The Prospects of the Corporate Taxation Agreement in the European Union

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Gheorghe Matei
University of Craiova
Daniela Pârvu
University of Pitești

Abstract. *In all the countries of the world, the fiscal policy is a tool used by the governments in order to get the public incomes and to stimulate the economic development, to reduce the fluctuations and the economic instability. Income taxation causes great difficulties within an open economy, like EU economy, since there is a competition of attracting investments. The tax rate agreement on the European companies' profits is subject of dispute and discussion. The European Committee's proposal to adopt measures to charge the capital companies' incomes according to a consolidated fiscal base for activities performed within the European Union has many supporters, attracted by the possibilities provided by a more concise taxation system and a better business planning that may result when applying such formula. This measures will be a very important step in the process of improving the business environment, by consolidating the Unique Market and increasing the competition. The opponents of the idea of corporate taxation agreement are, as a rule, countries which are currently favored by the reduced level of the taxation of the companies' incomes in their relations to their European neighbors (Ireland, Great Britain, Slovenia and the Baltic Countries). According to these countries' representatives, fiscal agreement will determine the migration of the investments to the more stable economies of the Central Europe, which have an infrastructure and benefit from the competitive advantages in different branches of the economy and it will limit the positive effects of the fiscal competition within the European Union.*

Key words: fiscal policy; tax harmonization; income taxation; Common Consolidated Corporate Base.

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JEL Codes: M 41, M42.
REL Codes: 14I, 14J.

Introduction

The elaboration of the fiscal policy of a state is a very complex decisional act which shall be based on the efficiency criterion. The taxes and the other extractions going to the state budget change the initial distribution of the income, influencing the economic activity, the investments and the expenditure. The policy in the tax field is essential for all the member states and the actions of a country may have an impact not only on the country itself, but also on the neighboring countries.

Along the time, the fiscal policy has remained for the UE countries one of the tools that the governments may use in order to influence the national economies. By the Stability and Growing Agreement, the fiscal policy was somehow constrained as by this agreement, the member states shall assure the increasing of the coherence on a long term of the public finance in order to limit the excessive deficits. Respecting the discipline rules in the fiscal and budgetary field will determine the general improvement of the quality of the public finance and to free the necessary budgetary resources in order to encourage innovation, investments, education and the creation of new work places.

Taking into account the above mentioned issues, it is not surprising that the taxation matter of the corporate incomes should be, at present, the topic of some heated disputes not only among scientists, but also among politicians. Mainly, one is trying to find an answer to the following question: "Which of the two possible systems would be more favorable for the economy of the European Union: the one based on fiscal agreement or the one based on fiscal competition?".

The points of view existing at present are moving between two extreme points: the ones promoting the whole fiscal agreement and the ones promoting the pure competition.

1. The pros and cons of the fiscal agreement

The competition in the taxation field may lead, at a certain moment, to a diminution of the tax cashing, which might question the possibility of the authorities of being able to satisfy the service and public goods demand. Introducing some overstate rules by which one should precise the minimum level of the taxation rates would guarantee the providing, under appropriate circumstances of public services and goods. This idea may be noticed in Zodrow's and Mieszkowski's (1986) works who supported, firmly, the need of some common taxation rules for all the member states by which one assures the collecting of enough fiscal incomes in order to guarantee the continuity of providing public goods and services. According to John D. Wilson (1987), the mobility of the capital and the liberality of the trade will lead to a competition in the field of the taxation of the mobile production factors, having damaging effects upon the public goods offer, the fiscal agreement being necessary, up to the end. The recent evolutions of the public financial resources in the UE countries may show the veridicity of the ideas rendered above. The European Commission even warns that the European

Union countries will face real crises of the public funds unless the governments cease the race for reducing the business taxation.

The budgetary deficits recorded in some of the countries which have chosen in the latest year for relaxing the companies' incomes taxation (see table 1) is a reason of worrying for the European Commission which see the goals of economic policy of the European Union threatened.

