Tax Harmonization in Fiscal Competitiveness Context

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Abstract. *The article treats European fiscal policy and the taxes harmonization evolution process. The study is divided into three chapters: the first one makes a synthesis of European taxation, Member States fiscal behavior and a division of the countries according to the category of taxes which are these based; the second chapter go into details of "tax harmonization" conceptas European objective and analyzes its implementation status referring to direct and indirect taxes, and the last part refers to tax competitiveness and its interference with harmonized taxes. Finally, the main conclusions of the article are extracted.*

Keywords: **fiscality, harmonization, taxation, tax competition.**

1. Introduction

In the context of overall European policy, taxation is considered to be essential for all Member States of the European Union. Even in this case, fiscal independence is influenced by the single marketcriteria, but also by the convergence criteria laid down in Maastricht, incorporated in the Stability and Growth Pact and recently in Fiscal Pact, ensuring the coordination of national fiscal policies in order to ensure a stable economic environmental and budgetary prudence[1]. As it has become increasingly difficult for taxation to be controlled for all Member States, one of the important objectives in this area is the taxes harmonization. But this goal during time met some impedimentd on the way to its fulfillment. Progresses have been made, directions are drawn, but there are categories of taxes that will be very difficult to be harmonized totally. In the following chapters, there are analyzed the behavior of Member States in terms of taxation and taxation harmonization stage at European Union level.

2. Taxation in the European Union

In the last three decades, how fiscal policies are applied and made, evolved visible. Globalization trend and also the rise of technology and access to information, increased mobility of tax bases and businesses began to play a decisive role in the economic development of a state. In response to these pressures, governments have adopted various fiscal measures, tailored to each state's economy. These reforms were aimedin order to decrease/increase the taxes, the tax base and revenues based on consumption taxes[2]. Adjusting tax burden in a given period of time is closely related to social and economic role of the state and its intervention, the last goal being to cover public expenditure and to support investment projects of population interests. Due to this "freedom" of the state to choose and adjust the level and perception of taxes, fiscal

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[1]Chilari D. Ene GS, "Harmonization and ficsla competitive in the European Union"
[2] Vlad C, Brezeanu P, " The analysisi of the evolution of fiscal pressure in correlation with the budget deficit in EU", Theoretial and Applied Economics, 2015

policy is placed in an area of national sovereignty. Unlike monetary policy, which is applied by the European Central Bank together with the central banks from the Member States, drawing the clear direction and with well-defined objectives, fiscal policy is not directly influenced by the European Union. Of course, there are some key points that must be pursued and fulfilled, but the fiscalitycore is the strategy of each state. At the tax level, the European Union has the following objectives:

- promoting economic growth;
- creating new jobs and reducing unemployment;
- ensuring Single Market functionality;
- removing and sanctioning unfair competition;
- application of taxes that do not put in an inferior position or does not discriminate residents of one State in relation to the rest of European citizens.

It is obvious that the objectives listed above do not target strict or specific fiscal rules. It is also one of the reasons there are so many differences between Member States. There are states based on the collection of direct taxes, other states collect more indirect taxes or states that maintain the balance between of two categories. In the chart below we can see GDP ratio between direct and indirect taxes in the EU for 2016.

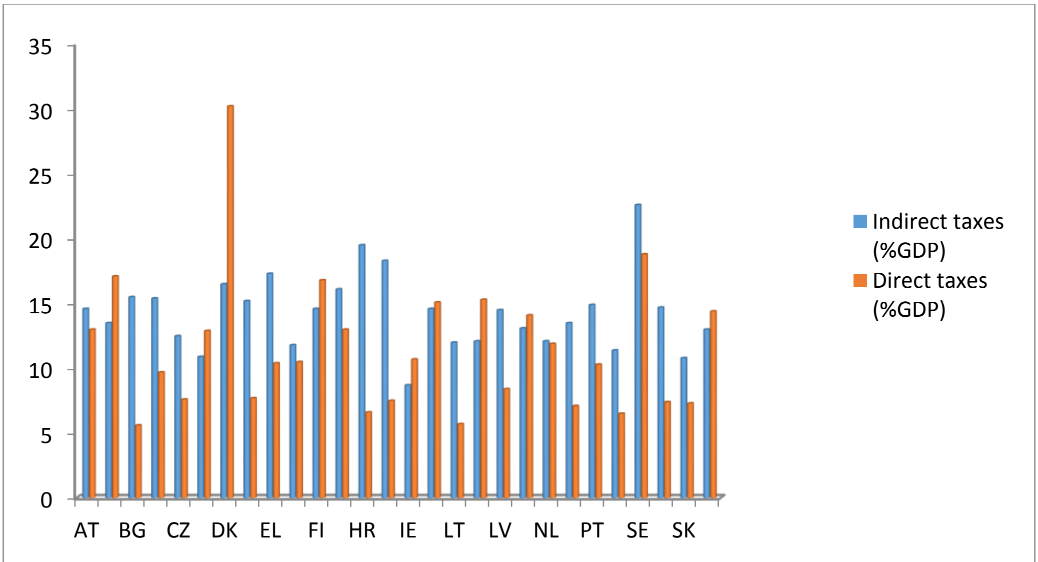

Figure 1: Share of direct and indirect taxes in GDPat EU level in 2016; own representation of data collected from www.eurostat.eu

