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EUROPEAN TAX HARMONISATION

THE IMPENDING THREAT

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SUMMARY

In recent weeks Gerhard Schroeder, Lionel Jospin and Romano Prodi have all called for radical EU tax harmonisation. The incoming President of the EU, Belgian Prime Minister Guy Verhofstadt, recently called for the introduction of an EU tax to be levied on every person in Europe.

The threat of tax harmonisation is genuine. The EU is pressing forward with plans to harmonise taxes in a wide range of areas but the process is seldom an open one. Tax harmonisation is being pursued by stealth. The tactic is to move towards full scale tax harmonisation in a series of small steps, each steadily enlarging the involvement of the EU in tax matters and each leading on to the next harmonisation initiative. As the Commission has recently stated:

> Given the difficulties in reaching unanimous decisions… the community should also consider the use of alternative instruments as a basis for initiatives in the tax field.

'Alternative instruments' are already being used. Perhaps the most powerful is the group headed by British Treasury Minister Dawn Primarolo, charged with the implementation of the Code of Conduct on Business Taxation. This Code was agreed by Gordon Brown and other EU finance ministers in December 1997. Meeting behind closed doors, the Primarolo group is empowered to recommend the abolition of tax rates and breaks which 'affect or may affect, the location of business activity in the community in a significant way'. While, so far, the group has concentrated on targeted business tax breaks, many fear that it will not be long before its attentions extend to across-the-board headline taxes. As Ms Primarolo has stated, 'its work will never be finalised.'

These fears were recently borne out when the commission called for the Code to be extended to personal income tax.

The harmonisation agenda was boosted at the Nice summit through the agreement of the 'enhanced co-operation' procedure, by which member states are allowed to proceed with projects not acceptable to the EU as a whole, by-passing both the legislative mechanism and the unanimity requirement. The Commission has recently stated that the procedure can and should be used in relation to taxes.

Further 'alternative instruments' for harmonisation exist in the European Court of Justice, which can strike down national laws which it deems to be inconsistent with the Treaty of Rome. In particular, the application of state-aid rules to tax breaks – i.e. treating them as subsidies – enables the Court to strike down tax cuts designed to boost domestic industries. The Court is also the main instrument by which the veto on tax matters could be circumvented. For example, tax measures might be introduced by using single market legislation, over which there is no veto. The Working Time Directive was applied to the UK in much the same way.

The most serious immediate threats to national tax-setting powers concern VAT and corporation tax. Labour MEPs recently demanded the full-scale harmonisation of VAT. The EU already sets minimum levels of VAT – currently 15% – and there is considerable pressure to raise this threshold, up to the European average of 19.4% or higher, well above the UK's 17.5%. European politicians are also looking at ways to end the UK's zero rates on food, books, newspapers, children's clothes and even on burial and cremation. These 'derogations' have always been criticised by the Commission and legislation is threatened as way of ending these 'transitional arrangements'.

Lionel Jospin has stated that 'the corporate tax system as a whole will have to be harmonised.' There have already been moves in this direction, as Ireland has been made to realise. The Commission and many member states are very hostile to low corporation tax regimes like Ireland's. EU tax commissioner Frits Bolkestein claims that corporation tax could come under the treaty provisions for 'approximating' taxes which affect the location of business in the community. There are even plans afoot to introduce a unified European corporate income tax.

Personal income tax is also the target of the harmonisation lobby, albeit a long term one. Despite Mr Bolkestein's recent statement that Brussels has no intention of harmonising income tax rates, the Commission has called for the remit of the Primarolo group to be extended to income tax on the grounds that it 'affects the location of business activity in the community'. It is also seeking to extend its power over income taxation 'in cross-border situations', a traditional door through which integration is advanced.

Brussels is also set on the harmonisation of fuel and energy taxes. It is supported by the British Government which has stated that 'there is a good single market case for the increasing the minimum rates of duty on fuels'. The Commission has made it clear that it wants to level up fuel taxes not bring them down.

In addition, there are plans for further harmonisation of taxes on tobacco and alcohol, and proposals for a range of new EU taxes on transport are being put forward, including new congestion and parking charges. The launch of the Euro has provided a further driver for tax harmonisation, with the Irish government formally censured over tax cuts.

The underhand methods by which the tax harmonisation agenda is being driven forward deserve the full attention of the British media and public. A striking aspect of the research in this paper is the sheer volume of EU initiatives on tax. Even if only one in ten succeeds, this would have dramatic consequences for British tax-payers. Not only would taxes rise, but there would be virtually no prospect of any future reductions in tax: tax harmonisation is a one-way street.

The Treasury currently collects £114 bn – 35% of the total tax take – from VAT, corporation tax and fuel duties, all taxes over which Brussels is seeking to extend its control, without recourse to the procedures of unanimity or legislative sanction.

INTRODUCTION

"Taxation without representation is tyranny":[1] the rallying cry of the American Revolution is one of the most famous statements of a universally applicable fact – that people resent paying taxes and will generally only do so if they have a say over the government which imposes them. From the birth of English parliamentary democracy in the Middle Ages, through the 1688 victory of Parliament over Crown, to the fuel tax protests of September 2000, tax remains at the heart of political debate.

The exclusive right to tax citizens is one of the hallmarks of statehood. That exclusive right is under threat in the United Kingdom and, with it, the continued existence of the United Kingdom as an independent nation state. There exists in mainland Europe, a well-articulated desire for harmonisation of taxes across the Member States of the European Union.

Tax is at the forefront of the minds of most people when they cast their votes at a general election. Transferring tax-raising powers to distant, unaccountable European Union institutions poses serious democratic and constitutional dangers.

Some have argued that there has been a change of heart in Brussels and that tax harmonisation is no longer an EU goal.[2] It is true that there have been certain statements to that effect. One should look not at what is said in Brussels but what is done. Despite a few warm words on the benefits of tax competition,[3] many across the EU's Commission, Council and Parliament are steadfastly pushing forward far reaching tax harmonisation projects.

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1 James Otis 1725-83.

2 'Brussels retreats on tax plans', *Financial Times*, 23rd January 2001.

3 *Tax Policy in the European Union – Priorities for the years ahead*, Commission Communication COM(2001) 260 states that "some degree of tax competition within the EU may be inevitable and contribute to lower tax pressure".

A striking aspect of the research for this paper was that it revealed the multiple different ways in which EU is pursuing its tax ambitions. Even if only one project in ten succeeds, this would have dramatic consequences for British tax-payers. Not only would taxes rise, but there would be virtually no prospect of any future reductions in tax: tax harmonisation is a one-way street.'

The threat of tax harmonisation is a genuine one. Too often, radical constitutional change has been achieved by stealth in the EU, its significance disguised by the adoption of an incremental approach, with each minor step towards centralisation leading on to the next. As Romano Prodi said on 29 May 2001:

> The genius of the founding fathers [of the European Community] lay in translating extremely high political ambitions, which were present from the beginning, into a series of more specific, almost technical decisions. This indirect approach made further action possible.

By examining current views and arguments on tax harmonisation and by cataloguing the sheer volume of harmonisation initiatives, this paper is designed to reveal this process to public scrutiny while we still have the power to stop it. But the clock is ticking. A few weeks ago, the European Commission stated that:

> …the last few years have seen some progress being made on tax co-ordination at EU level. While the Commission welcomes the trend, it believes further steps can and should be taken along this path [and that it would] …energetically pursue the avenues of tax policy co-ordination.[4]

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4 *Tax Policy in the European Union – Priorities for the years ahead*, Commission Communication COM(2001) 260 at p10 and 26.

CHAPTER ONE
THE WILL TO HARMONISE

POLITICAL SUPPORT FOR HARMONISATION

Across Europe, many national leaders as well as the European Commission and the European Parliament are all calling for the harmonisation of taxes.

In December 1998, a joint declaration by the French and German governments stated that:

> We will campaign for… rapid progress on the harmonisation of taxes.[5]

French Prime Minister Lionel Jospin followed the statement with the words:

> …the major common objectives [are] a desire for social and tax harmonisation.[6]

German Chancellor Gerhard Schroeder has persistently called for an end to the national veto on tax matters. stated that:[7]

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5 *Guardian*, 2nd December 1998. The House of Lords Select Committee, 15th Report of 1998/9 session, *Taxes in the EU: Can Coordination and Competition Coexist?*, (HMSO, July 1999) also noted an earlier statement by the French government: 'one way or another, the tax systems in the this European space (which is more and more integrated) must move closer to each other.' For a fuller version of this quote and for others along the same lines, see the Annex at the end of this paper entitled 'What They've Said'.

6 Speaking in Paris in December 1998.

7 See for example, *Sunday Times,* 15th October 2000.

> The times of individual national efforts regarding employment policies, social and tax policies are definitely over.[8]

The harmonising attitude is echoed from Austria[9] to Ireland.[10] The Belgian Prime Minister recently called for the imposition of an new tax levied directly by the EU on every person in Europe.[11] This proposal is being pursued enthusiastically by the Belgian Presidency of the EU.[12] Didier Reynders, Belgian Finance Minister, has said that:

> I am pleading for real genuine tax harmonisation.[13]

Commission President Romano Prodi recently stated that such a move "could well be a sound solution" to problems relating to financing the EU budget.

The European Commission has persistently supported tax harmonising measures and argued for increased EU involvement in tax: Romano Prodi has stated:

> On all these fronts [including tax] Europe is handicapped by the unanimity requirement. It is like a soldier trying to march with a ball and chain around one leg. I hope that [the] Helsinki [summit in 2000], by launching the reform process, will clearly show we have the ambition and the political will to rid ourselves of this encumbrance and to tackle the other crucial issues before us.[14]

The body which, supposedly, acts as a check on the Commission, the European Parliament, is also committed to the programme. In 1998 it resolved that:

> There is a clear need for... a certain degree of fiscal harmonisation, particularly in those areas where harmful tax competition could produce adverse effects (indirect taxes, business taxation, taxation of mobile factors such as capital, tax treatment of non-resident citizens and companies, energy and environmental taxes, treatment of cross border labour).[15]

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8 Speaking at the Hague on 19th January 1999.

9 See, for example, Rudolf Edlinger (then Austrian Finance Minister) in *The Times*, 2nd December 1998. Victor Klima, then Austrian Chancellor, stated in Autumn 1997 that his top priority was more European tax harmonisation in order to help the single currency.

