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Brussels, 24 November 1992

O P I N I O N
of the
Economic and Social Committee
on the
Conclusions and Recommendations of the
Ruding Committee of Independent Experts on Company Taxation

and the

Commission Communication to the Council and to Parliament
subsequent to the Conclusions of the Ruding Committee
indicating Guidelines on Company Taxation
Linked to the Further Development of the Internal Market
(SEC(92) 1118 final)

On 28 April 1992, the Economic and Social Committee decided, in accordance with the fourth paragraph of Article 20 of the Rules of Procedure, to draw up an Own-initiative Opinion on the

Conclusions and Recommendations of the Committee of Independent Experts on Company Taxation (Ruding Committee).

On 15 July 1992, the Commission decided to ask the Economic and Social Committee to draw up an Opinion on the

Commission Communication to the Council and to Parliament subsequent to the Conclusions of the Ruding Committee indicating Guidelines on Company Taxation Linked to the Further Development of the Internal Market.
(SEC(92) 1118 final).

The Section for Economic, Financial and Monetary Questions, which was responsible for the preparatory work, adopted its Opinion on 17 November 1992. The Rapporteur was Mr R. PELLETIER.

At its 301st Plenary Session (meeting of 24 November 1992) the Economic and Social Committee adopted the following Opinion by 78 votes to 54, with 4 abstentions:

I. ASSESSMENT OF THE CONCLUSIONS AND RECOMMENDATIONS OF THE RUDING COMMITTEE

THE OVERALL APPROACH ADOPTED BY THE RUDING COMMITTEE

The aim of eliminating the double taxation of cross-border income flows is a continuation of the Commission's earlier work (see the "parent-subsidiary" directive and the draft directives on extra-territorial losses and intra-group payments of interest and royalties).

So, this is a traditional approach which has already been approved by the ESC.

The aim of harmonising company taxation systems, rates and bases of assessment is more ambitious: it would eventually lead to the harmonisation of Member States' tax systems and of the relative weight given to different types of taxation: VAT, corporation tax and income tax.

It is based on the conclusion (which the Ruding Committee has taken over) that tax differences between Member States distort competition, since they have a impact on multinational companies' decisions to set up in a foreign country.

The Economic and Social Committee has reservations about the second objective, since it believes that the taxation of companies must continue to be decided autonomously by the Member States; it would point out here that the Commission's previous attempt to harmonise the taxation of companies did not meet with the agreement of the Member States; this has led the Commission to push the principle of subsidiarity.

DETAILED EXAMINATION OF THE RUDING COMMITTEE'S PROPOSALS

1. Elimination of the double taxation of cross-border income flows

1.1. Elimination of the double taxation of dividends distributed by a company in one Member State to a resident of another Member State

Extension of the "parent-subsidiary" directive

The recommendations of the Ruding Committee reflect the concerns already expressed by the ESC.

It is important to point out that, in general, while it is justified to require evidence of a parent-subsidiary relationship when the aim is to eliminate the double taxation of a group's profits, there is no need for one when the aim is to exempt dividend flows from withholding tax: eventually such flows must be exempted from withholding tax when they occur between companies situated in different Member States, since no distinction should be made between dividend payments and interest and royalty payments.

Introduction, to combat tax avoidance, of a 30% withholding tax on dividends other than those referred to in the "parent-subsidiary" directive and paid to shareholders not identified as EC residents

However praiseworthy the motives behind such a step may be, the introduction of a 30% withholding tax on dividends other than those referred to in the "parent-subsidiary" Directive and paid to shareholders not identified as EC residents would have the following serious inconveniences:

- it could discourage non-EC investors from committing funds to the EC and lead to EC residents investing outside the EC: it was precisely this double risk that made the Member States reject the proposal for a directive seeking to introduce a Community withholding tax on interest;
- it would be contrary to the principle of tax neutrality to encourage financing through loans at the expense of financing from capital, which determines the durability of any investment-led recovery within national economies.

1.2. Elimination of withholding taxes levied by source countries on interest and royalty payments between enterprises in different Member States

This proposal by the Ruding Committee reflects the concerns already expressed by the ESC.

