned problems with the help of really effective economic (short, as well as longer term), social, regional, transport and monetary and fiscal policies. Without that type of progress, the Community will just go round in circles and make no or insufficient headway against these problems. The Commission President, Mr. Jenkins, indicated the size of Community budget this would involve in his speech in Florence on 27 October 1977:

'The overall magnitude of budgetary spending at the European level for this type of Community has recently been estimated by a group of independent economists under the chairmanship of Sir Donald McDougall. As against present Community expenditure of the order of 1% of GNP, they estimated that very substantial progress on economic integration could be achieved with the aid of expenditure of 2 to 2½% of GNP; they believed that a definitive monetary union might be viable with expenditure of the order of 5 to 7% of GNP. These are of course very large sums of money, which would have to be built up gradually by a transfer of some expenditure from national budgets and not by a superimposition, but they are quite small by the standards of the classic federations where the top tier of government takes 20 to 25% of GNP. There is therefore for the Community a new and realistic model for a highly decentralized type of monetary union in which the public procurement of goods and services is primarily in national, regional or other hands. The public finance function of such a Community would be stripped down to a few high-powered types of financial transfer, fulfilling specific tasks in sectors of particular Community concern, and assuring the flow of resources necessary to sustain monetary union. These characteristics also make for a quite small central bureaucracy, which I think we would all consider an advantage . . . The prospect of monetary union should be seen as part of the process of recovering the substance of sovereign power. At present we tend to cling to its shadow.'

2.1.1.3. Whatever one's view of the statements we have quoted by the Commission and the Commission President, a degree of tax harmonization is undoubtedly necessary for the following goals of Economic and Monetary Union:

a) completely free movement of persons throughout the Community;

- b) intra-Community free trade in goods and services, freely competing and free of administrative barriers;
- c) free movement of capital.

Customs duties and taxes, the indispensable tributes of individual activity to the Community and to the Member States, must not stand in the way of these aims, but must, wherever possible or feasible, further them. Now that purely national solutions, partly because of the inter-relatedness of our economies, are proving less and less effective, we all look to the Community to play its considerable part in finding better solutions to the principal and most acute problems facing us in ensuring similar standards of welfare for all our citizens, without intolerable levels of unemployment and inflation and without the even more persistent discriminatory effects of social and regional disparities. But the Community needs the correct tools if it is to do this. One of the key tools for solving such problems is taxation, because of its manifold economic and social implications. To help assure the Community's efforts of lasting success we therefore need optimum harmonization of taxation.

2.1.1.4. Optimum harmonization of taxation does not mean standardization of every part of the tax system. That would not only be wrong but also impossible. There will still be differences between the tax systems and the financing of public expenditure by means of taxes and/or social security contributions in different Member States even after harmonization has been completed. These will be differences which do not form any obstacle to harmonization.

2.1.1.5. The discontinuance of border taxes will mean that largely importing Member States will lose considerable amounts of revenue, and largely exporting Member States unjustifiably gain corresponding amounts of revenue. Therefore, for all harmonized indirect taxes which are not to be carried to the stage further of becoming Community taxes paid into a common 'kitty', the Member States must be prepared for financial transfers between one another, unless adequate alternative means of off-setting revenue distortions can be found. Only then will such shifts of revenue be acceptable.

2.1.1.6. Tradition often represents a barrier to change. The obstacles tradition places in the way of tax harmonization tend to be exaggerated no doubt because money is involved and money is something about which people are proverbially very sensitive. Such obstacles can be overcome, as they are in all the other fields where they occur, without destroying things that are worth keeping.

That enormous changes in the tax system are possible, despite centuries-old tradition, has been proved especially by the Scandinavian countries. Until not so long ago these had no such thing as a turnover tax but in a relatively short space of time the proportion of tax revenue provided by indirect taxation rose in Denmark, for instance, to 36.2%.

One can think of many examples of such major breaks with the past in every policy sphere. So, however much he may wish to preserve traditions, no-one should be put off from speedy tax harmonization in the Community. Anyway, so-called hallowed traditions are often only pretexts for defending vested interests.

2.1.1.7. It is questionable whether the Member States' present tax systems are in fact so rooted in tradition and dictated by their different political systems. Although we would not deny that economic and social factors have had a contributory influence on individual aspects of taxation policy, a study of taxation developments in the 20th century alone would probably show the Community countries' fiscal policy as far less, if at all, the story of an ineluctable system as that of how they have tried, within the constraints imposed upon them by the need for political compromise, to obtain the necessary revenue using the means which would, or so they thought, encounter least resistance.

2.1.1.8. Harmonization of taxation taking care not to do too much violence to tradition, is an opportunity for us finally to tidy up the mess of national tax systems. This unique opportunity should be taken, because it is also a chance to make significant headway towards a rational and at the same time less burdensome tax system more in keeping with the interests of both the individual citizen and the tax authorities and avoiding the taxpayer discontent, extending to open revolt, which results from a lack of transparency in the tax system. For the individual citizen, for industry and for the tax authorities (in the latter two cases for reasons of cost), a rational tax system is one which manages with as few operations and resources as possible and is still as fair as is humanly possible.

2.1.1.9. Without a minimum of tax harmonization there can be no economic and monetary union as a stepping-stone to political union. The national electoral considerations which often retard the progress to harmonization must be overcome. This should be easier to do than before with the great transparency that will be brought to Community developments by the directly elected European Parliament. The harmonization of taxation is not an end in itself, but only a means to an end; it is, however, indispensable to that end.

2.1.2. The Timescale of Tax Harmonization

2.1.2.1. First of all, like the question about the chicken and the egg, it is a complete waste of time trying to work out which should come first, tax harmonization or economic and monetary union. Spending time arguing about this will hold up progress on both of these fronts and neither will advance. Therefore, no good will come of postponing tax harmonization until Community integration has progressed a bit further. We must try to advance tax harmonization in parallel with the general progress towards integration, and at one point in time it may be the other areas that are more advanced at another it may be the taxation field. We are not forgetting, of course, the crucial importance of the currency question, eventually leading up to a European currency.

The advances made in one field of integration will help along progress in others, and vice versa. We cannot expect to 'hit the jackpot' straightaway in whichever field. But harmonization can be achieved a bit at a time. We just have to 'plug away' at it singlemindedly. For a proper job we first need to have an overall plan of what we want so that as each little step proceeds we do not lose sight of the goal. (Before threading beads to make a necklace you need to know what the

whole necklace will later look like.) Of course the overall plan can only be tentative because it is quite possible details of the plan will be changed in the course of the twenty years we suggest the harmonization should take.

2.1.2.2. The timescale for the harmonization is admittedly a matter of dispute even when it is possible to reach agreement on the harmonization itself. But we can set a rough framework: even the optimists do not seriously expect to see harmonization in less than ten years; on the other hand, the most cautious would not wish and could not justify, to defer harmonization beyond the year 2000, i.e. a good twenty years from now. So splitting the difference, we should be able to agree on a target of roughly fifteen years in which to carry out the harmonization or till 1995. However, no serious-minded person would quibble over five years more or less for such a major work of European integration.