10 Support for a more co-ordinated approach to tax has been expressed by the Irish government, while rejecting harmonisation of rates. Evidence of the Institute of Directors to the House of Lords Select Committee, 15th Report of 1998/9 session: 'Taxes in the EU: Can Coordination and Competition Coexist' (HMSO, July 1999).

11 *European Voice*, 1st February 2001 and "Brussels plans new savings tax to pay for EU", *Independent,* 16th March 2001.

12 "Brussels plans new savings tax to pay for EU", *Independent,* 16th March 2001.

13 Belgian EU Presidency tax policy conference, 26th March 2001, Brussels.

14 Quoted on PA News, 1st December 1999.

15 Secchi report on the communication from the Commission on *A package to tackle harmful tax competition*, (European Parliament resolution A4-0228/98, 1998).

The Parliament has also resolved that

> It is conceivable that in the long term the optimum solution is likely to be one of European tax federalism with the political union that that would entail.[16]

A majority in the European Parliament has given enthusiastic support to virtually all the tax harmonisation proposals put forward by the Commission.

A majority in the European Parliament has given enthusiastic support to virtually all the tax harmonisation proposals put forward by the Commission, particularly the so-called Monti package.[17] The only criticism has tended to be that the Commission has not pressed forward with tax harmonisation quickly enough.[18] The Parliament's Economic and Monetary Affairs Committee has recently instituted an annual review of progress in tax co-ordination.

THE MOTIVATION FOR HARMONISATION

Some have advocated tax harmonisation as the next building block in driving forward political union in the EU and creating a United States of Europe. This is explored below under "The Euro".

Others have resorted to economic arguments, based on the EU single market. The single market programme is designed to encourage cross border trade by breaking down barriers between individual national markets. By exposing domestic operators to free and open competition from firms across the EU, the single market makes the cost of high taxation much more visible,[19] and opens up tax systems to increased competitive pressure from other Member States.

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16 Fourcans report on the co-ordination of fiscal and taxation policy (European Parliament resolution A4-0192/97, 1997.

17 The package consists of the Code of Conduct and the withholding tax, both of which are discussed further below. For European Parliament support for tax harmonisation, see, in particular, the Fourcans report on the broad economic guidelines of the economic policies of the Member States and the Community (COM(99)0143-C4-0208/99) (European Parliament resolution A4- 0222/99, 1999); Fourcans report on the coordination of fiscal and taxation policy (European Parliament resolution A4-0192/97, 1997); Secchi report on the communication from the Commission on *A package to tackle harmful tax competition* (European Parliament resolution A4- 0228/98, 1998); Secchi report on establishing a programme of community action to reinforce the functioning of the indirect tax systems of the internal market (Fiscalis programme) (C4-0036/98 – 97/0128(COD)) (European Parliament resolution A4- 0048/98)

18 Secchi report on the communication from the Commission on *A package to tackle harmful tax competition* (European Parliament resolution A4- 0228/98, 1998) at paragraph 23.

19 "Barriers real and imagined", *Economist*, 9th December 2000. See also, the evidence to the June 2000 public hearing of European Parliament Economic and Monetary Affairs Committee of Krister

There have always been practical limits on tax levels. If a government keeps on increasing the level of a particular tax, there will eventually come a point where an increase in rates leads to a decrease in tax revenue rather than an increase.[20] In theory, the single market acts as a downward pressure on taxes by ensuring that this maximum tax level is reached more quickly than in the past.

For example, suppose that the German government introduced an energy tax which impacted particularly harshly on the production of sproggets, pushing up costs for local producers. Before the introduction of the Single Market, a government could fairly safely have increased the tax levied on sprogget producers until, eventually, the levels were so high as to choke off demand for sproggets and drive producers out of business.

However, the single market makes it easier for goods to be imported from other areas in the EU, for a single firm to supply the whole the EU market from one geographical base and for firms to relocate in other Member States. In response to the tax rise, German firms and consumers can start buying in sproggets from other parts of the EU or relocate their sprogget production out of Germany, leading to a contraction in the size of the German sprogget industry. Whereas in the past, the German government could have prevented the import of cheap sproggets from low tax jurisdictions, the single market (in theory) makes this impossible. This effect is exacerbated by more efficient financial markets making it easier to move money around the world.[21]

A further example is provided by tobacco and alcohol taxes: the reason why governments tax these products so highly is that it takes considerable price hikes to reduce demand. UK taxes appear to be approaching their practical maximum. The existence of low taxes within a few hours' journey means that around 1 million pints of beer are brought across the Channel every day, at an expense to the Exchequer of approximately £1.5 billion a year.[22] It is arguable that the 1996 reduction of UK excise duty on spirits was induced by tax competition.[23]

Andersson, Member of Board of Directors of the Swedish National Tax Authority and Director of the Stockholm Institute of Economic Research.

20 European Parliament Directorate General for Research: "Tax Competition in the European Union", *Econonic Affairs,* Series ECON – 105 EN rev, 11-2000, PE 167.812 p14.

21 As noted in the *Report of the Committee of Independent Experts on Company Taxation* (the "Ruding Report"), March 1992. London's multi-trillion dollar eurobond market was generated by tax competition, as a result of the introduction of a withholding tax in the state of New York.

22 European Parliament Directorate General for Research: 'Tax Competition in the European Union', *Economic Affairs,* Series ECON – 105 EN rev, 10-2000 PE 167.812.

23 European Parliament Directorate General for Research: 'Tax Competition in the European Union', Economic Affairs Series ECON – 105 EN rev, 11-2000, PE 167.812.

Similarly, the trade in smuggled cigarettes has mushroomed as the gap between UK and French tax levels has widened.

Observing that national tax rates 'affect in a significant way the location of business activity in the Community',[24] supporters of tax harmonisation have warned that governments attempting to attract investment will take part in a 'race to the bottom', bringing down taxes across Europe and so frustrating social welfare objectives.

They further argue that, like subsidies, national tax-setting powers 'distort the single market' and lead to 'harmful' competition between Member States. This distortion is said to occur where a business operating in a low tax environment has a competitive advantage over those operating in other Member States with higher taxes. Individual Member States can attract business and jobs by setting taxes at modest or low levels, as the recent history of the Irish economy shows.

This has been labelled pejoratively as 'unfair tax competition'[25] or fiscal dumping,[26] and has been repeatedly condemned,[27] by Tony Blair, amongst

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24 *Interim report of the Primarolo Group*, November 1998, 12530/98 FISC 164. This was followed by a second interim report published in May 1999, 8231/99 FISC 119. The final report was published in November 1999: *The Primarolo Report*, SN 4901/99 (http://www.futd.nl/specials/staatssteun/ doc01.html).

25 A majority in the European Parliament has consistently condemned 'unfair tax competition'. See for example the Secchi report on the communication from the Commission on *A package to tackle harmful tax competition* (European Parliament resolution A4- 0228/98, 1998) and the Fourcans report on the coordination of fiscal and taxation policy (European Parliament resolution A4-0192/97, 1997).

26 Jean Arius (then French finance minister), 1997; Fourcans Report on the coordination of fiscal and monetary policy (European Parliament resolution A4-0192/97) at paragraph 11 and 12; Christa Randzio Plath MEP, Chairman of the Economic and Monetary Affairs Committee of the European Parliament, presentation to the committee, June 2000.

27 See for example:

- Danish Prime Minister, Poul Nyrop Rasmussen, speaking at the World Economic Forum in Davos in January 2001: 'EU divided on its stance towards McCreevy', *Irish Times*, 29th January 2001.
- Speeches of Swedish Finance Minister, Bosse Ringholm, at the Ecofin Council in Brussels on 19th January 2001 and to the Economic and Monetary Affairs Committee of the European Parliament on 22nd January 2001.
- Speech of EU Tax Commissioner, Frits Bolkestein, 'Taxation and competition: the realisation of the internal market', Hoevelaken, 17th March 2000. See also his speech in Barcelona on 9th October 2000, reported in *European Report*, Brussels, 11th October 2000.
- Christa Randzio Plath MEP, Chairman of the Economic and Monetary Affairs Committee of the European Parliament,

others.[28] For example, Christa Randzio Plath MEP, chair of the European Parliament's influential Economic and Monetary Affairs Committee, described Airbus's decision to locate to the Netherlands as stemming from 'ruinous tax competition'; Airbus had apparently taken the attractive Dutch tax environment into account in making their decision.[29]

Christa Randzio Plath MEP, chair of the European Parliament's Economic and Monetary Affairs Committee, described Airbus's decision to locate to the Netherlands as stemming from 'ruinous tax competition'.

Hence it has been claimed that tax harmonisation is necessary to complete the single market project. Tax harmonisation is described as the *quid pro quo* of the market liberalisation process which opens up domestic tax systems to competition. French President Jacques Chirac has said:

> We clearly can't have a single market, a single currency, the determination to liberalise public services – as we are being asked to do – without having regulations in the tax sphere.[30]

Just as the single market was supposed to produce a level playing field in terms of regulation, it is argued by some that the EU should also create a level tax playing field as well. The single market opens up national tax systems to increased competitive pressure.

THE OPEN-ENDED TAX HARMONISATION AGENDA

It is through the narrow doorway of preventing supposedly 'harmful' tax competition that lies the potential for the most wide ranging and damaging harmonisation initiatives. It is repeatedly stated that taxes which affect or distort competition within the single market should be harmonised and determined at an EU level.[31]

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presentation to the committee, June 2000: 'Today the prevailing view in nearly all Member States is that a lack of coordination in the field of taxation of capital income, energy and enterprises distorts competition. European tax policy shall thus help to diminish distortions in the internal market'.

- Code of Conduct on Business Taxation (discussed below).

28 "Brussels dispute worsens", *The Times,* 29th May 2001.

29 In her presentation to the Economic and Monetary Affairs Committee in June 2000.

30 President Chirac, Feire Council, 20th June 2000.

31 See for example,

- Article 93 of the Treaty of European Union, set out above, committing Member States to full harmonisation of indirect taxes and excise duties which affect the functioning of the internal market.

