DISPUTES ABOUT THE TAX HARMONIZATION AND THE TAX COMPETITION IN THE EUROPEAN UNION

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1. Disputes on the tax competition

The world economy globalization, the progress of trade liberalization and capital flow extent have made easier the movement of goods, services, labour and capital beyond the natural borders. In consequence, the taxpayers have more possibilities to avoid the high taxation in a certain country by moving the taxation to countries with lower fiscal rates, so that the opportunities of economic development move from one country to another. The fiscal competion occurs when the goverments are encouraged to lower the fiscal charges in order to attract direct foreign investments, financial investments or to achieve other goals of their economic policy.

Income taxation causes great difficulties within an open economy, since there is a world competition of attracting investments. Thus, most states have started the reform of their fiscal policies in order to improve their international competitiveness. But the fiscal charge is only part of the complex formula that describes the national competitiveness, together with the labour cost, its flexibility, the professional training, the political and legislative stability, etc.

In case of barrier removing regarding the free movement of capitals and labour, the European Union exemplifies the best the role of competition through taxes. A good example is Ireland. It was the poorest country in the Community when it adhered in 1972, but it became one of the richest within three decades. Obviously one of the main factors that contributed to this development was the affiliation to the European Union and the sizable support it received in time. Unlike other states (Greece, Portugal, Spain) that did not show the same levels of prosperity during the same period and on similar conditions (see table 1), Ireland chose a friendly fiscal policy with the lowest income taxes for the European Union's companies, attracting an important volume of foreign investments, while the infrastructure needs were financed from European funds.

When the central and eastern European countries adhered to the European Union, this scenario repeated. Thus, when the fiscal advantages for the foreign investors were cancelled, the new member states had to reduce the tax rates for both foreign and domestic investors, in order to maintain their economies attractive.

The net taxpayers to the budget of the European Union (Germany, France, Italy) stood against this situation, considering that the new member states should increase their taxes to avoid an unfaithful competition with the countries with higher taxes. Also the countries with generous fiscal policies became the attack targets of some international organizations such as the International Monetary Fund or the Organization for Economic Cooperation and Development. From these organizations' points of view, the fiscal competition between states will generate serious negative implications in income distribution and financing possibilities for social and cultural expenses. Given such conditions, setting up multilateral

agreements to avoid the fiscal dumping is a frequent idea in the European Union and worldwide.

In 1996, the Ministers for Finance of the member states asked the Organization for Economic Cooperation and Development to draw up a plan of measures to limit the distortions caused by the unfaithful fiscal competition within the investments and financing decisions, as a consequence of the fiscal national rate. This report was approved on April 19th, 1998 by the OCDE Council, that also adopted a Recommendation for the governments of the member states.

The problem disputed by the OCDE was also taken by the Group of countries G7 during the Summit in Lyon, 1996. They concluded that globalization creates new problems in the fiscal field. Developing fiscal facilities meant to attract investments may produce an unfaithful fiscal competition between the states, causing a risk of trade and investments and international fiscal disagreements in time. Moreover, this may prejudice the equity and neutrality of fiscal policies and may affect the world economy development, as well as the taxpayers' trust. Thus, the report admitted the limits of unilateral and bilateral responsibility caused by the unfaithful fiscal practices, which are – basically – multilateral, in case of globalization, a fact that implies the progressive liberalization of commerce and transnational investments, the strongest engine of economic development and living standard increase.

On the other hand, the European Union made a series of actions to avoid the unfaithful fiscal competition. In December 1997, the European Council adopted a set of measures meant to avoid this phenomenon, a fact that diminished the disagreements on the unique market, avoided the loss caused by different fiscal "recipes" and allowed more favourable fiscal strategies. At the meeting of the Council for Economy and Finance (ECOFIN) from January 1st, 1997, the Ministers for Finance of the Member States agreed unanimously upon a ***Fiscal Package to fight against the Unfaithful Fiscal Competition***, that included the action code regarding business taxation, the key elements of interest taxation and the principle agreement regarding the need to eliminate trans-frontier payment taxation on interests and royalties between companies.

2. The Fiscal Agreement in the European Union

The main objective of the CEE treaty is to create a common market within the economic union, dominated by a loyal competition and whose characteristics are similar to those of a national market. The agreement process for the indirect taxation in the Community, according to the Article 99 of the Treaty, includes those measures necessary to create and allow to function the Internal Market, by preventing the competition altering and by removing the impediments against a free movement of goods and services.

The first step to achieve this objective was initiated in 1967, by replacing the cumulative cascade taxation used by then by the Member States with a value added tax, non-cumulative, applied in all phases of production and commerce. Thus, a new general consumption tax was introduced in all Member States, based on the principle that the tax for goods and services is directly proportional with the price, no matter the number of transactions within the production process and delivery before the stage of taxation. The second step was to abolish the fiscal control on the internal borders of the Community.

