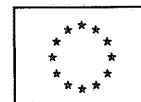
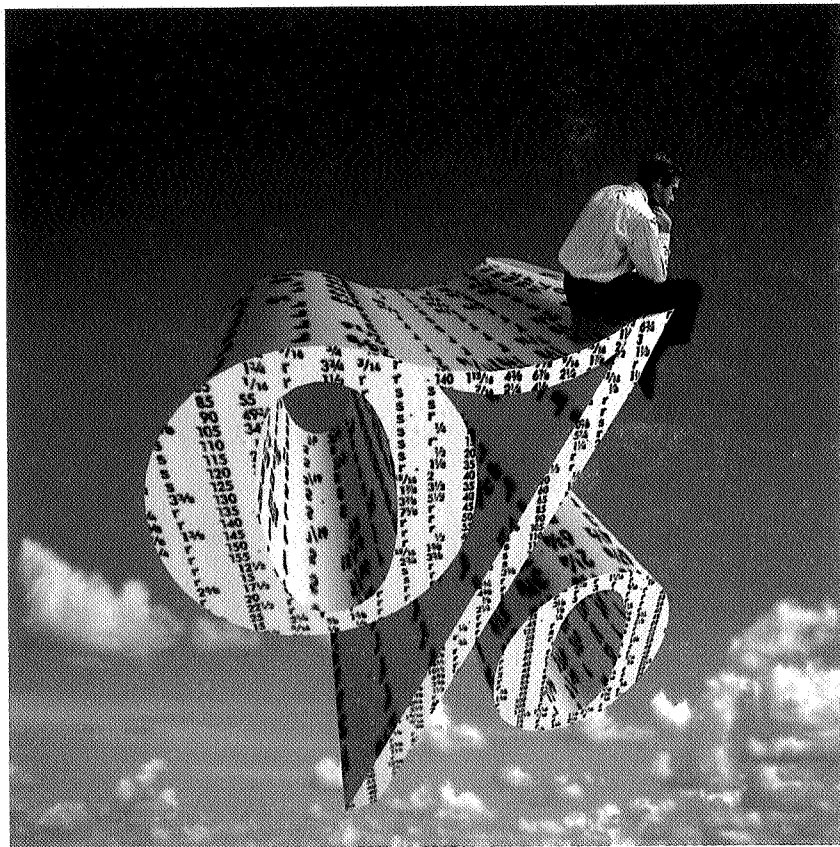
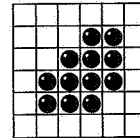


TAXATION IN THE SINGLE MARKET





Community tax policy aims for tax harmonization where this contributes to the smooth functioning of the European Community's single market. Harmonization involves both direct and indirect taxes.

Tax harmonization not only will have to facilitate freedom of movement but will also have to be accompanied by a substantial easing of the administrative burdens on firms and individuals.

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INTRODUCTION

■ ROLE OF TAXATION IN THE SINGLE MARKET

Approval by the European Council, meeting in Milan in June 1985, of the Commission's White Paper on completing the internal market marks a turning-point in the process of European integration. The Single European Act, which came into force in 1987 following its ratification by national parliaments, incorporated the internal market objective into the European Treaties. It was the first time the Treaties setting up the European Community had been amended. Article 13 of the Single European Act introduces into the EEC Treaty a new Article 8a, which defines the internal market as 'an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured'. The date set for completion of the internal market is 31 December 1992.

However, this objective is not entirely new. The Treaties of Rome, signed in 1957, provided for the establishment of a 'common market'. But, although the customs union was completed even before the deadline set in those Treaties (1968), the initial impetus slackened. The integration process entered a phase of stagnation. This situation was even dubbed 'Eurosclerosis'.

Some 10 years then elapsed before it was realized that a new impetus was required. The Community became aware of the benefits that a large and truly integrated market of 325 million consumers could bring for firms and individuals alike: creation of new jobs, faster growth, improved competitiveness. The Single European Act not only breathed new life into the internal market objective, it also speeded up and facilitated decision-making in the Community. Most decisions could henceforth be adopted by a qualified majority. An important exception is taxation, an area in which the unanimous vote of the Member States is

required. This goes some way towards explaining why the decision-making process as it affects tax matters remains slow and cumbersome.

One of the three major chapters in the White Paper, which lists the measures judged to be necessary to create the internal market, is devoted to taxation. The measures envisaged in this chapter relate solely to indirect taxation, since this is the area which gives rise to checks at frontiers between Member States. One of the principal reasons for frontier checks is the need to levy or monitor VAT and excise duties. As long as appreciable differences in VAT and excise-duty rates persist, Member States will be justified in carrying out frontier checks to ensure that the tax revenue to which they are entitled accrues to them and to prevent fraud. The abolition of tax frontiers, which plague both firms and individuals alike, is therefore a key element in the moves to complete the internal market.

