Opinion of the Economic and Social Committee on 'Direct company taxation'

(2002/C 241/14)

On 17 January 2002 the Economic and Social Committee decided, in accordance with Rule 23 of its Rules of Procedure, to draw up an own-initiative opinion on 'Direct company taxation'.

The Section for Economic and Monetary Union and Economic and Social Cohesion, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 25 June 2002. The rapporteur was Mr Malosse and the co-rapporteur Mrs Sánchez Miguel.

At its 392nd Plenary Session of 17 and 18 July 2002 (meeting of 17 July 2002), the Economic and Social Committee adopted the following opinion by 127 votes to none, with one abstention.

1. Introduction

1.1. On 23 October 2001, the Commission submitted a communication to the Council, the European Parliament and the European Economic and Social Committee entitled: Towards an Internal Market without tax obstacles: A strategy for providing companies with a consolidated corporate tax base for their EU-wide activities.

1.2. The aim of this communication is to set out the Commission's views on the actions that it deems are necessary and realistic to take in the field of company taxation in the EU over the next few years in order to adapt the taxation of EU companies to the new economic environment and enhance the effectiveness of the internal market by removing internal tax barriers. Corporate taxation represents 3,2 % of GDP in the EU.

1.3. The Commission is convinced that company tax regimes in the EU have not succeeded in adapting to such developments as globalisation, the economic integration of the internal market and Economic and Monetary Union. It therefore feels that a new approach is essential to ensure what it calls the tax 'welfare' of business operators.

1.4. To build this new approach the Commission is counting on the findings of a detailed economic and legal survey which has enabled it to highlight the tax burden on companies in the various EU countries and to identify 'fields in which company tax systems ... hamper cross-border economic activity in the Internal Market (and consequently) undermine the international competitiveness of European companies'.

1.5. More generally, and before assessing this communication in detail, one must note the importance of this initiative for the Commission, without precedent since the conclusions of the Ruding Committee in 1992. The most innovative element is undoubtedly the proposal for a consolidated basis for harmonised company taxation.

1.6. The EESC's initiative falls within the framework of the debate launched by the European Commission in its Communication. But it also takes into account all the factors that lead to big competitive differences between companies within the single market, such as social security contributions, the cost of capital and labour, general economic conditions, the standard of infrastructure and public services, training and staff skills. It must be noted here that taxation can be a decisive factor, but it is not the only one to be taken into account when choosing investment locations.

2. The findings of the European Commission's study

The study first of all gives many examples of the tax burden on companies in the various EU countries:

2.1. According to the Commission, to make a comparison one must consider not nominal but real rates, i.e. the tax really paid by companies during a given operation.

2.2. The Commission noted that even if taxation is only one factor among others in determining investment and financing decisions, the size of the variations in real tax rates from one Member State to another required thorough analysis. There are major variations — up to 30 % — between real company tax rates across the EU, and these are mainly due to differences in national legal tax rates, rather than differences in the basis of assessment.

2.3. Despite differences in the basis of assessment, rates are, according to the Commission, a good indicator of the overall tax burden. However, the Commission remains convinced that the fixing of company tax rates is, and must remain for the moment, the responsibility of the Member States.

2.4. Secondly, the study identifies a number of tax obstacles that hamper cross-border economic activity in the internal market. The co-existence of 15 separate sets of rules for determining the basis of assessment in the internal market, as well as generating compliance costs, causes numerous problems for the taxation of intra-group transactions ('transfer pricing') and increases the risks of double taxation.

In this respect, the study of the Commission highlights a series of unfavourable consequences:

2.4.1. Companies must assign profits to each jurisdiction on a basis of full competition through separate accounting.

2.4.2. Member States are reticent about allowing the deductibility of losses by affiliated companies whose profits they cannot tax.

2.4.3. Cross-border reorganisation is likely to generate taxation (capital gains and others).

2.4.4. Double taxation may occur through a conflict of tax laws.

2.5. In addition to these difficulties there are differences in regulations, the provisions concerning the collection of taxes, the rules on disputes and verification, in other words tax practices, which are even more difficult to identify than the basic texts.

3. **The strategy proposed by the European Commission**

The strategy proposed by the Commission to achieve the tax 'welfare' of business operators is in two stages.

3.1. In the first place, this strategy envisages a number of targeted measures covering such issues as the extension of the directives on dividends and mergers, cross-border loss offset, transfer pricing and double taxation agreements.

