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Preserving Progressive Taxation through Harmonisation

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Former Director of Tax Policy, EU Commission

April 25, 2013

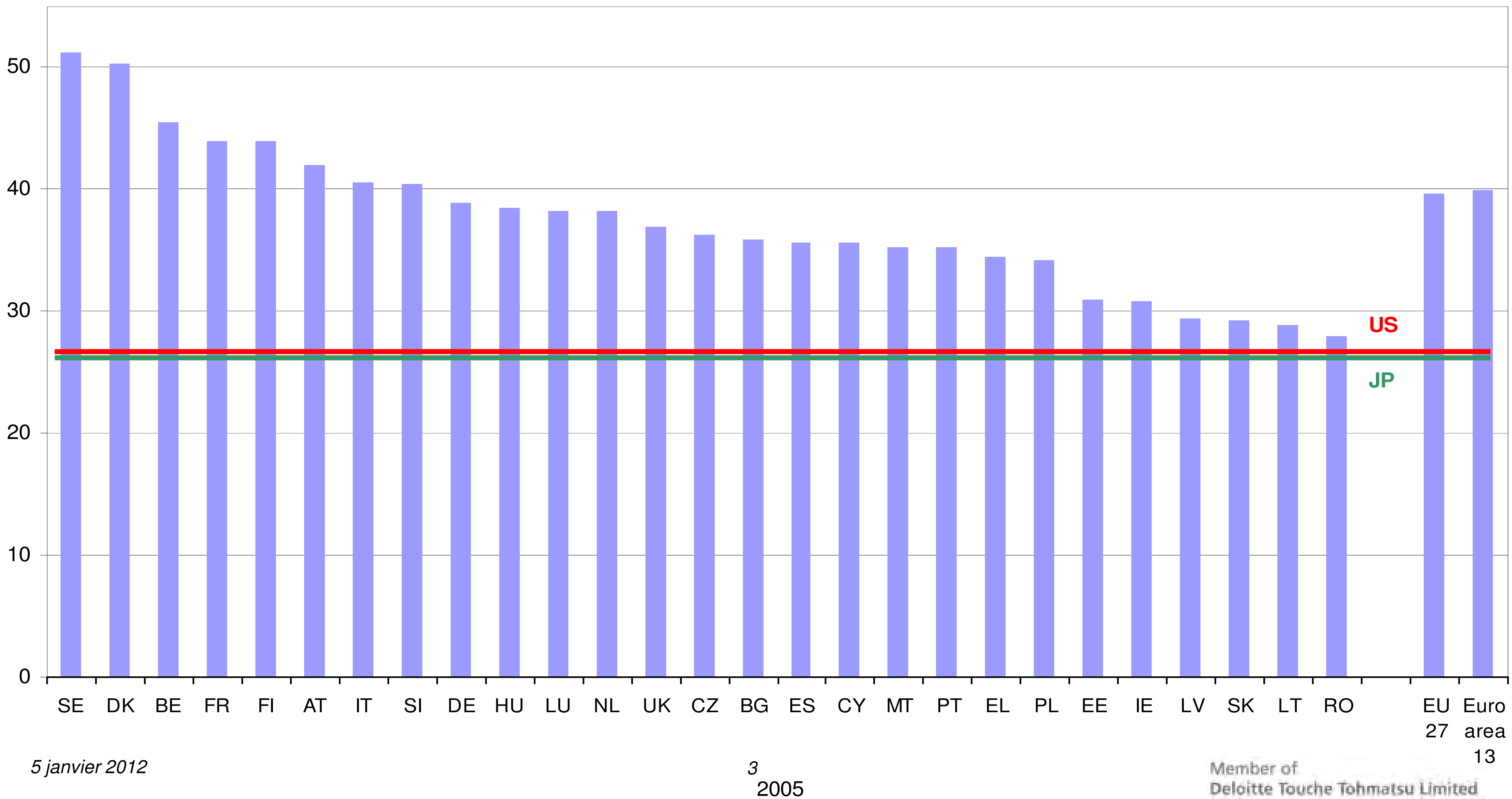
Taxation and economic performance

- **Low taxes do not mean better economic performance;**
- **High taxes do not mean efficient redistribution;**

- **Optimal model:**
  - An efficient VAT system (broad base, no reduced rates, few exemptions);
  - A fair progressive personal income tax (PIT);
  - A broad base/moderate rate corporate income tax (CIT);

- **OECD recommendation: the taxes that affect the least economic growth are by order:**
  - Recurrent property taxes,
  - VAT and excise duties (consumption taxes),
  - Personal income tax (PIT),
  - Corporate income tax

The overall tax burden (as % of GDP) varies significantly between Member States … but overall the EU is a high tax area



Structures of taxation in the EU

Structure of total tax revenues 2010 in % du PIB					
	Germany	Belgium	France	Italy	UE-27
Indirect Taxes :	**11,4**	**13,3**	**15,1**	**14,2**	**13,2**
VAT	7,3	7,1	7,0	6,2	7,0
Excises	2,6	2,2	2,1	2,0	2,7
Other indirect taxes on production	0,6	1,8	4,2	3,0	2,0
Direct Taxes :	**11,2**	**16,3**	**11,0**	**14,7**	**12,6**
CIT	2,2	2,7	1,9	2,3	2,4
PIT	8,4	12,3	7,6	11,7	9,1
Soc Sec Contributions	**15,5**	**14,2**	**16,7**	**13,4**	**12,7**
Total	**38,1**	**43,9**	**42,8**	**42,3**	**38,4**

