Editorial

EC TAX REVIEW 1998-1

The climate is changing

Mario Monti, *Member of the European Commission*

On 1 December 1997, we witnessed a historic agreement on taxation by ECOFIN Ministers: they unanimously adopted a package to tackle harmful tax competition, including a code of conduct for business taxation, key elements on the taxation of savings and agreement in principle on the need to eliminate withholding taxes on cross-border interest and royalty payments between companies.[1]

The last time the ECOFIN Council agreed unanimously on direct taxation measures was more than seven years ago. That was in July 1990, when the arbitration convention was signed and when the parent-subsidiary and merger directives were adopted after 21 years of Council negotiations.

The Minister's decision of 1 December underlines the need to reduce the continuing distortions in the single market. Furthermore, the smooth functioning of the single market will be essential for Economic and Monetary Union (EMU). The forthcoming introduction of the Euro will bring cross-border price transparency, will eliminate exchange risks and costs and will render cross-border flows more sensitive to tax competition between Member States. Harmful tax competition can distort the allocation of productive resources. It can also indirectly penalize employment as tax systems become increasingly reliant on less mobile tax bases such as labour rather than on activities which more easily take advantage of preferential tax regimes elsewhere. Greater awareness of these facts has altered the context in which discussions on tax coordination in the EU have been conducted.

Taxation is now higher on the EU agenda than it has been before. This is also demonstrated by the Resolution on economic policy coordination in stage III of EMU which Heads of State and Government adopted at the Luxembourg European Council on 12 and 13 December 1997. This Resolution states, among other things, that

> 'enhanced economic policy co-ordination should give full attention to national economic developments and policies which have the potential to influence monetary and financial conditions throughout the Euro area or the smooth functioning of the Internal Market. This includes: ... the fostering of tax reform to raise efficiency and the discouragement of harmful tax competition.'

The agreement reached by ECOFIN Ministers in December follows a process of intensive discussions on the key challenges to taxation policies initiated by the Commission in its Communication 'Taxation in the European Union'. In this communication the Commission presented a new and comprehensive approach to taxation, which was discussed by ECOFIN Ministers meeting in Verona in April 1996. Discussions were followed by the establishment of the High Level Group, later replaced by the Taxation Policy Group, consisting of high-level personal representatives of Ministers of Finance and chaired by the Commission. I am sure that the trust and co-operation that was created in these groups helped considerably in building the consensus which was reached on 1 December.

Let me be clear on the objectives of the package: it is a targeted effort to tackle harmful tax competition and to eliminate some distortions in the single market, it is not intended to raise taxes, which would damage the international competitiveness of the Union, nor is it intended to be the start of a process of wholesale tax harmonization, which would be incompatible with the subsidarity principle.

The December agreement will be followed up in the first half of 1998. I could sum-marize the highlights as follows: first, Member States and Commission will need to put into effect the code of conduct and establish the review group, which will assess potentially harmful regimes. In parallel with these developments the Commission will publish guidelines regarding the application of the state aid rules of Arts. 92 to 94 of the EC Treaty on measures relating to business taxation.

The Commission will also present a new proposal to eliminate withholding taxes on cross-border interest and royalty payments between companies. Subsequently the Commission will present a new proposal for a Directive on the taxation of savings. This will be based on the elements agreed by the Council, of which the coexistence model, under which each Member State would either operate a withholding tax on interest paid to residents of another Member State or would provide information on that income to the other Member State, is the most important.

The Council also requested that the Taxation Policy Group continues to provide assistance to the Commission in taking forward its work on taxation. As this

[1] The conclusions of the ECOFIN Council meeting are published in the Official Journal C2 of 6 January 1998, pp. 1-6.

Group has proved to be an excellent vehicle for making progress in this difficult and sensitive field, I am happy that it can continue to be a laboratory for new ideas and for discussion on new proposals.

One of the conclusions from the decision of 1 December is that the comprehensive approach, which entails the bundling of measures in a package, has been successful. This approach allows a balance to be maintained between the different interests of the Member States. The agreement reached on 1 December is a compromise: solutions which are perfect for everybody are simply not available. The central issue is that, in a process of give and take, Member States have been willing to reach a political agreement of major significance in an area which is vital for the single market. I am therefore confident about the future: there is a lot of work ahead to implement the tax package and to remove other distortions in the tax field, but it will undoubtedly benefit from the current changing climate.