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Controversies Regarding the Corporate Tax Harmonization Trend in the European Union

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Abstract. *The idea of harmonizing corporate income taxes is currently one of the most important topic of debate on the agenda of the European Commission, but also in the specialists' theoretical approaches. The extreme diversity of these approaches is a relevant indicator for the complex problems that prevent the formulation of well known solutions in this field, disregarding the political feasibility considerations. This paper present a critical approach of the main reactions of experts, politicians and business representatives regarding the trend of harmonizing corporate income taxes in the EU.*

Keywords: fiscal policy; harmonization; common consolidated tax base; effects; controversy.

JEL Codes: G32, H25.
REL Codes: 8K, 14K.

1. Introduction

Recently, many experts and politicians have been in favor of achieving a coherent and centralized policy at the EU level in order to corporate income tax. The key word used by those who believe that all Member States should align their tax systems to executive directives from Brussels is „harmonization".

One of the arguments used in favor of this measure is that the Union should have the power to set and levy taxes and not only to make recommendations to the Member States regarding measures of fiscal policy (Trovato, 2007). Moreover, according to the opinions expressed by the European Commission in 2001, the operation of different national tax systems in the Member States is the source of many problems:

- influencing (distorting) resource allocation, with negative consequences on capitalization of the true single market advantages, but also in terms of international distribution of tax revenues, which may disadvantage some Member States in relation to others;
- weakening of budgetary revenue through income loss associated with tax competition;
- trend of increasing the fiscal system inequity through the preferential approach of mobile tax bases;
- risk of double taxation.

The problems outlined above generate economic inefficiency because between taxpayers (corporations) and tax administrations occur frequently conflicts related some restrictive or discriminatory measures of the latter or competitive distortions caused by corporate actions. These conflicts are resolved with the cost of spending significant financial resources for achieving inspections and investigations, tax audit and others.

The problem of distortions caused by different taxation corporate income may be summarized as follows: if taxes are higher in a certain area, capital will migrate to areas with lower tax if other economic considerations do not keep better the original location. Countries affected by this migration will react to this situation, either by imposing barriers to free movement of capital or by reducing the tax to boost their inflow (James, Oats, 1998).

To solve these problems, at the EU level it is said frequently the need to partial harmonization (only the tax base) of corporate income taxation. Note that in order to prevent the "migration" of national tax bases, by moving corporate headquarters in countries with more favorable tax regimes, there have been proposals for total harmonization (both tax bases and tax rates) of corporate income taxation.

2. Positioning European politicians regarding the corporate income tax harmonization tend

The issue of corporate tax harmonization raised many political controversy in European Union Member States, generated by the doctrinal orientation of the empowered political parties. Thus, in England and Ireland the economic policy is focused on the role of the free market in allocating resources, promoting the principle according to which the state intervention through taxes should be minimal. The Continental European countries promote the importance of maintaining the state as a “dynamic player agent” of regulating some economic and social mechanisms if the taxation generates minimum distortions in the process of market economy. The Scandinavian countries promote the idea of social assistance universality and the important role of state involvement through tax levels to ensure a proper social development. The simple presentation of the main characteristics of economic and social models in European Union countries are sufficient to guess the position of their political leaders against the idea of corporate tax harmonization. Thus, countries with a predominantly neo-liberal political ideology (see England and Ireland) will not approve the idea of eliminating tax competition between governments, because it is the engine of efficiency and economic progress, and countries with a predominant socialist political ideology should be interested in the tax corporate discipline increase and the removal of the uncertainty related government tax revenue decrease as a result of foreign investments migration to advantageous locations in terms of tax.

Conversely, the positions of politicians against the tax harmonization depends on the real interests of their constituents which is in direct relationship with changes in economic and social environment and with the constraints to which they are subjected, and not with the political ideology. Thus, political leaders in the new Member States (which practice smaller income tax rates for companies), regardless of their doctrinal orientation, should be on a hostile position against the corporate tax harmonization, because their economies will lose such a substantial advantage when attracting foreign direct investment.

Description of key positions of European politicians against the issue of corporate tax harmonization will confirm this supposition.

