Tax Harmonization in the EU

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Abstract
The paper deals with the problems of tax harmonization in the EU. It is discussed from the tax theory point of view as well as from the view of the tax practice. Several attitudes to tax competition and tax harmonization are discussed, including the tax competition theories. The paper presents several successes which have been achieved in the area of direct tax harmonization and indirect tax harmonization. Harmonization failures are mentioned and discussed as well for they are the integral part of the harmonization process in the European Union. At the end, the possible models of corporate income taxation and its possible impacts on the tax competition in the European Union are discussed as well.

JEL Classification: **H20**

Tax harmonization

Tax harmonization represents the process of tax system convergence based on common set of rules. As quotes (Kubatova, 1998), there can be identified three main phases during the harmonization process (the harmonization process does not necessarily has to undergone all three stages – it can finished by harmonization of tax bases, for example). Firstly, the tax which is going to be harmonized has to be selected. Secondly, the harmonization of tax base takes place and for the last, the tax rate is harmonized.

Further, there can be defined certain levels of tax harmonization (Simon, 2000):

- different taxes in all states
- part of the taxes are common, some of the taxes are national – partial harmonization
- same taxes in all countries

The level of tax harmonization, when there are different taxes in all states can be divided further on the situation, when there is no tax harmonization (i.e. there are no double taxation conventions and no cooperation on administrative level) and on the situation, when there is slight harmonization (i.e. there are double taxation conventions and the cooperation on administrative level).

When there are applied same taxes in all countries, the following situations can arise:

- different tax bases – nominal harmonization
- harmonized tax bases – here can be identified another two levels:
- different tax rates – harmonization of tax bases
- same tax rates – total tax harmonization.

Total tax harmonization is defined by the tax theory as the result of the structural harmonization (i.e. harmonization of the structure of taxes) and harmonization of the tax rates. Tax harmonization can also be understood as the process (the tools for reaching the selected aim) and the result (harmonization of tax legislation itself) together (Nerudova, 2005).

EC Treaty in Art 93 and 94 considers as the aim of the harmonization process the establishment and smooth functioning of the internal market. If we consider the tax harmonization as the tool for reaching of smooth functioning of the internal market, then we can divide tax harmonization further on positive and negative. Positive tax harmonization represents the process of the convergence of the national tax systems of EU member states by the implementation of directives, regulation and other legislative tools. The result of positive harmonization is the same rules in all member states. On the contrary, negative harmonization is the result of the activity of the European Court of Justice (hereinafter as ECJ). Negative tax harmonization cannot be considered as the harmonization in real sense, for it does not provide the set of common rules, binding for all EU member states. The ECJ case law is binding for the parties involved in the case. ECJ case law does not comprise the means of remedies. That is the reason why the result of the negative tax harmonization cannot be the situation when there will be the same rules in all EU member states.

In respect to the actual development in the area of tax harmonization, the harmonization can be further divided on direct and indirect. Direct tax harmonization is understood as the classical harmonization process, which tries to harmonize the regulations directly by means of tax directives. On the contrary, indirect tax harmonization is understood as the effort to reach the harmonization of certain tax regulations by means of harmonization of different areas of law – for example commercial law or company law. At present, the situation is clearly visible in the area of corporate taxation.

If we consider the definition of the tax harmonization only as the process in the EU, then the tax harmonization can be understood as the mechanism, which enable to remove tax regulations which create obstacles to smooth functioning of the internal market or which distort the competition on the internal market. The aim of the tax harmonization in the European Union is not to reach a unified taxation system, but the convergence and the approximation of the taxation systems.

Theoretical background

Tax competition and tax harmonization

As quotes (Kubátová, 2006), competition is generally considered as the factor, which increases market effectiveness, for it enables the effective allocation of the sources. The same is not true for tax competition. In case of the market failure, the competition is not able to ensure effective source allocation. Taxes represent the market failure, for the taxpayer does not receive any equivalent for the paid tax and therefore it is not interesting for him to pay taxes in jurisdiction, in which he uses the public services. Tax competition could lead to the restriction of the public sector. In extreme situation it could result in removing of the tax.

According (Edwards and de Rugy, 2002) tax competition is harmful, for it decreases the tax bases of neighbouring countries and deforms the effective allocation of capital and services. The decrease of the statutory tax rates increases the competitiveness of the state. The result is the increased inflow of the good, services, capital and qualified labour force into the state with low statutory tax rates. The negative effect is represented by the decrease of the state budget revenues and implicitly also by the decrease in the economic growth of neighbouring countries.

Certain degree of tax harmonization, mainly in the area of corporate taxation, is needed, for the present situation does not allow EU companies to fully use the advantages connected and provided by the internal market, as mentions (Randzio-Plath, 2004).

According to (Zodrow, 2003), tax competition can lead to the inefficiency in providing public services. As further mentions (Sinn, 1990), the inefficiency can be found mainly in the area of the size of the redistributive programs. Therefore the tax competition is perceived as harmful, mainly by the groups, which highlight the task of the redistributive programs. The author mentions that also the positive side of the tax competition can be found, for it prevents the excessive expansion of the public sector.

As mention (Grau and Herrera, 2003), tax competition cannot be considered as the competition in real sense. Therefore it is not possible to search for the parallels between the market competition and tax competition. While in market competition, the law of supply and demand dominates, the tax competition is the play of political and economic interests. The looser in that game are immobile factors (labour force) and the winners are the owners of the capital (mobile factors). When the tax competition results in the decrease of the yield from the capital tax, the decrease is compensated very often by the higher taxation of labour force.