Financial indicators (as a percentage of GDP)

Table 1

Country	2005			2006		
	Govern-ment revenue	Govern-ment expen-diture	Govern-ment deficit	Govern-ment revenue	Govern-ment expen-diture	Govern-ment deficit
Slovakia	35.3	38.1	-2.8	33.5	37.2	-3.7
Poland	39.0	43.3	-4.3	40.0	43.8	-3.8
Malta	42.0	45.1	-3.1	41.5	44.1	-2.5
Slovenia	44.5	46	-1.5	44.1	45.3	-1.2
Hungary	42.1	49.9	-7.8	42.6	51.9	-9.2
Romania	32.4	33.8	-1.4	33.2	35.0	-1.8

Source: European Commission, Economic forecast autumn 2007.

Krugman and Baldwin (2000) noticed that in between 1975-1995, in the member states of the UE, there were not significant decreases of the taxation quotas of the companies' incomes, in spite of an important increase of the capital mobility. Moreover, during the above mentioned period, the incomes from the taxation on the companies' incomes increased not only as a percentage of the GDP, but also as a percentage of the total incomes. This evolution was explained by the so-called phenomenon of the „force crowd", according to which the localization of the industrial companies is important for the economic environment, as the investors prefer the regions where the economy development level is raised; thus a mobile production factor may become a half-fix one, whose mobility is influenced to a less extent, by the taxation level. As a consequence, the two economists denied the existence of a competition in the taxation field.

The evolution of the medium level of the taxation rate level of the companies' incomes in the UE state members in between 1995-2006 shows the reverse of the trend described by Krugman and Baldwin.

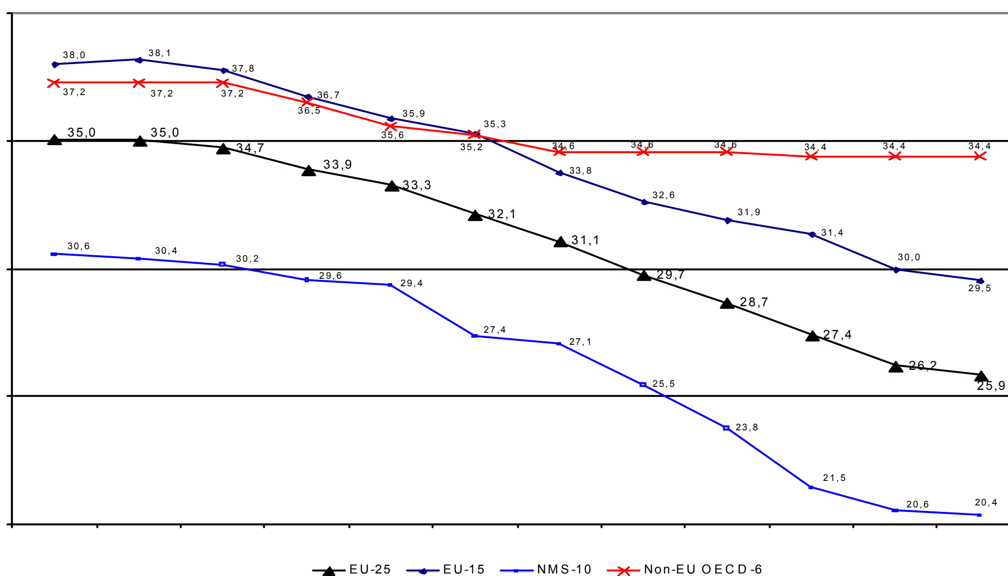

Figure 1. *Evolution of corporate income tax rate*

Source: Taxation trends in the European Union, European Commission, 2008.