In the late 1990s, the political leaders of some Western European countries considered the harmonization of corporate income taxes a way to eliminate "harmful tax competition", particularly after the publication of the first report of the Primarolo Group, which identified 66 "harmful tax measures" in Member States. Primarolo Group investigations were initiated after several politicians (in Germany, Belgium, Austria and others) have reported that differences between national tax profit systems on financial investments have led to the migration of their residents economies in other Member States in order to avoid domestic taxes. Since the restrictive legislation in the field of banking secrecy harms the cooperation of public authorities to combat tax evasion, the harmonization of income tax rates in all Member States should contribute to solving of this problem.

Another concern expressed by the political class in these countries cover reducing the amount of public goods and services provided to citizens under the influence of reducing revenues from direct taxes (as a consequence of tax competition manifested in the internal market). This idea is folded on the principles of socialist doctrine, represented politically by the governments of many European countries in the late 1990s and early 2000s. Clear positions in affirmation of these ideas were taken by the minister Oskar Lafontaine and Gerhard Schroeder - Federal Chancellor of Germany. These politicians have fought the idea that nation-states should compete in the tax area, showing that this approach is based on a mercantilist principle: "a state can become richer only acting in the detrimental of others". Such competition was counterproductive and could not be compatible with the proper functioning of the European market (Ussher, 1999).

The accession of new countries to the European Union has sharpened the political disputes on corporate tax harmonization theme. Thus, joining German Chancellor Gerhard Schroeder, who argued the need for the EU of a "tax corridor" (setting minimum and maximum rate of corporate income taxation), Dutch Minister of Finance, Gerrit Zalm, proposed, in 2004, the setting minimum corporate income tax rate of at least 20% (the Mooij, 2004).

A study about the attitude of European Parliament Members (MEPs) about the introduction of a minimum corporate income tax rate across the Member States, after questioning a number of 156 MEPs, from March to July 2007, revealed the situation shown in Table 1 (MPs responses were recorded on a scale from -4, representing total disagreement with the introduction of the minimum rate, to +4, representing total agreement with the introduction of the minimum rate):

Table 1

Results of the MEPs questionnaire regarding the introduction of the minimum rate of corporate income taxation in the European Union, according to the doctrine of the political group the respondents were affiliated to

Classification according to the political group	Political doctrine	Share of respondents in the parliamentary group (%)	Average Score
Alliance of Liberals and Democrats for Europe (ALDE)	Liberal	17.31	-0.11
European People's Party (EPP-ED)	Conservative, Christian democracy	19.78	-0.72
European United Left/Nordic Green Left (GUE-NGL)	Socialism, communism	1.2	1.4
Independence and Democracy Group (IND/DEM)	Euroscepticism	29.17	-3.71
Identity Tradition and Sovereignty Group (IST), dissolved in November 2007	Nationalist	17,39	1
Non-attached members (NI)	-	23.08	-4
Party of European Socialists (PES)	Social democracy	23.15	2.02
Greens – European Free Alliance (Greens-EFA)	Green, regionalism	14.29	3.17
Union for Europe of the Nations (UEN)	National conservatism	22.73	-1.8

Source: Osterloh, S., Heinemann, F., *The Political Economy of Corporate Tax Harmonization – Why Do European Politicians (Dis)like Minimum Tax Rates?,* Conference papers: Reflections on Fiscal Federalism: Elaborating the Research Agenda, October 2009.

It is noted that the parliamentary representatives of socialist orientation have a more favorable position regarding the corporate tax harmonization (including through tax rates) compared with the parliamentary representatives of liberal orientation.

In terms of respondents origin, the survey results in the European Parliament showed that representatives of Poland, the Czech Republic and Great Britain opposed, in mostly, the corporate tax harmonization idea, and representatives of Portugal, Austria and Belgium were most vehement supporters of the idea. Grouping the respondents according to accession to European Union of represented countries, the research generated the following result: almost all parliamentarians from the new Member States opposed the idea of minimum corporate income tax rate introduction, position also inferred by as above (Osterloh, Heinemann, 2009).