2.1.2.3. It is particularly important for the timetable that the Member States from now on should coordinate their tax policy so that all individual and Community measures in the tax field keep in step. In concrete terms this means all Member States refraining from national measures which would hinder or prevent implementation of the mutually agreed plan for tax harmonization. Member States must accordingly be obliged to submit for prior consultation all changes in their tax systems liable to interfere with the agreed plan.

2.1.2.4. The harmonization of indirect taxes (i.e. taxes on expenditure, paras. 4.2.2. and 4.2.3., transport, para. 4.2.4. and certain types of transactions, paras. 4.2.5.)¹ should by and large be completed by 1990. The other areas of tax harmonization could safely be put at the end of the harmonization programme.

2.2. Basis in the Treaty

2.2.1. The Treaty signed on 25 March 1957 establishing the European Economic Community contains few references to tax harmonization outside the context of the Customs Union (Articles 12-37).

Article 3 is of relevance as a general statement of objectives, calling as it does for a common commercial policy, abolition of obstacles to freedom of movement for persons, services and capital between Member States, a common transport

1. *Translator's note:* In the German classification of taxes used by the author taxes are classified into 'Besitzsteuern' (taxes on possessions), 'Verbrauchersteuern' ('taxes on expenditure') and 'Verkehrsteuern', which are taxes on transport and certain types of transactions ('Verkehr' in German means both 'transport' and 'transaction'), the two types often being distinguished by using 'Verkehrsteuern' for taxes in transport and the more explicit 'Rechtsverkehrsteuern' (literally 'legal transaction taxes') for 'transaction' taxes. Besitzsteuern include taxes on profits, income and wealth. Verbrauchsteuern cover (i) turnover tax (VAT) and (ii) excise duties (also called 'besondere Verbrauchsteuern' = 'specific expenditure taxes'). Verkehrsteuern cover (i) taxes affecting transport and (ii) (properly 'Rechtsverkehrsteuern') taxes such as real estate transfer tax, stock exchange turnover tax, capital duty, insurance tax betting and gaming tax.

policy, prevention of distortion of competition, coordination of economic policies and, last but not least, approximation of the Member States' laws to the extent required for the proper functioning of the Common Market. All these objectives are made in varying degrees easier to achieve by appropriate progress in tax harmonization.

2.2.2. Article 99 expresses a clear commitment to harmonization of turnover taxes, excise duties and other forms of indirect taxation. The general object of this 'Tax Provision' section (Articles 95-99) is to put a stop to all dumping and other forms of discrimination through taxes or reimbursement of taxes ('repayment') on goods which are imported or exported.

2.2.3. Articles 100 and 101 provide for the issuing of Directives for the approximation of laws. In the case of approximation Directives necessary for the establishment or functioning of the Common Market, the Council must act unanimously on a proposal from the Commission after consulting the Economic and Social Committee. In the case of Directives to prevent distortions of competition, Council unanimity is required only in the first stage; thereafter a qualified majority is sufficient.

2.2.4. Title IV (Articles 74-84) of the Treaty can further be cited as a basis for harmonization of taxes affecting the transport sector. This is stressed as an essential part of the moves to establish a common transport policy.

2.2.5. The 'own resources' provision of Article 201 must eventually mean tax harmonization in the fields which are selected to provide the Community's revenue.

2.2.6. Article 220 provides for the abolition of double taxation. It also provides for the mutual recognition of companies or firms constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law which operate for profit (chiefly limited companies). It is reasonable to assume that the latter provision implies, because this is a precondition for such mutual recognition, the harmonization of the taxation of companies and their shareholders (corporation tax, capital transaction taxes). Article 220, finally, provides for mutual recognition and enforcement of judgements of courts or tribunals and of arbitration awards. This must clearly also apply to judgements in the tax field.

2.2.7. Finally, blanket powers for all other areas of tax harmonization are conferred by Article 235, which allows the Council, in cases where one of the objectives of the Treaty cannot be achieved by other means, unanimously to take any appropriate measure, even where the Treaty does not make express provision therefor.

The Treaty provisions on free movement for persons, services and capital also unquestionably set requirements for the associated fields of taxation and their harmonization. However, the lack of concrete provisions means that this area can probably only be tackled with the blanket powers of Article 235.

2.2.8. Article 48(4) excepts employment in the public service from freedom of movement for workers. Yet the provision should not be interpreted as prohibiting harmonization moves in the field of tax administration. It did not, after all, prevent establishment of the Customs Union.

The practical problems of tax administration will be dealt with in detail later (paragraph 4.2.7.). However, it can already be said that even laws that make the law completely identical on paper will not by themselves produce uniform taxation, if owing to differences of personnel, organization or procedure or excessive differences of mentality in taxpayers the system of tax administration does not permit or ensure this.

2.2.9. The Treaty provisions referred to are reproduced in *Appendix 2*.

In conclusion, we can say that the few concrete statements about tax harmonization in the Treaty, which used to be given a narrow interpretation, must today clearly be taken in a different, broader spirit, after the Council Decision giving the green light for extension of the Common Market to an economic and monetary union with the ultimate aim of political union.

2.3. National Tax Situations in Relation to the Objective (politically neutral assessment)

2.3.1. With the list of all taxes and their revenue and the level of taxation in all the Member States (Appendices 3-5) in front of one, the following points can already be made without taking in political considerations:

- Some Member States will have to get used to new taxes; others will have to give up taxes they now levy;
- The harmonized tax system will leave scope for differences of emphasis;
- Increases in tax burdens and losses of revenue will present major problems.

2.3.2. That harmonization is going to cause problems is obvious from the extent of the differences between the current tax systems of the individual Member States. In 1974 (clearly the situation today will be somewhat different) the picture was as follows:

a) In the UK, France, Germany and Belgium, the levels of taxation (including social security contributions) were very similar, ranging from 35.5 to 38.1% of the national product. Against this we have relatively low levels of around 32% in Italy and Ireland and relatively high levels of around 46% in the Netherlands and Denmark. There are, however, other factors to be considered before we can appreciate the full significance of these figures, such as the level of transfer payments in the individual countries in relation to their prices and incomes policy (if any). But it would go beyond the scope of this Study to consider these. It is similarly impossible to consider in it tax-like payments, such as state school fees, road tolls, etc., but this is anyway very largely unnecessary as is shown by the fact that the differences between the individual German Länder in this respect do not cause any difficulty.

b) In the broad structure of their tax systems, the Member States fall roughly into four groups according to the proportion accounted for by VAT and excise duties as follows:

1. on 1974 figures:

- 25-28% Luxembourg and the Netherlands
- 30-36% Belgium, Germany, Denmark, United Kingdom and Italy
- 40% France, and
- 56% Ireland.

2. on 1975 figures which take into account social security contributions:

- 19.3 - 20.1% Luxembourg and the Netherlands
- 21.1 - 22.4% Belgium, Germany and the United Kingdom
- 27.9 - 30.8% Denmark, France and Italy, and
- 40.3% Ireland.

c) There are considerable differences between the Member States in respect of the individual taxes they levy; for example, not all countries have duties on wine or fats or a wealth tax.

