

TAX HARMONIZATION
IN THE EUROPEAN COMMUNITY -
PROTECTIVE ELEMENT ?

Address by
Mr. H. SIMONET
Vice-President
of the
Commission of the European Communities

at

the Law School - University of Harvard

on

28th March 1974

1
Tax Harmonization in the European Community -
protective element ?

I. Introduction

1. When speaking about taxation in the European Communities the subject has to be approached from two angles :

Viewed from the angle of the Community, there is a well-known necessity to harmonize national tax systems. Tax laws and tax rules are adapted to domestic policy objectives. It is the task of tax harmonization policy to adjust national tax systems and tax laws to the objectives of economic, social and political integration in the Community. This does not, however, mean unification or equalisation of taxation ; no "l'art pour l'art" is intended.

Seen from the point of view of the Member States, we have to start from the fact that taxes are no longer neutral revenue-raisers. In modern economies they have become instruments for policy on stabilisation, on distribution of private income, on the allocation of resources between public and private sectors as well as between regions and industries.

As ... other Community policies the tax harmonization policy also has to find solutions which are acceptable to Member States and to Community requirements as well.

2. It is somewhat surprising that there is only one clause in the Rome Treaty which explicitly mentions harmonization of taxes in the Community. This is Article 99 and even here the only reference is to the harmonization of indirect taxes, the most important of which are turnover taxes and excise duties.

Article 99 requires the Commission to propose ways and means of harmonizing national legislation on indirect taxes in so far as this is in the interest of the Common Market. However, the fact that the Treaty does not explicitly mention harmonization of direct taxes does not mean that the Treaty does not provide a basis for this being done. Authority for action in the field of direct taxation is found in a general provision (Article 100) which instructs

- 2 the Commission to make proposals for the approximation of those legal provisions of Member States which directly affect the establishment or functioning of the Common Market. So there is no doubt that Article 100 implicitly covers harmonization of direct taxes.

It seems clear, however, from the marked difference between the attitude to harmonization of indirect taxes on the one hand and of direct taxes on the other that the authors of the Treaty regarded the harmonization of turnover taxes and excise duties as a matter of primary importance. The Commission has, therefore, from the very outset given top priority to the harmonization of indirect taxes, and turnover taxes in particular.

3. The Resolution of the Council and of the representatives of the Governments of the Member States of 22 March 1971 on the achievement of economic and monetary union confirmed the principle whereby, at the end of the process leading to this union, the Community is to constitute an area within which not only goods and services but also persons and capital will move freely and without distortion of competition.

The problems to be solved in the field of direct taxation therefore relate mainly to taxation of capital movements (European capital market) and the removal of fiscal barriers hindering links and mergers between firms of different Member States (European industrial policy).

4. Since we are aiming at economic and monetary union, taxes must more than ever be considered from the point of view of economic management at the Community level. Compared to Member States' budgets the size of the Community budget is rather small; the potential of the Community budget cannot for the time being play a decisive role in stabilisation and structural policies, which will therefore have to be done by means of coordinating national policies. To improve coordination, national fiscal instruments will have to be harmonised and Community instruments created.

For that reason, certain areas of taxation may have to be included in the process of harmonization, quite apart from the aspect of free movement of products and factors of production.

3 Let me now outline - at least for the main fields of tax harmonization - the progress achieved until today and the future projects. At the same time we should examine possible protective elements in these areas of European tax policy.

I should, however, like to begin with some statistics showing the differences between the tax structures of the EC-countries and the United States.

II. Tax structures in EC and US

European countries are high tax countries compared to the United States: In 1971 the US total tax revenue came to 27.77 per cent of GNP, compared to Italy 31 per cent, Germany 34.5 per cent, Belgium, France and United Kingdom nearly 35.5 per cent and Denmark 44 % (Table 1).

If we compare the taxes on income and profits ("direct taxes") as a percentage of GNP between the United States, coming to 13 %, and the EC Member States, we are getting rather similar figures: United Kingdom, Netherlands and Luxembourg to 13 - 13.5, Denmark 16.6, Belgium and Germany 10 - 11; with the relatively low percentages of 5.5 each for France and Italy (Table 2).

