The EU should tax in harmony

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Like it or not, tax harmonisation, a core element on the road towards more economic union, seems to be advancing again at EU level. So far, the EU’s record in direct tax harmonisation has been limited, largely due to the need for unanimity in this policy domain. But the financial crisis has engendered strong support for further action, and technically unrelated dossiers are starting to make progress again at different levels. Policymakers are advised, however, to set their priorities carefully, while maintaining unity within the EU and a clear view of the overall picture.

The most notable achievement in tax harmonisation so far has been the 2003 Directive on the taxation of savings, where the last exceptions to the full exchange of information in the EU are only now being lifted. A few directives were also adopted in the 1990s to reduce double taxation in the field of corporate taxation, but the current debate in the member states seems to suggest that more initiatives could be on the way. Lastly, there is the seemingly growing momentum behind the financial transaction tax (FTT) in EU legislative bodies, although the bluntness of the measure and its procedure, i.e. enhanced cooperation, leave much to be desired.

In marked contrast to the advanced degree of market integration achieved in the EU, the level of corporate tax harmonisation is severely underdeveloped. In essence, two directives were adopted in the early 1990s, one abolishing double taxation of dividends and the other covering interest and royalty payments between enterprises of the same group. Several initiatives have been taken by various Commissioners in the last two decades to rekindle progress, in the Monti Group for example in 1996(!), but achievements have remained very modest. Faute de mieux, some cases have been brought before the European Court to force member states to correct the most egregiously distortive elements in national tax regimes, for example the Cadbury Schweppes Case (2006), but relying on this option is far from optimal.

Compared to that dossier, the adoption of the taxation of savings Directive can still be considered an exemplary achievement. Its hallmark is the full exchange of information between member states on interest income earned by residents in other states. That it was adopted just before the EU’s eastward enlargement meant that it also became acquis for the new member states. And the limited exemptions to the exchange of information granted to three member states (Austria, Belgium and Luxembourg) have almost come to an end. The next step is to bring offshore financial centres more fully under the regime.
Why is it then so difficult to extract more cooperation in the corporate tax domain? And does it not warrant much greater priority than other dossiers currently on the table? One proposal that is making only very limited progress calls for EU tax base harmonisation. Despite the fact that Germany added it to the 2011 Europlus Pact as a requirement for membership in the eurozone, no concrete proposals have been brought forward so far. Harmonising the tax base would eliminate an important element in the harmful tax competition between member states. It would also considerably ease European-wide business planning, with a tax declaration in the home country, and appropriation of tax income across member states according to certain ‘activity’ parameters, based on an extensive system of exchange of information.

Tax base harmonisation would also allow for a better form of taxation of banks than that offered by the indiscriminate FTT proposal that is currently on the table. The FTT falls short in meeting its stated objective, namely making the financial sector pay for the cost of the crisis, as it proposes to tax all securities and derivatives transactions, and thus will create disincentives to financial disintermediation. Moreover, the measure is creating unnecessary divisions in the EU, which is especially unhelpful now in light of the urgent need to create the Banking Union, and will be very costly to implement.

Hence, rather than expending unnecessary negative energy on the FTT, the EU should give priority to its tax base harmonisation project. Progress on this front would advance several objectives at once. It would make an important step towards more economic union, it would promote the EU as a business location and it would succeed in appropriating tax income to the location where corporate activities are effectively exercised. It would at the same time establish a better basis on which to tax the financial sector, which should meet the concern that financial institutions are insufficiently taxed. More harmonised financial sector taxation would also serve as another important building block for constructing a genuine banking union.