At present there is no unified regulation of the corporate or personal income taxation in the European Union. Based on the above mentioned, tax competition can be considered as beneficial, for it creates the pressure on the decrease in the budget expenditures. Therefore it could help to increase the competitiveness of the EU as a whole. On the other hand, unlimited and uncontrolled tax competition in the area of the mobile factors can endanger the budget revenues of EU member states and to endanger the redistributive role of public finances.

As quote (De Rugy and Rahn, 2003) let us expect the analogy between the tax competition and market competition. If the market competition results in the higher effectiveness and meets the demand, the tax competition has to result in higher budget effectiveness and in satisfaction of the voters.

The result of the tax competition in the area of corporate taxation in the EU is the situation, when the tax rates in different jurisdictions reflect mainly the international aspects of taxation and partly also the preferences of the member states. As further mentions (Hameakers, 1993), the tax competition itself leads to the spontaneous harmonization effect – i.e. to the spontaneous convergence of the tax rates and therefore there is no need for artificial harmonization.

As quotes (Smith, 1999), the declaration that the tax harmonization is needed due to the internal market or monetary union, is incorrect. The above mentioned supports by the example of the U.S.A., where there are remarkable differences in taxation, even though it is the area with higher economic and political integration than European Union. The fears from spillover effects to the low tax jurisdictions are according to the author not just. Higher tax jurisdiction in the EU offer qualified labour force and stable business environment. On the contrary, low tax jurisdictions try to establish on the internal market. The author adds, that in case that the process would be stopped by the tax harmonization, the European Union would be less converged than ever before.

According to (Mitchell, 2001) tax competition generates responsible tax policy. Lower tax burden of business subjects creates the fertile soil for higher economic growth. Without the tax competition the governments could behave as the monopoly – to levy the excessive taxes. As the mention (Mitchel, 2002), the tax competition always results in decrease in the statutory tax rates. The increased capital mobility results in situation, when the taxpayer can move the capital in the low tax jurisdictions very easily. From that reason the tax competition can be considered as very important factor supporting the liberalization of the world economics, for it creates the pressure on decrease in tax rates and in budget expenditures.

Tax competition is not harmful, for it does not cause the loss of budget revenues (Janeba and Smart, 2003). The decrease in the statutory corporate tax rates generally leads to the increase in the tax base. Therefore, there cannot be any decrease in the budget revenues and therefore there is not shift in the tax burden on other types of taxes.

As further quote (Mendosa and Tesar, 2003), tax competition cannot be considered as harmful, for in situation when one jurisdiction decreases the tax rate in order to maximize the economic growth, other jurisdictions are forced to follow this decrease. The overall result of that mechanism is the economic growth in all jurisdictions.

The empirical study of the Ruding Committee and further the complex study of the European commission from the area of corporate taxation (European Commission, 2001) have surveyed the relation between the tax rates and the shifts of the companies to the low tax jurisdictions. Both of the studies have proved, that even though the tax burden represents just one of the determinants in the process of investment placement, its sensitivity on the differences in statutory corporate tax rates is increasing.

Another reason for harmfulness of the tax competition can be considered the existence of the externalities. Tax system influences also the revenues of other countries and inhabitants. Big powerful stat can use their influence to affect the world prices and to improve terms of trade. Those states can establish tax legislation, which protects national industry (mainly by the fact that non-residents running business in that state in the form of permanent establishment are not treated by the same way as the residents).

The problems of tax harmonization and tax competition are not only the subject of the interests in European Union, but it is the world problem also solved by OECD. OECD has identified the factors which are characteristic for preferential tax regimes and tax havens. Based on that, there has been suggested the actions, which could help in the fight with the harmful tax competition (OECD, 1998). Those actions are also followed by the European Union.

Based on the above stated literature review, following conclusions can be done. The main negative effect of the tax competition is considered the shift in the tax burden from capital to labour and also the improper structure of budget expenditures. The tax competition can also result in the beggaring of the states, in situation when the company pays taxes in low tax jurisdiction and uses the public services in high tax jurisdiction. Last, but not least, the tax competition can significantly deform the flow of financial and real investments.

Tax competition theory

The discussion on the harmfulness of the tax competition has led to the development of certain models, which has been verified on the empirical data. In the tax competition theory there can be found two basic strands. First of them highlights the role of “tax game” and tries to identify tax reaction functions, which shows the dependence of the state on the tax policies of its neighbours. Most of the authors in that strand of literature have found out that the governments are adjusting the tax rates in reaction to the changes in the tax rates of its neighbours, which support to the standard tax competition theory.

As (Redoano, 2003) quotes corporate income taxes influence the corporations in their decisions about investments placements. From that reason the tax policy of the government tries to attract the tax bases in the frame of tax competition and not the voters, for the corporate income tax influences them only marginally.

(Altshuler and Goodspeed, 2002) have dealt in their research with the empirical estimation of tax reaction functions in case of corporate income taxes among OECD countries. They have proved the existence of positive correlation coefficient in all the cases – i.e. the decrease in tax rate of neighbouring country was followed by the studied country.