In fact, the European countries impose a heavier tax burden overall on their peoples because their taxes on goods and services ("indirect taxes") as a percentage of GNP are much higher than in the United States (Table 3).

The differences become even more marked when one compares the ratios of general taxes on consumption with most EC-countries coming to 4 - 8 % and the United States to just 1.7 % (Table 4).

One last comparison: the importance of taxes on corporation income as a percentage of GNP is not very much different between the US and the EC: US come to 2.9 % and the majority of the European countries to 2 - 3 % (Table 5).

Table 1:

Total tax revenue
as % of GNP (1)
(including social
security)

	<u>1971</u>
Denmark	43.99
Netherlands	42.20
United Kingdom	35.65
France	35.62
Belgium	35.22
Germany	34.46
Luxembourg	34.10
Ireland	31.54
Italy	30.92
United States	27.77

Table 2:

Main individual tax revenues
as % of GNP

average 1965 - 1971

	<u>Goods and Services</u>	<u>Income and Profits</u>
	14.7	16.6
	10.5	13.4
	10.4	13.4
	13.0	5.6
	12.3	10.2
	10.4	10.3
	7.5	13.0
	14.9	7.6
	11.6	5.5
	5.4	13.0

Table 3:

Main individual tax revenues
as % of total tax revenues

average 1965 - 1971

	<u>Goods and Services</u>	<u>Income and Profits</u>
	39.6	44.9
	27.2	34.7
	30.0	38.8
	36.3	15.7
	36.8	30.5
	30.8	32.1
	22.7	39.3
	52.1	26.7
	38.5	18.3
	19.5	47.4

(1) This and the following tables : Revenue Statistics of OECD Member Countries, 1965 - 1971, A standardized classification.

Table 4:

Table 5:

	General taxes on consumption as % of GNP	Taxes on corporation income as % of GNP
	<u>1971</u>	<u>1971</u>
Denmark	8.09	1.0
Netherlands	6.55	3.0
United Kingdom	2.47	2.8
France	8.87	2.1
Belgium	7.66	2.5
Germany	5.65	1.5
Luxembourg	4.07	5.2
Ireland	4.22	1.7
Italy	4.18	2.1
United States	1.70	2.9

III. Value added tax

1. The only major achievement in tax harmonization to date has been the introduction of VAT in all Member States. The national tax revenue structures have not been changed by the introduction of VAT, because Member States have chosen normally the rate or the rates of VAT which brought the same revenue as the former consumption taxes. This move towards tax harmonization has certainly not been a hinderance to American goods in EC markets.

Future plans for VAT harmonization: Pursuant to a Council decision of 21 April 1970 on replacing the Member States' financial contributions by the Communities' own resources, a major step forward towards further harmonization of the VAT-systems will have to be taken. In accordance with Article 4 of this decision, part of the Communities' own resources will be obtained by applying a rate, not to exceed 1 per cent, to a basis of assessment fixed uniformly for the Member States according to Community rules. The Commission presented a draft Directive on this subject to the Council in June 1973, which has not yet been adopted by the Council. No discrimination for American goods and services will arise out of this second step of VAT harmonization.

The next step of tax harmonization in the field of VAT should be - as stressed by the Commission - an abolition of the system of taxation of imports and refunds on exports in intra-Community trade. The abolition of "tax frontiers" is much more a political objective than a pure economic aim. It has to be seen as a long-term measure. There are two main alternatives to reach this objective. First, the harmonization of the level and the numbers of VAT-rates, an operation which could be carried out in stages. Once the tax rates have been sufficiently aligned, it would be possible in intra-Community trade to abolish all the checks and VAT formalities at the internal frontiers.

The second alternative would be a step-by-step abolition of tax frontiers, beginning with those intra-Community transactions of goods and services where free movement is possible without a planned harmonization of rates. The VAT technique makes this possible - at least for transactions between taxable persons in different Member States.

./.