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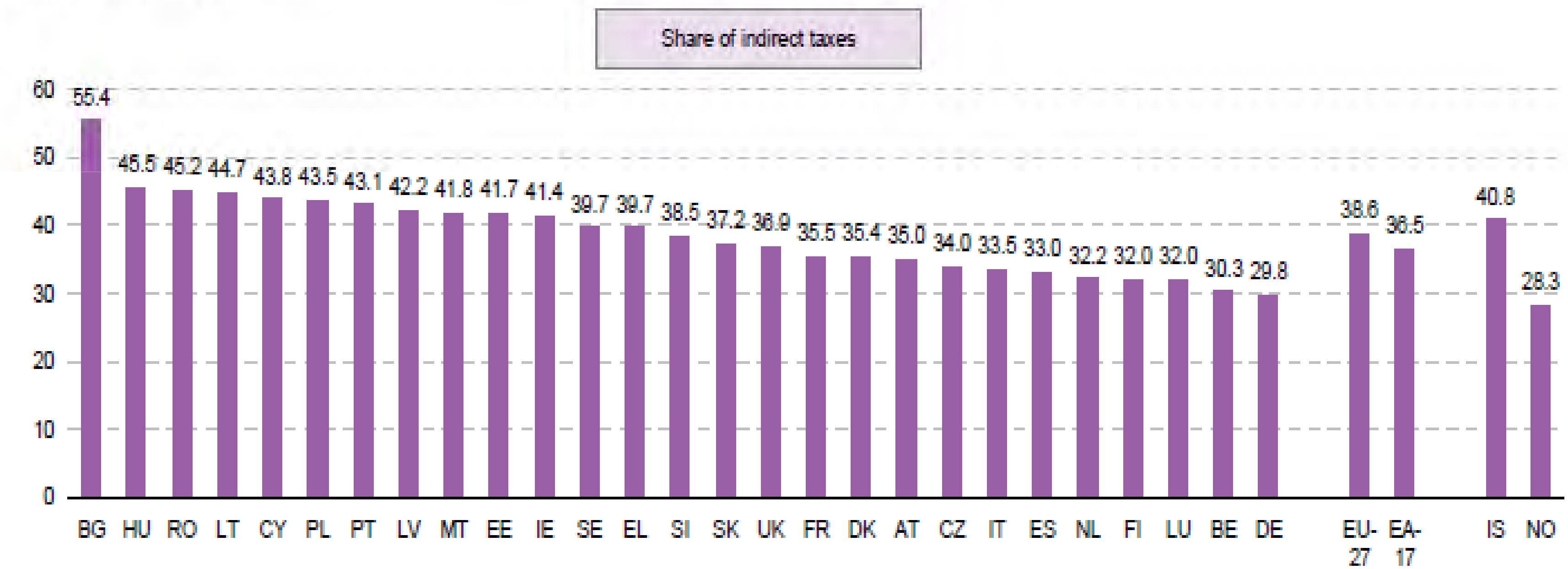
Share of indirect taxes in % of total tax revenues

Graph 1.5: Structure of tax revenues by major type of taxes
2010, % of total tax burden



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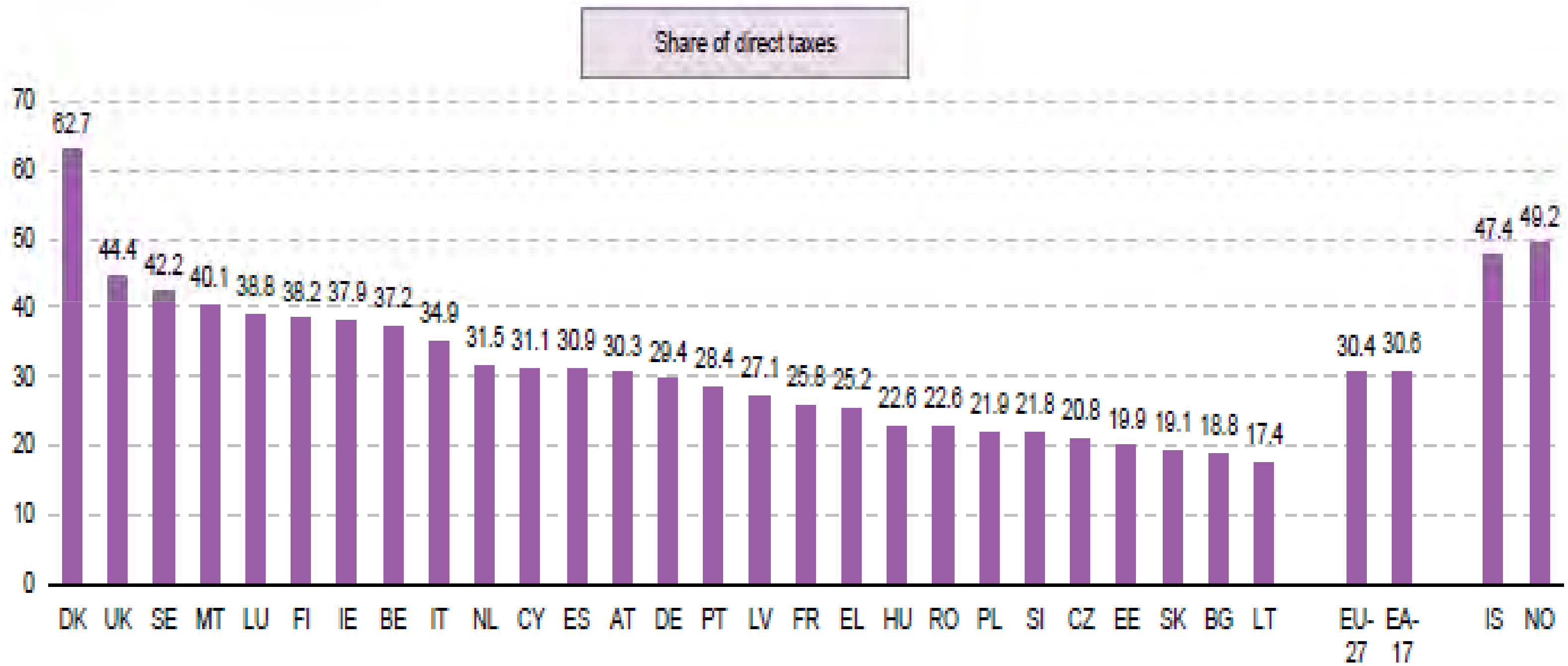
Share of direct taxes in % of total tax revenues