1.3. Elimination of double taxation arising from transfer pricing disputes

The Economic and Social Committee approves the guidelines suggested by the Ruding Committee. It also thinks it would be advisable to deal with the problems posed by thin capitalization and the allocation of headquarters costs under the heading of transfer pricing, and not under that of corporation taxes. It considers that it would be desirable here to extend the reflection exercise to all the issues raised by the invoicing of centrally-provided group services (including expenditure on research).

The ESC would also draw attention to the importance of implementing harmonised methods for calculating the interest rates applicable to cross-border financing within groups.

More generally, it feels there would be justification for laying down the principles for calculating transfer prices and the rules for allocating central group expenditure in a directive; one should not merely limit oneself to examining shareholder costs.

1.4. Offsetting by parents of losses incurred by branches or subsidiaries located in different Member

States

The Ruding Committee's proposals reflect the concerns already expressed by the ESC.

The Economic and Social Committee would point out that the reference to accounts losses could provide an alternative solution to establishing specific tax losses in accordance with the assessment rules applicable in the countries of registration of permanent establishments and subsidiaries. As such an accountancy approach would be consistent by its very nature, it would facilitate adoption of the Ruding Committee's second recommendation, i.e. full offsetting of losses within groups of enterprises.

1.5. Tax treaties

The Economic and Social Committee supports the Ruding Committee's proposals.

2. Corporation taxes

2.1. Removal of discrimination resulting from corporation tax systems and harmonisation of these systems

Apart from its reservations about the principle of harmonising corporation tax systems, the Economic and Social Committee feels that the Ruding Committee's proposals would lead to the country of residence of shareholders benefiting from extra-territorial dividends having to bear unilaterally the cost of reimbursing or imputing corporation tax paid in the source country of the dividend: in its view such a proposal is unrealistic and inadvisable.

2.2. Approximation of the statutory rates and bases of corporation taxes

- Statutory rates of corporation tax

The Economic and Social Committee observes that Member States compete with each other not only on tax rates but also on tax bases: it therefore feels it is unrealistic to fix a minimum and a maximum tax rate unless the rules on the base of corporation tax are totally harmonised. For this reason a long-term, step-by-step approximation of corporation tax should be started with a convergence of the principles governing tax bases, not least so that the necessary transparency of competing enterprises may be increased.

The proposal to include local taxes in corporation tax systems also seems impossible to put into practice, since such a step would jeopardise the political structure of a number of Member States.

2.3. Tax incentives

The Economic and Social Committee thinks it highly important that transparency be evident in the implementation of any tax incentives which have a subsidising effect.

2.4. Definition of taxable profits

The ESC considers that reference to the accounts should be used to avoid increasing the tax base in relation to the accounts, since such an increase more often than not amounts to a disguised increase in corporation tax rates out of keeping with the principle of transparency.

2.5. Depreciation

Even if complete harmonisation of depreciation methods is not possible at the moment, the first steps should still be taken towards an approximation of them. The Economic and Social Committee is against any harmonisation of depreciation rates at the present time.

On the other hand, it seems reasonable to calculate depreciation by incorporating the consequences of obsolete investments.

2.6. Intangibles; leasing; stock valuation; provision; business expenses; occupational (extra-legal) pensions

Any move to harmonise the rules for deducting the various charges under these headings would clash with the principle of subsidiarity raised by the Economic and Social Committee.

It does not think that such harmonisation can be decided at Community level.

2.7. Deductibility of pension contributions paid in respect of expatriate workers or to foreign pension funds

The Economic and Social Committee approves the Ruding Committee's recommendation, which in effect concerns freedom of movement for workers and also raises the issue of double taxation.

2.8. Headquarters costs; thin capitalization; tax losses

These issues are part of the specific problem of how to eliminate double taxation arising from cross-border income flows.

The comments on them can be found under that heading.

2.9. Capital gains

The Ruding Committee's proposals are at odds with the principle of subsidiarity raised by the Economic and Social Committee.