(Devereux, Lockwood and Redoano, 2002) quote that each country behaves strategically in the process of setting up the corporate income tax rates in respect to the corporate income tax rates set in neighbouring countries. The authors point out another very important factor in the tax competition – voters and politics. The government policy makers are following the tax rates of other states, for in case that they would set higher tax rates than neighbouring countries have the government need not to be voted again in elections.

The second strand in literature which can be found in tax competition theory is the influence of capital mobility on the level and structure of the tax rates. In that area the authors highlight the negative impact of capital mobility on the capital tax rates and the level of public expenditures. Some authors as (Garrett and Mitchell, 2002) fined positive relation between capital mobility and the level of capital tax rates and public expenditures, which is in contradiction with the “race to the bottom” theory which was mentioned above. The compensation theory serves as the basis for the theoretical arguments of the authors finding the positive relation between the capital mobility and the level of public expenditures. The compensation theory is based on the idea that economic integration (and connected increase in the capital mobility) causes also secondary effects as for example recession in some sectors of economy or higher volatility in consumers incomes, which leads to the higher demand for the public expenditures, mainly in the form of social programs. The defenders of compensations theory as (Rodrik, 1998) suppose, that higher tax burden on labour as a result of increase in the capital mobility should be compensated to the tax payers in the form of special social programs, which would be financed from the increased tax revenues from that type of tax.

(Bretschger and Hettich, 2002) have proved while using empirical data the existence of negative relation between the openness of the economy and the level of capital tax rates and public expenditures. On the contrary they have proved positive relation between the openness of the economy and the level of tax burden on labour. The globalization process has negative influence on capital tax rates, which is in accordance with the tax competition theory.

Indirect Tax Harmonization

In the 1960s two systems of the indirect taxation were applied within the Europe. France was the only state applying value added taxation system and all the other member states were applying cumulative cascade tax system of the turnover tax. Under this tax system (in contrast to value added tax) the tax is levied on the gross amount (not value added) of the production at each production stage. The cumulative cascade tax system of the turnover tax is not able to ensure the tax neutrality – the tax burden can be influenced by range of vertical or horizontal integration – it can cause distortions of the economic competition. Considering the above mentioned the European Commission decided, that the only system which can ensure the tax neutrality and would not deform the market competition, is the value added taxation system.

Value added taxation system enables two possible principles of taxation. First of them is the principle of destination under which the goods and services are taxed in the state of consumption. This system is demanding the economical cooperation because otherwise it could deform the market competition. Partly from the reason of the double taxation (in the case of goods delivered from the state applying the principle of origin – in the state of delivery the goods would be taxed for the second time according to the principle of destination) and partly from the reason of influencing competitiveness (in the situation when countries are applying different tax rates). From this reason the majority of the countries which are applying the principle of destination, exempt export from taxation and vice versa they tax import to eliminate double taxation.

The second principle is the principle of origin - under this scheme the goods and services are taxed in the country of their production. Of course this principle is supposing the unified tax rates because the differences in tax rates can deform the market competition.

The first phase of the harmonization in the EU was dedicated to the implementing of the uniform system of indirect taxation. Without the harmonization of this system, the establishment of the internal market would not be possible, for the different indirect taxation systems could deform the market competition on the internal market.

The effort to harmonize the indirect taxes is evident from the very beginning of the economical integration process in the European Union. Proposed harmonization had to be performed in two steps. In the first phase cumulative cascade tax system of turnover tax had to be replaced by the non cumulative system. In the second phase the substitution of this system by the uniform value added tax system had to follow. All these steps were executing in relation to the establishment of the internal market because its functioning was from the beginning the initial aim of the European Commission.

Legislation in the field of value added tax rate harmonization

In 1967 the first directive no. 67/227/EEC on the harmonization of legislation of Member States concerning turnover taxes was adopted. In this directive the Commission obliged all the member states to substitute existing turnover tax system by the uniform value added taxation system on the principle of general consumption tax, which is imposed on all goods and services and is set by the percentage of selling price and so it does not depend on the number of the stages in production or distribution process. The implementation of the value added taxation system ensured the tax neutrality. Tax rates and also tax exemptions were retained in the competency of the individual member states.

The second directive no. 67/228/EEC defines very clearly the object of the taxation. The object of the taxation is the sale of goods and provision of services on the territory of the member state realized by the taxpayer, and the import of the goods. Further, the directive defines the place of fulfilment, taxpayers, sale of goods and provision of services. The member states were retained the right to adopted special provisions eliminating tax avoidances, further the provisions setting special programme for small and medium sized companies and also this directive allows to set special programme for the agricultural sector.

The transformation of the taxation system and its implementation caused serious problems in some states. It was particularly the fact that implementation of new system could cause the pressure on the expenditures of member states budgets. For example Belgium collected turnover tax in the form of stamp duty and there were serious frights that transformation of the system will cause interruptions of revenue flow into the state budget. The value added tax was proposed in Italy as a part of necessary tax reform provoking fear from rejection from political reasons. The above mentioned was the reason for adopting so called third directive no. 69/463/EEC. The aim of this directive was to prolong the time for the implementation of value added tax for Belgium until the end of the year 1972. Two following directives - fourth directive no. 71/401/EEC and fifth directive no. 72/250/EEC were prolonging the time limit for Italy until the end of the year 1973.

The structural harmonization was finished by the implementation of the first and second directive. It was the first step in the process of the harmonization. The result of this step was not in any case the uniform system because directives allowed a wide range of the exemptions and differences (especially in the field of agriculture, cross-border provision of services or possibility of tax deduction from import). Instead of uniform system there were individual systems with national differences.