Addressing the fiscal harmonization issue of politically, we ask us why so many politicians support this process accepting to give up control of one of the most important levels of economic policy: the tax system. We find an answer in Masimiliano Trovato (2007) study, which argues that if the capital and labor move easily between countries, and developments in technology allow people to communicate easily among themselves and to establish fruitful business relationship, regardless of where they are, tax bases tend to become increasingly mobile. Public authorities can do little or nothing to prevent this trend. The role of politics in fiscal area will diminish, perhaps with the deepening of globalization. Thus, with the cost of short-term loss of their fiscal powers, politicians try to counteract the effects of globalization, replying that powers on a much larger scale.

3. Debates in the European business regarding the corporate income tax harmonization trend

European business reaction regarding the corporate income tax harmonization trend may be summarized by presenting the position of the Association of European Chambers of Commerce and Industry. Thus, in 2007, the Association of European Chambers of Commerce and Industry considered the fair tax competition between EU Member States a powerful driving force for the reduction of tax rates, the business growth and the job creation in Europe. Compliance costs are much higher for the companies with cross-border activity, and these costs are disproportionately high for the small and medium enterprises, since they must meet the requirements of 27 different tax systems. European Chambers of Commerce were positioned for a transparent tax competition because it is very important for small businesses wishing to expand their business abroad and are often unable to afford tax advice. Corporation tax rules in all Member States should be sufficiently comparable, so companies to easily identify the differences between tax systems and procedures in different countries. In these circumstances, the Association of European Chambers of Commerce and Industry supports measures that would help to minimize the tax costs for businesses operating within the European Union Member States. These measures should be translated by creating a common tax base and strengthening the free competition in terms of tax rates. However, the European Chambers of Commerce stated that the engagement of Member States in a “race to reduce tax rates” cannot express any European business interests and, still less, the interests of EU citizens.

A common consolidated tax base would provide companies established in more than one Member State the possibility of their income group determination in accordance with a single set of rules. This would facilitate the elimination of discretionary practices, the decrease of compliance costs, the reduction of administrative burdens, the elimination of double taxation situations, would allow automatically the strengthening of profits and losses (in this context, unrealized profits should not be taxed) and would contribute to creating a tax system more transparent. For these reasons, the Association of European Chambers of Commerce and Industry supports European Commission proposals for creation of a common consolidated corporate income tax, provided it is clear, simple and easy to use.

Harmonization of corporate income tax base is supported by most members of the Association of European Chambers of Commerce and Industry, with the exception of Chambers of Commerce in Great Britain and Ireland who are not convinced that this model is best suited to meet the needs of economic growth in EU. Although Cyprus Chamber of Commerce expressed reservations about the model of “the common consolidated corporate income tax”, it was willing to consider the impact of its introduction (Eurochambres, 2007).

Between 2004-2007, commenting the European Commission proposals on the introduction of a common tax base for corporate income taxation, the Union of Industrial and Employers' Confederations of Europe stated its support for the project, as far as the reform of corporate income tax system from Member States will contribute to increased efficiency of firms operating in multiple markets. The support of European business representatives for the corporate income tax harmonization project was demonstrated by a study of KPMG International in 2007, which shows that the most of EU corporations wants a single formula for the profit tax calculation. The study was accomplished by interviewing financial managers in over 400 companies from all 27 EU member states and Switzerland. Thus, it was revealed that a significant number of specialists in taxes supports the European Commission proposal about a single formula for calculating the profit tax base applied in EU. Politicians interviewed in the Czech Republic, Denmark and Spain were the most enthusiastic, in 100% they said that support the initiative. In Italy, in 96% they were in favor of the proposal, while in Greece, Luxembourg, Poland, Slovenia and Sweden it has been a support of 90%. The proposal was supported by 84% of the politicians interviewed in Germany and by 80% of the politicians interviewed in Austria, Finland, Hungary and Portugal. Among the most skeptical country was Britain, with a support of only 62% for the Commission's plans, while in Ireland and Slovakia 50% of respondents opposed this.

Is noteworthy that the European Commission's proposal does not support the introduction of a flat tax at EU level, but 69% of those interviewed said that in addition to a single tax base would accept a flat income tax throughout Europe. Only in Great Britain, Cyprus, Ireland, Poland and Switzerland, most respondents have decided against a flat tax.