2.3.3. Besides these differences in the tax systems themselves, there are also differences in the administration of taxation:

a) in the structure and functions of the tax authority (a single tax department in the finance ministry in some places contrasts with departments split up into as many as four parts within the ministry in others);

b) in the allocation of responsibility for particular parts of the tax system, e.g. that for VAT, which is allocated:

- in Belgium, Italy and Luxembourg to a department within the department responsible for indirect taxes,
- in Denmark and the UK to a department within the authority responsible for customs and excise duties,
- in the Netherlands to a department within the department responsible for direct taxes,
- in Germany and France to the general department responsible for direct taxes (no special department);

c) in the qualifications and training of personnel and in opportunities for further training;

d) in the conditions of work of personnel, such as range of duties, equipment, motivation, etc.

2.4. Previous Harmonization Measures

Appendix 6 details the voluminous, but qualitatively rather modest work done towards tax harmonization, together with the relevant Opinions of the Economic and Social Committee.

(Will be continued in the next issue of INTERTAX.)

EC: Tax Harmonization in the Community II

*INFORMATION REPORT OF THE SECTION FOR ECONOMIC AND FINANCIAL QUESTIONS OF THE ECONOMIC AND SOCIAL COMMITTEE ON TAX HARMONIZATION**

Rapporteur: Mr. Fredersdorf

(The first part of this report has been published in INTERTAX 1978/10.)

3. Problems of Tax Harmonization

3.1. Relative Importance to be given to (a) Taxes on Income and Wealth and (b) Taxes on Expenditure, Transport, Transactions, etc.

3.1.1. The two major groups of taxes, namely, taxes on income and wealth and all the other taxes, may loosely be called 'direct' and 'indirect taxes'. Social security contributions, which are not offset when cross-frontier movement takes place, are, for the purposes of comparing the relative importance of the two major groups of taxes in the various Member States, to be counted as direct taxes, in spite of the fact that the employers' contribution (if any) clearly has much in common with indirect taxes, and that the progressive element is absent. At any rate, the ideological gulf which once separated advocates of direct taxes and those in favour of indirect taxation has moderated somewhat since the following have been recognized:

- a) Indirect taxes, too, can have an element of social justice (e.g. basic necessities carrying a lower VAT rate);
- b) The progression in direct taxes must not be overdone because it can otherwise stifle effort, and this applies to the basic rate of tax, the progressive scale and the top rate;
- c) At least in times of inflation, increases in direct taxes produced by the automatic operation of the scale may, if the top rate of tax remains unchanged, be more socially inequitable than increases in indirect taxes. The effect of free operation of the progressive scale at such times is that more and more people who were already in the progression zone or who come into it with largely nominal rises in income begin to suffer from inflation-induced over-taxation, whilst the top income groups, if the top rate remains the same, continue to be taxed in proportion to the rise in their income. With indirect taxes, on the other hand, extra taxation can be imposed specifically on the top-income groups.

* Doc. CES 846/78; Brussels, 12 July 1978.

3.1.2. However, a balance between direct and indirect taxation will continue to be very important, because although indirect taxes can be aimed at particular socio-economic groups, they cannot take account of the individual's capacity to pay. In some Member States the changes required by tax harmonization are often opposed on the grounds that they go against tradition. Whilst this objection should not be dismissed lightly, the experience of recent decades, for example in Scandinavia (see above), shows that it is not a compelling argument.

3.1.3. If we were to take a ratio of approximately one-third indirect taxes to two-thirds direct taxes as just about the right mix, this alone would require quite considerable adjustments in the levels of VAT and excise duties in the individual Member States, as is clear from the tables in paragraphs 4.2.1.2. to 4.2.1.4. and also from the differences in the Member States' VAT rates:

VAT rates 1978

Member States	Rates in %			
	Standard rate	Reduced rate ¹	Higher rate ²	Zero Rating ³
1	2	3	4	5
Belgium	16	6	25	—
Germany	12	6	—	—
Denmark	18	—	—	yes ⁴
France	17.6	7	33 ¹ / ₃	—
Great Britain	8	—	12.5 ⁵	yes ⁶
Ireland	20	10	—	yes ⁶
Italy	14	6	35	—
Luxembourg	10	5 ⁷	—	—
Netherlands	18	4	—	yes ⁸

1. On certain basic necessities and certain services of a social or cultural nature.
2. On certain luxury goods and services.
3. Zero rating = exemption with deduction of input tax (only mentioned insofar as it applies to certain domestically consumer goods as well as to exported goods).
4. On newspapers.
5. On petrol and certain luxury goods.
6. On food, drink and medicines.
7. On certain basic foodstuffs, medicines and tobacco 2%.
8. On newspaper, gold bullion, uncut gems, and some other goods.

3.1.4. The greatest problem would be in Ireland, although major adjustments would also be necessary in France, Luxembourg and the Netherlands. In the five other Member States there would be no great problem. Taking social security contributions into consideration, however, there are also likely to be major problems in Denmark.

3.1.5. Before any further harmonization measures are taken it is necessary that a political consensus be reached on the right balance of direct and indirect taxes, because this is a fundamental decision which will determine the whole direction of harmonization and must be there as a point of reference for all the individual measures to be adopted. Some further studies will undoubtedly be needed in order to reach this consensus.

Whatever standard mix is decided upon by the Community, the actual balances in individual Member States can never be more than approximations to it since there are other factors to be considered such as the state's transfer payments.

3.2. Preconditions for the Removal of Tax Barriers

3.2.1. Taxes on Expenditure, Transport and Transactions etc.

3.2.1.1. Capital and goods can only move completely freely when frontiers and border controls within the Community are completely done away with, making the Community into one big unit in which all business can be conducted in exactly the same way as it is at present within each Member State. In this new scheme of things, it will be necessary for the country-of-origin principle to be applied as far as possible for collection of expenditure taxes (normally collected, except in the case of local taxes, when the product leaves the factory or the bonded warehouse) on finished goods for consumption in the Community (not, of course, on goods for export outside it). If the country-of-origin principle were not applied, the present border controls would have to be moved somewhere else which would involve enormous administrative cost. The same principle would have to be followed, though this time at the place where the taxable event occurs for transport and transaction taxes, i.e. domicile in the case of transport taxes, place of transaction in the case of transaction taxes. All this would be possible only with complete harmonization.

Local taxes on expenditure (see paragraph 4.2.6.5.), which are calculated and collected at the final point of consumption, may be disregarded since they are of absolutely no importance in the process of tax harmonization.

3.2.1.2. The lifting of border controls — without substituting other controls elsewhere — is bound to cause considerable problems. First of all, it will mean some Member States completely altering their methods of collecting expenditure taxes (turnover tax excepted) so that the collection of tax begins and ends at the production stage. (The charging of turnover tax only begins at the production stage but continues through the various stages of the distribution chain for the value added at each stage on the basis of output tax minus input tax, the last value being added and the last tax charged in the country where the product is finally consumed.)

3.2.1.3. Secondly, such changes will cause some Member States considerable losses of revenue. Germany, with its big 'export surplus' in intra-Community trade, would clearly stand to gain most. This will have to be balanced out by

financial adjustments on a Community basis or between Member States. Because of these difficult problems of financial compensation between Member States, some quarters of opinion would rather have the border controls of goods and persons continue in order that the country-of-destination principle can be maintained — unless other better tax collection techniques which maintain the country of destination principle can be found.