3.2. But secondly, the Commission feels that in the longer term companies must be offered the possibility of being taxed on the basis of a consolidated basis of assessment for corporation tax covering all their activities in the European Union, so as to escape the expensive inefficiencies which currently result from the co-existence of 15 separate sets of tax rules.

4. **First, a short-term strategy taking the form of targeted measures**

The Commission considers that the adoption of certain targeted measures 'can, at the same time, be preparatory steps for a comprehensive scheme' and that in the immediate future priority must be given to improving the rules in force and the way they are applied.

4.1. *Facilitate application of case law of the Court of Justice*

The Commission will formulate guidelines on the important judgments of the Court of Justice with a view to facilitating application in accordance with the Treaty and Community law. In 2001, the Commission started a programme of meetings with the Member States on this issue, which it proposes to continue and step up.

4.2. *Merger and Parent-Subsidiary Directives*

Cross-border income flows and restructuring operations are often affected by additional taxation. The Merger and Parent-Subsidiary Directives (90/435/EEC and 90/434/EEC) have not led to the solution of all the problems in this field.

4.2.1. The Commission will submit modifications to the Merger and Parent-Subsidiary Directives, together with detailed guidelines on their application and implementation.

4.2.2. In 1993, the Commission had already submitted proposals aiming to amend these directives (by widening their scope to cover all forms of companies subjected to corporation tax), but it now feels that these directives must also be extended and improved so as to cover a broader range of taxes and transactions. In addition, they will have to cover the companies which will in future be governed by the statute for a European company ('societas europeae', SE).

4.2.3. The possibilities of cross-border loss offset remain very limited, and groups are often taxed on the profits made

in one country of the internal market without being able at the same time to take account of losses suffered in another country.

4.2.4. The Commission will withdraw its 1990 proposal for a directive, which sought to allow companies to take into account losses suffered by their permanent establishments and subsidiaries located in other Member States, and which turned out to be unacceptable to the Member States.

4.2.5. In order to overcome the reservations of the Member States about any Community initiative in this field, the Commission proposes holding, in 2002, a series of preparatory technical meetings with the Member States with a view to drawing up a new improved proposal, possibly with a broader scope, and submitting a report on its legislative intentions before the end of 2003.

4.3. *Transfer pricing*

The issue of transfer pricing is, on the international front, one of the main bones of contention between companies and the tax authorities, or even between the tax authorities themselves.

4.3.1. The taxation levied on trade in goods and services within multinational companies is all the more important in view of the unprecedented growth in such trade in recent years, which now accounts for almost half of world trade. The tax authorities' view of multinationals and their internal commercial transactions is, of necessity, restricted by their territorial jurisdiction, and an overall view of operations is impossible.

4.3.2. It is also true that the yield on such trade does not always obey the law of the market place, as companies are often suspected of reducing their overall tax burden by transferring profits to countries where the tax system is most favourable. The tax authorities will therefore question prices which, in their view, do not correspond to those which would have been practised between independent companies, and the risk of double taxation is great because of differences in approach between countries. Thus, a price will be considered too high in one state and too low in another, leading to an adjustment in both cases, without the authorities being able to agree on what should be the 'correct price'.

4.3.3. Despite the action taken to work out fair principles, notably at the urging of the OECD, the risk of disputes with the tax authorities is very great, especially as their major priority is to safeguard tax income. As a result, there are frequent cases of double taxation.

4.3.4. In addition, since international tax conventions cannot effectively apply here, the solutions envisaged by no means remove the risk of differences in assessment occurring depending on the states, which have only a partial view of operations.

4.3.5. As this problem will arise with even more urgency in the future in an integrated European market, joint solutions must be found at EU level.

4.3.6. To do that, the Commission proposes to set up a Joint EU Forum on Transfer Pricing with the Member States in the first half of 2002. The aim would be to improve coordination between Member States, and between Member States and companies, as regards the taxation of cross-border intra-group transactions. Moreover, Member States are tending to impose increasingly strict documentation requirements on companies as regards transfer pricing. This forum could consider a number of issues that do not require the adoption of legislation, such as advance pricing agreements, documentation requirements and transfer-pricing methodologies, within the OECD guidelines on the matter.

4.4. *The Arbitration Convention and double-taxation agreements*

The machinery for reducing double taxation resulting from cross-border activities, whether it be bilateral double-taxation agreements or the 1990 convention aimed at eliminating assessment differences between national administrations regarding the adjustment of profit transfers between associated companies (the Arbitration Convention — 90/436/EEC) does not work properly.

4.4.1. In 2003, the Commission will submit a proposal for a Directive to renew and improve the Arbitration Convention and submit its provisions for interpretation to the Court of Justice.