Application of VAT in intra-Community trade could be based on the principle that the combined territories of the Member States form one single area involving the supply of goods between Member States and the supply of services within the Community would then be treated as business done within one country the taxable person supplying the goods or the services, who is subject to VAT in one Member State, will invoice the amount of tax owed in that Member State, while the purchaser of the goods or beneficiary of the service who has to pay tax in another Member State may deduct the amount from his tax liability.

If such an action were taken, the tax burden on goods and services would be exactly the same as before. There would be no change in intra-Community competitiveness.

Direct imports would, of course, be taxed with the internal VAT rate - as before. For those transactions "tax frontiers" would remain in force (mainly for travellers). To ease this - politically - rather unsatisfactory situation, certain tax exemptions for travellers are already permitted today. Other proposals are in discussion (facilities for small packages etc.).

The abolition of border tax adjustments may lead to a different sharing of VAT revenue between Member States according to the surplus/deficit situation of their trade balances and the differences of VAT rates. In order to adhere to the principles of allocation of VAT receipts to the State of consumption one could envisage a system of clearing between the Member States with a view to computing the amount of VAT collected in the country of origin and allocating it as accurately as possible to the country of destination.

2. Issue of Border Tax Adjustments

There is a long standing belief in the United States that because of the importance of general taxes on consumption in the EC (formerly in the form of turnover taxes, today in the form of value added taxes), American goods suffer unfair discrimination in EC markets. Relevant statements are often confused and misleading. Normally the difference between border taxes and border tax adjustments is not sufficiently stressed. A border tax (like a customs duty)

6

is a tax imposed when goods cross an international border, and as such must be damaging to international trade and therefore to the achievement of the economic benefits of international specialisation and division of labour. A border tax adjustment is an adjustment of taxes already imposed on a producer whenever the goods he produces cross an international border --, its purpose being to equalize the conditions of competition between domestic and foreign producers --, and thus permit comparative costs to govern trade patterns so that the economic benefits of international specialisation can be realized. Border tax adjustments are therefore compatible, whereas border taxes are incompatible with efficiency in the use of the world's resources.

You probably do not expect from me today a thorough analysis of the subject "Tax structures and the balance of payments", a subject which has kept students, tax administrations and especially international organizations busy for many years. Both the GATT and the OECD have made extensive inquiries into the trade effects of the VAT, and both concluded that the tax was neutral and did not distort competition between exports and imports.

Historically tax policy and the resulting tax structures are based upon prevailing views of equity, the pattern of expenditure benefits, stabilizing effects, contribution to growth, etc. Internal tax policy in Europe is certainly not influenced inherently by balance of payments considerations or by protectionist aims towards third countries.

In this context, the introduction of a VAT system according to the first and second VAT-directive of 1967 in all nine Member States, a process which has been concluded in April 1973 with Britain introducing VAT, has been a very important anti-protectionist measure. This is true because most continental turnover taxes had been so designed that it was impossible to identify the exact amount of tax that is imposed on domestic goods and thus identify the export rebate and compensatory duty at the border. In such cases, it is relatively more convenient to consciously overcompensate imports and exports than when the tax is identifiable and the protection more obvious. For this reason, the decision of the European Communities to shift from the gross turnover tax, whose design prohibits precise adjustments, to the VAT, whose effect is similar to a retail sales tax and as such easily identified, has eliminated whatever use has been made of the destination principle for protectionist purposes. This is true for border tax adjustments between Member

./.

States and between a Member State and a third country. Because of these reasons other European countries, which are not members of the EC, like Austria, Norway, and Sweden, adopted the VAT system also.

3. US reaction

The "border tax adjustment-controversy" has been placed by the United States not only in the context of the balance of payments question as a short run concern (especially in the years 1968-1972), but also in the context of equity requirements for international trade in the long run. Given the strategy of European tax harmonization, the often quoted US policy measures can be summarized as follows :

- The US should rebate certain indirect taxes presently not rebated. These taxes are usually levied at the state and local level in the form of retail sales taxes (with rates of generally 3 %, but occasionally 4.5 or 6 % at the state level and at county and city level an additional rate of 1 - 2 %) It has been estimated that the average of these indirect taxes is about 2 - 3 per cent of export sales prices.