3.2.2. Taxes on Income and Wealth

3.2.2.1. Taxes on income and wealth will have to be brought at least partially into the harmonization process if living conditions are to be made equal throughout the Community. Otherwise, not only businesses but also the self-employed and employees might some day, if all the other conditions are right, exploit their freedom of movement in order to take advantage of differences in taxation. With taxation at its present levels, direct taxation has a considerable influence on economic and social structures and economic trends.

3.2.2.2. Besides obstacles arising out of tradition which it should be possible to overcome (at least in the long term), the main problems here are posed by the varying relative importance of taxes and social security contributions and of tax-free allowances and transfer payments. A concrete example is Denmark, which does not levy social security contributions as such, but includes them in direct taxes. This does not mean that the Danish system must be changed, but only that this fact must be taken into consideration in the comparison. It need not cause difficulty provided the Danish taxpayers are more or less the same people as those paying social security contributions in the other Member States. In view of the considerable differences between the other Member States in the percentage of revenue coming from social security contributions (ranging from 15.0% in Ireland to 44.4% in Italy), they too are likely to cause some difficulty.

3.2.2.3. Similar difficulties will arise where for an identical case e.g. dependent children, one Member State gives tax relief, another pays out a straight subsidy, and another does both. Such differences, which do not emerge either in the overall level of taxation or in the tax mix, will therefore also have to be included in the harmonization process. This will not make things any easier.

3.3. Economic and Social Problems

3.3.1. Since taxation influences the behaviour of the economy and of people as harmonization progresses it will produce new problems for individual Member States. For example, the factors governing the choice of both business location and place of work may be affected. The present criteria determining such choices could change, leading to different assessments of the merits of particular locations being made and different decisions taken. The crucial importance of a country's tax system (relative to those of other countries) for its whole economic and social system is a major reason why even today, in the absence of joint Community

measures the Member States are often induced to take divergent action over taxation. But we must not be put off from tax harmonization by the effect it will have on Member States' economic and social systems; indeed if the Community is to play a proper and effective part in economic and social policy, it must use taxation as a positive instrument of this policy. Here again we will come up against revenue problems.

3.3.2. The economic and social problems raised by the harmonization with regard to the choice of business location and place of work can be minimized only if it follows more or less the same timetable in all the Member States.

3.4. Fiscal Problems

3.4.1. General Fiscal Problems

3.4.1.1. In addition to the problem mentioned above, all harmonization measures have fiscal implications, such as:

- a) increases in the tax burden (or, looking at it from the other side, increases in revenue);
- b) lightening of the tax burden (or losses of revenue) and
- c) shifts in the tax burden.

3.4.1.2. Increases of the tax burden (additional revenue), reductions of the tax burden (losses of revenue) and tax-burden shifts between Member States may come about through:

- a) tax increases, or introduction of new taxes previously unknown in a Member State;
- b) tax reductions caused by altering the structure of the tax system or doing away with some taxes entirely, and
- c) movements of businesses, capital and workers to another Member State of a non-member country because of changes in tax laws.

3.4.1.3. In all cases, the general fiscal problem of the taxpayer's ability to pay must be considered.

3.4.2. Fiscal Problems for the Community

As harmonization progresses in the tax rates, in abolishing old taxes and introducing new ones, the problem of Community taxes and/or Community financial adjustments will become more acute. Once this problem is solved, it will be easier to sort out many others.

3.4.3. Fiscal Problems in the Member States

The three main problems here are (i) the capacity to bear tax increases, (ii)

changes in the relative importance of direct and indirect taxes and (iii) losses of revenue due to various factors. The first two are a direct part of the harmonization process, while the third can be resolved only in conjunction with the question of Community taxes and Community financial adjustments. Complete tax harmonization would of course practically eliminate migration for tax purposes between member countries.

3.4.4. Fiscal Problems vis-à-vis Non-Member Countries

3.4.4.1. Measures to harmonize taxes in the Community could lead to a flight of taxpayers or taxable goods and activities to non-member countries because they are better off there. This problem should therefore be given adequate consideration in all harmonization measures. Also, sooner or later it will be necessary to conclude uniform if not Community, double taxation agreements with all non-member countries. It should not be individual Member States, but the Community Institutions who conclude such agreements with non-members. The cooperation between Member States' tax authorities and foreign governments, to curb international tax evasion, etc. should also be centralized. Only then it will be possible to resolve in a uniform manner the tax problems posed by multinationals with head offices or subsidiary companies outside the Community. These relate chiefly to transfer pricing and royalties.

3.4.4.2. Another problem is a Community tax policy towards developing countries, e.g. with regard to preferential treatment in double taxation agreements or the use of coffee duty to help the producing countries.

3.5. The Amount of Work Taxation Imposes on Taxpayers

The attitude of taxpayers to taxation depends not only on the rate of taxation, but also on whether a tax is simple, clear and readily understandable and on how much paperwork it involves (the requirements as regards keeping records and submitting returns). The speed at which harmonization measures are introduced will therefore have to take due account of the capacity of taxpayers in the different Member States to bear the administrative burdens involved. The alignment must be given time so that the changes do not overburden taxpayers. It is essential, also, that the tax harmonization be used to simplify the administrative formalities for the taxpayer.

The more simplicity and clarity harmonization brings into taxation, the easier it will make it to combat tax fraud.

3.6. Efficiency of Tax Administration

Tax laws alone say relatively little about the actual taxation situation in a country. The law only becomes meaningful with the use that is made of it. Therefore, at least as much importance must be assigned in the harmonization of tax law to

aligning the administration of taxation as to aligning substantive tax law. Otherwise, tax harmonization will remain to a large extent only on paper. One of the major tasks for tax administration is the joint and Community-level fight by all Member States against tax evasion.

The big problems in bringing Member States' tax administrations up to the same standard of efficiency lie in:

- a) the administrative structures,
- b) the number and, more important still, the quality of staff and the differences in mentality of the taxpayers.

4. The Objective of Tax Harmonization

4.1. The Objective seen from the purely Technical Angle

4.1.1. General

Ideas vary about the extent, the timetable and the associated political objective of tax harmonization. In this section we shall for the time being disregard the political objective and first try to establish, with a view to getting the widest possible agreement, exactly what is the minimum amount of tax harmonization required by the Treaty and its objectives. Different requirements emerge here for the different fields of taxation.

4.1.2. Excise Duties

4.1.2.1. Complete harmonization of excise duties is essentially if borders are really to disappear and persons and goods are to be able to move throughout the Community without let or hindrance. This would mean that by the end of harmonization there would generally be, except for excise duties of purely local interest:

- the same excise duties
- the same bases of assessment
- the same tax rates
- the same methods of collection.

4.1.2.2. The question whether all or some excise duties should eventually become Community taxes and, if not, whether financial transfers could become necessary if excessive distortions developed, and the form such transfers would take, will be considered in the section which discusses problems of tax harmonization with reference to the political objective.

4.1.3. Value Added Tax

Exactly the same as has just been said about excise duties also applies to turnover tax (now levied in all Member States as value added tax) since it has the general

characteristics of a tax on expenditure. However, VAT also resembles taxes on transactions in the technical point of being assessed at every stage, so that the country-of-origin principle referred to in 4.1.2.1. does not have the same significance in its case.