The most important directive in the field of indirect tax harmonization is the sixth directive no. 77/388/EEC. It is considered to be the basic directive for it quotes the definition of tax base, the territorial reach, the subjects, tax rates and others. The aim of this directive was to harmonize different national systems – in accordance with prerequisite comprised in the first and second directive – particularly taxation of intracomunitary transactions. This directive is considered to be the basic and until now it has been amended more than twenty times. From this reason the directive no. 112/2006/EC was adopted. It represents the recast of the sixth directive – i.e. it comprises sixth directive with all other directives in frame of one text.

The structural harmonization was finished by the implementation of the uniform indirect taxation system. The second step, tax rates harmonization, was not less complicated due to existence of several facts:

- tax rate harmonization is perceived by the member states as infringement of their national sovereignty;
- tax rates can serve as the tools for fiscal policy – their harmonization do not leave any space for aggregate supply and demand influencing;
- tax rates harmonization can endanger the revenues of state budget very seriously in the states, where the revenues from indirect taxation create the substantial part of budget revenues;

- European Commission unwillingness to legally enforce and assure the implementation of directives in to the national tax systems;
- national traditions – it is difficult for the states to abandon them.

During the harmonization efforts it emerged that tax rates harmonization is facing the problems mentioned above. From this reason the European Commission reassessed attitude to the tax rates harmonization. Total tax harmonization which means identity of the national tax systems in all aspects stopped to be necessary and instead of harmonization only the approximation was considering. In scope of the approximation of tax rates there were proposed different tax bands for the value added tax. In 1989 the European Commission firstly suggested reduced rate at 4-9% for the basic essentials of life as food, water deliveries, pharmaceutical goods, books, newspapers, magazines and public transport and standard rate at 14-20%. In 1991 there was adopted the directive no. 91/860/EEC which eliminated the fiscal borders between individual member states and influenced significantly the value added taxation system applied within EU. The abolishment of the fiscal borders enforced following changes:

- purchase by private entities is taxed exclusively in the state of purchase (abolishment of tax refund) with exception of purchase of the new transport means;
- export and import system were substituted within EU by so called system of intracomunitary acquisition of goods and services (i.e. intracomunitary fulfilment);
- export and import system is applied only with third countries.

With effect from 1993 **directive no. 92/77/EEC** stipulated the minimal limit for the tax rates. For standard rate the minimum of 15% was set and for reduced rate 5%. Directive also allowed transitional period in which the member states could apply in the area of reduced tax rate the rate lower than 5%. Evidence of unwillingness of the member states to implement this directive and also the evidence of incapability of the European Commission to ensure implementation of directives is the following table:

Table 1: VAT tax rates in EU member states

VAT tax rates in %		
Country	Standard Rate	Reduced Rate
Belgium	21	6,12
Denmark	25	0
Germany	19	7
Greece	19	8;9
Spain	16	4;7
France	19,6	2,1; 5,5
Ireland	21	4,8; 13,5
Italy	20	4, 10
Luxembourgh	15	3; 6; 12
Netherlands	19	6
Austria	20	10
Portugal	21	5; 12
Finland	22	8; 17
Sweeden	25	6; 12
United Kingdom	17,5	5
Czech Republic	19	7
Slovak Republic	19	0
Poland	22	3; 7
Hungary	20	15
Latvia	18	5
Lithuania	18	5;9
Estonia	18	5
Malta	18	5
Cyprus	15	5; 8
Slovenia	20	8;5
Bulgaria	20	7
Romania	19	9

Source: Amos,J. et al. (eds.). Global Corporate Tax Handbook 2007, Amsterdam, IBFD, 2007.

Transition from the principle of destination to principle of origin belonged to the major priorities of the European Commission in the field of the indirect taxation harmonization. But the transition to the principle of origin supposes the harmonization of tax rates because in opposite case the identical goods on the market would be sold at different prices according to the tax rates in the place of origin. From the above mentioned reasons this transition has not been done yet and principle of destination is still applied.

Although the original intention of the European Commission was only temporary solution, the existing functioning of this system has proved competent. The fact that application of this principle enables member states to sustain freedom in the determination of the tax rate is ensuring the tax neutrality - member states can impose such a tax rate which does not deform the market or does not cause movement of the companies providing services to the states with lower rates.

Legislation in the field of Excise duties Harmonization

Although the greatest emphasis is put on value added tax harmonization in the process of the tax harmonization in the EU, the same problems are appearing in the field of excise duties harmonization, because also these duties are significantly influencing the single market. The attention is mainly aimed at balancing amount of individual tax rates to avoid the advantage of national producers in the form of lower or zero tax rates. In relation to internal market a number of directives were adopting in the

1990s in this field. All the system of excise duties has been implemented in the EU as a part of the internal market since 1st January 1993.

The initial idea was to harmonize both - the structure and the tax rates of excise duties system. The harmonization efforts were (as well as in case of the value added tax harmonization) transferred rather to the structural field and only the minimum tax rates were set.

Analogically to VAT, the principle of destination was selected for the excise duties – goods subjected to excise duties are taxed in the country of consumption so that there would be no market deformation (principle of origin with existence of different tax rates does not ensure the tax neutrality). With effect from 1st January 1993 tax base harmonization is ensured by the uniform custom tariff and since the same date the minimum tax rates has been set.