- Another solution might be a change from US reliance on income taxes in favour of the adoption of a general tax on consumption (VAT). "If the United States cannot lick the system, perhaps it should join it."

It is, however, quite uncertain - as some studies are pointing out - that such a changeover would positively affect the international competitiveness of US products abroad.

Should future supplementary tax resources, needed for more public needs, come rather from a new VAT or from an increase of, say, personal income taxes?

Both possibilities would probably be influenced from the domestic standpoint much more than from the international aspects.

- Negotiations for changes of GATT rules with regard to the justification of border tax adjustments for direct taxes also.

The only direct taxes likely to be eligible for border adjustments would be corporate income taxes. Apart altogether from the numerous problems connected with this approach (degree of shifting of corporation taxes, administrative problems etc.), such a solution might not accomplish much for the United States in that effective corporate income tax rates in the US do not differ much from corporation tax rates in major European countries.

- The United States might ask for a renegotiation of GATT rules in order to prevent border tax adjustments for indirect taxes, especially VAT, or at least to seek a standstill arrangement with the Community countries not to increase "border taxes" in case of an increase in VAT rates. These VAT rates applied to imports (which are, of course, always the same as those applied to similar products within the countries) are of no importance whatsoever, because a higher or lower rate on goods imported is aligned automatically on the level applying within the country at the next taxation stage ("effet de rattrapage"). Tax adjustment on imports by taxable persons would accordingly not be necessary. Trade patterns, too, would not be influenced.

IV. Excise duties

The Council adopted a Directive on the harmonization of the structure of the excise duties on manufactured tobacco on 19 December 1972. This has been the first Council decision in the field of harmonization of excise duties. I shall now outline the main characteristics of the general program of excise duty harmonization.

1. Program of excise duty harmonization

On 7 March 1972 the Commission proposed that the excise duties on the following products should be maintained and harmonized:

- mineral oils
- manufactured tobaccos
- alcohol
- beer
- wine

Given the fact that the aim of harmonization in this field is the free movement of goods between Member States, and this without any distortion of competition, the other excise duties should be gradually abolished. The Member States, however, shall retain the ability to maintain or even to introduce new duties provided they do not involve, in trade between Member States, border tax adjustments. It will, of course, be possible later on to establish, at Community level, other excise duties.

On 7 March 1972 also, the Commission submitted to the Council several draft directives on structural harmonization of wine, spirits and beer excises. On 9 August 1973 a draft directive in the field of duties on mineral oils has been submitted to the Council.

Once the harmonization of the structure of the five excise duties will be achieved, it will most certainly be necessary to arrive at a certain alignment of rates. This, again, will be a long-term objective.

2. Tobacco taxation

According to the Directive of 19 December 1972 a first stage of harmonization has been fixed, covering the period from 1 July 1973 to 1 July 1975. During this first stage of harmonization national and imported cigarettes will be subjected to a proportional excise duty calculated on the maximum retail selling price, and to a specific excise duty calculated per unit of the product. Within certain limits the Member States are free to choose one or the other kind of cigarette taxation. These limits have been fixed in such a way that the specific excise duty element will not be lower than 5 % nor higher than 75 % of the aggregate amount of excise duty on cigarettes. It has been agreed in the same Directive that at the final stage of harmonization of structures, the same ratio shall be established for cigarettes in all Member States between the proportional excise duty and the specific excise duty.

The Directive also lays down certain general principles for the step-by-step harmonization of the tobacco duty, the grouping of manufactured tobacco (cigarettes, cigars, smoking tobacco etc.) and tax collection.

./.

Already at an early stage of the discussion of the Commission's proposals in this field, the United States expressed concern about the possible negative effects of such an harmonization on their exports of tobacco into the Community especially to Germany. In 1972, 60 per cent of the Community's imports of tobacco leaf were imported by Germany. This leaf is used to produce high quality and hence more expensive cigarettes containing about 50 per cent U.S. leaf. The current tax split in Germany is 75 per cent specific and 25 per cent ad valorem.