Under the circumstances of the of deleting the barriers in the way of the free movements of the capitals and of the work labor, the governments were encouraged to diminish the fiscal tasks in order to attract direct foreign investments, of the financial investments or in order to achieve other goals of their economic policy. Out of the above mentioned data, one notices that the pressures have been even greater for the member states of the European Union. Thus, under the circumstances of suppressing the fiscal advantages for the foreign investors, the new member states were forced to reduce the taxation quotas in order to keep their economies attractive. These steps of fiscal policy did not remain without echo from the old member states. The medium taxation level of the incomes of the capital companies decreased from 38.0% in 1995 up to 29.5% in 2006 in the UE-15 states, but this reduction was compensated by some steps increasing the calculation basis. This trend has continued in 2008 as it is shown by the diminution with 0.9 percentage of the average in the EU-27 countries. The reduction was even greater in the Euro area (1.2 points), whose taxation has remained however high (at a percentage of 26.5% the average of the Euro area is almost 3 points above the average of the whole Union). Seven member countries have reduced the taxation quotas in 2008, the most important reductions taking place in Germany (-8.9 points) and Italy (-5.9 points).

The reducing of the taxation quotas of the companies' incomes has caused a migration of the investments to the areas with a lower taxation, causing thus a decreasing of the cashing from the incomes in countries such as: Germany, Greece, Cyprus, Luxemburg, the Netherlands, Finland, Sweden (see table 2).

Evolution of corporate income taxation as GDP percent

Table 2

	2000	2001	2002	2003	2004	2005	2006
Belgium	3.2	3.1	3.0	2.9	3.2	3.4	3.7
Bulgaria	2.8	3.6	3.4	3.4	3.0	2.9	3.6
Czech Republic	3.5	4.1	4.3	4.6	4.8	4.5	4.5
Denmark	3.3	2.8	2.9	2.9	3.2	3.8	4.3
Germany	1.7	0.6	0.6	0.7	0.9	1.1	1.4
Estonia	0.9	0.7	1.1	1.6	1.7	1.4	1.5
Ireland	3.7	3.5	3.7	3.7	3.6	3.4	3.8
Greece	4.5	3.7	3.7	3.2	3.3	3.6	2.7
Spain	3.1	2.9	3.3	3.1	3.5	3.9	4.2
France	2.8	3.1	2.5	2.1	2.4	2.4	2.9
Italy	2.3	2.9	2.5	2.2	2.2	2.3	3.0
Cyprus	6.2	6.2	6.0	4.3	3.7	5.4	5.5
Latvia	1.6	1.9	1.9	1.5	1.7	2.0	2.3
Lithuania	0.7	0.5	0.6	1.4	1.9	2.1	2.8
Luxembourg	7.0	7.3	8.0	7.4	5.8	6.0	5.0
Hungary	2.2	2.3	2.3	2.2	2.1	2.1	2.3
Malta	2.9	3.2	3.9	4.5	4.2	4.0	4.5
Netherlands	4.3	4.2	3.6	3.0	3.3	3.7	3.7
Austria	2.2	3.3	2.4	2.4	2.4	2.4	2.4
Poland	2.4	1.9	2.0	1.8	2.2	2.5	2.4
Portugal	3.9	3.4	3.4	2.9	3.0	2.8	3.0
Romania	-	2.5	2.5	2.6	3.1	2.7	2.8
Slovenia	1.2	1.3	1.6	1.8	2.0	2.8	3.0
Slovakia	2.8	2.7	2.6	2.8	2.5	2.7	2.8
Finland	5.9	4.2	4.2	3.4	3.5	3.3	3.4
Sweden	3.8	2.7	2.1	2.3	3.0	3.8	3.6
United Kingdom	3.4	3.3	2.8	2.7	2.8	3.3	3.9

Source: Eurostat Statistical Books, Taxation trends in the European Union, 2008 Edition.

Taking into account all this, there are less and less economists who deny the existence of the fiscal in the European Union. But there are a lot of economists who consider the common taxation rules for the companies inefficient. For Fourçans and Thierry (2001), under the circumstances of a „federalized" money policy and of a fiscal policy forced by the Stability and Growing Agreement, the fiscal agreement, by introducing a minimum taxation level, seems farmost exaggerated. As a consequence of the fiscal the taxation, as a macroeconomic

tool, that the governments use in order to reduce the asymmetric shocks, will lose its efficiency. From the point of view of the two economists, the fiscal competition will lead to the reduction of the public incomes, forcing the governments the reduce the useless and inefficient expenses. This point of view is supported by the supporters of the theory of the "public choice", who assert that the competition, in general, and the competition between governments, especially, is beneficial as it reduces the waste of the public financial resources and makes the politicians disciplined (Janeba, Schjeldrup, 2002), being able to generate the increase of the living standard within society.

