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TAX HARMONIZATION AND THE ECONOMIC AND MONETARY UNION

Speech by

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to the

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It is Mr. President with the very greatest feeling of pleasure and honour that I find myself addressing you tonight.

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

From the Community's point of view, the need to harmonize national tax systems is well known. 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.

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 stabilization, on distribution of private income, on the allocation of resources between public and private sectors as well as between regions and industries.

As is the case with other Community policies the tax harmonization policy has also to find solutions which are acceptable both to Member States and to Community requirements.

2. Two periods of tax harmonization theory and practice can be distinguished.

The first period between 1958 (Treaty of Rome) and the early 1970's (plans and resolutions on EMU) has been a period where the common market approach of tax harmonization was dominant. The basic argument for tax harmonization has been, on the one hand, that various differences in indirect taxes, mainly general consumption taxes and excise duties, can distort trade ; whereas on the other hand differences in direct taxes, particularly corporation taxes, can distort capital movements.

Systems and structures of the major indirect taxes should be harmonized in order to allow exact border tax adjustments in international trade.

Moreover, rates should be brought into line or even made uniform throughout the Community so that tax frontiers may be abolished. A natural sequence of the elimination of customs frontiers would be the elimination of these border tax adjustments at intra-Community frontiers, whose existence is based on the destination principle of taxation. Similarly, harmonization of the corporation tax would prevent distorsions in the capital market as capital invested in any Member State would be taxed in an equal manner.

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Although tax harmonization remained an important objective in the Council resolution of March 1971 concerning the first stage of achievement of EMU, subsequent debates for the preparation of the second stage of EMU showed clearly a changing emphasis on the importance of the former ambitious plans for tax harmonization.

Whereas in former plans, lists for elaboration of concrete taxe measures had been decided, the still unadopted resolution on a second stage of EMU simply asks for the draft of a "programme of tax harmonization necessary for EMU".

3. The decision-making Community institutions, in fact, are now realizing - and that is the beginning of the second period of tax harmonization theory and practice - that the emphasis in this field must more and more be laid on the fact that taxes have become instruments in modern economies, instruments for structural and conjunctural policies. A too hasty move towards harmonized taxes, particularly of tax rates, in the name of "distorsion-free competition" in several major tax fields could considerably limit or sacrifice such vital functions for Member States at a time when the compensating factor - i.e. greater scope for fiscal action at the Community level - is not yet in sight.

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4. Let me now outline - at least for the main fields of tax harmonization - the progress achieved until today and future project

a) Value added tax

The only major achievement in tax harmonization to date has been the introduction of VAT in all Member States. Since April 1973 all the countries in the Community, including the new Member States, have been applying the VAT system according to the two VAT Directives adopted in 1967. That means that all former turnover taxes calculated on a cumulative multi-stage tax basis are now abolished. The shift to VAT has eliminated whatever use has been made of the destination principle for protectionist purposes.

Considerable differences still exist, however, between the Member States as regards the definition of the tax base and the number and level of rates.

According to a Council Decision of 21 April 1970 on the replacement of financial contributions from Member States by the Communities' own resources, part of these own resources are to accrue from VAT.

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Therefore, a uniform assessment basis for VAT is foreseen so that the own resources for the Community accruing from VAT can be collected in a uniform and equal manner in the nine Member States. That means, first of all, we require common rules for taxable supplies and persons, exemptions, territorial criteria, , special schemes for small enterprises and the agricultural sector.

In the summer of 1973 the Commission submitted to the Council a draft directive - the so-called sixth directive - aiming at the establishment of a uniform basis of VAT. After the usual consultations of the EP and ESC the Commission proposal was considerably amended in July 1974.

We hope that the Council will be able, by the end of this year, to define guidelines on a certain number of fundamental points such as the regime of real estate, of agriculture, small enterprises, passenger transport, the VAT regulation Committee and, last but not least, the zero rates, so that the technical work could progress in the experts'group and the directive be adopted in the course of next year. This would of course mean that the Community's own resources could not be levied on VAT from January 1, 1975, as originally planned, but would have to be calculated for some time, probably until 1 January, 1978, on the basis of GNP in accordance with the Council Decision of 21 April, 1970.