4.1.4. Transport Taxes

Previous Opinions of the Economic and Social Committee have stated that complete harmonization of mineral oil tax (also mentioned under excise duties) and of motor vehicle tax is desirable in the interests of smooth cross-frontier traffic and to avoid administrative friction. As was also stated in the Committee's Opinions, the tax harmonization must extend to the general renunciation of special transport charges including motorway tolls, which erect a sort of new 'frontier'.

4.1.5. Taxes on Transactions

What has just been said about taxes on the transport sector also applies to taxes on transactions, e.g. transfers of shares, except those which are of purely local interest and of no importance for the wider-scale legal transactions.

4.1.6. Taxes on Income and Wealth

4.1.6.1. In this field of taxation different degrees of importance exist. Despite freedom of movement for workers, harmonization of income tax on wages and salaries will not be essential, although really marked differences would definitely be undesirable, especially in connection with cross-frontier movements of labour. However, we will have to come back to this question in the chapter on the problems of harmonization with reference to the political objective, where we will relate it to social security contributions and transfer payments systems (e.g. the choice between family allowances and tax relief for dependent children), and widen it beyond the employee sector.

4.1.6.2. In the case of income tax on small businesses, harmonization is necessary, for competition reasons, for those elements of the tax that have a direct impact on costs. This would include the entire system of calculating profits. Fundamentally, therefore, it is a question of harmonizing the bases of assessment. Harmonization of the taxes as such and their levels is not necessary, unless — as will be examined later — political considerations lead to a different view.

4.1.6.3. If we are to have free movement of capital and mutual recognition of companies, a high degree of harmonization will be necessary in the case of corporation tax, including tax on dividends. The harmonization must cover the tax systems themselves, the bases of assessment, the rates and the administration.

4.1.6.4. For the objectives set out in the Treaty, harmonization of wealth taxes, including death duty, is not necessary, unless these taxes have business implications which interfere with competition. Whether, quite apart from this, harmonization should be aimed at for political reasons will be examined later.

4.1.6.5. The tax on trade and industry ('Gewerbesteuer') including payroll tax, which some people classify as a direct tax and others as an indirect tax, must definitely be completely harmonized because it has a considerable bearing on competition.

4.1.7. Local Taxes

Local taxes, whatever the nature of the levying authority — this is irrelevant for the decision whether or not to harmonize — clearly do not need to be harmonized insofar as they do not overlap with the types of taxes referred to above. Taxes such as dog licence fees, ice cream tax, publicans' licence fees, alcoholic drink duty, entertainment tax, etc. should be excluded from the outset from the moves towards harmonization. The same applies to those taxes on real estate which are purely and simply a levy on location in a specific place and which involve too small a sum to have a significant impact on costs and hence on competition.

4.2. The Objective from the Political Angle

4.2.1. General

4.2.1.1. The harmonization of taxation in the Community, which as we tried to show in paragraph 2.1. above, is necessary — though it need not go so far as a complete standardization — will provide a unique opportunity in the coming decades:

- to clear away the jungle of national and Community tax legislation;
- to make the tax system simpler and easier to understand and administer;
- to make the tax system more in keeping with social justice and maximum fairness of competition;
- to make for a better attitude towards taxation through optimum uniformity of taxation in the Community.

Therefore, before proceeding to individual measures we need to have an overall plan for tax harmonization, including, as an essential point, agreement on the desirable balance for the Community between direct and indirect taxation.

To meet the objectives set out above, all Member States should resolutely work towards a straightforward system of taxation, which current knowledge indicates should as far as possible be confined to the following major taxes:

- Income tax,
- Corporation tax,
- Wealth tax and death duties,

= three taxes on income and wealth ('direct' taxes);

- Value added tax

= general tax on expenditure, collected from the final consumer.

- Duty on mineral oils (perhaps including vehicle tax for cars),

- Duty on alcoholic beverages (including mixed drinks), i.e.
 - duty on spirits,
 - duty on wines (including sparkling wines),
 - duty on beer,
 - Duties on tea and coffee,
 - Duty on tobacco,
-
- = six excise duties ('indirect' taxes);
- Motor vehicle tax (where not incorporated in the duty on mineral oils, i.e. for commercial vehicles),
-
- = one general transport tax;
- Taxes on transactions;
 - Tax on real estate (property) as a local tax on location in the particular place.

Whether in addition local taxes, which are without significance from the harmonization angle, are needed and, if so, to what extent, should be left for the individual Member States to decide.

If the tax burden is not to become excessive, each transfer to the Community of the right to levy a tax must be accompanied by the transfer of the corresponding responsibilities and expenditure from the Member States to the Community.

4.2.1.2. The following table gives a percentage breakdown of total tax revenue in 1974 according to tax categories (see also *Appendix 5* and, for the key to the code, *Appendix 7*);

Category	B	DK	D	F	UK	Ir	I	L	NI
R 61	54.6	62.3	51.4	33.4	53.2	34.9	30.8	60.3	57.2
R 72	1.0	0.4	0.3	1.0	1.6	1.9	1.7	0.5	0.8
R 20	—	—	—	—	—	—	2.1	—	—
R 201	26.3	17.3	20.9	40.5	10.5	18.3	28.7	15.0	23.2
R 202	2.1	1.0	1.3	1.1	2.3	2.9	2.2	1.1	2.4
R 203	9.3	12.2	12.7	10.8	16.8	28.6	21.4	8.7	10.2
R 204	1.0	0.1	1.3	1.6	1.0	0.8	2.9	0.5	0.1
R 205	—	4.0	1.4	0.5	12.3	9.5	—	0.9	0.4
R 206	2.9	1.4	0.7	2.6	0.7	1.6	6.6	5.4	1.4
R 207	2.9	1.9	10.4	8.9	1.6	1.5	2.7	8.0	4.0
	99.1	100.6	100.4	100.4	100.0	100.0	99.1	100.4	99.7

Revenue from social security contributions (R 62) stood at the following percentages of tax revenue:

45.8	1.3	50.8	63.5	22.7	13.2	0.07	39.6	65.4
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4.2.1.3. The breakdown of tax revenue plus social security contributions in 1974 was as set out below (see also Appendix 4). The figure for Italy disagrees with the 0.07% just quoted.

Category	B	DK	D	F	UK	Ir	I	L	Nl
R 61	37.7	62.2	33.7	20.4	43.4	30.9	20.9	43.2	34.8
R 72	0.7	0.4	0.2	0.6	1.3	1.7	1.0	0.4	0.5
direct taxes	38.4	62.6	33.9	21.0	44.7	32.6	21.9	43.6	35.3
R 62 = Social se- curity con- tributions	31.4	1.3	33.7	38.8	18.5	11.7	41.7	28.4	39.6
direct taxes plus social security contribu- tions	69.8	63.9	67.6	59.8	63.2	44.3	63.6	72.0	74.9
R 201	18.1	17.1	13.8	24.8	8.6	16.1	16.8	10.7	14.0
R 203	6.4	12.0	8.4	6.6	13.6	25.3	12.6	6.2	6.2
Value added tax and ex- cise duties	24.5	29.1	22.2	31.4	22.2	41.4	29.4	16.9	20.2
Other	5.7	7.0	10.2	8.8	14.6	14.3	7.0	11.1	4.9
of which R 205 = real estate (property) tax	—	3.9	0.9	0.3	10.1	8.4	—	0.6	0.2
of which R 207 = tax on trade and industry, etc.	1.6	0.7	6.9	5.2	1.3	1.4	1.6	5.4	2.4