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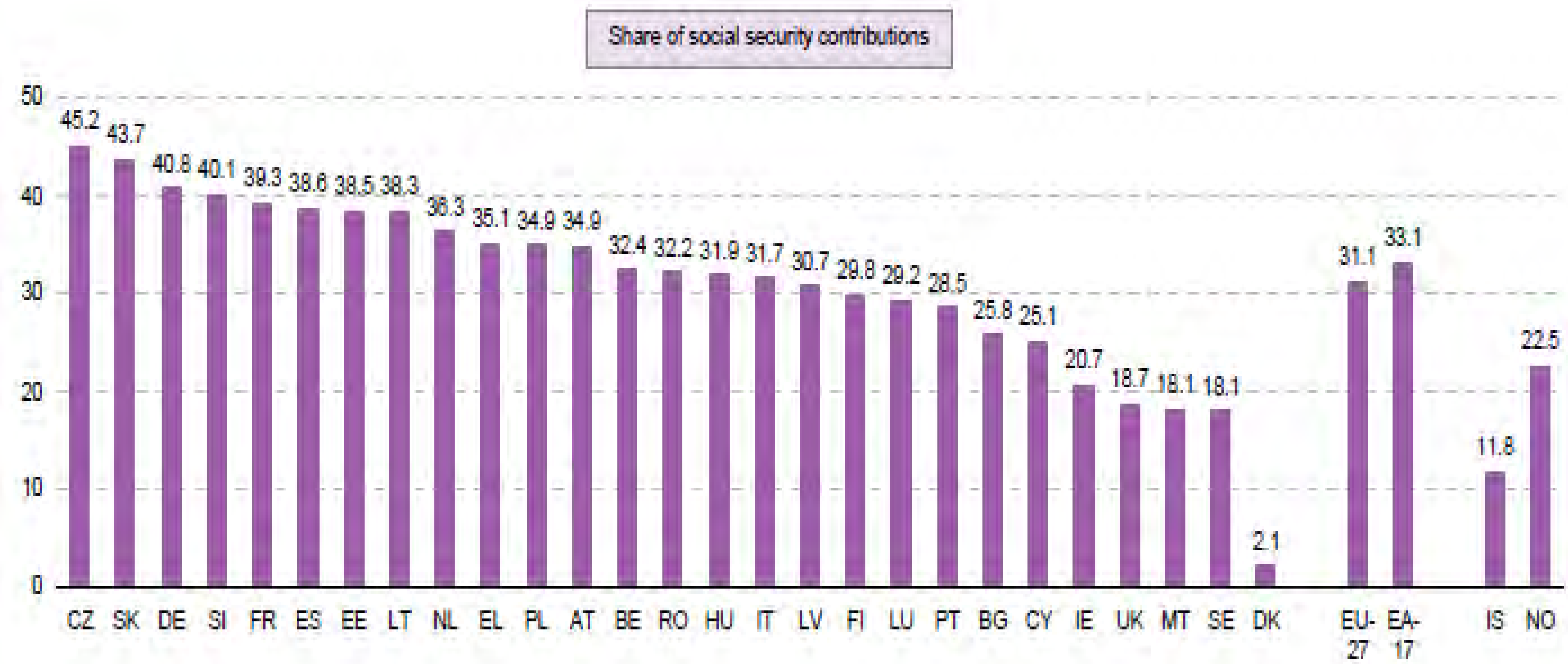
Share of social Security contributions in % of total tax revenues



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Competition

- **Global Competition needs a framework: the EU has competition rules, notably State aid rules contribute substantially to this framework;**

- **Even more so in a Single Market where citizens and companies have been granted rights (fundamental freedoms) across the EU Single Market (role of EUCJ);**

- **Today more than ever, strong competition for internationally mobile factors:**
  - Profits/investment
  - Highly skilled labour
  - Portfolio investments of households

- **Main focus of public debate on tax policy:**
  - Income from capital (savings by individuals)
  - Corporate tax

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Tax competition: good or bad ?

- **FOR:**
  - Means to discipline the State and protect citizens and companies from excessive taxation (Leviathan model)

- **AGAINST**
  - Decrease in tax revenues and risk for European social models with additionally potential negative repercussions on the tax system as a whole
  - Basic models of tax competition:
    - Harmful tax regimes
    - Race to the bottom in tax rates
    - Can capital and corporate tax survive?