4.4.2. In 2004, the Commission intends to publish a communication on double taxation agreements which will stress the need to adapt certain provisions of the bilateral agreements between Member States based on the OECD model convention, so as to bring them more into line with the principles of the EC Treaty. The aim is eventually to have a Community version of the OECD model convention and its comments which would satisfy the specific requirements of EU membership, and even to draw up an EU multilateral convention.

5. **Second, a long-term strategy for a consolidated basis of assessment for corporation tax**

This is the main innovation in the communication.

5.1. Even if the various targeted measures quoted above will allow some progress to be made on removing tax barriers, the Commission is aware that the basic problem, namely the co-existence of 15 different tax systems in the internal market, will still exist. It is therefore necessary to tackle the root causes of the problem.

5.2. The study appended to the communication gives plenty of food for thought by simulating the effects of a theoretical harmonisation of certain features of the tax systems.

5.3. The most significant effect would be obtained by introducing a uniform nominal tax rate within the EU. No other scenario will have a comparable impact.

5.4. But the Commission feels that defining a consolidated basis of assessment for corporation tax covering all of a company's activities in the EU would make corporation tax schemes simpler, more efficient and more transparent, in particular by reducing compliance costs.

5.5. Setting up a consolidated basis of assessment for corporation tax would allow companies having cross-border and international activities in the EU:

— to compute the income of the entire group according to one set of rules; and

— to establish consolidated accounts for tax purposes, thus eliminating the potential tax effects on purely intra-group transactions.

5.6. To do this, the Commission study has identified several possible technical approaches. The options studied were:

5.6.1. Parent company home-state taxation. The consolidated tax base of a multinational group would be calculated in accordance with the tax code of the state where the parent company is located (i.e. where its registered office is).

5.6.2. Common consolidated base taxation. The consolidated tax base of a multinational group would be calculated according to completely new and harmonised rules, which would apply throughout the EU.

5.6.3. European company income tax: income tax would be levied on companies at European level and the proceeds would fund (at least partly) the EU budget.

5.6.4. Compulsory harmonisation of existing tax bases. Unlike the three options above, which would co-exist with national tax systems, the consolidated tax base for all EU companies would be calculated from harmonised rules.

5.7. Future developments as regards the European company (European statute for SMEs as proposed by the own-initiative opinion of the EESC adopted on 21 March 2002 [1]) suggest that a general corporation tax code and a consolidated basis of assessment for corporation tax may be envisaged for these companies too, covering all their activities within the EU.

5.8. For this second phase, the Commission has begun a genuine debate on what company taxation in Europe must eventually be, with a presentation of several options for which clear choices must be made.

6. **Basic principles to be adopted**

6.1. The EESC supports the ambitious approach adopted by the European Commission. It feels that it is really up to the European executive to make proposals that correspond to the needs of European integration.

6.2. The EESC nevertheless regrets that the scope of the Commission's proposals is concentrated primarily on the fiscal obstacles to companies' cross-border activities, whereas tax disparities affect all companies, especially small ones. The EESC considers that one must not underestimate the negative consequences of a lack of transparency or of excessive differentials that may create serious distortions of competition, with tax dumping effects.

[1] OJ C 125, 27.5.2002, p. 100: 'A European Company Statute for SMEs' (INT/109).

6.3. The establishment of fair competition between companies, as the Ruding report pointed out, must be a priority of any European initiative on taxes.

6.4. Equal treatment for all categories of companies, especially the smallest, must be more than an objective; it must be an imperative, underpinning this project at all stages in its implementation.

6.5. These tax proposals must be consistent with the EU's main political objectives. For example, according to the strategies decided in Cardiff and Luxembourg, it is important for these proposals to create a job-friendly climate, so they should aim at tax neutrality in relation to the two production factors that are labour and capital. It is also important for these proposals to be resituated in relation to the competitiveness objectives of the Lisbon European summit and promote a tax code which encourages the creation and development of businesses and jobs.

6.6. The EESC supports an approach that will enable tax codes to be simplified, both for cross-border and domestic activities. To achieve this goal, it is essential to aim at transparency in EU corporation tax codes.

6.7. The EESC feels that the EU should take its cue from tax solutions that have already been found in countries where different codes, while respecting diversity and territorial sovereignty, do not jeopardise the principle of fair competition and are applied openly. The Swiss example is worth closer study here, for it would appear that it has managed to reconcile subsidiarity with overall harmony.