The higher the proportional (or ad valorem) part of the excise duty on cigarettes, the more cigarette producers are - so the American-argument runs - encouraged to produce cigarettes from cheap tobaccos. Therefore it is in the American interest that the specific excise duty will be relatively high at the final stage of harmonization of the structure of the tobacco duties.

Today it is, however, not possible to foresee such a final ratio, because the harmonization will take place in several stages, where the experiences of each stage will have to be seen in the light of the aims of the necessary harmonization, which are mainly the opening of the national markets in the Community towards a free movement of tobacco products without distortion of competition.

I do not propose to go into all the aspects of this complicated problem. I would, however, like to repeat for this field of harmonization also that there has never been an intention to discriminate against US tobacco products. It is clear that such kind of structural harmonization may lead to changes in patterns of trade with Members of the Community. A common market for these products will most probably be even more attractive to high quality tobacco, because of changing consumer tastes.

V. Company taxation

Virtually no progress has been achieved in the field of direct taxation.

Taxation obstacles are undoubtedly one of the main factors hindering the cross frontier restructurations of companies. For this reason, as early as January 1969, the Commission forwarded to the Council two proposals for directives on

the taxation system applicable to companies situated in different Member States (taxation of mergers and parent-subsidiary companies). The Council, however, has not yet ruled on this matter, which became still more complicated as result of the enlargement of the Community.

In its program for the harmonization of direct taxes of 26 June 1967, the Commission suggested a general tax on company profits, having the same structure throughout the Community and based on broadly similar methods of assessment and rates.

According to the Resolution of 22 March 1971 on EMU it is envisaged to harmonize:

- certain types of tax which might have a direct effect on capital movements within the Community, and in particular withholding taxes on interest on securities and on dividends;
- the structure of company taxation.

1. Structure of company taxation

There are three basic systems of taxing companies and their shareholders. Examples of each are to be found in at least one EC country: the two-rate (or split-rate) system, the imputation system and the classical (or separate) system.

Under the classical system, which is practised in the Netherlands, Luxembourg, Denmark, Italy (since January 1974) and in the United States, the corporation tax on company profits is regarded as a completely different tax from the personal income tax which shareholders have to pay on dividends received. Under this system, no tax relief or only little tax relief (like the U.S. 100 % deduction for shareholders) is given to the shareholder to take account of the fact that the profits out of which he has ^{been} paid have already borne corporation tax. This is sometimes known as "economic double taxation".

Under the two-rate system, practised in Germany, undistributed profits are taxed at a higher rate on the grounds that this is the final tax while distributed profits are taxed at a much lower rate, on the grounds that the dividends paid are going to be subject to further tax in the hands of the shareholders.

Under the imputation system (France, United Kingdom, partially Belgium) profits are taxed at the same rate whether distributed or not, but shareholders receive an imputation credit (or an "avoir fiscal" as it is known in France) which in effect reduces their own tax burden.

I do not propose to go into all the domestic pros and cons of these different systems.

The Commission opted for the imputation system as a harmonized Community System on November 21, 1973 and will make concrete proposals in the course of 1974.

The Commission favours the imputation system mainly for domestic reasons:

- it is more neutral in respect of the various methods of financing firms;
- it is more neutral in respect of the different legal forms which a company may adopt;
- it has many positive aspects in respect of fiscal law;
- it provides less incentive for very rich tax payers to avoid paying taxes by inventing fictitious companies;
- it is also likely to bring on to the shares market savers with average or even modest incomes.

It has been explicitly acknowledged that there will be problems of various kinds to avoid international and intra-Community discriminations if capital or income flows across frontiers.

The Commission is presently examining appropriate solutions.

A truly harmonized imputation system should, of course, not lead to distortions in the EC-share markets - there should be not tax incentives to invest in companies of certain Member States from the point of view of shareholders.

Concerning shareholders whose place of residence is outside the Community the Commission is in favour of settling these cases within the context of Double Taxation Agreements.