Apart from this objection on a point of principle, the Economic and Social Committee considers it reasonable that only gains in real terms (i.e. after netting out inflation) should be taxed.

In addition, it appears that exemption on condition that gains are reinvested in fixed assets is not the only possible formula; gains may be reinvested in order to increase working capital.

It is therefore also justified to apply a reduced tax rate to gains realised from the transfer of fixed assets, provided that they are not distributed: by following a line of reasoning based on updating, such a technique may achieve the same effect of reducing the tax burden as would be achieved by the deferred payment of capital gains tax in a system allowing exemption on reinvested gains; moreover, it does not introduce any distortion between the taxable figure and the fiscal figure, and is therefore simpler to apply.

2.10. Harmonisation of the dates at which taxes of common application are payable

It seems difficult to reconcile this proposal with the Member States' sovereignty on budget matters; it is important to point out here that the financial year does not always correspond to the calendar year, which may affect the date on which taxes are due.

II. ASSESSMENT OF THE COMMISSION COMMUNICATION

The Commission approves the recommendations of the Ruding Committee concerning elimination of the double taxation of cross-border income flows, pointing out that these recommendations are fully consistent with the measures that it has itself proposed or which have already been adopted by the Council.

It is not so keen about the alignment of national laws on corporation tax because they are so complex and because it is wary about the economic basis of the measures proposed by the Ruding Committee and their effects on the tax receipts and power of decision of the Member States.

The Economic and Social Committee shares the Commission's general line, feeling that the principle of subsidiarity continues to be an obstacle to the adoption of proposals to align national laws on corporation tax.

Having examined the Commission Communication in detail, it wishes to make the following comments:

1. Elimination of the double taxation of cross-border income flows

1.1. Extension of the "parent-subsidiary" and "mergers" directives; studying, in collaboration with the Member States, of new procedures to simplify and speed up the machinery for applying agreements on withholding taxes

The Economic and Social Committee approves the Commission's recommendations and repeats its previous call that the participation threshold for triggering application of the "parent-subsidiary" directive should be lowered from 25 % to 10 %.

More generally, it considers that, while it is justified to require evidence of a parent-subsidiary relationship when the aim is to eliminate the double taxation of a group's profits, there is no need for one when the aim is to exempt dividend flows from withholding tax: eventually such flows must be exempted from withholding tax when they occur between companies situated in different Member States.

It would also stress the importance of implementing new procedures to simplify and speed up the machinery for applying agreements on withholding taxes.

1.2. General rules applicable to transfer pricing

The Economic and Social Committee approves the approach adopted by the Commission, which consists of dealing with the problems posed by thin capitalization and the allocation of headquarters costs under the heading of transfer pricing, and not under that of corporation taxes.

It also considers that the Commission's reflection exercise must be extended, in collaboration with the Member States, to all the issues raised by the invoicing of centrally-provided group services (including expenditure on research).

It would also draw attention to the importance of implementing harmonised methods for calculating the interest rates applicable to cross-border financing within groups.

While it is in favour of a procedure for consultations between Member States prior to any correction of transfer prices and with a view to strengthening the Arbitration Convention, it would also like a directive to spell out the principles to be followed when calculating transfer prices and the rules for allocating central group expenditure.

1.3. Bilateral agreements designed to prevent double taxation

The Economic and Social Committee approves the Commission's guidelines.

1.4. Taxation of groups of companies

The Economic and Social Committee recalls the Opinion it issued on the proposal for a directive on the offsetting by parents of losses incurred by branches or subsidiaries located in different Member States: the reference to accounts losses could provide an alternative solution to establishing specific tax losses in accordance with the assessment rules applicable in the countries of registration of permanent establishments and subsidiaries.

As such an accountancy approach would be consistent by its very nature, it would facilitate adoption of the Ruding Committee's second recommendation, i.e. full offsetting of losses within groups of enterprises.

1.5. Neutrality of treatment as between foreign-source and domestic-source dividends

The Economic and Social Committee would point out that the Ruding Committee included under the heading on corporation tax its recommendation for ending the existing discrimination over the taxing of dividends originating from profits gained in another Member State.