Preventing so-called 'distortions of competition' has been used to argue in favour of harmonisation of fuel and energy taxes,[32] transport taxes,[33] excise duties, VAT and corporation tax.[34] Article 96 of the EU Treaty permits EU action where the legal or administrative rules of a Member State distort competition within the EU. Legislation can be adopted under Article 96, via qualified majority voting. So far, Article 96 has not been used to impose tax measures but the Commission has issued scarcely veiled threats that it might one day seek to do so.

The reader will notice that the concept of 'harmful' tax competition is wholly open-ended.[35] Any tax which businesses take into account in deciding where to locate their business has an effect on the single market.[36] A sensible business

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- New draft Article 93, proposed by the French government at the Treaty of Nice, which would have given the EU competence over any direct tax measures which had an effect on the functioning of the internal market. This proposal was not accepted.
- Commission press release, 'Intergovernmental Conference: Commission presents further contribution to the use of qualified majority voting in tax and social security matters', Brussels, 14th March 2000, IP/00/261.
- Tax Commissioner Frits Bolkestein quoted in the *Independent* 25th January 2001. See also his speech in Barcelona on 9th October 2000.
- Christa Randzio Plath MEP, Chairman of the Economic and Monetary Affairs Committee of the European Parliament, presentation to the committee, June 2000.
- Fourcans report on the coordination of fiscal and taxation policy (European Parliament resolution A4-0192/97, 1997)
- Secchi report on the communication from the Commission on'*A package to tackle harmful tax competition* (European Parliament resolution A4- 0228/98, 1998) (see particularly paragraphs 5 to 7.

32 See below under 'Energy taxes'.

33 See below under 'Transport taxes: infrastructure charging'.

34 See below under 'Corporation Tax'.

35 See the comments of Malcolm Gammie (chairman of the Tax Task Force of the Centre for European Policy Studies and research fellow at the Institute for Fiscal Studies) to the House of Lords Select Committee, 15th Report of 1998/9 session, *Taxes in the EU: Can Coordination and Competition Coexist?* (HMSO, July 1999) (paragraph 58): 'there is no satisfactory line between harmful tax competition and tax competition in general'.

36 As pointed out in 'Barriers real and imagined', *The Economist*, 9th December 2000. See also, the evidence to the June 2000 public hearing of European Parliament Economic and Monetary Affairs Committee of Krister Andersson, Member of Board of Directors of the Swedish National Tax Authority and Director of the Stockholm Institute of Economic Research: 'income tax has a very important effect on labour costs on hence on business location'.

person considers a whole range of taxes, from labour taxes like National Insurance to personal income tax.[37]

There is no sensible way to distinguish 'harmful' from 'harmless' tax competition; most attention has, thus far, certainly been focused by European and Labour politicians on targeted tax breaks. However, there is no reason, under the elastic terms laid down in the Article 96 or the EU's Code of Conduct on taxation (which is discussed below), that their attentions will not be extended to across-the-board rates of headline taxes.

All taxes affect where businesses choose to locate and all affect competition within the single market and so all are in danger of coming within the scope of the harmonisation programme.

The dividing line will always be subjective and political. In 1996, Theo Waigel, then German Finance Minister, described London as a tax haven because low personal income tax in the UK had encouraged German financiers to move their businesses there. *All* taxes affect where businesses choose to locate and *all* affect competition within the single market and so *all* are in danger of coming within the scope of the harmonisation programme.

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37 In his paper *Is tax competition harmful?*, November 1998, published by the European Policy Forum, Keith Marsden adverted to the real danger posed by attempts to harmonise income tax.

CHAPTER TWO
THE ARGUMENTS AGAINST HARMONISATION

REBUTTING THE SINGLE MARKET ARGUMENT: THE BENEFITS OF TAX COMPETITION

The argument for tax harmonisation, outlined above, rests on the premise that it is a natural continuation of the 'liberalisation' programme, the necessary deepening and extending of the Single Market. But harmonisation is an attempt not to devolve power but to centralise it, not to free up commercial movement but to restrict it. The project is a reversal of the Single Market principle. And it is not just the UK, and those countries with below-average taxation, which would suffer. The whole of the EU could experience a decrease in output and wealth if the harmonisation agenda is carried through.

It is an article of economics that what drives trade is the differences between countries, which makes each attractive to the other; by specialisation and division of labour the sum output is increased and wealth driven up across the board.

Indeed the tax harmonisation project is an attempt by European politicians to limit the very salutary effects of the Single Market; to circumvent natural upper limits on tax and resist the downward pressure on taxation which is exerted by tax competition.

It is said that 'unfair' competition 'distorts' the Single Market, and that such competition is 'harmful'. But to demand a 'level tax playing field' is to mistake the nature of the single market project. The effect of such levelling out would be to hinder trade, not to further it. For it is an article of economics that what drives trade is the *differences* between countries, which makes each attractive to the other; by specialisation and division of labour, the sum output is increased and wealth driven up across the board. Trade is made worthwhile because of comparative advantage, where one country is better at doing one thing than another. It is the *irregularities* in the playing field that facilitate commerce. If production costs were equalised everywhere, there would simply be no trade: free movement would be rendered pointless. As *The Economist* has pointed out, disparity in taxes has a positive effect on the EU economy:

> Free trade within the EU between rich countries…is a fine idea, not despite the differences in production costs (including the costs associated with [government/tax] policy), but because of them. It is these differences which create the opportunities to change the structure of production in cost saving ways, which in turn raises incomes and living standards on both sides.[38]

The real motivation for tax harmonisation is to enable countries to export their high taxes across the EU and hence to decrease competitive pressures. Liberalisation, globalisation and technology also invalidate the optimistic assumption that harmonisation will stop jobs fleeing abroad to low-tax 'havens'. The EU cannot eliminate tax competition from the rest of the world. Establishing 'corporatism in one continent'[39] can no longer provide the protective barrier from competitive pressure that it might once have done. Harmonising taxes upwards would simply stifle innovation and experimentation, shackle those countries which do have the courage to reduce the role of the state and help to price Europe out of the market, driving business and jobs off shore.[40]

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38 'Barriers real and imagined', *The Economist*, 9th December 2000. See also, the evidence of Malcolm Levitt (of Barclays Bank), the IOD and the CBI to House of Lords Select Committee, 15th Report of 1998/9 session: *Taxes in the EU: Can Coordination and Competition Coexist?'* (HMSO, July 1999). Other witnesses giving evidence did state that some minor changes in taxation might be helpful in facilitating cross border trade in financial services: see the evidence of the Association of British Insurers and the London Stock Exchange.

39 This phrase was used by Bernard Connelly in *The rotten heart of Europe: the dirty war for Europe's money*, Faber and Faber, London 1995.

40 Malcolm Gammie (chairman of the Tax Task Force of the Centre for European Policy Studies and research fellow at the Institute for Fiscal Studies), in his evidence to the European Parliament's Committee on Economic and Monetary Affairs at its June 2000 public hearing on tax, said 'There is no reason to suppose that even on a fully coordinated basis, EU countries would be able to maintain corporate tax systems which were significantly out of line (ie significantly less favourable in terms of tax base and tax rate) with those adopted in the main non-EU economies.'

In the US, different tax regimes across the states are regarded as 'an advantage that stimulates innovation, competition and choice and facilitates a dynamic and adaptive economy'.[41] It can also be pointed out that tax competition promotes greater efficiency in the public sector by forcing governments to examine their spending more critically.[42]

In the US, different tax regimes across the states are regarded as 'an advantage that stimulates innovation, competition and choice and facilitates a dynamic and adaptive economy'.

Harmonisation or co-ordination of taxes at an EU level would deprive the Member States of the ability promptly to adapt their tax systems to global economic trends and change.[43] Increasing globalisation makes the ability to react quickly and nimbly to new circumstances even more vital than it has been in the past: the idea of a rigid, centralised fiscal policy taking into account the divergent needs of a dozen economies – many more once Eastern European countries join the EU – is seriously misguided. It is sobering to reflect that at present, EU legislation takes at least two to three years to enact and implement, while more controversial measures often take 10 years or more.[44]

The response of the EU and its Member States to the economic future should be neither tax co-ordination nor harmonisation but tax reduction, achieved through more, not less, tax competition. For whatever downward pressure competition exerts, it is evidently outweighed by upward pressure. Most of Europe's economies are over-taxed, while those that are not show the clear route to success. The Irish economic miracle is a striking example of how tax reductions can be used to transform an economy, delivering significant improvements in living standards for ordinary people. In less than a generation, Ireland has been

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41 Evidence of Graham Mather (former MEP and President of the European Policy Forum) to The House of Lords Select Committee, 15th Report of 1998/9 session, *Taxes in the EU: Can Coordination and Competition Coexist?* (HMSO, July 1999) (noted at paragraph 59).

42 These and other tax competition issues are discussed in Keith Marsden's excellent paper *Is tax competition harmful?* November 1998, published by the European Policy Forum. See also the paper by Baldwin and Krugman published by the Centre for European Economic Policy Research and reported in 'EU tax harmony 'could cause damage'', *Financial Times*, 29th November 2000.

43 A point made by Malcolm Gammie (chairman of the Tax Task Force of the Centre for European Policy Studies and research fellow at the Institute for Fiscal Studies) in his evidence to the European Parliament's Committee on Economic and Monetary Affairs at its June 2000 public hearing on tax.

44 The Take-over directive is still under discussion, 10 years after it was first mooted, the directive on the winding up of credit institutions is in its 15th year of discussion, the chocolate directive took 30 years to agree and the European Company Statute took 40 years.

transformed from a backward agrarian economy into a Celtic tiger. For the last few years, the Irish economy has been growing at a rate of nearly 10%. On some measurements, its wealth per head now exceeds that of the UK. For the first time in three centuries, Ireland has become a net importer of people. And most pertinently, drastic cuts in tax rates have actually led to an increase in tax revenues.[45]

It is particularly vital for small countries like Ireland to retain control over their tax systems. On the EU's geographic periphery, with limited natural resources, tax is a vital tool for the creation of a business environment capable of attracting capital and compensating for other disadvantages.[46] Retaining tax flexibility becomes even more vital within the euro-zone, as the economic needs of small countries will never determine the euro-zone interest rate (Ireland's GDP is around 1% of the total for Euroland).[47]

Lastly, differences in tax rates reflect different conceptions of the role of the state and different political choices and priorities. Democratically elected governments should be free to set their own tax rates in accordance with the wishes of the people who elected them. Many in mainland Europe seem to view the economy as a cash cow for funding state sponsored egalitarian projects, through high taxation and redistribution.[48] The norms of economically powerful countries should not be imposed on the rest of the EU.[49]

RAISING TAXES

It is argued by apologists for tax harmonisation that tax competition will lead to a 'race to the bottom', with countries competing for investment by reducing taxes to the point where social welfare programmes become unaffordable. The evidence suggests otherwise: in the 15 years or so since the launch of the single market, the tax burden has tended to rise in Europe rather than be driven down by competitive pressures, as is shown by the table below. For there exists a natural *upward* pressure on tax, too: the desire of politicians to tax and spend. The EU proposes to give the green light to this pressure by removing the one remaining downward pressure. Far from a 'race to the bottom', the threat facing Europe today is a race to the top.[50]

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45 See 'Scrapping employer's PRSI ceiling is irrational', *Reuters Business Briefing*, 8th December 2000.