- **A degree of tax competition is useful;**

- **But when tax competition becomes harmful it is a negative-sum game: revenue is lost but no growth/jobs created!**

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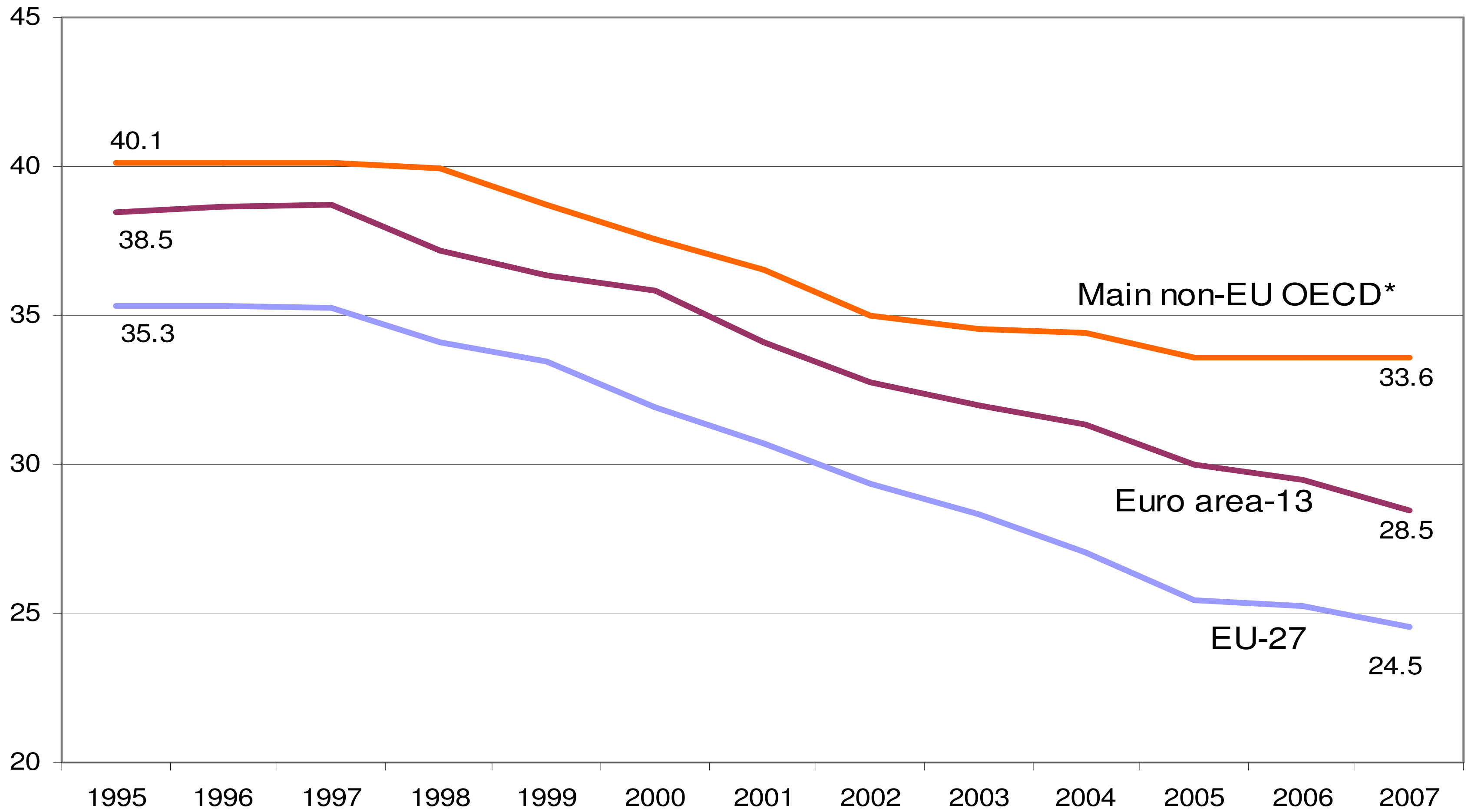
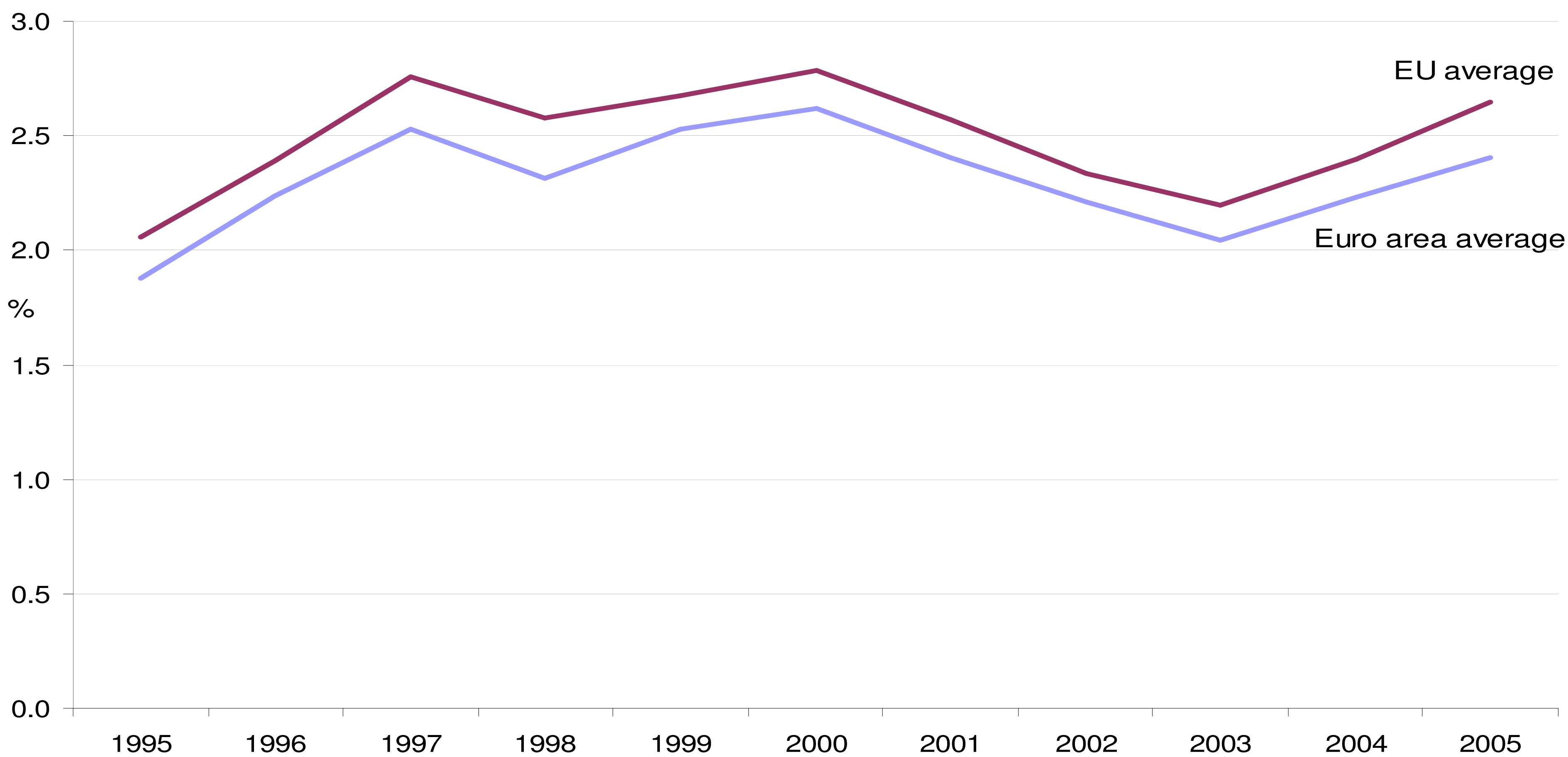
Corporate tax rates have declined rapidly in EU, levelled off in other main OECD countries*