Excise duties harmonization in the EU is based on three groups of directives:

- **directive no. 92/12/EEC** called as **horizontal directive**, which serves as general regulation for the production, holding and transport of products subjected to excise duty;
- so called **structural directive** – related to harmonization of structure of excise duties; is structuralizing excise duties into excise duty on mineral oils, alcohols and alcoholic beverages and tobacco;
- **four directives on approximation of tax rates of** above introduced excise duties.

Horizontal directive no. 92/12/EEC is related to mineral oils, alcohol and alcoholic beverages and tobacco. Directive further enables individual member states to impose above the scope of excise duties also other indirect taxes (for example from environmental reasons). Application of these taxes does not have to signify any formalities during cross-border trade between member states. Directive, except the object of taxes, also defines taxable fulfillment, production, products moving and tax payments. The directive is regulating excise duties in general and concrete types of excise duties are regulated by individual directives.

Energy Products and Electric Energy

Directive no. 92/81/EEC comprises unification of basis for tax assessment and adjustment of tax structure in relation to custom tariff. This directive defines individual types of mineral oils subjected to excise duty. If the mineral oil serves to consumption, is sold or serves as fuel, then it is the object of the tax. Directive stipulates that also the product, which is not directly listed as a mineral oil, but is sold or used as a fuel is object of the tax.

Directive no. 2003/96/EC restructures taxation of mineral oils on the energy products and electric energy. It extends taxation of mineral oils to coal, natural gas and electric energy. This directive sets minimum tax rates on energy products in dependence to purpose of the use. It distinguishes between energy products serving as fuel or as a mean for production of electric energy.

Table 2: Minimal tax rate of excise duty on mineral oil used as fuel

Minimal tax rates of excise duty on mineral oils used as fuel			
	tax base	min. rate since 1.1. 2004	min. rate since 1.1. 2010
leaded petrol	1000 l	421,0 EUR	421,0 EUR
unleaded petrol	1000 l	359,0 EUR	359,0 EUR
diesel	1000 l	302,0 EUR	330,0 EUR
oil	1000 l	302,0 EUR	330,0 EUR
LPG	1000 l	125,0 EUR	125,0 EUR
gas	gigajoule	2,6 EUR	2,6 EUR

Source: Directive no. 92/12/EC

Source: Directive no. 92/12/EC

Table 3: Minimal tax rates on mineral oils – industry or commercial use

Min. tax rate on mineral oils - for industry or commercial use		
	tax base	min. rate since 1.1. 2004
diesel	1000 l	21,0 EUR
oil	1000 l	21,0 EUR
LPG	1000 kg	41,0 EUR
gas	gigajoule	0,3 EUR

Source: Directive no. 92/12/EC

Table 4: Minimal tax rate on mineral oils used for heating and electric energy

Min. tax rate on mineral oils used for heating and electric energy			
	tax base	min. rate since 1.1. 2004 for commercial use	min. rate since 1.1. 2004 for non-commercial use
diesel	1000 l	21,00 EUR	21,00 EUR
furnace oil	1000 kg	15,00 EUR	15,00 EUR
oil	1000 l	0,00 EUR	0,00 EUR
LPG	1000 kg	0,00 EUR	0,00 EUR
gas	gigajoule	0,15 EUR	0,30 EUR
cole and coke	gigajoule	0,15 EUR	0,30 EUR
electric energy	MWh	0,50 EUR	1,00 EUR

Source: Directive no. 2003/96/EC

Alcohol and Alcoholic beverages

The harmonization of excise duties is from the very beginning connected with the great unwillingness of individual member states. The main opponents are traditional producers of wine (French, Spain and Italy) and traditional producers of whiskey or liqueurs. For majority of these countries it is very difficult to change excise duties systems which are historically rooted in their tax systems (their beginnings are dating to the Middle Ages). That is why also **directive no. 92/83/EEC** is based on historical classification of products on:

- beer;
- wine;

- other fermented beverages (unlike beer and wine);
- intermediate product and alcohol.

Directive no. 92/84/EEC concerns taxation of **beer.** The object of the tax is defined as beer, mixture of beer and nonalcoholic beverages with the content of alcohol higher than 0, 5%. Minimal tax rate is set by the directive at 0, 748 EUR/hl and at 1, 87 EUR/hl/degree of alcohol of the final product. Directive also allows member states to impose lower tax rate depending on annual output of brewery.

Directive no. 92/84/EEC concerns the taxation of **wine.** It distinguishes wines on two following types:

- **non-sparkling wine** – wine with content of alcohol 1,2% - 15% and with content of alcohol 15% - 18%;
- **sparkling wine** – wine with content of alcohol 1,2% - 1,5%.

Minimal tax rates are set at 0 EUR/hl for both categories described above. Zero minimal tax rates are set with respect to traditional wine producers and their unwillingness to tax this traditional production.

Minimal tax rate for **fermented beverages** (directive no. 92/84/EEC), is also set at 0 EUR/hl enabling member states to set the rate basically at any amount.

Excise duty on intermediate products (directive no. 92/84/EEC) covers the products with content of alcohol between 1,2% - 22% and which cannot be classified as beer, wine or other fermented beverages. **The minimal tax rate** is set at 45 EUR/hl. Directive again leaves the space for member states regarding application of lower tax rate to intermediate products with content of alcohol lower than 15%.