The process of fiscal agreement in the European Union started in 1996, when the European Committee presented a program of actions in order to quicken the transition of VAT system to a final common system. This program

contained five phases referring to the general VAT principles (taxation object, taxation share, taxpayer's definition, exceptions, rate approximation, etc.), taxation place, meaning the taxation principle in the origin place (the territorial VAT purpose, taxation place and taxpayers control), measures to support transition to the final system, maintaining the special models and procedure to share the fiscal incomes between the Member States. Although the idea of adopting the final VAT system, based on the principle of taxation in the origin country of the goods and services represents a strategic priority of the Community, it was proven very difficult to find agreement between the Member States on this matter. Therefore the Committee proposed on June 14th, 2000, a new *Strategy to ensure a more efficient operation of the VAT system on the common market (IP/00/615).* This strategy admits the impossibility to reach quickly the final common VAT system, and identifies the main actions to make the existing system efficient: increasing fiscal incomes by improving the control and administrative co-operation between authorities, fraud fighting, establishing a minimum standard VAT rate; decreasing the administration costs for taxpayers and simplifying the payment, record and refund VAT procedures, establishing special arrangements for some categories of goods and services, etc. A community system regarding the excise taxes was introduced on January 1st, 1993, as part of the Internal Market. The goods included in the community excise tax system are: mineral oils, tobacco and alcohol products. The community legislation defines those products that may be subject to excise taxation together with a minimum rate system for each group of products. The Member States can maintain or introduce excise taxes on other products, provided they do not involve formalities regarding the passing of Community internal borders and under conditions and obligations of the Treaty. According to the Community legislation regarding the excise taxes, the goods are subjects of taxation when they are produced in the Community or imported by the Community from third countries, but the tax must be paid only when the goods move for consume. Thus the excise taxes are paid to that Member State where the goods are consumed and the rates applies in that Member State.

In case of the excise taxes, the main measures adopted after 1995 regarded the closeness of structure and excise taxes in the Member States, as well as perfecting the fiscal control in order to apply excise taxes and mutual assistance of fiscal authorities. On March 14th, 2001, the European Committee presented the proposal for the Directive regarding the change of Directive 92/79/EEC, Directive 92/80/EEC and Directive 95/59/EC, regarding the structure and excise taxes applied for the tobacco products. The proposal objective is to minimise the difference between the excise tax rate applied for the same products in different State Members and to increase the excise tax rate in general. Specific taxation measures were adopted in the European Union in the fields of transport and energy, to promote biological fuels and environment protection. The European Committee adopted a program of actions and proposals for two directives meant to stimulate the use of alternative fuel sources in transport, by a normative and fiscal promotion of the biological fuels. The proposed actions will co-ordinate the national taxation models of biological fuels and will help the Member States to implement economic and legal premises to reduce the carbon dioxide emissions and to support the energetic security of the European Union. On July 24th, 2002, the Committee presented the proposal for the Council Directive regarding the change of Directive 92/81/EEC and Directive 92/82/EEC regarding the introduction of special fiscal arrangements for diesel fuels used for commercial purposes and aligning the

excise rate for oil and diesel fuels. The purpose of this proposal is to eliminate the unfaithful competition on the liberalised market of motor transports, through an agreed excise tax rate for the commercial fuels.

In case of direct taxation, the following measures for fiscal agreement may be pointed out:

- the proposal regarding the common system of interest and royalty taxation between the associated companies from different Member States, presented by the European Committee in 1998 and whose purpose is to abolish the double taxation of interest and royalty payments between associated companies (including branches) from different Member States. The Member States where the companies (branches) are located, and that perform the payments stipulated by the directive to the associated companies which are permanently located in other Member States will not apply any taxes or fees for these payments. The respective amounts are assigned to the taxation base of the commercial companies to whom benefits were transferred, in order to determine the income tax.

- the proposal regarding the ensuring of an efficient taxation of the natural persons' incomes as deposit interests on the Community territory, presented by the Committee in 1998, but carried out as a project in 2001. This directive is based on the principle that all incomes resulted from the interest payment due to a natural person resident of a Member State has to be charged according to the legislation of that state. The main mechanism provided by this directive to attain the mentioned goal is the information exchange between the agents that perform such payments and the fiscal authorities of their states on the first hand, and the automated information exchange between the fiscal authorities of different Member States. It was difficult to agree upon this Directive, because its implementation and the protection of the economic interests of some Member States meant to adopt some similar mechanisms by the states that are not part of the E.U. but may influence the capital flow to improve transparency for the fiscal purposes in the E.U.