*** US, JP, CDN, AUS, CH**

Cyclical pick-up, base broadening, profitability and " incorporatization" have been offsetting the impact of cut in corporate tax rates on revenues (as % of GDP)



Interpreting the results

- **Continued and sharp reduction of corporate statutory tax rates is mainly a "European" reality, source of specific political concern;**

- **Evidence that governments are competing more for profits or "taxing rights" than for physical investment;**

- **Relative stability of the corporate income tax may be explained by a series of factors: some base-broadening reforms, business cycle, higher profitability, and “incorporatization”.**

Marginal personal income tax rates: a clear decreasing trend

Table 1.3: Top personal income tax rates
1995-2012 income, in %

																		Difference	
	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	1995-2012	2000-2012
BE	60.6	60.6	60.6	60.6	60.6	60.6	60.1	56.4	53.7	53.7	53.7	53.7	53.7	53.7	53.7	53.7	53.7	53.7	-6.9	-6.9
BG	50.0	50.0	40.0	40.0	40.0	40.0	38.0	29.0	29.0	29.0	24.0	24.0	24.0	10.0	10.0	10.0	10.0	10.0	-40.0	-30.0
CZ	43.0	40.0	40.0	40.0	40.0	32.0	32.0	32.0	32.0	32.0	32.0	32.0	32.0	15.0	15.0	15.0	15.0	15.0	-28.0	-17.0
DK	65.7	64.7	65.9	64.5	64.2	62.9	62.8	63.0	63.0	62.3	62.3	62.3	62.3	62.3	62.3	55.4	55.4	55.4	-10.3	-7.5
DE	57.0	57.0	57.0	55.9	55.9	53.8	51.2	51.2	51.2	47.5	44.3	44.3	47.5	47.5	47.5	47.5	47.5	47.5	-9.5	-6.3
EE	26.0	26.0	26.0	26.0	26.0	26.0	26.0	26.0	26.0	26.0	24.0	23.0	22.0	21.0	21.0	21.0	21.0	21.0	-5.0	-5.0
IE	48.0	48.0	48.0	46.0	46.0	44.0	42.0	42.0	42.0	42.0	42.0	42.0	41.0	41.0	41.0	41.0	41.0	41.0	-7.0	-3.0
EL	45.0	45.0	45.0	45.0	45.0	45.0	42.5	40.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0	49.0	49.0	49.0	4.0	4.0
ES	56.0	56.0	56.0	56.0	48.0	48.0	48.0	48.0	45.0	45.0	45.0	45.0	43.0	43.0	43.0	43.0	45.0	52.0	-4.0	4.0
FR	59.1	59.6	57.7	59.0	59.0	59.0	58.3	57.8	54.8	53.4	53.5	45.8	45.8	45.8	45.8	45.8	46.7	46.8	-12.3	-12.2
IT	51.0	51.0	51.0	46.0	46.0	45.9	45.9	46.1	46.1	46.1	44.1	44.1	44.9	44.9	44.9	45.2	47.3	47.3	-3.7	1.4
CY	40.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0	38.5	-1.5	-1.5
LV	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	23.0	26.0	25.0	25.0	0.0	0.0
LT	33.0	33.0	33.0	33.0	33.0	33.0	33.0	33.0	33.0	33.0	33.0	27.0	27.0	24.0	15.0	15.0	15.0	15.0	-18.0	-18.0
LU	51.3	51.3	51.3	47.2	47.2	47.2	43.1	39.0	39.0	39.0	39.0	39.0	39.0	39.0	39.0	39.0	42.1	41.3	-9.9	-5.8
HU	44.0	44.0	44.0	44.0	44.0	44.0	40.0	40.0	40.0	38.0	38.0	36.0	40.0	40.0	40.0	40.6	20.3	20.3	-23.7	-23.7
MT	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	0.0	0.0
NL	60.0	60.0	60.0	60.0	60.0	60.0	52.0	52.0	52.0	52.0	52.0	52.0	52.0	52.0	52.0	52.0	52.0	52.0	-8.0	-8.0
AT	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	0.0	0.0
PL	45.0	45.0	44.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0	32.0	32.0	32.0	32.0	-13.0	-8.0
PT	40.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0	42.0	42.0	42.0	42.0	45.9	50.0	49.0	9.0	9.0
RO	40.0	40.0	40.0	48.0	40.0	40.0	40.0	40.0	40.0	40.0	16.0	16.0	16.0	16.0	16.0	16.0	16.0	16.0	-24.0	-24.0
SI	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	41.0	41.0	41.0	41.0	41.0	41.0	-9.0	-9.0
SK	42.0	42.0	42.0	42.0	42.0	42.0	42.0	38.0	38.0	19.0	19.0	19.0	19.0	19.0	19.0	19.0	19.0	19.0	-23.0	-23.0
FI	62.2	61.2	59.5	57.8	55.6	54.0	53.5	52.5	52.2	52.1	51.0	50.9	50.5	50.1	49.1	49.0	49.2	49.0	-13.2	-5.0
SE	61.3	61.4	54.4	56.7	53.6	51.5	53.1	55.5	54.7	56.5	56.6	56.6	56.6	56.4	56.5	56.6	56.6	56.6	-4.7	5.1
UK	40.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0	50.0	50.0	50.0	10.0	10.0
NO	41.7	41.7	41.7	41.7	41.5	47.5	47.5	47.5	47.5	47.5	43.5	40.0	40.0	40.0	40.0	40.0	40.0	40.0	-1.7	-7.5
IS	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	46.1	46.1	31.8	-	-
EU-27	47.4	47.2	46.5	46.2	45.4	44.8	43.8	43.0	42.3	41.3	40.0	39.4	39.2	37.9	37.2	37.9	37.6	38.1	-9.3	-6.7
EA-17	49.0	49.0	48.8	48.0	47.4	47.1	45.9	44.9	43.8	42.4	41.9	41.5	41.0	40.9	40.8	41.6	42.3	43.1	-5.9	-4.0