Direct taxation (taxation of company profits, income tax, etc.) does not necessitate frontier checks. Nevertheless, national provisions exist which erect, as it were, invisible frontiers that hamper cooperation between firms from different Member States. Take in particular double taxation, which impedes, for example, mergers between firms established in different Member States. Elimination of such double taxation is therefore an integral part of the programme for completing the internal market.

■ LEGAL BASES FOR TAX HARMONIZATION IN THE TREATY

The 1957 Treaty of Rome provides for the establishment of the common market and for the progressive approximation of the economic policies of Member States. Articles 95 to 99 concern taxation, with Articles 95 to 98 being designed primarily to

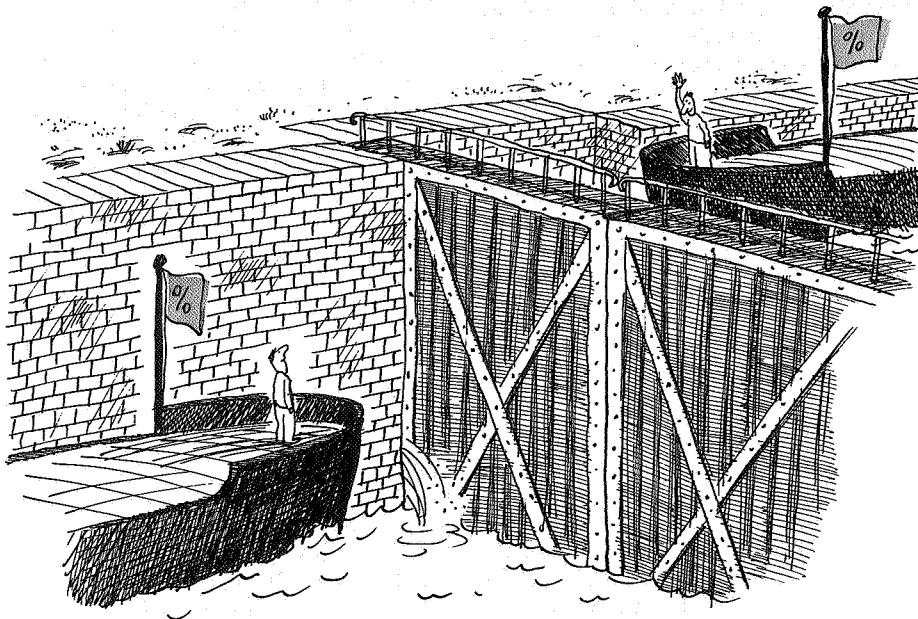
supplement the rules concerning the removal of obstacles to the free movement of goods.

They prohibit discrimination in the tax treatment of similar domestic and imported products as well as any repayment of 'internal' (i.e. domestic) taxation in excess of that charged. It should also be noted that these articles are concerned simply with the taxation of products. In other words, they do not cover taxes imposed on the producing enterprise itself or, more especially, on individuals (i.e. what are generally called 'direct taxes').

Article 99 was, in its initial version, more general in scope, providing for the harmonization of indirect taxes in the interest of the common market. It constitutes the basis for the Community VAT system. It was amended by the Single European Act to reflect the needs of the internal market: 'The Council shall, acting unanimously on a pro-

posal from the Commission and after consulting the European Parliament, adopt provisions for the harmonization of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonization is necessary to ensure the establishment and the functioning of the internal market within the time-limit laid down in Article 8a'. This condition of necessity underlies the Commission's measures to abolish tax frontiers.

The legal basis for the harmonization measures in the field of direct taxation is Article 100 of the EEC Treaty, which is very general in nature and provides as follows: 'The Council shall, acting unanimously on a proposal from the Commission, issue directives for the approximation of such provisions laid down by law, regulation or administrative action in Member States as directly affect the establishment or functioning of the common market'.



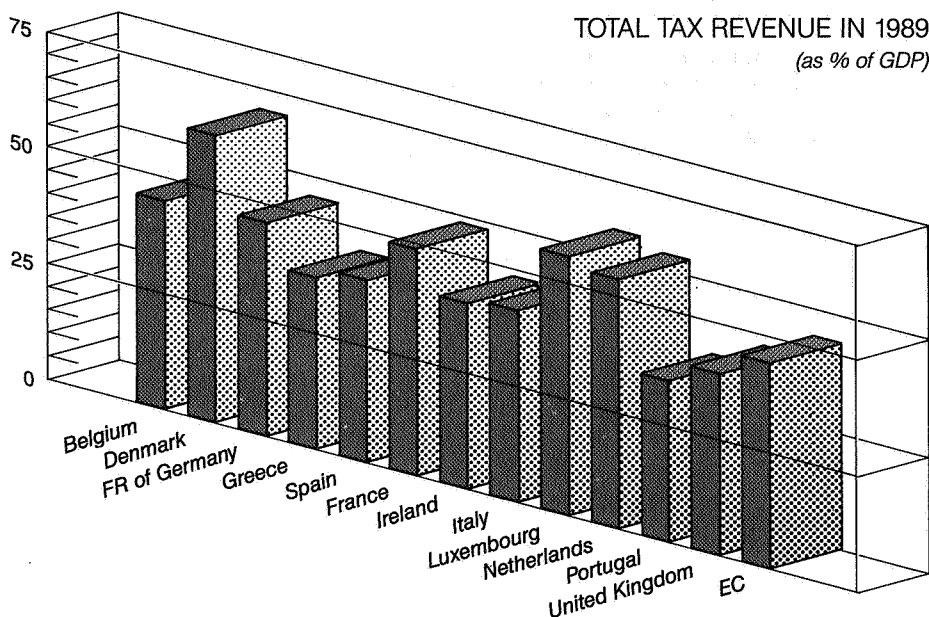
It is this concept of 'direct effect' in particular which, until now, has limited the Commission's scope for action.