It can be noted that countries like Bulgaria, Croatia, Hungary, Latvia, Poland, Romania have tax system based on the collection of indirect taxes, VAT and excises being main ones. At the other pole, direct taxes are the main budget revenues for Denmark, France and Luxembourg. This is not by chance: Eastern Europeanmembers joined later the European Union, have unemployment rates higher than the rest of Europe, the rate of tax evasion higher, which imposes a fiscalityfocused onindirect taxes - these are paid by the final consumer and included in the purchase price of the products. Nordic the Westerncountries collects more taxes from direct taxes - hostimportant companies with high profits, offering employees jobs and tax evasion is very low. There are countries that had found a balance (at least in 2016 managed to do it) between the two categories of taxes: Italy, Malta, Netherlands and Spain.

3. Fiscal Policy Harmonization in the European Union

One of the EU main objectives since foundation has been to create a single market which allows the free movement of persons, services, goods and capital. Step by step, the single market was established and applies its effects in all Member States, but can not be declared a closed project. Economy and applying economic theories are constantly changing, and the goal of having unique practical and free movement of any kind in all states is in progress. In this respect, a key issue is the tax harmonization: a tax policy that that can be applied in all states.

Early efforts regarding tax harmonization were made for indirect taxes, as they have a significant impact on the movement of goods and services, imports and exports. Customs taxes, excises and VAT were the main taxes that were the basis of this strategy, over time being implemented several directives that are meant either to increase or to limit the intervention of the European Community. For example, in customs taxes case, Member States are not entitled to tax intra-Community or international trade, the European Community is competent to adopt legislation or to conclude international treaties[3]. Regarding VAT, the most important category of indirect taxes, it opted for the rights and powers of intervention between each state and EU; Thus, member states are free to apply the right VAT rate, but standard rate may not be less than 15% and it is allowed max 2 reduced VAT rates up to 5%.

We take as example the VAT to observe the application in accordance with European directives. In the chart below, we compared the standard rate applied in each Member State. Data are for 2018, VAT rate can be switch / revised twice a year, in January and July.

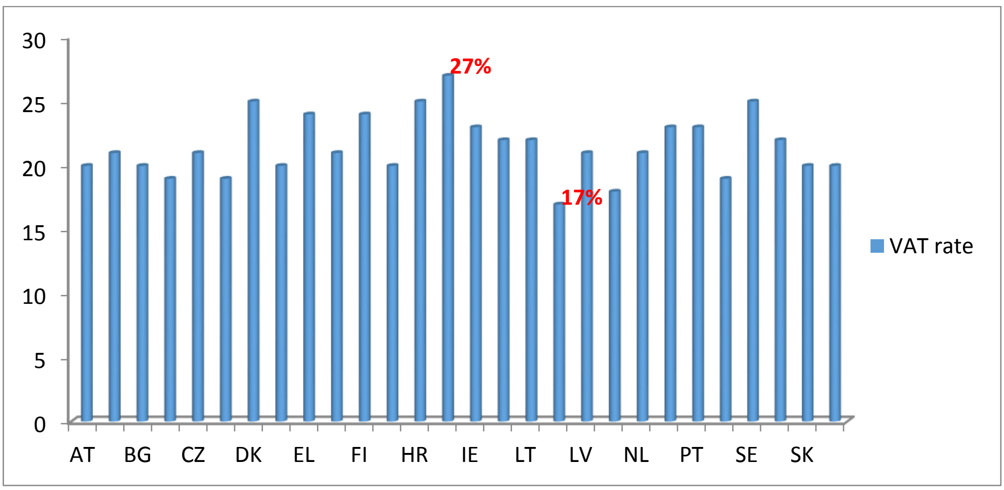

Figure 2: Standard VAT rates in Member States in 2018; own representation of data collected from www.europa.eu

[3]Chilarez D., Ene G.S., "Harmonization and tax competition in the European Union"

It can be seen from the graph that there are differences between rates of VAT applied in every state, the application of themare not fully harmonized, despite Community regime emerged. However, the minimum required 15% is an important stepwhich established from one point of viewthe rates; the lower VAT rate is applied in Luxembourg – 17% and highest rate in Hungary 27%. In percentage terms, between the 28 states the range is not high (17% -27%), especially if we consider that most countries (14 of 28) have rates very close between 19% and 21%. This represents a step towards harmonization. Also, it is noted that for intra-Community acquisitions is not add VAT to avoid double taxation or tax evasion. And this measure is applied in order to achieve a complete harmonization in the future.