46 See the evidence to the June 2000 public hearing of European Parliament Economic and Monetary Affairs Committee of Krister Andersson, Member of Board of Directors of the Swedish National Tax Authority and Director of the Stockholm Institute of Economic Research.

47 See below under 'The Euro'.

48 See "Ireland fights the UK's battle", *Daily Telegraph,* 28th January 2001.

49 See *Is tax competition harmful?* Keith Marsden, November 1998, published by the European Policy Forum.

50 There is also little evidence to support the recurrent allegation that competition has eroded the tax base for mobile factors of production such as capital, leading to a heavier burden on immobile factors such

The CBI has stated:

> Harmonisation driven through a political process will… tend to raise tax burdens.[51]

UK taxes would rise if taxes were harmonised across the EU. There are a number of reasons for this conclusion.

Harmonisation would remove one of the few constraints on governments wishing to increase their revenues – the fear of driving business and jobs off shore[52]. It would also remove the most important constraint of all - the democratic pressure to reduce taxes. As the House of Lords Select Committee on the EU pointed out

> ...while tax decisions remain with Member States, the wish of politicians to be re-elected acts as a restraint. We consider that there would be a danger of upward alignment continuing unchecked if tax decisions were handed to a supranational body which was not accountable to an electorate.[53]

Furthermore, after the reforms of the 1980s, the UK enjoyed a significant competitive advantage over mainland Europe because of its low tax regime. This competitive advantage has been steadily diminished as UK tax levels have grown steeply over the last four years. However, the overall tax burden still remains lower than the average across the rest of Europe.

The most frequently cited rationale for tax harmonisation is the need to eliminate "harmful tax competition.[54] By definition, this must mean levelling up UK tax levels to those prevailing in mainland Europe.[55] The aim of those wishing to eliminate or reduce tax competition is to prevent countries like the UK and Ireland from undercutting high rates of tax in other Member States. The aim is to bring UK levels *up* to those prevailing in countries such as France, Germany

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as labour, as is set out in *Is tax competition harmful?* Keith Marsden, November 1998, published by the European Policy Forum.

51 Evidence to the House of Lords Select Committee, 15th Report of 1998/9 session: *Taxes in the EU: Can Coordination and Competition Coexist?* (HMSO, July 1999). Another witness who gave evidence to the Committee, the Luxemburg Minister of Justice, expressed his concern that 'certain parties' wanted upward harmonisation, aligned towards the highest rate of taxation.

52 As pointed out by European industry group UNICE, and by Graham Mather, to the House of Lords Select Committee, 15th Report of 1998/9 session, *Taxes in the EU: Can Coordination and Competition Coexist?* (HMSO, July 1999) (paragraph 91). See further below under 'Competition versus Coordination'.

53 The House of Lords Select Committee, 15th Report of 1998/9 session, *Taxes in the EU: Can Coordination and Competition Coexist?* (HMSO, July 1999) at paragraph and 92.

54 This is discussed further below.

55 As pointed out in *Is tax competition harmful?* Keith Marsden, November 1998, published by the European Policy Forum.

and Italy, rather than to bring down tax levels in mainland Europe.[56] Austrian finance minister, Rudolph Edlinger, has stated that:

> If the EU established minimum taxes, the countries where the level is lower than that will have to raise them.[57]

On energy taxes, for example, the European Commission has consistently warned against rate cuts by Member States[58] and demanded increases.[59] Proposals have met opposition from Member States who fear that harmonisation will inevitably lead to tax increases.[60] As we shall see, the Commission has repeatedly called for harmonisation of excise duty on tobacco, alcohol and fuel. The Commission's views on the environment and public health rule out advocating cuts in these taxes. In that case, the only way is up.

Simple maths would suggest that even this eventuality would mean hefty increases for the UK tax burden.

The best which the UK could hope for is that a compromise level is set somewhere in between the highest and the lowest Member State. The history of harmonisation shows that this result is not uncommon. Simple maths would suggest that even this eventuality would mean hefty increases for the UK tax burden.

The following table, shows where Britain's tax burden is currently positioned in relation to those of other EU states. It uses OECD figures showing the ratio of total tax revenues, including social security contributions, to gross domestic product. The UK, at 37.6% in 1998 was ranked 11th out of the 15. The average, unweighted figure for the 15 comes out a hefty 42.19%.

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56 The Luxembourg budget minister expressed this fear in his evidence to The House of Lords Select Committee, 15th Report of 1998/9 session, *Taxes in the EU: Can Coordination and Competition Coexist?* (HMSO, July 1999) (paragraph 91).

57 *Daily Telegraph*, 2nd July 1998.

58 See, for example, "EU warns against cuting fuel tax", *Daily Telegraph,* 19th May 2001 and "Fuel tax cut banned by Brussels", *Daily Mail* 19th May 2001. During the fuel tax crisis of September 2000, Environment Commissioner, Margot Wallstrom, strongly urged Member States not to cut taxes.

59 Tax Commissioner, Frits Bolkestein, speaking after an informal Ecofin meeting in Malmo in May 2001, reported in "Slight progress over important issue of taxation during Malmo informal", *Agence Europe*, 23rd May 2001.

60 As revealed by Tax Commissioner, Frits Bolkestein im May 2001, after an informal Ecofin meeting in Malmo, reported in "EU Commissioner backs further energy tax talks", *Dow Jones International* 23rd May 2001.

Total tax revenue as a proportion of GDP at market prices[61]

	1980	1985	1990	1992	1994	1995	1996	1997	1998
Sweden	48.8	50.0	55.6	51.0	49.0	47.9	50.0	51.9	53.0
Denmark	45.4	48.9	47.1	47.3	49.9	49.4	49.7	49.3	49.3
Finland	36.9	40.8	44.9	45.9	46.7	45.2	47.1	46.5	46.9
Luxembourg	43.0	47.7	43.9	42.7	44.7	44.4	46.6	46.5	48.1
Belgium	43.7	46.9	43.9	44.0	45.9	45.4	45.8	46.0	46.3
France	41.7	44.5	43.0	43.1	43.7	44.0	45.0	45.1	45.2
Italy	30.4	34.5	38.9	41.7	41.4	41.2	42.9	44.4	43.5
Austria	40.3	42.4	40.0	43.0	43.3	42.4	44.1	44.3	44.3
Netherlands	45.2	44.1	44.6	46.8	44.7	42.0	41.5	41.9	41.0
Germany*	38.2	38.1	36.7	38.0	38.4	38.5	37.6	37.2	37.1
United Kingdom	35.1	37.5	36.3	35.3	34.5	35.2	35.1	35.4	37.6
Portugal	24.7	27.2	30.2	33.6	32.6	33.3	33.2	34.2	34.9
Greece	24.3	29.0	29.7	30.8	31.7	32.1	32.0	33.7	-
Spain	23.9	28.8	34.4	35.9	35.0	32.8	32.7	33.7	34.2
Ireland	32.6	36.4	33.6	34.5	35.7	33.1	33.2	32.8	32.3
OECD total	32.8	34.53	35.6	36.3	36.8	36.5	36.9	37.2	36.6
EU 15	36.9	39.8	40.5	40.9	41.1	40.5	41.1	41.5	41.0

Notes: Ranked by 1997 figures
* Unified Germany beginning in 1991

Source: OECD, *Revenue Statistics*, 1965-1998

Once harmonised, tax levels would forever after be determined at an EU level.

Even were harmonisation to take place at the same level as current UK taxes, severe problems would still remain. Once harmonised, tax levels would forever after be determined at an EU level. To reduce taxes, the UK government would have to get the consent of 15 – soon to be many more – different Member States. It is inconceivable that such a reduction would ever be agreed, given the enthusiasm for high taxes displayed by so many EU member governments. For example, people in Britain would be stuck, permanently, with current high levels of fuel tax no matter what government they chose to elect.

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61 Figures taken from House of Commons Research Paper 00/65, 22nd June 2000, 'The Burden of Taxation' and were collated from regular studies by the OECD. The EU statistics body, Eurostat also produce such figures as does the National Statistics Office in its publication *National Trends*.

CHAPTER THREE
HARMONISATION BY STEALTH

DEFINITIONS

The term tax harmonisation has a spectrum of meanings. It has been defined as 'the situation where identical tax bases, rates, systems etc are proposed or achieved among Member States',[62] via the use of EU legislation. This is characteristically open-ended, however, and there is a significant overlap with other terms frequently used as code words for the same broad agenda. The same terminology has frequently been used to signify a variety of meanings. While full harmonisation remains the goal of many enthusiasts for European integration, there remain a series of alternative descriptions which should be seen as staging posts on the way to full harmonisation. The most commonly-used, with their approximate definitions, are:

- Tax Convergence: Member States' tax systems and rates draw closer together as a result of competitive pressure.
- Tax Approximation: as a result of political agreement or EU legislation, Member States' tax systems and rates draw closer together, without becoming identical.
- Tax Co-ordination: a notoriously elastic term, often been used to describe non-legislative action taken by the Commission to influence the tax practices of Member States, such as conventions, recommendations, guidelines, peer

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62 *Report of the Committee of Independent Experts on Company Taxation*, March 1992 (the "Ruding Report").

pressure etc.[63] Others have used the term to cover political agreements on tax between Member States which take place outside the formal framework of EU legislation and are not enforceable in the European Court of Justice. The only sanctions for breach are political. Examples include the Code of Conduct on Business Taxation (see below).