It considers that this recommendation, together with the abandonment of the reciprocity rule suggested by the Commission, would lead to the country of residence of shareholders benefiting from extra-territorial dividends having to bear unilaterally the cost of reimbursing or imputing corporation tax paid in the source country of the dividend: in its view, it is highly improbable that such a proposal would obtain the unanimous agreement of the Member States.

2. Measures relating to the rates, the base and the systems of corporation tax

2.1. Corporation tax rates

The Economic and Social Committee agrees with the Commission that it is inadvisable to set a maximum corporation tax rate and that the proposed reform of local taxes is politically motivated and unrealistic.

It also has reservations about entering into discussions with the Member States on the principle and the level of a minimum corporation tax rate.

As the Commission points out, Member States compete with each other not only on tax rates but also on tax bases: it therefore seems difficult in practice to separate the discussion of a minimum rate from a discussion on the harmonisation of the rules determining the tax base.

2.2. Tax base for company profits

The Economic and Social Committee would point out that the Commission's previous attempt to harmonise the taxation of companies did not meet with the agreement of the Member States; this has led the Commission to push the principle of subsidiarity.

It therefore has reservations about having a detailed discussion on the desirability and possibilities of harmonising the tax base, since the utility of such talks seems debatable.

Similarly, the ESC feels that any specific action to define taxable profits in terms of a minimum base which would be the profit for accounting purposes seems to clash with the principle of subsidiarity.

However, it approves of the detailed analysis which the Commission wishes to undertake of the deductibility of contributions paid to foreign pension funds by or for expatriate workers, since the issue which has been raised cannot be considered as being merely associated with the harmonisation of tax bases.

It also supports the Ruding Committee's proposal concerning small and medium-sized enterprises and seeking to allow unincorporated enterprises the option of being taxed as if they were a company: it approves of the steps taken by the Commission on this point. Finally, as regards tax incentives, it shares the Commission's preference for instruments of the tax credit type rather than for those acting through the tax base.

2.3. Link between the tax treatment of shareholders and corporation tax

The Economic and Social Committee supports the Commission's suggestion that a debate on the choice of a common corporation-tax system should be initiated at Community level.

On the other hand, however praiseworthy the motives behind such a step may be, the introduction of a 30% withholding tax on dividends other than those referred to in the "parent-subsidiary" directive and paid to shareholders not identified as EC residents would have the following serious inconveniences:

- it could discourage non-EC investors from committing funds to the EC and lead to EC residents investing outside the EC: it was precisely this double risk that made the Member States reject the proposal for a directive seeking to introduce a Community withholding tax on interest;
- as the Commission itself hints, it would be contrary to the principle of tax neutrality to encourage financing through loans at the expense of financing from capital, which determines the durability of any investment-led recovery within national economies.

III. FINAL REMARKS

1. The Ruding Committee's brief was very wide-ranging, since it was asked for "an assessment of the impact of taxation relative to other factors" which might lead to major distortions affecting the functioning of the internal market.

The Ruding Committee was also asked to look into the possibilities of correcting any such distortions "taking into account the influence that other policies (e.g. economic and monetary union) might have on the extent of the tax-induced distortions".

2. Through a lack of time or through its own modesty the Ruding Committee has voluntarily limited its investigations to the strictly fiscal aspects of company taxation.

The Economic and Social Committee regrets that the Ruding Committee has thus deprived itself of the findings of an in-depth analysis of the place of company taxation in national economic policies. The Ruding Committee did not seek to go into the role and economic impact of corporate taxation, which is unfortunate.

3. One question worth answering would have been whether it is possible for a Member State which has to encourage its industry to make up a development gap to have the same corporate taxation as the most advanced EC countries.

4. Should Member States be deprived of taxation as a traditional intervention - or incentive - tool?

The Ruding Committee does not hide its distaste at the use of taxation as a lever. It questions the effectiveness of tax aids as an investment incentive and seems to prefer direct subsidies, sometimes even to the point of contradicting itself, as when it says taxation plays a decisive role in investment location.

But the Ruding Committee's position is understandable when one realises that its members are mostly tax specialists who - quite rightly - are wary of the secret manipulations of tax base rules.

