Editorial

Where Does Tax Harmonization Stand Today?

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On 1 November 1983, the Treaty of Maastricht became effective, at a time when the economy of the Community is in the middle of a deep recession. From the perspective of the Community, the current economic crisis is quite surprising because it was expected that additional economic growth would be created with the opening of the internal market on 1 January of this year. However, negative effects on the Community economies seemed to be much stronger and have created significant unemployment in the Member States. The following are only a few of these economic problems:

At the time of German reunification there was some industrial over-expansion, particularly in the western part of Germany due to the anticipated needs of the people in East Germany. Additional demand was created by generous exchange rates on savings and the free availability of such funds. Equally or even more important was the impact of the opening of the iron curtain and the immediate availability of cheap labour to western economies. Another impact was created by the amazing progress of some developing countries, especially mainland China.

This economic situation has created a new wave of pessimism in Europe which has been in part responsible for recent calls to slow down the European integration process. It is understandable that in particular, the Community blue-collar workers object increasingly to further European integration, for they suffer the most from the recession and the consequent reduction in their standard of living. At least psychologically, they blame European integration as the cause for their despair.

The resulting deep European pessimism also affects trends of taxation in the Community. This hardly will allow a rather farreaching harmonization of company taxation which in my view is necessary if the Community wants to compete successfully with both the world's industrial giants and emerging tigers.

From a Community tax perspective, the Treaty of Maastricht is a step backwards. For example, Article 73d allows the Member States the possibility to discriminate against EC private investors who are resident in another Member State and who had so far been protected by the Directive on Capital Movement of 1988. Here Member State governments introduced new tax law without any democratic authority other than the fact that they represented usually a majority of the people of their countries. National parliaments usually had only the possibility to vote yes or no to the complete treaty and not with respect to individual articles. This is a good example of taxation without real representation. Obviously, the governments of the Member States had feared that the European Court of Justice might interpret Article 67 of the treaty together with the Directive on Capital Movements in such a way that a Member State must also grant imputation tax credits for dividends from companies of other Member States. This is an unfortunate step backwards because in my view the uniform capital market can only be created when investment decisions are not distorted by major tax considerations. It should be mentioned, however, that the more important anti-discrimination clauses such as Article 48 for employees and Article 52 for enterprises with direct investments will continue to apply.

The incorporation of the general principle of subsidiarity in the Treaty of Maastricht (Art. 3b) may also have an impact on taxation. It seems clear that a fair tax system within the Union cannot be sufficiently achieved by the Member States alone and 'can therefore by reason of the scale or effects of the proposed action, be better achieved by the Community'. This general text seems to be written for taxation measures.

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Subsidiarity is basically not an economic term but a political one. Its meaning will depend on the interpretation by the European Court of Justice. Will it be different from the sense of 'federalism'? In my view, the need for tax harmonization is primarily an issue of fair competition between enterprises which is basically an economic issue. Consequently, in my view, there is a clear priority of competitive needs in taxation over subsidiarity.

Looking back to the meetings of the Ruding Committee I can only say that in the meantime our worst fears have been realized in one respect: tax competition continues to get stronger among Member States in the Community. Some of the new measures are reasonable, for example, Germany is reducing its tax rates: although the differential between corporate tax rates on retained and distributed income is getting bigger. Particularly when the 5 per cent withholding tax on intercompany dividends is eliminated in mid 1996, distortions will be notable. The change in corporate income tax rates in the German tax reform brought an even stronger discrimination of permanent establishments from other Member States *vis-à-vis* subsidiaries. It is surprising that this rather obvious point was accepted by the German Minister of Finance and by Parliament. In the case of Germany, the increasing tax competition with other Member States led to the need to introduce several treaty overriding provisions; this would have been unacceptable just a few years ago. One can observe that even today, for the larger Member States in the Community, community and international tax aspects still seem to be of secondary importance, often to the detriment of their own businesses.

The proposed Directives on interest and royalty payments between enterprises of the Community seem to be stuck within the EC Council of Ministers. In my view, a solution could be much easier found when the Member States would agree on levying the same rate of withholding tax on royalties and interest payments which are made to persons non-residents of the Community.

Important developments may be in the pipeline as far as border workers are concerned. There is a new case before the European Court concerning a Belgian who crosses the German border every day in order to work in Germany. In my view the tax differences between resident and non-resident persons must be substantially reduced in order to do away with discrimination. On the other hand, perhaps the exemption with progression approach should also be introduced for non-resident taxpayers (as is traditionally done in Switzerland).

Are there any points of light in this rather dark picture?

The VAT rules for intra-community trade have become effective. A number of problems came up, some of them expected, others not. In general, it can be said that the transition went more smoothly than anticipated. Statistics did not show losses in VAT revenue, although a few fraud cases have already come up. To the extent excise taxes are concerned, the transition brought more problems.

Another positive aspect is the big success of the Parent/Subsidiary Directive despite a few small problems, such as differences in its scope of application at the Member State level. Nevertheless, the extra cost of investing and doing business abroad are substantially reduced. The Merger Directive on the other hand is quite useless as far as cross-border mergers and demergers are concerned; it appears that most Member States are content to wait until the civil law instruments of universal succession are introduced, which in turn seem to be dependent on action at the Community level.

Also, in the future, tax harmonization will in principle require unanimity. This makes the situation extremely difficult, particularly for the Commission. In view of this difficulty it seems that the active part, as far as direct taxes are concerned, was shifted from the Commission to the Court of Justice in discrimination cases. Starting with the landmark decision of Commission versus France in 1986, the Court of Justice applied the general principles of non-discrimination also to taxation. It is surprising that the Member States have not acted more quickly to amend the domestic law which gives rise to those obvious cases of discrimination. A good example is §23 (2) of the German Income Tax Act which states that the general rule of exemption from capital gains taxation when an investment asset is held by a private investor for more than six months does not have to be observed in case of *German* bonds bought in *Germany*. On the other hand the immediate sale of bonds issued by persons of other Member States would not fall under this exemption, nor the sale of German bonds bought in another Member State. It is amazing that such a clear violation of simple Community principles has never been tested before the courts.