"Our English Friends have asked asked us not to use the word 'harmonisation' and instead the word 'co-ordination" – Oscar Lafontaine, December 1998.

Over the last few years, it has become fashionable to use the term co-ordination in an attempt to dispel Eurosceptic fears about tax harmonisation. It is dangerous to accept such protestations at face value, however. In theory, the inter-governmental arrangements described exist independently of the framework of the EU and are similar to arrangements concluded, for example, via the OECD. But there is a historical tendency for such measures, agreed initially on an inter-governmental level, to be subsequently communitarised and become part of EU law.[64] The term tax co-ordination is frequently deployed where formal legal harmonisation of systems and rates (of the type described below as 'tax harmonisation) is contemplated. The recent shift of emphasis in Brussels is merely presentational and semantic. The agenda of transferring power over taxes to the EU is unaltered; only the terms used to describe it have changed, in order to 'take the sting out' of the measures proposed.[65] Oscar Lafontaine, when German Finance Minister, stated that:

> Our English Friends have asked asked us not to use the word 'harmonisation' and instead the word 'co-ordination'.[66]

PEER PRESSURE, THE CODE OF CONDUCT AND THE PRIMAROLO GROUP

The semantic trickery of the harmonisation lobby alerts us to the principal method by which the programme is now furthered: stealth. Speaking at the World Economic Forum in Davos in January 2001, Nobel prize-winning economist Robert Mundell referred to:

> …the hidden agenda [to] establish a framework for tax harmonisation.[67]

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63 *Report of the Committee of Independent Experts on Company Taxation*, March 1992 ("the Ruding Report"). See also speech by Commissioner Frits Bolkestein in Barcelona on 9th October 2000, where he highlighted the usefulness of these non-legislative measures.

64 See for example the Brussels Convention on Jurisdiction and the Schengen Accord on border controls.

65 Evidence of Richard Baron of the Institute of Directors to the House of Lords Select Committee, 15th Report of 1998/9 session: *Taxes in the EU: Can Coordination and Competition Coexist?* (HMSO, July 1999).

66 At a conference of his Social Democratic Party in Saarbrucken, reported in *Daily Telegraph*, 9th December 1998.

Throughout the history of the EU, there has been a tendency to implement radical constitutional change under the guise of a series of technical changes, each apparently fairly innocuous in itself but with the cumulative effect amounting to a radical transfer of power to EU institutions. Political realities dictate that this gradualist approach must be used in the tax field in an attempt to hide the harmonisation agenda. Because of the major political and constitutional significance of tax, obvious and high-profile attempts at harmonisation are liable to run into the sand, as they did at last year's Nice summit.

The declared approach is to extend EU competence over taxes which are easiest to harmonise, before going on to more sensitive areas.

A piecemeal and incremental approach has therefore been adopted, with a view to the progressive extension of EU competence over different taxes. The declared approach is to extend EU competence over taxes which are easiest to harmonise, before going on to more sensitive areas.[68]

The Commission has recently expressed its discontent with the limitations of the orthodox legislative methods:

> Moreover, while it remains the Commission's view that a move to qualified majority voting at least for certain tax issues is indispensable, the legal basis will, for the present, remain unanimity. Given the difficulties in reaching unanimous decisions on legislative proposals, which will be compounded by enlargement, the Community should also consider the use of *alternative instruments* as a basis for initiatives in the tax field.[69] [emphasis added]

There is already a range of 'alternative instruments' which are being used to drive forward tax harmonisation. One of the main instruments is 'peer pressure', by which national governments quietly agree to cede sovereignty without the noise created by legislative diktat.[70] A truly silent revolution occurred shortly after the election of the Labour Government, at the Ecofin meeting of December 1997, when Member States adopted the Commission's proposals for a 'Code of

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67 Speaking at the World Economic Forum in Davos in January 2001: 'Nobel economist defends McCreevy's strategy', *Irish Times*, 27th January 2001 and 'EU divided on its stance towards McCreevy', *Irish Times*, 29th January 2001. Mundell has been dubbed the 'father of the euro' because of his theories about monetary zones and abolishing national currencies.

68 As advocated, for example, by Komar in 'Probleme der Steuerharmonisierung in der EG' 1983.

69 *Tax Policy in the European Union – Priorities for the years ahead*, Commission Communication COM(2001) 260 at p10.

70 See the speech of EU Tax Commissioner, Frits Bolkestein, 'Taxation and competition: the realisation of the internal market', Hoevelaken, 17th March 2000.

Conduct for Business Taxation' designed to identify and eliminate what the Code termed 'unfair tax competition'.[71] The Code covers:

- those business tax measures which affect or may affect, the location of business activity in the community in a significant way' which was said to include;
- those tax measures which provide for a significantly lower effective rate of taxation including zero taxation, than that which generally applies in the country in question.

In assessing whether a measure is 'harmful' or not, factors taken into account include whether particular measures are:

- accorded only to non-residents;
- ring-fenced from the domestic market;
- granted without any real economic activity.

An assessment was to be made as to whether tax breaks granted to support the economic development of particular regions were 'in proportion to and targeted at, the aims to be sought'.

Member States undertook:

- to inform one another of existing or proposed tax measures which might fall within the scope of the Code;
- not to introduce new tax measures 'harmful to the community interest, including the effective operation of the single market';
- to 'roll back' existing 'harmful' provisions.

The Council established a working group to examine tax measures suspected of breaking the Code, named after its Chairman, British Treasury Minister Dawn Primarolo.[72] The Primarolo Group examined a list of tax measures supplied by the Commission, largely on the basis of information provided by Member States. The list contained around 200 measures (later narrowed down to 85) identified as potentially harmful. These included various special tax schemes for:

- particular industries (such as tax breaks for British films);
- specified geographical areas (such as the UK's Enterprise Zones);
- dependent territories of Member States (such as Gibraltar).

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71 Acting on the Commission's proposals in *Towards Tax Co-ordination in the European Union: a Package to Tackle harmful Tax Competition*, (1997) and *A Package to tackle harmful tax competition in the European Union* (1997). The latter document scaled down the extensive scope of the proposals on direct and indirect taxation contained in the former.

72 At the Ecofin Council of meeting on 9th March 1998

The Primarolo Group's Report identified 66 'harmful' tax measures. On the eve of the Nice Summit – subsequently hailed as a victory for British tax autonomy – Member States endorsed the findings of the Group and agreed to dismantle the systems deemed harmful by 1st January 2003.

The Group's final report was presented in November 1999 and identified 66 'harmful' measures which it had decided did 'affect in a significant way the location of business activity in the Community'.[73] On the eve of the Nice Summit – subsequently hailed as a victory for British tax autonomy by the Blair Government – Member States endorsed the findings of the Group and agreed to dismantle the systems deemed to be harmful by 1st January 2003.[74] As Commissioner Frits Bolkestein said at the time, it was a 'historic night' for EU tax policy.[75] Unsurprisingly, a majority in the European Parliament has expressed fulsome support for the Code of Conduct[76] and the work of the Primarolo Group.[77]

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73 Interim report November 1998, 12530/98 FISC 164. this was followed by a second interim report published in May 1999, 8231/99 FISC 119. The final report was published in November 1999: *The Primarolo Report*, SN 4901/99 (http://www.futd.nl/specials/staatssteun/doc01.html).

74 Agreement was reached between EU finance ministers as part of the tax package accepted at the Ecofin Council meeting of 26th and 27th November 2000. See *Agence Europe*, Brussels, 27th November 2000 'Fifteen reach agreement on savings'.

75 Addressing the Economic and Monetary Affairs Committee of the European Parliament in November 2000.

76 European Parliament resolution on the preparation of the meeting of the European Council in Helsinki (B5-0308, 0309 and 0312/1999) at paragraph 16; Katiforis report on the Commissions' recommendation for the Broad Guidelines of the Economic Policies of the Member States and the Community (European Parliament resolution A5-0134/2000) at paragraph 17; Fourcans report on the broad economic guidelines of the economic policies of the Member States and the Community (COM(99)0143-C4-0208/99) (European Parliament resolution A4- 0222/99, 1999); Fourcans report on the coordination of fiscal and taxation policy (European Parliament resolution A4-0192/97, 1997); Secchi report on the communication from the Commission on *A package to tackle harmful tax competition* (European Parliament resolution A4- 0228/98, 1998). Christa Randzio Plath MEP, Chairman of the Economic and Monetary Affairs Committee of the European Parliament, is particularly enthusiastic, for example, in her presentation to the committee of June 2000.

77 See for example, Christa Randzio Plath MEP, Chair of European Parliament Committee on Economic and Monetary Affairs: *Draft report to the Committee on Economic and Monetary Affairs on Progress*

THE LONG TERM THREATS POSED BY THE CODE OF CONDUCT

The open-ended nature of the commitment which Gordon Brown undertook when he signed the Code of Conduct on Britain's behalf is a cause for concern. The Government has always sought to justify its stance on the Code of Conduct by dismissing it as a technical measure confined to uncontroversial business taxation matters. It is true that, so far, the Group has applied the Code only to special tax breaks rather than to taxes applicable across the board; it is also true that, so far, no UK measures have been deemed to breach the Code.[78]

Paul Farmer, a senior Commission tax adviser and one of Brussel's most influential fonctionaires, declared that once the Code of Conduct and the tax package was agreed, 'we would be on a roll.'

However, the significance of the Code lies not only in what it presently says but in its potential for expansion. Many see the Code as opening the door to much more wide-ranging EU participation in tax matters.[79] At a recent Conference of the Confederation Fiscale Européene in Brussels,[80] Paul Farmer, senior Commission tax adviser and one of the brightest and most influential of Brussels' powerful *fonctionaire* caste, described the Commission's tactics with admirable frankness. Acting quietly, behind the scenes, the Commission and Member States had instituted a full-scale study into business taxation in the EU. Ominously, he also declared that once the Code of Conduct and the tax package was agreed, 'we would be on a roll'. Political agreement on the tax package would open the door to more wide ranging harmonisation of business taxes.