6.8. The EESC would stress that tax regulations must be closely linked to the harmonisation of accounting standards.

6.8.1. The EU has not achieved a true harmonisation of European companies' accounting obligations. While it is true that the adoption of the Fourth and Seventh Company Law Directives has brought national accounting standards for companies closer together, modifications and the special rules for certain types of company have created a whole complex of rules that makes harmonisation impossible.

6.8.2. The use of International Accounting Standards (IAS) could be a solution, and has already been included in the Community standards [1] for companies listed on a stock exchange, financial companies and insurance companies. However, it has to be borne in mind that these international norms have a basic purpose: to give accounts information to investors, whereas corporation tax needs an accountancy code that reflects the state of the company's assets, so that the result obtained in each tax year can be worked out.

6.9. The EESC supports the approach of linking the EU's tax proposals to European company statutes. As stated in the EESC's own-initiative opinion on a European company statute for SMEs [2], these must be accessible to any category of company.

6.10. The EESC considers that the forthcoming enlargement of the EU to include countries whose income generally is a long way below the EU average, is a factor for speeding up any European initiative on company taxation. On the one hand, enlargement can only aggravate existing tax disparities within the single market and, on the other, it is useful to establish a certain number of common principles for countries which are setting up their tax codes on entirely new foundations.

7. **The positions of the EESC**

7.1. As regards the first stage, the EESC first of all supports the European Commission's proposals aimed at speeding up measures to avoid double taxation, particularly the proposal to set up a Joint EU Forum on transfer pricing.

7.1.1. The EESC considers such proposals to be a major step towards removing fiscal barriers within the single market. Even so, these initiatives will have no effect on the exaggerated tax distortions which persist within the single market and are likely to get worse with enlargement.

7.1.2. The EESC urges that this first phase of practical solutions be implemented without delay.

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[1] OJ C 260, 17.9.2001, p. 86: 'Application of international accounting standards' (INT/101).

[2] OJ C 125, of 27.5.2002, p. 100: 'A European Company Statute for SMEs' (INT/109).

7.2. As regards the next phase, the EESC [1] approves the aim of having an internal market free from tax barriers. It feels that this can only be a means of establishing common principles to encourage an internal market where fair competition would prevail. These common principles should also encourage simplification, competitiveness and job creation.

7.2.1. The EESC feels it is essential to create tax code transparency in the EU prior to establishing conditions for fair competition. With this in mind, the fourth option proposed by the Commission, that of a harmonised basis of assessment, is the only option to meet this aim. The other three options proposed by the European Commission (except the case of a non-optional European tax) seek to create two different codes for companies, depending on whether they trade beyond their national borders or not. These solutions would create a sort of tax privilege, a two-speed tax system. They cannot therefore be accepted.

7.2.2. The objective of a harmonised tax base for all EU companies is compatible with the tax sovereignty of the EU's Member States and regions because it preserves their power to fix the level of tax. It must be stressed here that the transparency of a harmonised tax base would enable economic players to put strong pressure on national authorities, which is not the case today because tax codes are so opaque. An eventual real convergence of the levels of direct company taxation would be desirable. An intermediate stage could be to fix tax bands that, among other things, meet the Lisbon summit's objectives of boosting EU competitiveness.

7.2.3. When considering what should be a harmonised tax base, the European Commission should also take into account the need for a tax code that has a neutral effect on production factors, taking particular care not to discourage employment.

7.2.4. The EESC thinks the process for having a harmonised tax base should be tried by companies that have opted for a European statute, on the understanding that they will have no tax privileges compared with other companies. To help them, however, and to make European statutes attractive, one could propose to them a consolidated tax base in accordance with the European Commission's second option, which would simplify matters for companies with transnational activities. The EESC is in favour of all companies, whatever their organisation and size, being allowed to opt for a European statute. In this connection the EESC asks the European Commission to examine without delay its own-initiative opinion calling for a European statute for SMEs.

7.2.5. The EESC also supports the institutional advances which would make it possible to achieve an internal market with a transparent tax code, particularly the modification of the rule of unanimity for corporate taxation matters. It is also in favour of the procedure for strengthening co-operation as defined in the Treaty of Nice, which would enable a group of Member States to move forward as pathfinders in accordance with Community rules.

[1] OJ C 48, 21.2.2002, p. 73: 'Tax policy in the European Union – Priorities for the years ahead' (ECO/072) and OJ C 149, 21.6.2002, p. 73: 'Fiscal competition and its impact on company competitiveness' (ECO/067).

Brussels, 17 July 2002.

The President

of the Economic and Social Committee

Göke FRERICHS