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b) Excise Duties

The first - and so far - only Council Decision in this field concerns the harmonization of the structure of excise duties on manufactured tobacco. This decision was taken in December, 19

In point of fact, the Commission proposed in March of that year that the excise duties on mineral oils, manufactured tobacco, alcohol, beer and wine should be maintained and harmonized. The other excise duties should be gradually abolished. The Member States, however, shall retain the ability to maintain and even to introduce new duties provided they do not involve, in trade between Member States, border tax adjustments or border controls.
It would, of course, be possible later on to establish, at Community level, other excise duties.

This framework directive was accompanied by several draft directives on structural harmonization of wine, spirits and beer excise duties. In August 1973 a draft directive on mineral oils was prepared and submitted.

All these proposals are at present under discussion in the ad hoc Council working party. There are, in addition, serious difficulties concerning both the selection of the excise duties to be harmonized, e.g. wine and non-alcoholic beverages, and the long-term programme to be adopted now for the abolition of all duties giving rise to border tax adjustments or border controls.
Here again, it is incumbent on the Council to provide the necessary political incentives.

c) Company taxation

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

Taxation obstacles are one of the main factors hindering the cross frontier restructuring of companies. Because of this, as early as January 1969, the Commission proposed two Directives on the taxation system applicable to companies based in different Member States (taxation of mergers and parent and subsidiary companies).

The Council has not yet ruled on this issue, which was made more complex since the enlargement of the Community. We hope, however, that the Council will be able to decide in the near future on these problems, for which the technical discussions are now most advanced. In particular, our representatives in the appropriate Council working party have put forward a compromise solution on a method for avoiding double taxation which, during a transition period, would allow the existence of the tax exemption method and the tax credit method currently applied in particular by the United Kingdom.

According to the resolution of 22 March 1971 it is envisaged to harmonize :

- the structure of company taxation,
- and 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 dividends.

+ 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 system, the imputation system and the classical system.

The Commission, after many years of discussions, opted for the imputation system as a harmonized Community system in November 1973 and intends to make concrete proposals during the first months of 1975.

I do not propose to go into all the pros and cons of these different systems. 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 furthermore has many positive aspects in respect of fiscal law and
- it provides less incentive for very rich tax-payers to avoid paying taxes by inventing fictitious companies.

It has been explicitly acknowledged that there will be problems of various kinds to avoid international and intra-Community discriminations if capital or income flow 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 no tax incentives to invest in companies of certain Member States from the point of view of shareholders.

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

♦ 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 ideal 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 tax avoidance.

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 in principle to be in favour of substantial deductions at source, it realizes that to apply such a measure in the present circumstances would give rise to a capital drain from the Community.

Therefore, in the draft resolution on the implementation of the second stage of Economic and Monetary Union, the Commission suggested that the introduction of a harmonized system of withholding tax on the income of bonds run parallel to the establishment of a common control system for capital movements between the EEC and third countries.

It should be noted, however, that this draft resolution has not been adopted by the Council. Moreover, we notice increasingly divergent developments in the member states' control systems of capital movements. It would thus seem to be more difficult than ever to harmonize the different national capital movements regulations and to embody them in one Community system.

The Commission is also very much aware of the fact that, to finance their deficits, several member states had considerable recourse to the Euro-capital market, where no withholding tax at all is applied. They probably will be dependent on this market for a considerable time to come.

So we must recognise that time is not ripe for progress to be made in this field.

d) International tax evasion

I'll now say a few words 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 on this matter in its report of the 18th June 1973 on "Holding Companies" and more recently its report on "Multinational Companies".

The separate aspects of this matter include :

- international tax control,
- tax avoidance,
- transfer of profits.

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

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

For the problem of the transfer of profits, it is normally the authorities of the country from which the profits have been transferred who 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. This is the so called"dealing at arm's length"clause. But, very often, the authorities do not have all the details needed for adjusting the price, particularly where several companies are involved successively in the same transaction. This is why at Community level, it is necessary to intensify cooperation between the national authorities in order to uncover these profit transfers.

There are, however, inherent difficulties in applying the principle of "dealing at arm's length". The real problem with which we are faced is that of establishing practical guidelines for the positive application of this principle in certain situations as,for instance, in the U.S.

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All these aforementioned problems are under consideration by the Commission in cooperation with experts from the Member States. Other international organizations, notably the OECD and even the UN, are also engaged in similar studies but have not, as yet, found definite solutions.