Excise duty on ethyl alcohol (directive no. 92/84/EEC) concerns beverages with content of alcohol higher than 22% and beverages with content of alcohol higher than 1,2% under the codes CN 2207 and 2208. Also in this case the directive allows individual member states to apply lower tax rate in cases of small producers with annual output not exceeding 10 hl of pure alcohol a year. Lower tax rate does not have to be lower than 50% of standard national rate. Directive also allows applying lower tax rate to products with content of alcohol not exceeding 10% - French rum and Greek alcoholic drinks with flavor of anise. **The minimal tax rate** is set at 550/EUR/hl of pure alcohol. Directive stipulates that states applying tax rate between 550 – 1000 EUR are not allowed to lower this rate (in connection with minimal tax rate). States applying tax rate higher than 1000 EUR are not allowed to lower this rate under the limit of 1000 EUR.

3.2.3 Tobacco and Tobacco products

The first directive adopted in this field was the directive no. 72/464/EEC. This directive includes general regulations related to excise duty on tobacco and specific regulation in the field of structure of excise duty on cigarettes. Directive no. 79/32/EEC classifies tobacco products on basic categories – cigarettes, cigars, cigarillos and tobacco for smoking. Tobacco for smoking is further divided on:

- flake tobacco/shag or divided tobacco appropriate for smoking without further industrial processing;
- other tobacco for smoking.

Directive defines cigarettes as:

- rolls of tobacco which are smoked as such and are not cigars neither cigarillos;
- rolls of tobacco which are put into form from cigarette paper by simple non industrial manipulation;
- rolls of tobacco which are packed into cigarette paper by simple non industrial manipulation.

Directive no. 92/97/EEC sets the minimal tax rates – total tax has to amount minimally 57% of the selling price and does not have to amount less than 64 EUR for 1000 pieces of cigarettes. Except this, the directive sets that specific tax rate has to be within the range of 5 – 55% of total tax burden. For the other kinds of tobacco products (cigarillos or fine-cut) the minimal tax rates are set by **directive no. 92/80/EEC**. Directive admits both the ad valorem rate and specific rate.

Direct Tax Harmonization

In the 60s of the 20th century there was a very similar structure of the direct taxation in the member states of the European Union. All the member states excluding Italy applied separately the system of corporate income taxation and personal income taxation. The evident structural similarity of the system was hiding huge differences in the methods of tax base construction, systems of the deductible amounts and tax sales, which are significantly influencing the final tax burden of the taxpayer.

European Commission, with respect to the difference in the methods of tax base construction, was focusing during the harmonization mainly on those types of the direct taxes, where at least the partial harmonization is considered to be the necessary condition for eliminating the obstacles to the smooth functioning of internal market. Especially corporate income tax is considered to be this type of tax. The integration of the financial markets made capital highly mobile factor, which can quickly move to the states with more advantageous tax regimes. In the frame of practical harmonization the European Commission decided for the structural harmonization at first and then successively for the harmonization of the tax rates.

In the 1970s and 1980s the wide range of the harmonization efforts failed in this field, because the member state perceived them as the effort to restrict their fiscal sovereignty. The reason of the failure is also the fact that harmonization measures of the European Commission have to be introduced in the form of directives to be obligatory for all member states. The adoption of directive expects unanimity. It very often happens that the harmonization measure is blocked by one or two member states.

Growth of the globalization and the impact of the multinational corporations, which wanted fully exploit the advantages, which are connected with business activities in the internal market resulted in the establishment of so called Ruding’s committee. The purpose of the committee was to find out:

- if the different systems of the corporate income taxation cause the obstacles to the internal market (especially if it acts about competition and investment);
- if the obstacles can be eliminated through the market forces or tax competition or if there is necessity of the intervention;
- which provisions will be necessary to adopt in connection with eliminating of the barriers or with their moderation.

Based on the realized research it was find out that the differences in the individual corporate tax systems are causing the obstacles on the market and especially they influence the decisions about the investment placement of the multinational corporations very strongly. That is the reason why the European Union has set following priorities:

- to eliminate provisions of the national tax systems, which cause obstacles and above all in the field of the foreign investment;
- to create the rules for tax base construction and to set the minimum tax rates;
- to ensure the transparency of all tax incentives.

It was already mentioned above that the member states are not willing to renounce their conventions and they understand the harmonization efforts as interference to the internal affairs. For that reason only the partial success was reached in this field.

Legislation in the field of the direct taxes

Considering the fact that the European Commission is not successful in promoting the harmonization measures in the form of the directives, the negative harmonization has become very important recently in the field of the direct taxes – i.e. harmonization of the tax systems through the ECJ case law.

The fundamental directive in this field is Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation. This directive adjusts the exchange of the information, cooperation during ensuring and investigating and presence of the officers of one member state on the territory of another member state from the reasons of control of the multinational companies’ activities. In 1997 the validity of this directive was extended and includes the indirect taxes too (especially value added tax).

In connection with the establishment of the internal market two very important directives were adopted in 1990 concerning the corporate taxation. Both of these directives are in force since 1993. The first Council directive no. **90/434/EEC** from 23rd July 1990, is known as **The Merger Directive.** It regulates deferment of the tax liability resulting from capital yield during merger, business divisions, transfer of assets and cross-border shares exchange within the European Union. The aim of the directive is to avoid taxation of the profit, which can arise during the merger from the difference between value of the transfer of assets and liabilities and their accounting carrying value.