The same thing can not be said about direct taxes, because here things become a little complicated. Unlike indirect taxes, which are applied to products and services included in the price of purchasing and paid by end consumers by purchasing of any kind of goods, level of direct taxes need to be set depending on many variables: standard of living, quality of services provided by the state, economic development, etc. For showing significant differences, in the chart below are exemplified corporate tax rates applied to companies in each Member State.

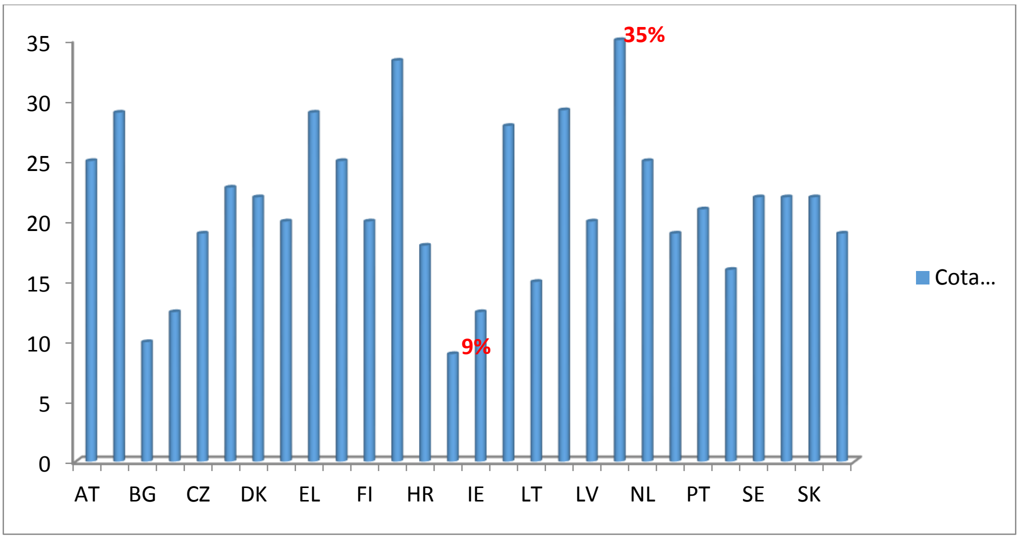

Figure 3: The standard rates of profit taxes incomes in Member States in 2018; own representation of data collected from www.europa.eu

Even at first view, in Fig. 2 is immediately observed significant differences between the rates applied and the level of harmonization. In the case of rates applied on profits, we can see percentages below 10% (in the case of Hungary, practicing lowest point of 9%) but in the same time we can see rates higher than 30% (such as Malta, with 35% and France with 32%). The range is quite wide and we can not say that there is a tight range which fits majority of states, such as VAT. Compared with VAT rates and indirect taxes in general, this dispersion is much higher and making this comparison we can draw two important conclusions: harmonization of direct taxes is far in comparation with indirect taxes, and without restrictive directivesfrom the European Commission, Member States will not align their tax rates; each state aims is to attract a larger volume of contributions (and then practice higher taxes), or attracting foreign investment and foreign capital (and then use fiscal leverage through reduced taxes).

Another category of different rates of direct taxes is represented by income tax. These are divided mainly between taxes paid by employers and taxes paid by the employee, differing from state to state, with a broad range: 10% - 82%. Also, the type of tax is different: Member States may apply flat tax rate (in Eastern European countries) and progressive rate (generally applicable in the countries of Central and Western Europe).

In these conditions, fiscal harmonization efforts should be tracked and further developed. In time, important steps havebeen made, but the present situation is far from its resolution. The more it is the advance in this direction and the explores of effects and all that harmonization of taxes in the 28 member states mean, the more difficult it seems to apply; distortions occur on other plans, influencing an entire economic cycle. And here comes the inevitable question: will manage the functionality of a single market in the true meaning of the word, referring here especially to the complete harmonization of direct and indirect taxes, to align all Member States, with significant differences between countries and paying the price for competitiveness elimination, and finally all of these to bring prosperity and economic progress?