- the European Committee presented on May 28th, 2001 and October 23rd, 2001 the official statements *"The Fiscal Policy in the European Union. Priorities for the next years"* and *"Toward the internal market without fiscal impediments. Strategy for supporting the companies with a consolidated corporate tax base on activities of community dimension".* The first statement contains a strategy for the future E.U. fiscal policy on terms stated by the European Council in Lisbon regarding the E.U. turning into the most competitive world economy by 2010. The second statement describes the need of a new approach of the taxation system for the companies in the E.U. The European Committee noticed that the significant fluctuation (up to 30%) of taxation rates for the commercial companies in different Member States represents a serious barrier against the trans-frontier economic activity within the Common Market, a fact that justifies the Community's interference. Therefore a short-term perspective was established, by adopting some measures to extend the field of action of the directives regarding interests and fusion, and the conventions regarding the double taxation. At the same time, the Committee considers that the companies' incomes will be charged according to a consolidated fiscal base for the activities performed within the European Union, in order to avoid inefficiency and current losses generated by a set of different fiscal rules.

The system proposed by the European Committee, known as the Common Consolidated Corporate Tax Base 'CCCTB', is going to be applied in parallels with the existing calculating methods in each member state, so that the companies may choose to adopt the pan-European system or to apply the national rules further. Those companies

that will use the unique formula will have to calculate the total profit within the territory of the European Union and then they will budget to those countries where these companies perform economic activity, in order to be charged with the tax rate applicable in the respective countries. The simplification of the taxation system for the companies' incomes would allow the investors that operate in more countries of the European Union to apply the same principles to calculate the tax as in other states, a fact that implies less time spent on fiscal administration.

A European Committee policy to achieve a common consolidated corporate base is motivated only as a first step to an agreed corporate fiscal level. Thus, the corporations that use the European infrastructure, the public services and the qualified employees will not be able to avoid the contribution to their financing.

3. The Taxation Rate Evolution in the E.U.

If starting with the first half of the 19th century, most of the world states adopted a progressive or gradual taxes system, at present we can notice that several governments opt for the unique tax system. Thus, the flat tax on income was introduced by Estonia, followed by Latvia (1994), Lithuania (1994), Russia (2001), Serbia (2003), Ukraine (2003), Slovakia (2003), Georgia (2004), Romania (2005), Bulgaria (2008).

Although the "flat tax" is not considered to be a panacea for all the economical problems, more and more countries – among them the new member states – introduced or are in the process of elaborating new universal taxation regimes. Most of these countries confront themselves with considerable budget deficits and some of them confront with the need to align the economic statute to the Euro Area requirements. The flat tax should contribute to the bureaucracy elimination, to counterbalance taxes avoidance and evasion, to offer stimulants for working, economizing and investing, to generate bigger budget incomes, so on so.

At the same time, though, a fixed taxes system assumes the elimination of all forms of taxes exemptions and facilities, favoring the rich to the detriment of the poor.

An essential conclusion cited by some researchers is that the efficiency and the success of the unique taxation quota regime depend on the level of this unique quota: the lower it gets, the more it tends to become more efficient. Experts also signalize the fact that, besides the tax system or the type of support granted to the new entrepreneurs, one country's competitiveness is determined by other factors as well. If it is true, generally, that in an economy the taxes reduced level lets more money to circulate and to be invested and that the fixed taxes grow citizens' will to pay them, low taxes can also be concretized in lower budget incomes, big budget deficits and budget expenses uncovering.

In case of a delayed fiscal reform, as that in Romania, the flat tax and the fiscal relaxation prove to be options with multiple consequences. It is obvious that the flat tax effects do not limit to the budget aspect. The collateral effects of flat tax introduction hint to multiple economic and social problems. Analyzing the economic situation of some European countries that adopted the flat tax system, one may notice that the benefits of this kind of taxation are evident mainly in case of a coherent approach of the fiscal reform and a stable economic environment. For most member states of the European Union, a policy of fiscal relaxation compatible to the need of avoiding the fiscal dumping will prove its indisputable advantages.

Taxation may contribute to the development and welfare of a country as follows:

- the taxes support most incomes needed to finance the public

services and social transfers to a higher quality;

- the taxes may be instruments that influence the labour occupancy rate and the efficient and sustainable use of the natural resources;
- the income redistribution between citizens, social groups, economic sectors and geographical regions are made through taxes.

The lack of co-ordination between the existing fiscal systems in the European Union may compromise the achievement of these objectives. If there is a mobile capital or if the taxation rate is different from one country to another, the multinational companies may use a complete set of fiscal optimising strategies (the profit transfer to the areas with low taxes, or setting some financial departments in fiscal paradises to finance the investments by credit lines within the group). These types of tax non-payment strategies generate income losses in the countries with high fiscal level and disadvantage the small and medium size companies that enter in competition on the same market. This process is evident in case of the taxes on the personal capital income or capital profit. The fiscal competition strongly influenced the taxation rate evolution in the European Union.