4.2.1.4. The 1976 'Eurostat' tax statistics covering 1970-1975 give the following percentages for 1975:

Category	B	DK	D	F	UK	Ir	I	L	Nl
R 61	40.0	60.9	31.6	18.4	45.2	31.6	23.7	39.4	35.1
R 72	0.7	0.3	0.1	0.7	0.8	1.1	0.2	0.3	0.4
direct taxes	40.7	61.2	31.7	19.1	46.0	32.7	23.9	39.7	35.5
R 62 = social se- curity con- tributions	31.5	1.4	35.7	39.9	18.2	15.0	44.4	30.5	39.4
direct taxes plus social security contribu- tions	72.2	62.6	67.4	59.0	64.2	47.7	68.3	70.2	74.9
R 201	15.7	17.4	14.0	23.4	8.7	14.6	14.4	11.9	14.1
R 203	6.5	13.4	8.4	6.2	12.4	25.7	13.5	7.4	6.0
Value added tax and excise duties	22.2	30.8	22.4	29.6	21.1	40.3	27.9	19.3	20.1
Other	5.6	6.6	10.2	11.4	14.7	12.0	3.8	10.5	5.0
of which R 205 = real estate (property) tax	—	4.0	1.1	1.3	10.8	7.1	—	0.6	0.2
of which R 207 = tax on trade and industry, etc.	1.8	0.7	6.6	6.5	1.0	1.1	1.1	5.6	2.4
Remainder	3.8	1.9	2.5	3.6	2.9	3.8	2.7	4.3	2.4

It is amazing how much the proportions have changed in just one year, sometimes the movement being the opposite way to the convergence that is vital for harmonization. This shows very clearly the need to coordinate during harmonization, through compulsory consultation on the part of the Member States.

4.2.1.5. It is clear that the question of what to put into each group is not always straightforward and this must be cleared up if there is to be full comparability. For example, the German 'equalization of burdens' levies, now being phased out, must be omitted from R 61, while the French 'taxe professionnelle' which superseded the 'contribution des patents' on 1 January 1977 and is more significant than its predecessor, ought to be included in R 207. The same goes for all the other major changes that have since taken place.

4.2.1.6. Despite their undoubted imperfections, it is possible to see from the tables where in theory, i.e. regardless of political considerations, the main problems would lie in bringing the various tax systems to a common denominator:

- Belgium would have to reduce the proportion of direct taxes (R 61) and increase that of excise duties (R 203);
- Denmark would have to cut the proportions of VAT (R 201) and excise duties (R 203) and increase those of direct taxes and social security contributions (R 61 and R 62);
- Germany would have to reduce the importance of the tax on trade and industry (R 207) and increase that of VAT (R 201);
- France would have to rely less on VAT (R 201) and more on direct taxation (R 61);
- The United Kingdom would have to lower the proportions of real estate taxes (R 205) and excise duties (R 203) and raise those of VAT (R 201) and social security contributions (R 62);
- Ireland would have to reduce its dependence on excise duties (R 203) and increase the share of direct taxation (R 61) and social security contributions (R 62), which is particularly difficult until incomes go up sufficiently to make higher direct taxes possible;
- Italy would have to cut back on excise duties (R 203) and raise direct taxation (R 61);
- Luxembourg would have to lower direct taxation (R 61) and instead increase value added tax (R 201) and excise duties (R 203);
- The Netherlands would have to rely less on direct taxation and social security contributions (R 61 and R 62) and more on excise duties (R 203).

4.2.1.7. If we accept as about right an indirect tax share of approximately one third of total tax revenue or one quarter of total revenue including social security contributions (see 3.1.3. above), at the end of harmonization we could aim to have in the Member States tax systems looking approximately (not necessarily exactly) like this:

	Percentage of total revenue	
	excluding social security contributions	including
Direct taxes (R 61 and R 72)	55	70
Value added tax (R 201)	23	16
Excise duties (R 203)	12	9
Other taxes	10	5
	35	25

4.2.1.8. The basic political decision on the proportions of different kinds of taxes should be taken as quickly as possible so that the goal to be steered towards in the coming decades is clearly fixed. Only in this way will it be possible to keep Member States from adopting new taxation measures in the meantime which are in conflict with this goal.

4.2.2. Value Added Tax

4.2.2.1. If the frontiers in Europe are to disappear completely one day, full harmonization of value added tax with regard to

- the basis of assessment,
- exemptions (including zero-rating),
- rates, and
- collection

is essential. This harmonization should be synchronized with the harmonization of excise duties. A Community administration of value added tax is not necessary, but there must be a guaranteed uniform system for its collection by the Member States' tax authorities. A system of financial adjustment out of the portion of VAT revenue paid to the Community or out of the VAT revenue of the individual Member States will be absolutely necessary with the final abandonment of adjustments at frontiers, for otherwise those Community countries with big export surpluses would reap most of the benefit.

4.2.2.2. Just how difficult harmonization will be is shown by the differences between the contributions of VAT to total tax revenue in 1974:

	Percentage of total revenue from VAT (R 201) in 1974	
	without (see Appendix 5 and para. 4.2.1.2.)	with Social Security Contributions (see para. 4.2.1.3.)
Belgium	26.3	18.1
Denmark	17.3	17.1
Germany	20.9	13.8
France	40.5	24.8
United Kingdom	10.5	8.6
Ireland	18.3	16.1
Italy	28.7	16.8
Luxembourg	15.0	10.7
Netherlands	23.2	14.0

However, there has probably been some improvement in this state of affairs in the meantime, because of changes in the rates of VAT, so that the discrepancies may not now be quite so great.

4.2.2.3. The following schedule for harmonization should be aimed at, provided agreement can now be reached on a uniform (mathematical) basis of assessment:

- by 1985, full (not simply mathematical) standardization of the basis of assessment;
- by 1990, standardization of tax exemptions (including zero rating);
- by 1995, standardization of rates and collection.

4.2.2.4. At the moment, it looks as if it might be possible to agree on a standard rate of between 15 and 18%, with the special rate for non-zero-rated basic necessities, mainly for social reasons, not exceeding a third or so of the general rate, i.e. 5 – 6%. For practical reasons, particularly the demarcation difficulties and the associated danger of abuses, there should be no further differentiation of the VAT rate. Special rates could, however, perhaps be introduced to replace taxes on transactions if it is decided to abolish these and incorporate them in VAT. Zero-rating, on the other hand, will no longer be needed once there has been a clear decision on exemptions and there is a determination to refrain from unverifiable hidden subsidies.

4.2.3. Excise Duties

4.2.3.1. If the opportunity tax harmonization provides of making taxes easier to understand, comply with and administer is to be taken, one of the most urgent tasks is to clear the jungle of excise duties which exists today. First to be tackled must be the major excise duties, which for administrative reasons and so as to

have the same quantitative incidence are generally collected from the producer or the importer when the taxable goods are put into circulation.