The issue of the competition and the fiscal agreement in the European Union has not been a debate topic only for scientists. Among the politicians, there are lots of views generated in most of the cases, by the national economic interests. Thus, the representatives of the countries where the taxation level is high and which have the status of clear tax payers to the European Union budget (Germany, France, Italy) are the supporters of the fiscal agreement and of adopting a minimum taxation rate, especially in the case of an increased capital mobility. Unlike these, the representatives of the states having adopted a more relaxed fiscal policy in order to stimulate the investments and the work, assert against restrictive fiscal steps. These states are based on a sustained economic growth, having as a concrete example of success in attracting the investments by reducing the medium taxation level of the companies' incomes among the countries with a well established status within the European Union, as instance of Ireland.

It was the poorest country in the Community when it adhered in 1972, but it became one of the richest within three decades. Obviously one of the main factors that contributed to this development was the affiliation to the European Union and the sizable support it received in time. Unlike other states (Greece, Portugal, Spain) that did not show the same levels of prosperity during the same period and on similar conditions (see table 3), Ireland chose a friendly fiscal policy with the lowest income taxes for the European Union's companies, attracting an important volume of foreign investments, while the infrastructure needs were financed from European funds.

Ireland's economic development, compared to the four poorest countries of the European Union (depending on the gross domestic product – 100% represents the average value for the EU)

Table 3

	1983	1993	1995	1997
Ireland	64%	80%	90%	100%
Portugal	55%	69%	70%	70,7%
Spain	71%	78%	76%	77%
Greece	62%	65%	64%	64%

Source: Department of the Taoiseach, Ireland and the European Union, Dublin, 2006.

The intention of the European officials of establishing a set of rules common to all the member states for the taxes on the companies' incomes is motivated by the existence of some significant differences among the quotas of the taxes on the companies' incomes in the European Union (see table 4) encouraging the multi-national companies to use a complete set of fiscal optimization (the profit transfer to the areas with low taxes, or setting some financial departments in fiscal paradises to finance the

investments by credit lines within the group) which will generate income losses for the countries with a high fiscal level and disadvantages to little and medium size companies which take part in the competition on the same market.

Corporate income tax rates in some Member States

Table 4

Countries	Italy	Ireland	Spain	Greece Austria Portugal	Germany	Cyprus Bulgaria	Slovak Republic	Romania	Malta
Tax rates	27.5	12.5	32.5	25	29.8	10	19	16	35

Source: European Comission, Taxes in Europa database, 2008.

The nominal taxation quotas are not more than an incomplete marker of the fiscal task. The effective fiscal task has to take into account the way of calculating the taxable income and the different technical procedures used to calculate the taxation quota. That is why to refer also to the implicit taxation quotas of the capital, which compare the collected tax from the companies to the exploitation gross budget excess of the companies.

One may use a difference about the investors' taxation among the very low taxation quotas used by the new member states compared to the average of European Union, as well as the existence of a very restrictive taxation (such for Estonia) which has been partly enlarged in the same time with the economic fiscal policy on the European level. The countries which have recently joined benefit from a very low effective taxation level of the investments compared to that used in the Union. In some countries (the Czech Republic, Hungary, Poland and the Slovakia) the index tax/GDP decreased in between 1999-2002, except for the Czech Republic, where it increased 38.9 to 39.2. Concerning Hungary, the same index decreased from 39.1 to 37.7, in Poland from 35.5 to 34.3 and from 34.4 to 33.8 in Slovakia.