Economists generally have a less restrictive view, but there is unanimity on the basic principle of transparency when granting aid. Aids must be public and known to all.

But one must not forget that monetary union will considerably reduce the Member States'

room for manoeuvre in economic policy. Perhaps it is not a good thing to further reduce, or even do away with, the few remaining instruments for acting on the economic cycle and economic growth.

5. The Economic and Social Committee regrets that the Ruding Committee did not take a more overall look at the burden weighing on enterprises, by including, for instance, the question of provisions for retirement: of course, this is a welfare matter but it has a considerable effect on the profits base, since the Ruding Committee considers that tax-exempt provisions may account for 6% of the balance sheet in Italy and Belgium and up to 27% in Germany.

6. The ESC wonders why the Ruding Committee has nothing to say on essential aspects of the very subject which the Commission asked it to study.

As regards its very precise proposals for harmonising the rules on the tax base and corporation tax rates, the Ruding Committee did not think it useful to consider what would be the effect of its proposals on Member States' budget receipts. The excuse given, that there was a lack of reliable statistical information, is unconvincing as tax receipts are, without doubt, among the most reliable statistics available to researchers and economists.

What would be the effect of a big cut in company taxation on other taxes, particularly personal income taxes?

Did the Ruding Committee not have the possibility of setting up an econometric model to show the effects of its proposals for transferring the tax burden?

7. The Economic and Social Committee considers that the Commission should try and remedy this oversight, for the problems of tax harmonisation cannot be tackled without considering the budgetary impact of the measures being proposed and the effects of transferring charges from one tax category to another.

8. The ESC is concerned about the lack of information on the effect that establishing a uniform level of company taxation - as a medium-term objective - will have on investment location. It is not unreasonable to suppose that, far from ensuring neutrality in the operation of the economic union, such a degree of harmonisation would increase the concentration of industrial activity around existing centres at the expense of outlying or less-developed areas in the EC. This seems all the more probable since the Ruding Committee itself concludes from simulations that tax differences affect investment location.

The ESC feels that additional analysis should concentrate on knowing whether corporate tax unification would not lead to a sort of "reverse distortion", benefiting the strong and hurting the weak.

9. The Ruding Committee has not avoided certain contradictions which the Commission itself was obliged to mention. Thus, after clearly stating its support for the principle of subsidiarity and arguing in favour of harmonisation limited to "the minimum necessary to remove discrimination and major distortions", the Ruding Committee finally proposes the adoption of a common system of company taxation entailing both a unification of tax bases and a considerable narrowing of the range of rates.

The discrepancy between the Ruding Committee's proposals and respect for the principle of subsidiarity is at its widest when the Committee proposes that local taxes be incorporated into a corporation tax rate "so that the combined rate of tax falls within the range of 30 to 40% prescribed by the Committee".

10. Despite these few criticisms of the Ruding Committee's report the ESC has much esteem for the quality of a study which will remain a reference document for researchers.

11. As the comments on the Commission's recommendations to the Council show, the ESC is pleased that

the Commission has generally taken up positions which are less categorical and more measured than those in the Ruding Committee's report.

12. Taxation undoubtedly poses the most difficult problems for the achievement of economic and monetary union. The rule of unanimity in Council decisions acts as a curb to the development of Community legislation - albeit essential in future - but also prevents an undue proliferation of rules, which all Member States are not yet prepared to accept.

The ESC would like to see the healthy principles of subsidiarity safeguarded in this area and the necessary prudence shown in everything to do with the burden borne, at the end of the day, by all taxpayers.

It feels it should point out that the unification of corporation tax systems and the harmonisation of rates and tax bases should not be considered in isolation from the effect of such measures on Member States' relations with non-EC countries; the bilateral context of the renegotiation of agreements concluded with countries would not necessarily be adapted to the existence of a harmonised corporation tax.

Done at Brussels, 24 November 1992.

The Chairman The Secretary-General
of the of the
Economic and Social Committee Economic and Social Committee

Susanne TIEMANN Simon-Pierre NOTHOMB

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