4. Tax Competition and Its Impact on Taxes Harmonization

In literature, there were developed many economic models and it was bennshown that a reduction in taxes has a positive impact on economic growth, while increasing their level can brake growth: when taxes go higher, people are tempted to save, to spend money wisely, and when their income increases due to the tax burden decrease are encouraged to consume more, being in a period of economic development. One of the most important effects of the harmonization of taxes is the cancelation or even destroying the competition and tax competitiveness. When rates and tax bases will be the same in all countries from European Union, companies will be able to operate in any country without paying different taxes. For example, as long as the corporate tax will be 16% in all states, companies will evaluate other criteria when they will open a new branch, which can be harmful in some cases. Why fiscal equity can be harmful? There are many variables to consider such as the ideology of states depending on the living standard and economic development. Overall, in European Union, countries are divided into three categories:

❖ United Kingdom and Ireland, where economic policy is based on the natural course of the free market , with minimal involvement of the state in terms of adjusting fiscal policy to influence the economic environment;

❖ Continental Europe, which includes countries from central and west, where the state is a “ dynamic player" being involved in regulating mechanisms of economic and social policies, when taxation creates distortions in the market economy;

❖ Eastern Europe, where the idea of socialismis promoted and the state has an important role in ensuring good developments of society through fiscal levers[4].

This division is primarily based on direct taxes application; it is not accidental and was made naturally tracking the behavior of investors on the one hand and Member States strategy on the other hand. The Central and Western Europe economy

[4] Matei G., Pirvu D., “Controversies trend towards harmonization of corporate tax in the European Union ', Theoretical and Applied Economics, Vol. XVII (2010), No.8, pg 27-37

is based on well-established one, traditional and based on direct taxes. These countries have the infrastructure, attract populations from the rest of Europe with a high living standard and attract the investors with a stable economic environment proper for the growth and the development of their businesses. Basically, having all these, the state does not need to interfere with fiscalconditions orattractive taxes. At the opposite pole, there are the post-communist Eastern Europen countries, which were characterized along with socialist policy, not having traditional economy oriented to capitalism. These states require employers, unemployment rate is higher than in Western Europe, need foreign investment to increase revenue of the state budget through contributions, require high consumption to support economic growth. All this can be made by investors, by companies offering jobs, raising the living standards and helping the general economical growth. And to benefit from this, the state has a major impact by using fiscal levers tax: establish a lower corporate and income taxes than the other states, offers different tax incentives to companies.

Complete harmonization of the tax system, especially when we refer to direct taxes, it would be hard to accommodate in all three directions: on the one hand states with liberal ideology (eg Western Europe) will not agree eliminating tax competition, because competition is seen as a progress, as a motivation to adapt to new practices; on the other hand, Eastern European states have managed over the last 10 years to give up a larger tax base in favor of attracting foreign investment; practically sacrificing tax rates, also an advantage for them, and the context of harmonization would eliminate that tax advantage, which will lead many investors to open their doors to more developed countries with better infrastructure; this would install unemployment and inflation.

The latest changes in tax rates which were aimed to increase competition, attracting foreign investments, improving unemployment, lowering inflation and fight against tax evasion, e.g. Bulgaria in 2008 when he decided to apply a flat tax on corporate profits and household income of 10%, followed by Hungary that modified the corporate tax rate to 9% in 2011. Moreover, they are the smallest rates applied in the EU. This model is expected to be implemented in the future by the other states.

Although some Member States may suffer, harmonization of taxation is an important point in European policy. Given that capitals and labor are free to move easily and without restriction, evolutionof technologies determine a real-time communication between people from different places of the world, relationships and businesses develop at distance, but accurately, money circulating in different currencies in accounts all over the world, finding a common point in the taxes and creating a unique fiscal policy seems only a matter of time. Authorities will play a small role in the context of globalization.

5. Conclusions

Based on the analysis performed by this article, we can draw some conclusions. Although economic strategies and goals are carefully monitored and followed up by the European Commission, fiscal policies in each state have their uniqueness. Countries select and implement the most appropriate tax policies, according to the economic development, the population's needs, the individual goals, but respecting the main directions. In this respect, there are significant differences between countries - eastern countries base their budgetary revenue onindirect taxes, the Nordic countries and Western collect more direct taxes, meanwhile Central and West Central countries seek balance between the two categories.

The differences arewanted to be reduced, and the word "harmonization" in the field of taxation is increasingly speculated in studies. In the context of surging globalization, application of same taxes or the same tax base in all Member States should facilitate on the one hand the processes of monitoring and surveillance in the tax area and on the other side would relieve the authorities of the subject, their intervention aiming to be increasingly reduced. In fact, this is very difficult to enforce and it can be seen that progress is small. Comparing the two categories of taxes, we could conclude that progress has been greater in terms of indirect versus direct taxes, and this could be seen on the charts. Reaching a complete harmonization of taxation seems far away, especially when it comes with side effects, the most important being the elimination of tax competition. At first glance, we would be tempted to say that would be good, because it would be removed the unfair competition, but in the acceptance of several states, canceling competition will harm progress, economic and social development. Some states cope with this competition naturally through infrastructure, standard of living, innovation, but there are countries using tax levers to face the competition and to determine growth and full harmonization would change all this.

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