[*] Figures in *italics* represent flat-rate tax

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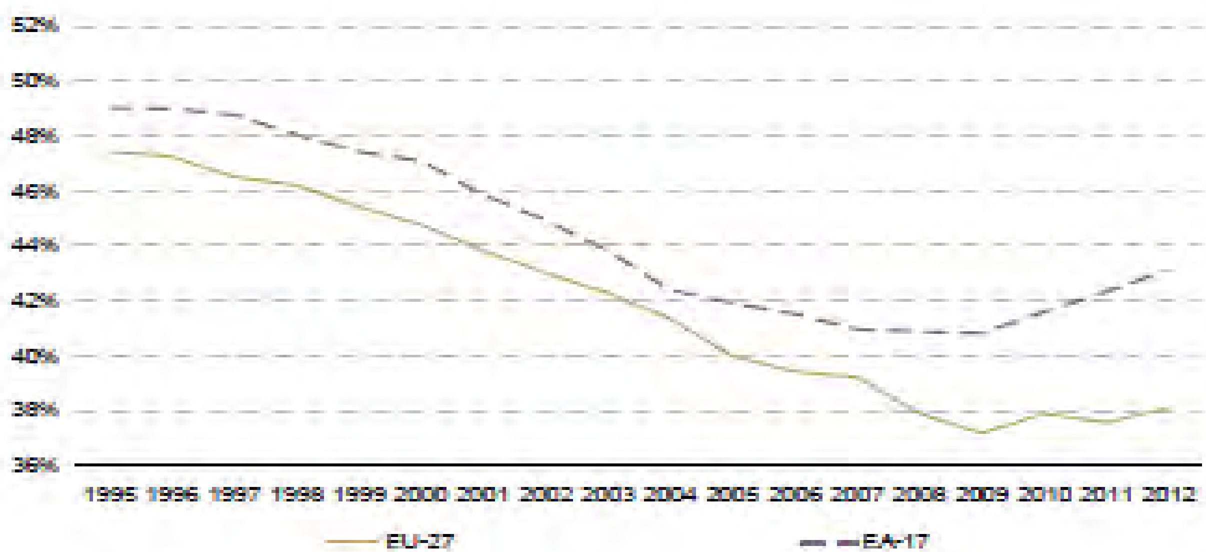
Marginal personal income tax rates: a clear decreasing trend

Graph 1.12: Development of top personal income tax rate
1995-2012, in %



Source: Commission services

Tax Policy in the EU: the Main stages

- **Tax Policy in the EU: 1st Period:**
  - **1962** : Neumark report: Adoption of VAT; first suggestion of company tax harmonisation; Multilateral tax treaty?
  - **Period 1970-80**:
    - implementing the full Common VAT System;
    - several attempts of harmonisation of company taxation: no success.
- **Tax Policy in the EU: 2nd Period:**
  - **1985** White Paper Internal Market
  - **1990** Adoption of Parent-Subsidiary Directive; Merger Directive; Arbitration Convention.
  - **1992** Internal Market without border controls: Harmonising VAT and Excise duties

Tax Policy in the EU: 3rd Period, from 1996, a new way of making tax policy?