4. Supporters and opponents of the "Common Consolidated Tax Base"

The "Common Consolidated Tax Base" system reflected the European Commission conception concerning the partial harmonization (only the tax base) of income tax for companies doing business within the European Union Member States. Technical solutions regarding the implementation of this system were (and are) discussed by experts of the European Commission and representatives of the Member States reunited within a working group established in 2004. Some European Union countries (Ireland, Great Britain, Poland, Latvia and Slovakia) were expressed against the introduction of the common consolidated tax base for corporate income, which created a real concern in the European Commission because the new legislation on direct taxes would need the unanimous support of Member States. The arguments presented by representatives of these countries can be summarized as following (Gnaedinger, 2008):

- during debates on the adoption of the Lisbon Treaty, Irish politicians have argued that the "Common Consolidated Tax Base" is a violation of national sovereignty in taxation, and the ultimate goal of the European Commission in implementing this system would be full harmonization (tax base and tax rates). Common consolidated tax base was defined as a "Trojan horse of Europe" which, once adopted, will allow the Commission to put pressure on Member States to harmonize the tax rates;
- Great Britain refuses to give the EU more powers in the fiscal area (such as those required by the operation of a common consolidated tax base);
- in 2006, Polish finance minister Michal Tarka said that his government could support the introduction of consolidated common tax base if this would apply obligatorily for all companies with cross-border activity. In 2007, the same minister said that, despite his personal opposition to the European Commission proposal, the Polish government decided to participate in further at debates on the system "Common Consolidated Tax Base." Opinions expressed by Polish politicians resonate with business representatives position in this country. Thus, a report of the Polish Confederation of Private Employers, published May 15, 2008, stated that the introduction of the common consolidated tax base would have a negligible effect on FDI inflows into Poland, but could generate the reduction of tax revenues and the increase of work volume in tax administration;

- in Latvia, we find the view according to which the introduction of the common consolidated tax base for corporate income will generate a reduction in government revenue collected by income tax because the new system would require a smaller tax base than currently exist. A similar view was expressed in 2007 by Slovak Prime Minister Robert Fico.

Even the above states opposed the European Commission, they have not refused to participate in working group discussions, realizing that, on the long-term, the introduction of the "Common Consolidated Tax Base" will generate undeniable benefits for the EU economy. To avoid a possible rejection of the project currently it has established that the proposal of Directive who introduces this system could be enhanced cooperation between Member States, that there is at least eight participating countries (DG ECOFIN Training and Support Community, 2008).

Business representatives were actively involved in discussion of technical aspects of the common consolidated corporate income tax. The Union of Industrial and Employers' Confederations of Europe and the Association of European Chambers of Commerce believe that the introduction of "Common Consolidated Tax Base" should be speeded up, because a tax system based on a broad tax base and lower tax rates and on the principles that generate stability and reducing administrative costs is an important incentive for investors. It should be noted that business representatives were pronounced tight to keeping the optional of consolidated common tax base adoption.

5. Conclusions

The necessity of a corporate income tax reform in the European Union has become urgent, but it should not ignore the fact that the social preferences of each state reclaim independence in creating a national fiscal policy. Since the fiscal diversity is considered a form of independence and sovereignty manifestation of a state, we can explain the resistance of some politicians against the introduction of a tax system based on common rules. In the context of economic integration, for the European companies' representative, predictability, stability and neutrality of the tax laws are the essential elements of a stimulating business environment. For investors it is important to know the exact tax burden that will be subjected before deciding the location of their capital to achieve an adequate business plan. Given that all participating companies in the game market will be subject to the same rules for determining the tax base, and will be consolidated at the group level and shared Member entitled, the income tax will no longer be an element of distortion in investment location, realizing a more efficient allocation of capital within the European Union. With the implementation of "Common Consolidated Tax Base", public authorities in countries that currently bet on low corporate taxation to attract foreign direct investment will have to engage in action to identify and value other benefits available in their economies. It is explicable so the reluctant attitudes of the representatives of Member States in Central and Eastern Europe (who practice a relaxed tax on corporate income) regarding the introduction of the common consolidated tax base.

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