Editorial

Capital gains tax: the case for competition

Barry Bracewell-Milnes, Banstead, United Kingdom

Capital gains are not immune from the European Commission's natural proclivity to harmonise everything, irrespective of whether harmonisation is serving a useful purpose. As early as 1988, the commentary on Article 16 of the Preliminary Draft Directive on the taxable profits of undertakings (XV/13/1; XV/27/88-EN) argued that companies' capital gains should be treated as ordinary profits and taxed at the normal rate, not at the reduced rates applicable in certain Member States. This shows how easily the subject of the tax base can lead to that of tax rates.

This thought is echoed in Chapter 10 of the Ruding Committee Report: 'The Committee recommends that the Commission proposes by way of a directive a proposal to the effect that in the absence of reinvestment within a certain period of time all capital gains realized on fixed assets and controlling shareholdings be taxed at the ordinary rate of corporate income tax.' The Commission's Information Memo of 24 June does not refer explicitly to this proposal; but it says of a series of proposed measures 'relating to the rates, the base and the systems of corporation tax' that 'the Commission is in the process of examining those suggestions'.

Throughout the industrialised world there is a wide diversity of approach to the taxation (or non-taxation) of the capital gains of corporations and individuals. For individuals, this diversity is substantiated in the OECD's 'Taxation of Net Wealth, Capital Transfers and Capital Gains of Individuals' (1979 and 1988). The range of practice stretches from the exemption of capital gains to their taxation as income. These differences of practice reflect differences of tax philosophy, since some regard capital gains as income while others regard at least long-term capital gains as entirely different. In recent years the United States, the United Kingdom and Australia, for example, have subjected capital gains to marginal rates of income tax; the Netherlands and New Zealand, by contrast, have rejected the idea of having a capital gains tax at all. Intellectual opposition to the concept of capital gains taxation remains vigorous: for example, in September the Institute of Economic Affairs, London, published their Readings 38 entitled 'A Discredited Tax: The Capital Gains Tax Problem and its Solution'.

In 1987 Chancellor of the Exchequer Nigel Lawson increased the British rates of tax on corporate capital gains to the rates on corporate income profits; and in 1988 he did the same for the capital gains of individuals. The opposition to this new regime is so widespread that there is now a serious chance that these measures will be rescinded in the near future. A similar mistake once entrenched at European Community level, however, would not be so easily corrected. And a uniform minimum capital gains tax would be another heavy fiscal load for the Community to bear, not least in competition with third countries such as the 'Tigers' of the Far East: for example, Lee Kuan Yew, Prime Minister of Singapore for many years, is said to have regarded the absence of capital gains tax as a necessary condition for rapid growth.

For the foreseeable future, there is unlikely to be a consensus in the Community on the taxation of corporate (or indeed individuals') capital gains. This is highly unsuitable terrain for initiatives by the European Commission. Under the principle of subsidiarity, the matter should be left to the discretion of the Member States. If the resulting tax competition means a downward pressure on capital gains taxation, so much the better.