The emphasis, therefore, has been on the harmonization and approximation of indirect taxes, the idea being that these directly and visibly affect trade between Member States and can distort competition. Though perhaps less visible, direct taxes on a firm's profits, capital, etc. are also important for competitiveness. Aware of this situation, the Commission has launched a number of initiatives to harmonize or at least to bring more closely into line the structures of company taxation. As yet, these initiatives have

not borne fruit. The question which has still to be examined concerns the extent to which the harmonization or approximation of direct taxation is necessary.

Pending completion of the internal market, we are therefore faced with a situation in which the common tax base is fairly broad for indirect taxation but very narrow for direct taxation. If tax frontiers in the internal market are to be abolished, indirect tax measures are essential. Abolition of the double taxation of firms is also important. Even so, progressive integration in the Community might lead to an approximation of direct tax systems.

TAXATION IN THE COMMUNITY



Before analysing the Commission's proposals in the tax field, it would be useful to take a general look at the current structure of taxation in the Member States.

financial centre, a large proportion of its tax revenue is not derived from Luxembourg residents.

■ TAX RATIO

In order to be able to make any judgment about the tax structure in Member States, we need first to take account of tax revenue expressed as a proportion of gross domestic product, i.e. the tax ratio.

The tax ratio in the Community has increased on average by some five percentage points per decade, rising from 34.9% for the period 1961-70 to 39.4% for the period 1971-80 and to 43.6% by 1989.

The tax ratio is highest in Denmark, Luxembourg, the Netherlands and France. Luxembourg is a special case in that, as a major

■ DIRECT AND INDIRECT TAXATION

In assessing the Community's tax problems, it is important to examine not only the level but also the composition of total taxation, i.e. the relative weights of direct and indirect taxation.

'Direct taxation' refers to the taxes which are imposed directly on individuals or firms, with the requirement that they transfer the corresponding amounts to the Treasury. It covers, for example, personal income tax, corporation tax, inheritance tax, etc.

In the case of indirect taxation, the taxes are included in the price of goods or services and

are therefore borne by the final consumer. However, it is the enterprise selling the goods or services which transfers the corresponding amount of tax to the Treasury. The person liable to pay the tax is not therefore the same as the person who bears the tax charge. The most common indirect taxes are VAT (value-added tax) and excise duties (special taxes on the consumption of certain goods such as tobacco, alcoholic beverages and mineral oils).

The breakdown of the tax burden as between direct and indirect taxes varies fairly widely from one country to another, and this clearly has an important bearing on tax harmonization.

In the case of direct taxes in 1986, the tax burden measured as a proportion of GDP was highest in Denmark at 28.4%, followed by Belgium and Luxembourg (18.3%), a

number of other countries (between 13% and 15%) and then a group made up of the three Mediterranean countries that joined the Community on the occasion of its most recent enlargement and France (8%), with Greece in last position with 6.4%. The Community average was 13.6%, with the Federal Republic of Germany, Italy, the Netherlands, Ireland and the United Kingdom all around that level. The gap between the lowest and highest figures (22 percentage points) was much wider than in 1965 (11.7 percentage points) (see Table 2).

In the case of indirect taxation, the average for the Community of Twelve was 12.8%. The figure was above 15% in four countries (Greece, Portugal, Ireland and Denmark, with the latter recording the highest figure—17.9%). The United Kingdom, France, the Netherlands, Belgium and Luxembourg

TREND OF DIRECT TAXES

TAXES ON INCOME AND PROFITS (as % of GDP)

	1965	1980	1986
Belgium	8.5	17.8	18.3
Denmark	13.7	25.0	28.4
France	5.6	7.6	8.0
FR of Germany	10.7	13.3	13.0
Greece	2.0	5.5	6.4
Ireland	6.7	12.4	14.5
Italy	4.2	9.3	13.7
Luxembourg	10.9	17.7	18.3
Netherlands	11.9	15.1	12.6
Portugal	4.5	5.7	6.9
Spain	3.6	6.3	7.6
United Kingdom	11.3	13.3	14.9
EC	7.8	12.4	13.6

Source: OECD.