4.2.3.2. Excise duties on top of VAT must either be charged on all the goods in a category, including substitutes, or not at all. Thus, a duty on matches but not on flints is illogical and arbitrary. So, too, is a duty on edible fats which covers margarine but not butter. The same applies to a duty on alcoholic drinks which leaves wine as the only form of alcohol not taxed as is the case in Germany (though some people would nevertheless argue against subjecting wine to an excise duty). The following measures are therefore necessary to streamline the excise duty system, synchronized as far as possible with the VAT harmonization.

4.2.3.3. Apart from any purely local taxes (section 4.2.6.5.) only the following excise duties should be levied on top of VAT:

- duty on mineral oils,
- duty on alcoholic drinks (including mixed drinks) =
 - duty on spirits,
 - duty on wine and sparkling wine,
 - duty on beer,
- duty on tobacco;

plus duties on tea, coffee, cocoa, bananas, etc. to the extent that these are still charged in the Member States, and as long as they are not, or cannot be, turned to the benefit of the developing countries, by either abolishing them but keeping the old prices so that the exporting countries in fact receive a higher price, or abolishing them and reducing the price so that consumption rises (care would have to be taken to ensure that importers or dealers did not cash in on the abolition of the duty).

4.2.3.4. There remains the question — which will have to be decided at political level — whether the mineral oil duty charged to cover road costs should eventually be expanded into an excise duty on all forms of energy consumption. The point made in 4.2.3.2. argues in favour of this, particularly since mineral oil duty is already being charged on fuel oil and, in Germany, for instance, a quasi-fiscal charge in aid of coal is being levied on electricity consumption.

4.2.3.5. In the final phase of tax harmonization, these excise duties on top of VAT should be subject to Community rules to ensure a uniform manner of collection. To obviate the need for a financial equilization system (see paragraph 3.2.1.3.), which would be almost impossible to operate, it may be necessary for these duties to become Community taxes, administered by the Community.

4.2.3.6. Where Community taxes are levied, the Community should of course take over the financing of expenditure equivalent to that previously funded by the revenue from the transferred national taxes.

4.2.3.7. These excise duties must be fully standardized with regard to:

- the basis of assessment (tax on weight or volume),
- tax exemptions,
- tax rates and
- tax collection (from the producer or importer, perhaps using the simple and foolproof system of revenue stamps for tobacco and alcohol, except beer).

4.2.3.8. Other excise duties not simply collected locally at the point of consumption should be abolished. They are either illogical and arbitrary (e.g. duties on margarine, on matches and on table water and lemonade), could in view of their low yield easily be dispensed with in aid of greater clarity (e.g. duties on playing cards and on sugar), or should be abolished for both these reasons (e.g. duty on salt but not on other spices, duty on vinegar but not on lemon, duty on electric lamps but not on other types of lamps).

4.2.4. Transport Taxes

4.2.4.1. The conclusions already reached by the Economic and Social Committee with regard to the taxation of transport should basically be adhered to. Consequently it is proposed that harmonization should be on the following lines.

4.2.4.2. The only taxes on transport should be the duty on mineral oils (perhaps as a general energy tax) and motor vehicle tax. Other taxes should be dropped, as should be road tolls, which are tantamount to the erection of new barriers.

4.2.4.3. Motor vehicle tax should be harmonized in line with the harmonization of excise duties (duty on mineral oils). This particularly applies to commercial transport (lorries, articulated lorries, trailers, buses). For private transport (cars and motorcycles) the complete charge for the use of roads should be included in the mineral oil duty. Only if inclusion of a motor vehicle tax portion in mineral oil duty fails or is not completely successful, should an annual flat-rate non-reimbursable duty be levied to pay for normal and peak-hour road use.

4.2.5.1. As part of the harmonization process, capital duty should be dropped

4.2.5.1. As part of the harmonization process, capital duty should be dropped completely, as has the tax on securities, so that a single tax on capital transactions, the stock exchange turnover tax remains. This tax should be harmonized.

4.2.5.2. It will have to be decided whether real estate transfer taxes, insurance tax, the tax on fire insurance and similar taxes on transactions which are not simply of local significance (such as taxes on mortgages and rents) should be incorporated in VAT with special rates perhaps), or should continue to exist as separate taxes. In the latter case, they would have to be harmonized step-by-step in line with the harmonization of VAT so that they do not impede the free movement of capital.

4.2.5.3. There is no fundamental need to harmonize betting and gaming taxes.

4.2.6. Taxes on Income and Wealth

4.2.6.1. Corporation Tax

Sooner or later corporation tax will have to be harmonized. Capital yield tax ('Kapitalertragsteuer') must be included in the harmonization, and the question of mergers, disbanding of associated firms and the changing hands of whole firms or parts of firms must also be dealt with. This is the only way to ensure an undisturbed movement of capital without distortions of competition. However, there is no need for the harmonization of corporation tax to go the whole way to standardization. Certain margins in the level of tax (the tax rates) will be tolerable if it proves possible to standardize the main tax bases used in determining profits (depreciation, reserves, provisions for special contingencies, profits on sales of assets, losses brought forward, loss carry-back, valuation of stocks, etc.). The Economic and Social Committee has already approved the move towards harmonization insofar as it has endorsed the system of partial imputation with margins, in which withholding tax is also included. The harmonization should be continued on the same lines.

As part of the harmonization process solutions are also urgently needed to the problems of investment companies and transfer pricing between associated firms or parts of firms.

4.2.6.2. Income Tax

The comments on corporation tax apply *mutatis mutandis* to the tax levied on the income of small businesses because only then can distortions of competition between firms subject to corporation tax and businesses subject to simple income tax be avoided.

Harmonization in the area of income tax and particularly that on wages and salaries should confine itself, including social security contribution in the picture, to setting margins of at most 10 percentage points for the bottom and top rates on the progressive scale, with the basis of assessment also largely standardized. For example, if the bottom and top rates were set at 15% and 60% respectively, the Member States could then set their bottom and top rates anywhere between 10 and 20% and 55 and 65%. To work properly, however, a system with margins must be sure not to be undermined by wildly differing allowances or other big differences in the rules on the calculation of income.

4.2.6.3. Death Duties

In the final phase of tax harmonization, alignment of death duties would appear to be necessary because of their impact on long-term business planning and the need to avoid major transfers of taxation between Member States. Both the basis of assessment and the tax rates (including tax exemptions) should be harmonized. Of particular importance is a clear definition of the local responsibility for tax-

ation among the Member States so as to counter unjustifiable transfers. A gradual start should be made on the harmonization of death duties so that it is completed by the end of the general process of tax harmonization in the EEC.

4.2.6.4. *Other Current Taxes on Income and Wealth*

Wealth tax, which exists only in Denmark, Germany, Luxembourg and the Netherlands, at varying rates, could be abolished for natural persons in the course of the harmonization process if the right structure were found for death duties and real estate duty. For legal persons, especially limited companies, which are not liable to death duties, a wealth tax according to the tax situation of such companies, in lieu of death duties, must be retained, so that there are equal conditions of competition between partnerships and limited companies.

There is another, very firmly held, point of view on this, resting on compelling political grounds, namely that a wealth tax should be generally introduced in all Member States in the course of harmonization and its basis of assessment harmonized, as would anyway be necessary for a wealth tax on legal persons. The argument is used that there must surely be a good reason why four Member States have a wealth tax. A general wealth tax is considered to be vital as a social leveller, particularly since wealth is generally even more unevenly distributed than income.