1995-1997 A new approach: the Tax Package;

1997-2005 Negotiation/Implementation of the Tax Package;

- Code of conduct/Harmful Tax Competition;
- Savings Taxation
- Interests and Royalties Directive

2001- now Completing the Approach of Tax Policy in the EU:

- Tax Policy Communication (May 2001);
- Study, Report and Communications on Company taxation (Oct 2001);
- Targeted solutions (amending directives 2003-2005, JTPF);
- Coordination of tax systems (December 2006): Exit tax, Cross border loss compensation, Anti-abuse measures;
- CCCTB Proposal (March 2011);
- Fight against fraud and evasion.

Tax competition: the EU Code of Conduct

Defining harmful tax competition:

- Effective rate lower (or zero) than normal/standard rate
- 5 Criteria:
  - Favouring non-residents,
  - Ring fencing,
  - No real economic activity,
  - Transfer pricing: not arm's length,
  - Non-transparent/discretionary

Tax competition: the EU Code of Conduct

- **The Code of conduct: a political engagement;**

- **Rolling back more than 100 regimes + Standstill provision;**
  - Method
    - Peer review
    - No binding legislation
  - State aid proceedings (17) and Commission guidance 1998: Clarifying of how the rules apply.
  - Rollback and standstill
    - 400 measures examined
    - 100 harmful
    - Process continues

- **Revisiting the code:**
  - New forms of harmful regimes, Impatriates, Dividends, Mismatches (Hybrids);
  - Moving to horizontal issues and promotion to third countries (good tax governance)

Taxation of savings

- **Freedom of capital movements**: from early 90's taxing savings invested in neighbouring countries becomes more difficult when no withholding, no exchange information !
- **Savings Directive (2005):** principle of automatic exchange of information on interest paid to non-residents from the EU between MS;
- **Equivalent measures:** apply in 5 neighbouring third countries (CH, MON, LIE, SI AND) and the USA;
- **Importance of Definitions** for a harmonized system: paying agent, beneficial ownership, interest payments,
- **Derogation for (now) 2 MS**: Austria and Luxembourg: withholding at a rate of (now) 35% until third countries apply OECD/TIEA model of exchange of informatio upon request;
- **Amending Directive, COM/2008/727 of November 2008:** extending the scope, closing loopholes, trusts etc. Still blocked by Lux and AUT.

Some conclusions on automatic exchange of information (AEI) on income from savings

AEI works well, even in multilateral framework but need for substantial harmonization of concepts and scope;

EU Directives 2011/16/UE on administrative cooperation sets out a step-by-step approach aimed at ensuring automatic exchange of information for 5 (8) categories of income and capital by 2015;

TIEA/OECD movement can help ending transitional provisions but USA position (FATCA) is crucial;

Quality of information exchanged must be improved;

Effective use by tax administrations must be encouraged;

Effective and progressive residence taxation remains dependent on AEI!

OECD/G 20: BEPS (Base Erosion Profit Shifting)

"Recently more and more enterprises organized abroad by American firms have arranged their corporate structures aided by artificial arrangements between parent and subsidiary regarding intercompany pricing, the transfer of patent licensing rights, the shifting of management fees, and similar practices[...] in order to reduce sharply or eliminate completely their tax liabilities both at home and abroad"

Statement made by President J. F. Kennedy in 1961

"...We reiterate the need to prevent base erosion and profit shifting and we will follow with attention the ongoing work of the OECD in this area"

G20 Leaders Declaration of 19 June 2012, Los Cabos

The report concludes that, in addition to a need for increased transparency on effective tax rates of MNEs, key pressure areas include those related to:

- International mismatches in entity and instrument characterisation including, hybrid mismatch arrangements and arbitrage;
- Application of treaty concepts to profits derived from the delivery of digital goods and services;
- The tax treatment of related party debt-financing, captive insurance and other intra-group financial transactions;
- Transfer pricing, in particular in relation to the shifting of risks and intangibles, the artificial splitting of ownership of assets between legal entities within a group, and transactions between such entities that would rarely take place between independents;
- The effectiveness of anti-avoidance measures, in particular GAARs, CFC regimes, thin capitalisation rules and rules to prevent tax treaty abuse;
- The availability of harmful preferential regimes.

Clamping down on tax evasion and avoidance: December 2012, Commission presents the way forward

An Action Plan with a long (shopping) list of different elements: new initiatives that can be progressed this year, initiatives planned for next year and those requiring a longer timeframe;

Two Commission Recommendation:

- one on aggressive tax planning: addressing legal technicalities and loopholes which some companies exploit to avoid paying their fair share. The accent is on anti-abuse: a GAAR and a revision of anti-abuse in existing directives;

- the other on measures intended to encourage third countries to apply minimum standards of good governance in tax matters

A new Platform for Tax Good Governance will monitor and report on Member States' application of the Recommendations (call for application just launched this week).

CORPORATE TAXATION: Why not a comprehensive solution? A Common Corporate Consolidated Base (CCCTB)

Common corporate tax base: a broad base, no niches, few exemptions ?

Getting rid of transfer prices: Consolidated with apportionment;

Apportionment:

- A single formulae for the EU;
- 3 Factors: Labour, Capital, Sales

Administration: a one stop shop solution ?