The Group's precise activities are hard to assess since it meets behind closed doors. Dawn Primarolo has been at pains to keep the profile of the Group as low as possible, demanding, for example, that a recent discussion in the European Parliament take place in camera. Important details on the measures under consideration by the Group only came to light in the UK after publication on a Dutch government website.[81] The secrecy surrounding it has heightened fears that its work would lead to the levelling up of taxes.[82]

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in Tax Coordination in the European Union (2000/2040(INI)), paragraphs 9 and 10.

78 Although certain measures in UK Dependent Territories are still under threat.

79 See, for example, the comments of Commission tax advisor, Paul Farmer, set out below under 'Labour's record'.

80 27th March 2000.

81 'Secret plan for a 100 euro taxes' *Mail on Sunday,* 23rd May 1999.

82 House of Lords Select Committee, 15th Report of 1998/9 session: *Taxes in the EU: Can Coordination and Competition Coexis?'* (HMSO, July 1999), paragraph 133.

For what the Group, in its secret meetings, has at its disposal is a dangerously open-ended instrument for harmonisation. The Code currently covers business taxation. The most high-profile business taxation measures are corporation tax and capital gains tax; the Code is already being deployed to try to drive up Irish corporation tax.[83] Presumably, however, the Code could be extended to cover other business taxes such energy taxes and employers' National Insurance contributions. The Primarolo Group looked at tax schemes covering income tax[84], taxation of income from investments[85] and patents,[86] national insurance type contributions,[87] local taxes and rates[88], inheritance tax[89] and property taxes.[90]

It has given the EU a clear involvement in direct taxation for the first time. The Code of Conduct has given Brussels a "foot in the door" on direct tax which it has always craved; EU institutions are already seeking to capitalise on the opportunities it provides. It is probably only a matter of time before competitive rates of personal taxation also come under the scrutiny of the Primarolo Group. The Commission has persistently refused to guarantee that there would be no such extension of the group's remit.[91] It has recently stated that there is a good *prima facie* case for applying the Code of Conduct to personal income tax.[92] The European Parliament has called for the Code of Conduct to be expanded as follows:

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83 See below under 'Irish corporation tax'.

84 *The Primarolo Report*, SN 4901/99: AAM008 Private foundations (Stiftungen) Austria; B006 Madeira and Sta. Maria (Azores) Free Zones Portugal.

85 *The Primarolo Report*, SN 4901/99: B006 Madeira and Sta. Maria (Azores) Free Zones Portugal.

86 *The Primarolo Report*, SN 4901/99: B006 Madeira and Sta. Maria (Azores) Free Zones Portugal.

87 *The Primarolo Report*, SN 4901/99: EAM083 IRAP exemptions Italy.

88 *The Primarolo Report*, SN 4901/99: B001 The International Financial Services Centre (Dublin) Ireland; EAM083; IRAP exemptions Italy; B002 Trieste Financial Services and Insurance Centre; B006 Madeira and Sta. Maria (Azores) Free Zones Portugal; B008 Åland Islands - Captive Insurance Finland; EAM033 Large scale product-line investments financed with foreign capital Greece.

89 *The Primarolo Report*, SN 4901/99: AAM008 Private foundations (Stiftungen) Austria; B006 Madeira and Sta. Maria (Azores) Free Zones Portugal.

90 *The Primarolo Report*, SN 4901/99: B001 The International Financial Services Centre (Dublin) Ireland; B006 Madeira and Sta. Maria (Azores) Free Zones Portugal.

91 In a discussion between tax Commissioner Frits Bolkestein and the European Parliament's Economic and Monetary Affairs Committee in December 2000.

92 *Tax Policy in the European Union – Priorities for the years ahead*, Commission Communication COM(2001) 260 at p18-19.

- Minimum EU levels of business taxation should be identified – any Member State whose tax levels were below these thresholds should be deemed to be engaging in unfair tax competition.[93]
- Provisions for co-ordination of the taxation of capital in general should be included in the Code of Conduct, including minimum rates below which Member States should not be permitted to go.[94]

The onward march, by which every step towards harmonisation justifies the next, is unrelenting. The Group continues to operate and there is no indication that it will be wound up. According to Dawn Primarolo:

> Its work will never be finalised.[95]

The Code has the potential to undermine the veto on tax. Keith Marsden has stated that:

> ...a Code of Conduct for business taxation is really a dishonest device to side-step EU treaties that require unanimity among Member States before tax harmonisation can legally be imposed... Of course members of a club who have agreed to a new 'Code of Conduct' would be expected to honour it... Once there's a commitment, it will become as powerful as any directive, because no country will want to be seen to be breaking its word.[96]

These anxieties were borne out when Treasury representative, Colin Mowl, told a House of Lords Select Committee that:

> The Code of Conduct can be used to make progress where it is unlikely that progress would be made under unanimity... although the Code is not legally binding the Government has entered into an international commitment which it expects to honour and which it expects other people to honour.[97]

When pressed as to what would happen if the UK and other Member States disagreed about whether a UK tax measure was 'harmful' within the terms of the Code, Mr Mowl said that he did not:

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93 European Parliament Information Service: http://www.europarl.ep.ec/dg4/ factsheets/en/3_4_9.htm, reporting on an opinion given by the European Parliament's Committee on Economic and Monetary Affairs. See also Secchi report on the communication from the Commission on *A package to tackle harmful tax competition* (European Parliament resolution A4- 0228/98, 1998).

94 Ibid.

95 Addressing the European Parliament's Economic and Monetary Affairs Committee, 10th October 2000.

96 *Is tax competition harmful?*, Keith Marsden, November 1998, published by the European Policy Forum (at page 48).

97 The House of Lords Select Committee, 15th Report of 1998/9 session, *Taxes in the EU: Can Coordination and Competition Coexist?* (HMSO, July 1999).

> …know precisely… but there will be a collective discussion in Ecofin, but because this process reflects national competence any action is for any Member State to take. It is not as though you need unanimity formally.[98]

The French government representative who gave evidence to the Committee stated that:

> …the Code is not legally binding but only because there is no legal sanction, at least at this stage… I do think that we shall, sooner or later, have to look into this and see what legal power we can give to [the Primarolo] Group.

> ***"However often the government repeats that the Code is not legally binding, it seems to us that agreeing to it has obviously created a moral if not legal obligation on the government to 'roll back' tax measures which are ultimately deemed to be harmful" – House of Lords Select Committee.***

The Committee expressed the following anxieties about the Code of Conduct:

> We remain unclear about the implications for the United Kingdom of having agreed to this Code, in particular in relation to national sovereignty and to the principle of unanimity in tax matters. However often the government repeats that the Code is not legally binding, it seems to us that agreeing to it has obviously created a moral if not legal obligation on the government to 'roll back' tax measures which are ultimately deemed to be harmful and not to introduce new measures of the same kind._The actual impact on the UK will of course depend on which (if any) of our tax measures are ultimately deemed harmful. But there remains the risk that the process could lead to the UK being obliged – in practice if not in law – to adopt tax measures damaging to the interests of the economy or of citizens. This would matter less if all other Member States took the same view as to how binding the Code was but we are not convinced that they do. That raises the fundamental question of whether a Code of Conduct approach can work, and work equitably, in a body with such diverse styles of government as the European Union. We think Parliament deserves a much clearer explanation of how the system is supposed to work than the Government has so far provided.[99]

ENHANCED CO-OPERATION

Contrary to the publicity material issued after the Nice Summit, the new treaty agreed by Mr Blair provides a new means by which the EU can increase its role in tax by circumventing the traditional legislative mechanisms. A new procedure known as "enhanced cooperation" was agreed at Nice which permits groups of states to proceed amongst themselves with projects for further integration which

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98 The House of Lords Select Committee, 15th Report of 1998/9 session, *Taxes in the EU: Can Coordination and Competition Coexist?* (HMSO, July 1999).

99 The House of Lords Select Committee, 15th Report of 1998/9 session, *Taxes in the EU: Can Coordination and Competition Coexist?* (HMSO, July 1999.

are not be acceptable to the EU as whole. Such projects cannot be vetoed by non-participating states. The Commission has recently stated that enhanced co-operation could be used in relation to taxes.[100]

There is a danger that tax harmonisation measures unpalatable to some Member States could be given political impetus using the new procedure. A precedent is provided by the Schengen Accord which started as an inter-governmental agreement between a group of countries and was subsequently turned into EU law with non-participating EU countries being given an opt-out.

This change is more significant than it looks at first glance, since the weight of the EU machine has always seen opt-outs as merely temporary derogations. Schengen has gone from being an inter-governmental arrangement between various Member States to being the EU norm. Tax measures adopted via enhanced cooperation could follow the same path. Once a group had adopted tax measures, they would be keen to exert political pressure on others to join in at a later stage.

THE EUROPEAN COURT OF JUSTICE

Besides the stealthy work of the Primarolo Group, there exists a powerful institutional mechanism which can also be used to further the tax harmonisation project: using a formula successfully used in other areas of European integration, the European Court of Justice (ECJ) acts in a sort of pincer movement with the Commission to drive forward the integrationist agenda. The European Commission recently signalled its intention to resort to the Court more frequently and vigorously in pursuing its tax policy.[101]

The UK is constrained by the European Communities Act of 1972 from exercising any of its legislative powers inconsistently with the Treaty of Rome. This principle applies to tax as it does to every other area of government activity,[102] and the Court has not been afraid to use its powers. *The Economist* has noted that:

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100 *Tax Policy in the European Union – Priorities for the years ahead*, Commission Communication COM(2001) 260 and 'Brussels retreats on tax plans', *Financial Times*, 23rd January 2001. See also comments of Commissioner Wallstrom on using such procedures in relation to energy and transport taxes: Independent 25th January 2001.

101 EU Tax Commissioner Frits Bolkestein's speech in Barcelona on 9th October 2000. The same point was repeated in a leaked paper presented by Mr Bolkestein to the Commission in January 2001: 'European Commission draws lessons from the failure of European Summit in Nice on taxation', *Agence Europe*, Brussels, 23rd January 2001.

102 Case C-279.93 Finanzamt Koln-Altstadt v Roland Schumacker, paragraph 21.

> The same principle – that the court can overrule national sovereignty in tax matters, where it clashes with other aspects of European law – could theoretically be applied to other taxes too.[103]

For example, in the Jessica Safir case,[104] the ECJ ruled that the taxation of life assurance in Sweden was illegal because it discriminated against firms from other European countries.