2. Withholding taxes for interest payments and international capital markets

If we consider interest on bonds solely in the light of the Community capital market and of the cost of financing firms, then the best solution is the abolition of any deduction at source. But this is incompatible with the requirements of fiscal law and runs counter to the efforts being made by the Commission, in cooperation with Member States, and by the OECD, to stop tax frauds and evasions.

However, to make an important step forward in fiscal law and to take account of the preoccupations of a social nature which were so much in evidence at the Paris Summit, we must choose to make it the general practice to levy substantial deductions at source (about 25 %). Although the Commission has declared itself to be in principle in favour of substantial deductions at source, it noted that to apply such a measure in the present circumstances would give rise to a drain of capital from the Community. Under these conditions, the Commission is of the opinion that this measure cannot be brought into effect until the Community has established machinery for controlling movements of capital at its external frontiers. The Council in the Resolution on the implementation of a second phase of Economic and Monetary Union has recently decided that such machinery should be established and invited the Commission to submit a proposal for that and before 31 December 1974.

The Commission is endeavouring to submit to the Council, also before 1975, a draft directive concerning withholding tax on bond interest.

VI. International tax evasion

Let me now say something about international tax evasion.

The European Community is faced with this problem both in the field of capital investment and insofar as it affects the competitiveness of business. The Commission expressed its political view of this matter in its report of the 18th June last on "Holding Companies" and more recently in its report on Multinational Companies.

The separate aspects of this matter include :

- (a) international tax control
- (b) tax avoidance
- (c) transfer of profits

(aa) International tax control must be organised, at Community level, to combat international tax fraud through a system of cooperation between the tax authorities of Member States.

The aim must be an exchange of information between Member States which would be appropriate to a real Common Market.

(bb) Tax avoidance (which is not necessarily illegal, like tax fraud) consists in having income collected by a so-called "base-company", established in the tax haven and therefore subject to very little or no tax at all. Several types of base-companies can be distinguished depending on the different categories of income collected: companies holding patents, financing companies, purchasing and sales companies, property management companies, companies providing services, etc.

(cc) Concerning the problem of transfer of profits, normally the authorities of the country from which the profits have been transferred tend to adjust these profits upwards on the principle that prices between companies in the same group must be fixed as if the transactions were effected between independent persons (dealing at arm's length clause) but, very often, the authorities do not have all the details needed to adjust the price, particularly where several companies are involved successively in the same transaction. So at Community level it is necessary to intensify cooperation between the national authorities in order to uncover these profit transfers. This is the problem of international tax controls mentioned earlier, but, to make such cooperation between the tax administrations of the different countries workable, it is again necessary to apply the principle of "dealing at arm's length". There are, however, inherent difficulties in applying this principle in practice. The real problem with which we are faced is to establish practical guidelines for the concrete application of this principle in certain situations as, for instance, you have done in the U.S.

All these aforementioned problems are under consideration by the Commission in co-operation with experts from the Member States. Other international organizations, notably the OECD and even the UN, are also engaged on similar studies but have not, as yet, found definite solutions. Accordingly, we in the Commission could not be expected to predict when we will be in a position to present solutions to the Council or what the nature of those solutions will be but I have to emphasise that we consider this a very urgent matter.

VII. Recent international tax problems : DISC

As you know, the tax treatment of Domestic International Sales Corporations (DISC), introduced into US-legislation in December 1971, led to a thorough examination of the various trade and taxation implications in European countries and in other trading partners of the United States. Even before the enactment of this new tax scheme, the Community expressed its concern about these measures in a note verbale on October 5, 1971, to the American Government:

"The DISC tax arrangement would involve very considerable exemptions from direct taxes on profits and would be such as to encourage exports artificially by reducing prices. This exemption would be incompatible with the commitments of the United States under the General Agreement as regards export subsidies and would involve the risk of serious disturbances in international competition".

The DISC statute allows practically indefinite tax deferral on 50% of profits to American firms of which 95% of their business are exports.