The Merger Directive was amended by the directive no. 2005/19/EC, which was adopted particularly in connection with the establishment of the statute of the European company. This directive extends existing competence of The Merger Directive to European company and European cooperative society as well. Directive particularly:

- enables transfer of the seats and reorganization of the European company and European cooperative society within the European Union without any tax obstacles;
- ensures that transformation of the branch to the subsidiary will not have any tax consequences;
- includes a new type of transaction – so called split off.

The second directive no. **90/435/EEC** from 23^{rd} July1990 known as **The Parent-Subsidiary Directive** regulates the system of the taxation of the group of companies, which operate on the national level and companies, which operate within the European Union. The aims of the directive are following:

- to ensure that member state of the parent company either does not tax the incomes of the subsidiary with the seat in other member state or if these incomes are taxed, it enables parent company to deduct the income tax paid by subsidiary in other member state from the tax base;
- to exempt the distribution of the net profit of the subsidiary from the withholding tax.

In 2003 was adopted the directive no. **2003/123/EC**, which amends the original Parent-Subsidiary Directive and extends the competence of directive to:

- distribution of profits obtained from the permanent establishment located in one member state from the subsidiary, which is resident in other member state (different from the state where the parent company is situated);
- distribution of profit of the company to permanent establishments, which are located in other member state than companies and subsidiaries;
- new types of the companies – to the European company and European cooperative society.

The directive also comprises gradual decrease in the size of share, which serves for the identification of the company as a subsidiary from 25% to:

- 20% with the effect from 1.1.2005;
- 15% with the effect from 1.1.2007;
- 10% with the effect from 1.1.2009.

So called Arbitration Convention **no. 90/436/EEC** is valid in the European Union since 1995 for the period of five years and its aim is to eliminate double taxation which could arise in the case of different interpretation of principle of the transfer pricing in different countries. Until now the validity of the convention has been always extended by other five years. Nowadays it is valid until 2010 and its validity was extended to ten new member states of the European Union as well.

The Tax Package

On 3^{rd} June 2003 the Council has adopted the Tax Package with the aim to restrict the provisions that could cause harmful tax competition. It comprises three main parts:

- Code of conduct for business taxation;
- Measures for the higher approximation of income from savings taxation systems;
- Agreement on elimination of withholding tax from interests payments and royalties.

Even though the fact that **Code of conduct for business taxation** is legally not biding, it does have political power because by its adopting member states are obliged not only eliminate existing tax provisions causing harmful tax competition but they can not introduce any new provision of the similar character in the future. The rules are aimed mainly at the provisions which significantly influence the headquarters location. This happens in the cases where non-residents posses advantageous tax condition in comparison with residents. The Code of Conduct for Business Taxation sets criteria which are used for identification of harmful tax provisions. The deadline for elimination of those provisions was 1st January 2003. Member states will preserve to companies which posses' benefits from harmful tax competition these benefits until the end of 2005.

If we take into account the fact that capital is very mobile factor – i.e. it can very quickly move from country to country, according the tax conditions, it is obvious that certain degree of **approximation of savings taxation** is needed to be reached. Transfers of the savings to the countries with lower taxes cause in the countries were investors are resident tax distortion and tax fraud. It is essential due to the smooth functioning of the single market to ensure that the decision about investments placement will be done according to the real qualities of supplied products and not according to the lower tax rates or the possibility of tax fraud. In connection with this situation **Savings Directive** no. **2003/48/EEC** was adopted. The aim of the directive is to enable the taxation of the incomes in the form of interests payments resulting from the member state to persons, who are trying through their residency to decrease or eliminate taxation. The duty to implement this directive to the national legislations was set until 1st January 2004 with effective date 1st July 2005. **Directive does not concern the incomes of the legal entities; it comprises only the incomes of individuals.**

Based on this directive the member states are obliged to provide other member states with information about interests, which were paid off to the individual savers. Directive also sets the transitional period for Belgium, Austria and Luxembourg, enabling them to refuse providing information and instead of that to apply 15% of the withholding tax in 2005-2007, 20% in 2008-2010 and 35% since 2011.

Withholding tax from interests payments and royalties paid between companies (active in individual member states) belonging to one group (associated companies) can cause the compliance costs of taxation. The uniform system of the interest payments and royalties taxation between associated companies is set **in Interest and Royalties Directive no. 2003/49/EC,** which has entered into force since 1st January 2004. Directive eliminates withholding tax in case of interests and royalties cross-border payments between associated companies.

The Models of Corporate Tax Harmonization in the EU

In environment of the economic and monetary integration the investments are highly sensitive to the differences in the corporate taxation. From the whole economic efficiency point of view, the tax systems should be neutral – decisions about the investment placement should not be influenced by the tax rates. For these reasons the European Commission proposed four possible models of corporate income tax harmonization:

- **Home State Taxation** – corporations would use for the taxation of the companies with "European" activities the rules valid in the home country (in which the seat of headquarters is situated); system would be optional – corporations could choose, if they will tax their profits in every country differently or if they will be subjected to one tax system under the home state taxation scheme;
- **Common Consolidated Tax Base** – supposes the existence of the common rules for tax base constructions for the corporations choosing this system (again it hast to be corporation with "European" activities);
- **European Union Company Tax** – this system would introduce the uniform consolidated tax base but only for huge multinational corporations;

European Union Company Tax would be operating on the EU level and of it would have unified corporate income tax rate within EU;
- **Compulsory Harmonized Corporate Tax Base** – this system would compulsory introduce the uniform tax base for every company in the EU (domestic and multinational).