It will certainly take a long time to define common rules on all these problems. But we think that the first action to be taken in this field should aim at organizing the cooperation at Community level between national tax administrations. This would enable us not only to combat more efficiently tax evasion practices at least in the common market, but also to eliminate double imposition of multinational firms resulting from entirely autonomous national taxation of parents and subsidiaries.

The Commission intends to ask in the near future for a discussion of these problems in Council with a view to reaching agreement on general principles of cooperation at Community level, laid down in a Council resolution.

5. Future prospects

I shall concentrate on the economic arm of EMU. It is unrealistic to consider fixed parities in the Community for the near future - and inflexibility of exchange rates is, of course a main characteristic of a monetary union. In the meantime we shall have to find a compromise in the field of exchange rate between individual floating of Member States and final rigidity of pegging.

It would be a mistake to overemphasize the importance of monetary union at the expense of the major aspects of economic union.

There are, on the contrary, powerful arguments and very strong factors pressing for economic union, which will at the same time make possible a parallel advance towards exchange rate stability : the energy crisis, the inflationary processes and unemployment - all fields where purely national actions and solutions are not fully effective. But the objectives of economic union have their own justification. These are full employment, adequate growth in the weaker regions of the Community and the solidarity of the Community for economically disadvantaged social groups. Essentially this means a considerable Community budget able to re-allocate resources among different areas within its borders, with a view in the short term to compensate for differing levels of employment and real incomes and in the long term to improve

Now, where do we stand today ?

I have already given a short description of the tax measures envisaged for the last few years (the so-called first three-year stage) which, however, did not progress very much.

The first three-year stage according to the Council Resolution of March 1971 should have ended in December 1973 and was essentially preparatory in nature. In part it concerned machinery for regular consultation and the formulation of agreed guidelines for economic policies in the Member States. This stage should also have seen important parts of tax harmonization, abolition of all exchange controls and other obstacles facing capital movements, and a reduction in the fluctuation margins of currencies.

I do not have to underline that progress has been extremely slow. Exchange markets are in greater disarray than ever, no start has been made on the Regional Fund, economic policies are discussed but hardly coordinated, exchange controls have even been strengthened. The path to EMU is proving more difficult than that of the customs union.

Without any doubt, of course, the present international environment is drastically different from that of the 1960's.

Commercial relations between member countries were made easier by the evidence that they collectively presented a balance-of-payments surplus, on current accounts, with the rest of the world. In such a climate of rapidly expanding trade and increasing freedom of capital movements, it has been much easier for the Community to dismantle trade and financial barriers among its member countries than at present. The new situation of collective balance-of-payments deficit, on current account, has already produced a different mood among governments. The further removal of trade and other barriers in a world faced with recession and increasing balance-of-payments deficits will be extremely difficult.

6. Conclusions

First of all, European policies have to overcome the present's pressing problems. In the near future a re-thinking of plans and ways of achieving economic and monetary cooperation must take place.

So, at present it is simply not possible to define an economically and politically sensible Community tax harmonization programme in the context of the final stage of EMU. A new pragmatic approach is needed.

But in the meantime progress is necessary and possible in the field of European tax policy - but only in taxation areas where structural harmonization of tax rules is intented. Planned harmonization of tax burdens will neither be needed nor achieved.

Therefore, - and given the view that a growing Community budget and the use of fiscal policy by the Community are essential for achieving the objectives of economic union -, my conclusions for the role of tax harmonization in the context of economic union in the coming years run as follows :

1) The future financing of the Community budget necessitates a strong harmonization of VAT tax bases so that Community tax levies are transparent and equitable between Member States.

2) Tax harmonization should not limit the provision of instruments for common and/or national economic management. There is, indeed, a positive need for differentials in tax rates for both structural and conjunctural policies.

3) But much remains to be done to increase the efficiency of European industry, to formulate European energy, transport and environment policies as well as other common policies. Tax policy has to play a role in all these contexts, either through avoiding tax obstacles, double taxation, etc. or through positive actions to implement one of the other of the common policies. Much is also to be said for achieving better mutual assistance in tax matters, strengthening the control of taxation of multinational companies such as transfer pricing, and parallel actions on European company and tax law.