The legal taxation rate on the capital companies' incomes decreased from 38.0% in 1995 to 29.5% in 2006 in the E.U. 15 states, but this reduction was compensated by some measures that increase the calculation base. This trend has continued in 2008, as shown by an 0.9 percentage point drop in the EU-27 average. The cut was even stronger in the euro area (1.2 points), whose rates nevertheless remain higher (at 26.5 %, the euro area average is almost three points above the average for the Union as a whole). Seven Member States countries cut the corporate tax rate in 2008, most prominently Germany (-8.9 points) and Italy (-5.9 points).

Although the downward trend has been quite general, corporate tax rates still vary substantially within the Union (see table no. 2)

As in the case of personal income tax, the lowest rates are typical of countries with low overall tax ratios. Consequently, the new Member States tend to have low corporate income taxation as GDP percent (see figure no.1).

4. Conclusions

The fiscal integration within the European Union is achieved by relating to the four fundamental freedoms established by the European Union Treaty, respectively the free movement of goods, services, people and capitals. The tax rate agreement on the European companies' profits is subject of dispute and discussion. The governments of the countries that choose to increase the competitiveness and attractiveness of their national economies by fiscal policies as the unique tax rate dispute with the governments of the countries that count on a high fiscal rate in order to support the necessary resources to finance the "general welfare state". The European Committee's proposal to adopt measures to charge the capital companies' incomes according to a consolidated fiscal base for activities performed within the European Union has many supporters, attracted by the possibilities provided by a more concise taxation system and a better business planning that may result when applying such formula. This measures will be a very important step in the process of improving the business environment, by consolidating the Unique Market and increasing the competition. Among the 25 member countries, Ireland, Malta, the U.K., Estonia and Slovakia opposed to the idea of fiscal tax agreement, stating that tax rate should remain a decision of the national governments.

Table no. 1 Ireland's economic development, compared to the four poorest countries of the European Union (depending on the gross domestic product – 100% represents the average value for the E.U.)

	1983	1993	1995	1997
Ireland	64%	80%	90%	100%
Portugal	55%	69%	70%	70,7%
Spain	71%	78%	76%	77%
Greece	62%	65%	64%	64%

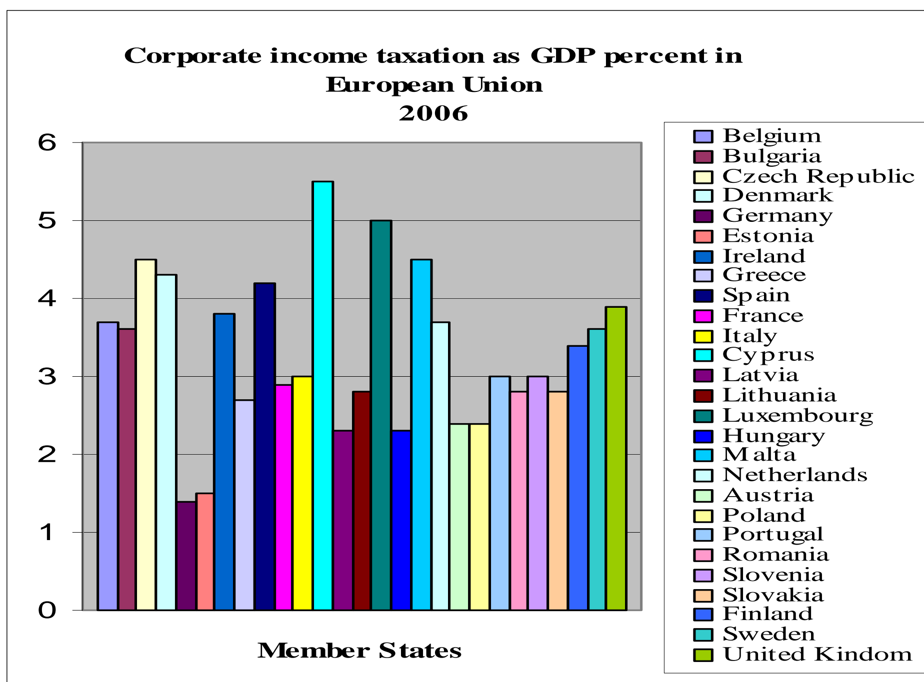
Source: Department of the Taoiseach, *Ireland and the European Union*, Dublin, 2006

Table no. 2 Corporate income taxes in some Member States

COUNTRIES	TAX RATES
Italy	27,5
Ireland	12,5
Spain	32,5
Greece, Austria,Portugal	25
Germany	29,8
Cyprus, Bulgaria	10
Slovak Republic	19
Romania	16
Malta	35

Source: European Comission,*Taxes in Europa database*, 2008

Figure no.1



Source: Eurostat Statistical Books, *Taxation trends in the European Union*, 2008 Edition

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