2. The prospects of the corporate taxation agreement in the European Union

In 1997, there was adopted asset of steps about direct taxation, having the purpose of fighting against the damaging taxation, with the intention of supporting the fiscal coordination within the European Union. The new European fiscal strategy (called "the Monty Strategy") was published by the European Commission in October of the same year. Its purpose is to reduce the differences in direct taxation, according to the goals of the action plan for an unique market, so that these ones should lead to a better occupancy of the labor force.

This goal of the corporate taxation agreement can be achieved by:

a) Home State Taxation - HST: the taxation basis could be calculated according to the rules of the fiscal jurisdiction where the main social headquarters is. This will not influence pan-UE consolidation of the taxation basis; there remain separate taxation bases in each member state where taxable

activities take place, but all go according to the same rules;

b) Common Consolidated Corporate Tax Base - CCCTB: a new system of calculating the taxation basis according to which the companies would calculate in consolidate way the volume of the taxable incomes. The incomes would be taxed according to the rates of every fiscal jurisdiction, and the taxation basis attached to every fiscal jurisdiction would be set according to some distribution rules of the consolidated basis;

c) European Corporate Income Tax-EUCIT: led by a new fiscal authority, using the same taxation rates on the whole territory of the EU upon a pan-European taxation basis calculated according to a single set of rules valid all over EU. The fiscal product due to this tax would be going to be sent to the EU budget;

d) The traditional approach: the taxation agreement of the rules by setting a single system of calculating the taxation basis compulsory valid in all the fiscal jurisdiction and replacing the national systems.

There are advanced discussions in the case of the system known as the Common Consolidated Corporate Tax Base which is to be applied in parallel with the existing calculation methods in every member state, the companies having the possibility of choosing to adopt the pan-European system or to put into practice the national rules. The companies which will use the unique formula will calculate the total of the profits obtained on the whole territory pf the European Union, then, they will reassign them to the countries in which the companies have economic activity, in order to be taxed with the quota of benefit tax valid in the respective countries. The simplification of the income taxation system would allow to the investors operating in more countries of the European Union to use the same principles for the calculation of the tax on the benefit as in other countries which would mean that they would use less time to the fiscal management.

A European Commission policy of achieving a common consolidated corporate basis is motivated only as a first step to a standardized corporatist taxation level. The corporations using the European structure, the public services and the qualified employees will not be able to avoid the contribution to financing these.

The goals of the fiscal reformation go from the general objective, that of simplifying and making more efficient the taxation systems on the companies' incomes in order to assure a better functioning of the home market and reach specific and operational goals such as: conforming/ managing cost cuts attached to the taxation of the companies paid by fiscal companies and administrations, the making easy of new trans-border activities, the promotion of the fiscal neutrality between the home investments and the EU ones and the reduction to a minimum of the distortions caused by the differences between the countries about the investments repartition and the taxation bases.

Concerning the technical aspects of the Common Consolidated Corporate Tax Base project, one shall mention the following:

▪ *The fix assets and the depreciation.* The assets fulfilling the necessary conditions may be paid off either individually, which needs an estimation of the life-time of every asset

when purchased (according to the common EU regulations) and an individual paying-off along the life-time, either in one or more groups, having a commonly established life-time. The commission considers that the development of the grouping method within the CCCTB implies important advantages;

- *Deductions for provisions*. The deductions may generally be not fiscally deductible, completed by a list of fiscally deductible exceptions, or they may generally be fiscally deductible completed by a list of not fiscally deductible exceptions. The Commission considers that the commissions fiscally deductible shall be defined and completed by a list of exceptions not fiscally deductible;

- *General methodology*. The start point for calculating the taxation basis of a company may be set by taking into account the opening and closing balance sheets or the benefit and loss account of the company. In the first case, one shall prepare a fiscal balance sheet according to some norms commonly defined which should also include the benefit and loss account. In the second case, it is necessary to have only the benefit and loss account defined commonly in the CCCTB laws; the information related to the balance sheet can be checked by comparing them with the financial accounts. The Commission considers that a fiscal balance sheet is not necessary, this one representing an extra administrative burden;