Use of the ECJ may be one way in which the Commission can circumvent the requirement of unanimity in tax matters. For example, Article 87 and the rules on illegal state aid are subject to majority voting. These have been deployed to strike down tax cuts in Member States. Tax breaks can be ruled illegal under Article 87 of the EU Treaty, if they affect trade between Member States and are confined to a particular industry or region.[105] In such cases, tax measures in Member States can be struck down by the ECJ, unless they have the prior approval of the Commission and can be brought within one of the areas of state aid permitted by the Treaty (for example state aid directed at protecting the environment or promoting research and development).

Another aspect of the highly significant package of tax measures agreed by Gordon Brown at the December 1997 Ecofin Council concerned state aids. Member States called for the rigorous application of state aid rules to tax measures. Competition Commissioner Mario Monti consequently issued a communication outlining the Commission's approach in investigating whether the tax systems of any Member State contravene the EU rules against state aids to industry.[106] These developments were warmly endorsed by a majority in the European Parliament.[107]

There is also a danger that QMV could be applied to tax by resorting to treaty articles on the single market (such as Article 96). This tactic was used successfully to impose the Working Time directive on the UK, despite its opt out of the Social Chapter. Ominously, the European Commission has issued scarcely veiled threats that it may seek to use Article 96 on tax matters:

> The Commission cannot, as guardian of the treaties, be lenient on infringements in the tax field... In this context, it may also be recalled that Article 96 of the Treaty

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103 5th December 1998, noted at paragraph 109 of The House of Lords Select Committee, 15th Report of 1998/9 session, *Taxes in the EU: Can Coordination and Competition Coexist?* (HMSO, July 1999).

104 Case C-118/96 [1998] ECR I-1897. For other examples, see below under 'Income tax' and 'Other corporation tax issues'.

105 See, for example, case C387/92 Banco de Credito Industrial SA (now Banco de Espana SA) v Ayuntamiento de Valencia, reported in *Simon's Tax Intelligence*, 16th June 1994.

106 'Communication on the application of the State Aid rules to measures relating to direct business taxation' (SEC (1998)1800). See also Commission communication 98/C 384/03 of OJ C 384) and Commission press release IP/98/983, 11th November 1998.

107 Secchi report on the communication from the Commission on *A package to tackle harmful tax competition*, (European Parliament resolution A4- 0228/98, 1998) at paragraph 34.

> provides a legal basis for the Commission to take action to deal with distortions of competiton in the internal market, including proposing directives, which may be adopted by qualified majority.[108]

There are grave suspicions that the ECJ may 'attempt to go where other community institutions fear to tread by attempting to harmonise Member States' tax raising powers.'[109] Tax expert, Ian Stitt, expressed the concerns of many when he said:

> The Court's interpretation of broadly worded provisions in the Treaty of Rome, on such topics as free movement of workers could lead to significant 'instant tax harmonisation'... the ECJ can often stretch their analysis of the relevant principles to achieve an extremely broad interpretation of the Treaty of Rome… If the ECJ is effectively allowed to take the lead in direct tax harmonisation, there will be no proper scrutiny of the principles that are being developed, by those elected and appointed to law-making powers.[110]

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108 *Tax Policy in the European Union – Priorities for the years ahead,* Commission Communication COM(2001) 260 at p23.

109 'Direct taxation and the community after Gilly', Antony Seely, *Tax Journal*, 29th June 1998.

110 'International tax: the avoidance of parochialism', Hardman Memorial Lecture, November 1996 at pp6-8.

CHAPTER FOUR
INDIRECT TAXATION

As we shall see, there are clear moves towards the harmonisation of direct and personal taxes. Fittingly for the stealth agenda, however, it is in the field of indirect taxation that most of the progress on harmonisation is being made. Article 93 of the Treaty of European Union requires the:

> ...harmonisation of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market.[111]

The European Commission has consistently criticised competition in indirect taxes between Member States.[112] The European Commission has recently stated that:

> a high degree of harmonisation is certainly essential in the indirect tax field.[113]

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111 Ex article 99. The Council, acting unanimously on a proposal from the Commission and after consulting the European Parliament and the Economic and Social Committee, adopt provisions for the harmonisation of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market within the time-limit laid down in Article 14.

112 *Daily Telegraph* 10th October 2000 'Britons Face New Fuel Tax' reporting a speech by Commissioner Frits Bolkestein in Barcelona on 9th October 2000.

As Tax Commissioner, Frits Bolkestein, has pointed out:

> a significant degree of harmonisation has already taken place.[114]

Tax harmonisation is more advanced on VAT than on any other tax.

VAT

Tax harmonisation is more advanced on VAT than on any other tax.[115] VAT was originally introduced in the UK because of EU membership and compliance with VAT rules has always been a part of the obligations of Member States of the EU. VAT laws are determined at an EU level. The EU is thus involved in some of the most sensitive tax issues in British politics. In 1997, for example, the UK Government needed the permission of EU authorities to reduce VAT on domestic fuel.[116] Unable to obtain EU consent for his promise to cut VAT on church repairs, Gordon Brown had to introduce a system of grants, whereby the Government would effectively pay the VAT uplift, by reimbursing the churches with difference between the full and the reduced rate.[117]

The VAT system is notorious for its complexity and irrationality. It is a burden for businesses, particularly those which operate across the EU. The current VAT rules are contained largely in the Sixth VAT Directive[118] which was aimed at ensuring that all countries have a broadly similar VAT base – i.e. that they levied the tax on the same transactions. Though the EU sets the minimum rate of VAT – currently 15% – large divergences still exist between Member States

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113 Commission Communication COM(2001) 260 at p8. See also the speech of Frits Bolkestein in Barcelona, 9th October 2000.

114 Speech in Barcelona, 9th October 2000. See also Secchi report on the communication from the Commission on *A package to tackle harmful tax competition* (European Parliament resolution A4-0228/98, 1998), particularly paragraph 7. See also the comments of his predecessor as Tax Commissioner, Mario Monti, noted at paragraph 63 of The House of Lords Select Committee, 15th Report of 1998/9 session, *Taxes in the EU: Can Coordination and Competition Coexist?* (HMSO, July 1999): there was a case for 'quite extensive harmonisation'.

115 R. Seely, *Tax harmonisation*, House of Commons, Business and Transport Section, 6th July 1998 at p1.

116 Another instance where the EU's involvement in VAT has hit the headlines was when the European Court of Justice ruled that EU law required VAT to be charged on privately funded road and bridge tolls in the UK: ECJ Cases C-276/97, C-358/97, C-359/97, C-408/97 and C-260/98 12 September 2000. So anxious were the UK government to avoid the political fall out (charging VAT on the Tamar Bridge, for example, has particularly sensitive regional implications) that they undertook to meet the cost of the VAT out of the public purse. It is not as yet clear whether this is legal or not and if so, how it will operate in practice.

117 In his 2001 budget.

118 77/388/EEC of 17 thMay 1977

(exemptions and zero rates also vary significantly). A number of attempts to set a maximum harmonised rate of VAT have so far been unsuccessful.[119] But there remain other, more complicated ways in which VAT may be harmonised.

Since its inception in 1970, VAT has been levied according to the 'country of destination' principle: the rates of VAT and excise applied are those of the country of final consumption. The transaction is zero-rated in the countries from which the goods/services were supplied and the VAT is paid to the government of the Member State where eventual consumption takes place. In 1987, the European Commission put forward radical proposals for the creation of 'a definitive system' for VAT based on the 'country of origin' approach.[120]

Under this proposal, transactions between Member States bear the ordinary tax of the country of origin, thus treating cross border transactions in the same way as domestic ones. A London-based trader, could, for example, treat transactions with traders in Munich in exactly the same way as ones in Manchester. The proposal proved to be highly controversial, however, since estimates show that the introduction of the country of origin principle would involve substantial transfers of revenue, notably to Germany and Benelux, from other Member States.

The Commission therefore proposed a clearing system to re-allocate VAT collected in the countries of origin to countries of consumption, which could be based on VAT returns, macro-economic statistics or on sampling techniques. This was unacceptable to Member States and the proposals foundered. However, revenue sharing has recently been accepted by Gordon Brown and other EU finance ministers in relation to the withholding tax (see below, Chapter 5). It remains to be seen whether this development will breathe new life into the country of origin proposal.

In the meantime, a transitional arrangement has been agreed, applying the country of origin principle to consumer transactions (leading to the abolition of personal VAT travellers' limits).[121] The country of destination approach was retained for business to business transactions.

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119 COM(87)321 (minimum 14% and maximum 20%), COM(95)731 (minimum 15% and maximum 25%), COM(1998)693 (minimum 15% and maximum 25%). In its most recent major proposal for VAT harmonisation, the Commission has not proposed any maximum rate.

120 COM(87)322. for a more recent demand to move to the country of origin principle see the draft report to the European Parliament's Committee on Economic and Monetary Affairs by its chairman, Christa Randzio Plath MEP: *Progress in Tax Coordination in the European Union* (2000/2040(INI)), paragraph 23 and 26.

121 Directives 91/680/EEC of 16th December 1991 and 92/111/EEC of 14 December 1992.

In its most recent major statements on the issue, the Commission has firmly reiterated its support for the move to a definitive system[122] (although admitting that this is unlikely to happen in the immediate future).[123] Despite repeated requests that it abandon this goal, the Commission steadfastly refuses to do so,[124] as does the European Parliament.[125]

Though no certain predictions can be made of the level at which a harmonised rate (or narrow band of rates) would be set, a harmonised VAT regime would almost certainly see an increase in the British rate. Denmark and Sweden levy VAT at 25%; the average across the EU works out at 19.37%, well ahead of the UK's 17.5%.[126]

A harmonised VAT regime would almost certainly see an increase in the British rate.

Even more seriously, harmonisation would be virtually certain to see an end to the UK's zero rates. The political attachment to the UK's zero rates for food, books, newspapers, and children's clothes should not be underestimated. Furthermore, UK zero rates go beyond the headline cases. They also include medicines and medical care, dental care, equipment for the disabled, goods

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122 *Tax Policy in the European Union – Priorities for the years ahead*, Commission Communication COM(2001) 260 at p11. See also Commission discussion documents, *A Common system of VAT: a Programme for the Single Market*, 22nd July 1996 and *Description of General Principles, Commission Services General Note* (XXI/1156/96). A summary is available at: www.europa.eu.int/rapid/start/cgi/guesten.ksh?p_action.gettxt=gt&doc=IP/96/618|0|AGED&1g=EN.