Corporate taxation in the EU: The World Today

DE

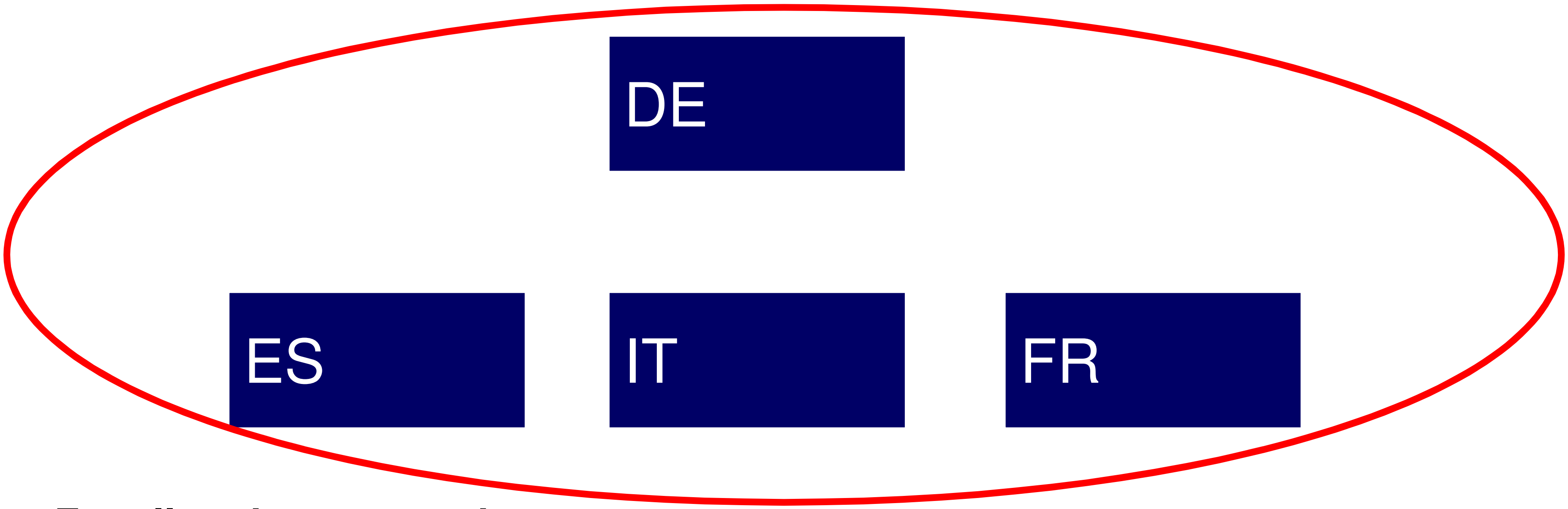
ES

IT

FR

- Separate tax rules and filing arrangements in each MS
- Transfer pricing and thin capitalisation rules
- Limited cross-border loss relief between group members

The New World of CCCTB



For all opting companies:

- One set of tax rules (the common base)

For consolidated groups:

- One consolidated tax return filed in one State (one stop shop)
- Intra-EU transfer pricing and thin capitalization rules replaced by consolidation and formulary apportionment of results
- Automatic offset of losses within group

CCCTB: The decision process

- Need **unanimity of Council** + opinion EP + opinion EESC;
- **European Parliament**: gave a positive opinion on April 19, 2012; with some amendments (on the optional character: compulsory after 5 years) and rate approximation not excluded in future developments !
- **EESC report Oct 26, 2011: positive opinion (an important step for the internal market);**
- **C of R: positive opinion on December15, 2011**
- **Euro Plus Pact: Heads of Government Euro and BG, DK, LV, LT, PL and RO agreed that « developing a common corporate tax base could be a revenue neutral way forward to ensure consistency among national tax systems while respecting national tax strategies, and to contribute to fiscal sustainability and the competitiveness of European businesses »**
- **Enhanced cooperation? At least 9 MS but authorization to proceed by qualified majority voting and provided not a barrier or distortion of competition!**

CCCTB: The decision process (2)

Subsidiarity and proportionality: Protocol 2 of Lisbon treaty and yellow card procedure; national parliaments have the right to issue reasoned opinion stating proposal not in conformity with the principle of subsidiarity;

Two votes for each national parliament (total 54) ; if 1/3 negative votes, COM must review its proposal;

9 Parliaments gave a negative vote cast of 13 (BG 2, IE 1, MT 2, NL 1, PL 1, RO 1, SE 2, SK 2, UK 1) which is below the threshold of 18 votes;

6 Chambers of national Parliaments sent in positive opinions (BE, CZ (Senate), LU, PT, IT (Deputies and Senate))

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How to apply the principle fo subsidiarity to taxation?

- What are the tests to be performed for centralizing decisions/decentralizing decisions?
- Is there a clear legal or economic test?
- Is distortion of competition the principal element of the test?
- Is the “inattributability” of the tax an element of the test?
- Is overlapping of tax sovereignty/competence part of the test?

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Council Discussion

he proposal has been discussed under the HU and PL Presidency and a complete examination was conducted under the DK Pcy of the provisions concerning the calculation of the common tax base (no consolidation).

riority was given to certain aspects (protecting the tax base), e.g. limitation of interests deductions, limitation on carry forward of losses, allocation of profits to Pes, CFC and anti abuse rules on hybrid mismatches of entities and financial instruments;

DK Pcy has presented a first compromise text, interest was expressed by delegations to, pursue work, even if some maintained substantial objections, Technical discussion finalized by Cyprus;

n March 2013, Ireland suggests that for the time being a detailed examination of a solution limited to a Common Base would be welcome !

Hello harmonization, Good bye global reform ?

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