- *Local taxes*. In some of the member states, there are high enough local taxes. These ones can be deductible from the consolidated basis and thus included in the repartition mechanism or nationally retained and deduced only from that part of the consolidated basis which is due to the respective member state. The Commission considers that generally it is preferable to a set of norms as large as possible in order to avoid as much as possible the national derogations or the extra taxes. In spite of all of these, one needs an extra analysis of all the consequences, as the repartition of the deductions for the local taxes in EU, but the non-repartition of the national taxes at the level of the common basis might generate a lack of coherence;

- *Foreign incomes*. The foreign incomes may be completely excluded from the CCCTB or they can be included in CCCTB; in this situation, one needs a method of including these ones in the mechanism of consolidation and repartition. One raises this issue as one shall take into account different methods to avoid the double taxation used at present by the member-states according to the national legislation, as well as the bilateral agreements with third countries. The Commission considers that it is preferable to set a method to include the foreign incomes in CCCTB and which should be completed, if there is the case, by a form of exemption in order to avoid the double taxation;

- *Defining the group notion*. One will need a detailed definition of the notion of group of companies, having in view the consolidation. Apart from setting a commonly acceptable ownership level, the multitude of ownership structures is questionable. For instance, if a foreign company owns more companies in EU and it is, in its turn, owned by a company in EU, it seems preferable that all the companies in EU of the group should be consolidated;

- *The transactions within the groups*. Avoiding the problems related to the transfer prices represents an important advantage of the consolidation. In spite of all of these, there are more methods of eliminating the transactions within the groups in the same time with the basis consolidation. These may be ignored, acknowledged at the cost level or acknowledged at the set price under circumstances of true competition. Every method presents advantages and disadvantages, reason for which the Commission shall decide which of them is preferable or if it is possible that every group should have the possibility to choose;
- *The repartition mechanism*. Except for the fundamental matter about adopting a macroeconomic approach, one based on the added value, of a formula or combined type, one raises some problems related to defining certain aspects. For instance, within the approaching of the formula type the importance of every possible factor and the precise elements to be included in every factor shall be carefully examined before tacking a decision.

The European Commission Project is supported by most of the EU states, by the European Parliament, by the Economic and Social Council, and by the European Business Community. The opponents of the project are, as a rule, countries which are currently advantaged by the low level of taxation of the companies' income taxation in their relation with their Europeans neighbors, Ireland, Great Britain, Slovenia and the Baltic Countries. Their reasons are:

- the rate of taxation of the companies' income is only a part of the effective taxation rate equation, and the standardized fiscal bases represent fiscal agreement which embarrasses the fiscal competition;
- this fiscal agreement will determine the migration of the investments to the more stable economies of the Central Europe, which have an infrastructure and benefit from the competitive advantages in different branches of the economy;
- the project hides the true financial problems of the EU generated by the lack of the internal reforms in the Euro area economies.

Conclusions

In our opinion, the fiscal competition is a real matter which the economies of the member states of the European Union face as a consequence of the free circulation of goods, service, work labor and capital inside the UE. Taking into account the point of view of the developing European economies, the fiscal competition may generate some benefits as attracting direct foreign investments (as Romania has proved by reducing the taxation quota for the companies' incomes from 25% to 16% in 2005) and it may encourage the process of becoming efficient in the countries collecting incomes in an inappropriate way. The negative impact of the fiscal competitions is more powerful, especially in the context of the even more accentuated financial instability which the world economy is facing. In the EU countries, one shall take steps by which the fiscal system should gain in efficiency, transparence and simplification. From this point of view the

fiscal agreement is the best solution to avoid some disturbances in the system of the public finance and to assure a good functioning of the internal market. We also consider that the corporate incomes agreement is a compulsory part in continuing the process of fiscal agreement. The fiscal agreement has become an important part of the European integration, significantly contributing to the increasing of the interdependences among states, so that limiting the national sovereignty considerably loses its importance. According to declarations of the European Commission, since the present mandate of European Parliament is drawing to a close, the adoption of the CCCTB project will be postponed for the next years, for certain will not renounce to the idea of the corporate taxation common rules setting up.

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