We think that the DISC legislation is not only in violation of GATT (Article XVI (4)), but also in violation of the international code of conduct in fiscal matters:

Concerning GATT, the Community has invoked the procedures of Article XXIII : 2 of GATT, designed to afford the opportunity for complaints to be examined on a multilateral basis. Bilateral discussions already took place some time ago.

The argument of the Community concerning a violation of the international code of conduct runs as follows: EC Member States have concluded tax agreements with the United States, having been given assurances that the more or less total remission of certain taxes, which would normally be due under the

national legislations would not lead on the side of the US to exemption of certain income arising in Europe. DISCs, however, precisely create cases of exemption of a kind for which no provision was made when the agreements were drawn up. In order to avoid that DISC's are gaining an undue advantage, there may be pressure on governments to review certain clauses of these agreements (e.g. definition of "permanent establishment" in a more restrictive sense).

There is obviously a certain danger that other countries will have to adopt similar tax measures, a course which would be damaging to world trade.

VIII. Conclusions

1. In the long run EMU necessarily involves national governments giving up sovereignty over fundamental areas of economic life: the exchange rate, the budgetary balance and monetary management. If the resulting situation was to be made tolerable to the population of the Community, arrangements would have to be made for the EEC at the centre to discharge the functions formerly performed by the national governments in maintaining high levels of employment, minimum standards for incomes and adequate industrial competitiveness. Essentially this means a strong Community budget able to redistribute resources among different areas within its borders both to compensate in the short term for differing levels of employment and real incomes and to improve the long-term competitiveness of the weaker areas which will no longer have the exchange rate instrument available to them.

To achieve these objectives the Community will need to develop effective revenue and expenditure policies. Success, however, would certainly not be achieved without progress in the development of effective Community institutions particularly a strengthening of the European Parliament.

2. In the shorter term we are likely to be faced with a situation in which matters continue to be settled on the basis of bargaining between national governments, and central authority will be a relatively weak one.

Taxation will reflect the differences in national economic and social situations and policies. At the present moment it is particularly difficult to define an economically and politically sensible Community tax harmonization program - because tax harmonization is not an end in itself, but an instrument that serves to promote - and at the same time to a certain extent reflects - the process of economic, social and political integration, and the future directions and requirements of these objectives are unable to be readily defined at this point in time.

3. Tax harmonization policy does not ignore the outside world. The points of reference for European tax policy are, of course, first of all Community aspects. But no systematic discrimination towards Third Countries is intended. More frequent and thorough discussions among the representatives of the United States and the European Community dealing with international fiscal affairs could help to avoid misunderstandings about the respective tax philosophies. Existing international organizations should be the forum for these talks. We welcome the initiative of former Secretary of the Treasury, John B. Connally, presented in a speech before the International Fiscal Association in October 1971 in Washington for "a continuing and heightened organized effort" to deal with international fiscal affairs. ⁽¹⁾

(1) For your information:

In discussing the implications of EC tax harmonization for the United States, Stanley S. Surrey, former Assistant Secretary of the Treasury, in a talk delivered before the National Industrial Conference Board, New York, on 15 February, 1968, proposed a "harmonization" of the EC-tax systems with those of the United States. "It means", as Mr. Surrey underlined, "the process whereby national tax systems that may differ both in kind and in burdens imposed can coexist in the world without creating difficulties for each other ... can coexist in harmony." Further on, he suggested that exploration in GATT and in other ways "is needed to preserve freedom of action for countries to establish their domestic tax systems and the distribution of their tax burdens in keeping with their notions of economic growth and tax equity without at the same time prejudicing their international trade position. The essential question is how may countries which desire to rely on a progressive tax structure or countries which do not wish to place heavy overall tax burdens on their peoples, and hence have no need for high rate sales taxes, continue in these domestic goals and still maintain in their international trade full competitiveness with the European countries which have a different domestic tax philosophy? For sure, a better answer can be found than that the rest of the world to protect its trade position must simply emulate the Europeans and their domestic tax philosophies whatever may be the impact of that emulation on the tax systems and internal economies of the other countries.

The United States - and the rest of the world - thus have a high stake in a full exploration of these issues - issues which are made both more pertinent and more important by the process of tax harmonization in Europe."