The European Commission did not choose only one strategy for the practical corporate taxation harmonization but twin-track strategy – i.e. following more targets at the same time. The main long-term target of the European Commission is the introduction of **Common Consolidated Corporate Tax Base** for corporations with European activities. This common (uniform) tax base would mean following advantages for the corporations:

- the introduction would increase the transparency of the effective tax rate; **all the prerequisites for establishing fair tax competition should be fulfilled** by implementation (complex of harmonization rules for tax base construction, which would be valid for the company that decided use this system without difference);
- it would enable to eliminate the obstacles of the multinational mergers and acquisitions in the form of insufficient coordination of the member states during capital profits taxation;
- the introduction would decrease compliance costs of taxation for the companies would not meet 25 different taxation systems anymore;
- it would enable remarkably to eliminate the problem of transfer pricing between associated companies;
- the system would also automatically enable to offset the loss from the activity in one member state against the profit from the activity in other member state (in frame of the companies of one group) – it would ensure the tax neutrality.

Apart from the advantages this system has also disadvantages. System **discriminates** small companies without European activities. Companies without European activities have to apply home state taxation rules in this system. The existence of two different taxation systems for the companies **opens the space for the speculations, tax fraud and for various types of tax arbitrations.**

The **Home State Taxation** system is considered to be a measure which could help in short time period to eliminate obstacles that small and medium sized companies have to face. By introducing this system of taxation the companies with business activities in more member states would tax their taxable profit according to the rules valid in their home country (i.e. taxable profit of organizational body with business activities in other member states would be set according to the rules valid in the home country). The above described system would signify for the corporation considerable facilitation because they would be subjected only to one tax system. Costs related to the existence of 27 tax systems are very often disproportionably high for small and medium sized companies. This model can also **lead to increase in tax competition with purpose to attract the companies to set their headquarters in order to tax their European activities** (according to the rules valid in this country). At present, there is no development in discussions about above mentioned harmonization model, The Commission considers as the priority Common consolidated tax base.

By introducing of **Compulsory Harmonized Corporate Tax Base** for all companies (domestic and multinational) the problem of the existence of two taxation systems would be eliminated. The main element which can cause this system is competition between individual states to attract tax basis of the companies with European activities (the system of the uniform consolidated tax base does not enable it). This system **does not leave the space for speculation, tax fraud and for various types of tax arbitrations**. In spite of the above mentioned advantages the **European Commission did not select this system as an objective.** The reason is the fact that only this system provides the real harmonization followed by loss of the great part of the national tax sovereignty. Unfortunately, nowadays the member states are not willing to loss such a great part of the national tax sovereignty and it is the reason why the enforcement of the model is not real.

Direct Tax Harmonization in relation to the principles of competition

The structural resemblance of the direct tax systems, which is nowadays in Europe, is hiding huge differences inside, particularly in relation to the different accounting systems and from them resulting differences in concept of income from the operations. In Europe we can find two different accounting systems – so called **tax accounting** - the income from the operations is identical with tax base and **accounting**, where the income from the operations is not identical with tax base and this income from the operations **has to be transformed to the tax base by specific operations.**

Based on that, problems are connected not only with structural harmonization, but also with the harmonization of tax rates. For deep analysis of tax rates in order to find the best uniform tax rate is not possible to use nominal tax rates. Due to the above mentioned facts the Commission was forced to accomplish extensive analysis in the member states in order to calculate the **effective tax rates.** This kind of tax rate can be compared with others because it comprises all the other operations valid in member states, which decreases or increases tax base or tax liability.

Table 5: Effective nominal tax rates of EU old member states

Nominal and effective corporate tax rates in %		
Country	Nominal rate (1)	Effective rate
Austria	34,00	29,8
Belgium	40,17	34,5
Denmark	32,00	28,8
Finland	28,00	25,5
France	40,00	37,5
Germany	52,35	39,1
Greece	40,00	29,6
Ireland	10,00	10,5
Italy	41,25	29,8
Luxembourg	37,45	32,2
Netherlands	35,00	31,0
Portugal	37,40	32,6
Spain	35,00	31,0
Sweden	28,00	22,9
United Kingdom	30,00	28,2

Source: COM(2001)582 final

(1) including surcharges and local taxes

Table 6: Effective nominal tax rates of EU new member states

Nominal and effective cosporate tax rates in %		
Country	Nominal rate (1)	Effective rate
Cyprus	15,00	14,5
Czech Republic	28,00	25,5
Estonia	26,00	22,5
Hungary	17,70	18,4
Latvia	15,00	14,4
Lithuania	15,00	13,1
Malta	35,00	32,8
Poland	19,00	17,5
Slovenia	25,00	21,6
Slovak Republic	19,00	16,7

Source: European Commission, Working paper no. 7/2004

(1) including surcharges and local taxes

In comparison with the initial aims of the European Commission in the field of the direct taxes it is necessary to highlight, that the European Commission **is not trying to achieve the tax rates harmonization** any more but only the harmonization of the tax basis. **The aim** in this field is only the **structural harmonization**. In the situation, when the tax basis are defined uniformly there is no difference between nominal and effective tax rate. Companies themselves are able to identify the tax burden in individual states that opens the space in the field of the tax rates for the fair tax competition.

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