But there are strong arguments against a wealth tax for natural persons:

- a) Wealth tax treats something which is dynamic as static since property and liabilities are not calculable with any certainty in the medium and long term.
- b) The data used for valuating assets for a wealth tax are highly questionable (e.g. fluctuating prices, machinery and plant not being used to capacity, land, etc.).
- c) The possibility of valuing assets varies greatly from one type to another, and this is bound to lead to extremely different tax assessments.

These injustices attaching to wealth tax as a tax independent of return or earnings on the asset (i.e. excluding the cases where, against the nature of a wealth tax, return is used as an assessment criterion) are impossible to overcome in practice. The tax on trade and industry and payroll tax (i.e. a tax paid by employers on the number of people on the payroll), which is to be found as such only in Germany and Luxembourg, though in a quite different form it also existed, and still in fact exists, to some extent in France as the 'contribution des patents' (up to 1976) and the 'tax professionnelle' (since 1977), should be abolished in the harmonization. For Germany and Luxembourg the obvious step would be synchronization with the harmonization of VAT, whereas in France there would have to be a shift to direct taxes. A gradual start should be made on this.

4.2.6.5. *Local Taxes*

The local taxes listed in Appendix 8 need not be harmonized. Nonetheless, they should be streamlined. These taxes generally provide very little revenue and should be abolished as far as possible for the sake of clarity.

This does not apply to real estate taxes, which are very important in the United Kingdom and Ireland and moderately important in Denmark, as these taxes' shares of the total tax revenue in these countries (12.3%, 9.5% and 4.0% respectively in 1974, or as a proportion of total tax revenue plus social security contributions 10.8%, 7.1% and 4.0% for 1975) testify. It will not be necessary to harmonize these taxes in detail, but in the general move towards tax harmonization it will not be possible to avoid substantially reducing their revenue and in return increasing that of other taxes (VAT in the United Kingdom and Denmark and direct taxes in Ireland) because of the need for harmonization of the latter. In the countries which now have a wealth tax it would be possible to raise their currently very low real estate duty in return for complete or partial abolition of the wealth tax.

4.2.7. Administration of Taxation

4.2.7.1. If the administration of taxation is not more or less the same everywhere, tax harmonization will remain an unsatisfactory mass of paper and will meet with great resistance. Therefore, the material harmonization of taxes must be backed up with:

- a constant campaign to bring the attitudes of taxpayers in different countries more into line,
- moves to bring about greater similarity between the staff of tax administrations, by extending staff exchange schemes, aligning the general and vocational training of tax officials and the content of their jobs, standardizing and coordinating career structures, harmonizing administrative structures, and aligning working conditions
- through to setting-up the Community administration which might be required for assessing and collecting customs duties on imports from non-EEC countries and the major excise duties (excluding VAT).

4.2.7.2. In addition, there must be a guarantee of comprehensive and unrestricted mutual administrative and legal assistance in all fields of taxation, particularly to combat tax fraud and tax evasion. These moves to harmonize the administration of taxes must run parallel with the harmonization of taxes in substantive law. They are particularly urgent in cases where extensive scope for tax evasion due to regional differences needs to be eliminated.

5. Summary and Conclusions

5.1. Harmonization of taxes must be advanced at a quick pace if the Community is to become a reality, and if it is to have taxation as one of its instruments so as to be capable of tackling urgent political issues where moves by individual countries are no longer of any help. To this end, value added tax and excise duties as well as taxes on transport and transactions should be gradually harmonized, according to a timetable, with 1990 or thereabouts as the date for completion of this harmonization. The other taxes and the administration of taxation

should also gradually be harmonized, paying due regard to the variety of practice and experience, with 1995 as the completion date.

5.2. The Economic and Social Committee does not imagine that, in presenting this Information Report, it has submitted a self-contained plan for the harmonization of taxes in the EEC, solved the immensely difficult political and technical questions of tax harmonization in the Community for the individual Member States, or has been able to make any decisive contribution towards bringing about this harmonization. Three points are important, it thinks, as the outcome of this Information Report:

- a) The Economic and Social Committee is presenting in this Information Report the interest groups' views on the general issues of tax harmonization. In future it will not need to debate the underlying principle of tax harmonization and the goal of such harmonization each time it is consulted on individual measures.
- b) The Commission and the Council, together with the European Parliament should, notwithstanding all the extraordinary difficulties and resistance, without delay work out their blueprint for tax harmonization and in so doing take account of the views of the Economic and Social Committee, for only if they do these two things will the individual measures have a context and will they be easier to implement politically.
- c) The Member States are urged to refrain from taking divergent action in the field of taxation, to keep to the Community's objective in this field, and to undertake to engage in prior mutual consultations where this objective may be affected.

A Europe without frontiers and without tax barriers needs tax harmonization.

6. Dissenting Opinion

6.1. Since agreement could not be reached in the Section about certain parts of this Information Report, both on general principles and on points of detail (and particularly on the section about the objective of harmonization seen from the political angle), a note of dissent must be added as a counterbalance to the point of view put forward in the Information Report. Many members of the Section take the view that the proposal made in the Information Report goes much further in regard to both the extent and the timing of tax harmonization than is required by the Treaty or by practical need. Their reasons for this belief are as follows:

- a) Owing to the differing, historically evolved social and economic conditions in each of the Member States, financial and fiscal policy which is tailored to these various conditions and should continue to be tailored to them in the future, must as far as possible remain within the jurisdiction of the Member States.
- b) Only the measures expressly provided for in the EC Treaties should be implemented, with a reasonable timescale, giving priority to uniform monetary policy.

- c) Tax harmonization should be confined to the measures which are essential for free movement and for preventing distortions of competition.

6.2. It is considered inappropriate to carry tax harmonization further than these three principles.

The following comments are thus made on pages 46 ff. of the Information Report.

An Information Report on tax harmonization should initially confine itself to a careful description of the situation in the various Member States, in order to gain a better idea of the divergence and differences between them.

After that one might proceed to establish the principles of a strategy for a certain degree of harmonization. However, one cannot go so far as to lay down the blueprint and the radical measures for the alignment of the Member States current tax and social security revenue. This would be to ignore the possible political consequences of such a radical uniform blueprint in particular Member States.

Moreover, it is to be feared that such a blueprint would be viewed by the Commission and the Council, or at least by some individual Member States, as unrealistic and would thus be liable to reduce the document's overall impact. The aim therefore should be to prepare the way for subsequent steps, rather than trying to cover all the ground at one go.

Done at Brussels, 12 July 1978.

The Chairman
of the
Section for Economic and
Financial Questions

Alfons MARGOT

The Rapporteur
of the
Section for Economic and
Financial Questions

Hermann FREDERSDORF

Acting Secretary-General
of the
Economic and Social Committee

Roger LOUET

Appendices (not reproduced)

1. Memo on Action Programme for Taxation
2. Relevant Articles of the Treaty
3. Levels of Taxation including Social Security Contributions
4. Tax Revenue by Category of Taxes in 1974
5. List of Taxes and Social Security Contributions in the Member States in 1974
6. Tax Harmonization: Progress to Date
7. Key to Code Numbers of Tax Categories
8. Local Taxes.