123 Speech of EU Tax Commissioner, Frits Bolkestein, 'Taxation and competition: the realisation of the internal market', Hoevelaken, 17th March 2000; 'Member States set to back tax reforms', *European Voice*, 4th May 2000.

124 See for example the Commission's response to European Parliamentary Written Question E-1635/00 of 5th July 2000 (tabled by the author).

125 Torres Marques report on the proposal for a Council directive amending Directive 77/388/CEE on the common system of value added tax, with regard to the length of time during which the minimum standard rate is to apply (European Parliament resolution A5-0366/2000). Adopted 14th December 2000 (Conservative voted against and Labour and Liberals in favour). See also Fourcans report on the coordination of fiscal and taxation policy (European Parliament resolution A4-0192/97, 1997).

126 Headline rates as of 1st May 2001: Belgium 21, Denmark 25, Germany 16, Greece 18, Spain 16, France 19.6, Ireland 20, Italy 20, Luxembourg 15, Netherlands 19, Austria 20, Portugal 17, Finland 22, Sweden 25 and UK 17.5 (figures from European Commission document *VAT Rates Applied in the Member States of the European Community*, DOC/2905/2001-EN).

donated to charity shops, water (other than mineral and bottled water) and public transport.[127] Even the zero rate for cremation services is threatened by a move to a definitive VAT system.

These zero rates survive only because of a specific derogation to the normal rules. The zero rates already in force on 31 December 1977 are allowed to continue so long as:

- they exist for clearly defined social reasons;
- they benefit the consumer;
- and the country-of-origin principle is still not being generally applied.[128]

Thus with the general shift to country of origin, the UK's derogation would end.[129] The Commission has called for the harmonisation of the special reduced and zero rates and has emphasised their temporary and transitional status. In response to a parliamentary question tabled by the author last year, the Commission replied that they are:

> …only a transitional measure, pending adoption of the common VAT system.[130]

"The continued existence of a variety of derogations in both the VAT and excise duty fields is unhelpful" – European Commission Paper 2001.

More recently the Commission has stated that:

> The continued existence of a variety of derogations in both the VAT and excise duty fields is unhelpful.[131]

It is committed to a review of these rates some time after the end of 2002.

Indeed the current arrangements are regarded as aberrations by the rest of Europe. Apart from a single exception for books in Denmark, the UK and Ireland are the only EU countries to apply zero rates. When the two countries joined what was then the European Community, it took some very tough negotiating to secure these zero rates.

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127 The Commission has been particularly supportive of harmonisation of VAT on passenger transport: see COM(94)584.

128 Article 28 of the Sixth VAT Directive (77/388/EEC of 17th May 1977), referring back to Article 17 of the Second VAT Directive of 11th April 1967.

129 See also the Food and Drink Federation: *Single Currency, Tax Harmonisation and the Possible Loss of VAT Zero Rating on Food*, press release October 2000.

130 Commission response to European Parliamentary Written Question E-1635/00 of 5th July 2000 (by the author).

131 *Tax Policy in the European Union – Priorities for the years ahead*, Commission Communication COM(2001) 260 at p10.

A move to the new system would be subject to unanimity and the UK government would have a veto. This would obviously give the UK an opportunity to negotiate a further derogation. However, the whole point of a move to the definitive system is to eliminate such national divergences. Alternatively, the UK could try to have its zero rates extended to the rest of the EU and included as part of the new harmonised framework. This is inconceivable, given the amount of revenue dependent on VAT in other Member States. It is impossible to predict the outcome of such negotiations but a cutback in the range of zero rates would seem to be highly likely in the give-and-take process of EU negotiations. The danger of losing UK zero rates is compounded by recent Labour support for a move to a definitive system.[132]

In addition to curtailing the right of Member States to forgo VAT receipts on certain socially important goods, the Commission is working to harmonise the tax on commercial products including banking and insurance,[133] postal services,[134] passenger transport[135] and, somewhat bizarrely, cut flowers.[136] It is also seeking to extend its remit to e-commerce and digital products. Normally, services are taxed at the place of establishment of the supplier. Thus non-EU suppliers need not charge VAT. Advances in technology mean that it is increasingly easy to purchase services, including telecoms, from non-EU suppliers. In 1997, therefore, the Member States agreed to change to rules so that the purchaser of the service became liable for the tax.[137]

The Commission is working to harmonise the tax on commercial products including banking and insurance, postal services, passenger transport and, somewhat bizarrely, cut flowers.

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132 Labour MEPs called for the adoption of the definitive system as soon as possible, voting in favour of Torres Marques report on the proposal for a Council directive amending Directive 77/388/CEE on the common system of value added tax, with regard to the length of time during which the minimum standard rate is to apply (European Parliament resolution A5-0366/2000). Adopted 14th December 2000.

133 *European Voice*, 4th May 2000: 'Member States set to back tax reforms'.

134 *A Strategy to Improve the Operation of VAT System within Context of the Internal Market*, COM(2000)348. See also *European Voice*, 4th May 2000: 'Member States set to back tax reforms'.

135 COM(92)416.

136 COM(94)584.

137 COM(97)0004 – C4 – 0100/97 – 97/0300(CNS), 29th January 1997; Cox report on a proposal for a Council directive amending Directive 77/388/EEC as regards the VAT arrangements applicable to telecommunications services (European Parliament resolution, A4-0266/99).

EU firms are required to charge VAT on purely digital products such as web design, music, and computer software, whereas non-EU providers are not. The Commission has recently put forward a draft directive to require non-EU firms to charge VAT on such products (classified as services for the purposes of VAT rules). They would be required to register in a single Member State, even where they choose to do business around the EU. This proposal has been criticised on the grounds that:

- different rates would be charged for the same product in the off- and on-line environments, contrary to the principles for the Ottawa Accord. For example, a digitally delivered newspaper, book or educational course, would be charged at the full rate whereas such products would be zero rated or exempted in the UK if sold in physical form;
- suppliers would be unable to identify the VAT status of their customers with certainty – whether they are businesses or private individuals, whether they are within or outside the EU, etc. Requiring a credit card billing address may be one way to deal with the latter problem but even this may only be a short term solution as the development of electronic money makes anonymous payment increasingly easy;
- there is no realistic way to enforce the tax. Large firms anxious to maintain a respectable reputation may feel obliged by peer pressure to register but less reputable firms could flout the law with impunity;
- the proposals look at one single aspect of internet taxation rather than taking a general view. One of the reasons for the success of e-commerce in the US is its *de facto* (if not *de jure*) tax free status. Member States should be considering boosting their e-economies by cutting taxes on e-commerce rather than introducing new ones.

The French presidency of the EU has proposed that non-EU firms should be required to register in every Member State in which they do business. This could give rise to yet further problems as the complexity of such registrations might contravene WTO rules. Moreover, retaliatory measures could leave EU firms having to tackle 100 different sales tax regimes. The Commission's proposals have received the support of a majority in the European Parliament[138] but no agreement has so far been reached in the Council of Ministers.

TRANSPORT TAXATION: INFRASTRUCTURE CHARGING

In 1999, the European Commission's High Level Group on Transport Infrastructure Charging published a wide-ranging plan to impose taxes on the use

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[138] Garcia Margallo report on the proposal for a Council directive amending Directive 77/388/EEC as regards the value added tax arrangements applicable to certain services supplied by electronic mean (COM(2000) 349 - C5-0467/2000 - 2000/0148(CNS)) – Committee on Economic and Monetary Affairs VAT arrangements applicable to services provided by electronic means (amendment of Directive 77/388/EEC) (European Parliament resolutions A5-0362/2000).

of cars, motor insurance, parking, air transport and airports, shipping and ferries, ports and bridges, roads, railways, stations and other means of transport.[139] These proposals enjoy wide support in Brussels. They have yet to be put before Member States but have been endorsed by the European Commission, which has issued Green and White Papers on the subject.[140] The political momentum behind them came from Neil Kinnock[141] and his enthusiasm is shared by his successor as EU Transport Commissioner, Loyola de Palacio. The proposals were recently approved by a majority on the European Parliament.[142]

In 1999, the European Commission published a wide-ranging plan to impose taxes on the use of cars, motor insurance, parking, air transport and airports, shipping and ferries, ports and bridges, roads, railways, stations and other means of transport.

Concurrent with these proposals, moreover, are plans for the harmonisation of vehicle taxes in the EU, with a view to Brussels setting vehicle excise duty,[143] thus further extending EU involvement in transport taxes.

EU infrastructure charging proposals are based on the usual – and dubious – justification that 'large differentials in taxation between countries will distort the internal market';[144] it is also argued that the individuals[145] who use a particular

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139 Dated 9th September 1999. See the same group's earlier reports of 26th May 1999, *Final Report on Estimating Transport Costs* and 2 June 1998, *Final report on pricing principles*.

140 1995 Commission Green Paper, *Towards Fair and Efficient Pricing in Transport Policy* (COM(1995)691); 1998 Commission White Paper, *Fair Payment for Infrastructure Use: A Phased Approach to Common Transport Infrastructure Charging in the European Union* (COM(1998)466. See also the 1986 Commission survey on infrastructure charging.

141 See http://www.europa.eu.int/en/comm/dg07/press/ip98487en.htm for Commission Press Release 'Kinnock endorses user pays principle'.

142 The Costa Report on Transport Infrastructure Charging (European Parliament resolution A5-0345/2000 (2000/2030(INI)), adopted 18 January 2001). The report was supported by UK Labour and Liberal MEPs and opposed by Conservative MEPs.

143 Speech of EU Tax Commissioner, Frits Bolkestein, 'Taxation and competition: the realisation of the internal market', Hoevelaken, 17th March 2000; *Agence Europe*, Brussels 11/10/2000; *Daily Telegraph* 10th October 2000: 'Britons Face New Fuel Tax'.

144 *High level group on transport infrastructure charging – Final report on pricing principles*, 2 June 1998; Costa Report on Transport Infrastructure Charging (European Parliament resolution A5-0345/2000 2000/2030(INI), adopted 18 January 2001) at paragraph 3; 1998 Commission White Paper*, Fair Payment for Infrastructure Use: A Phased Approach to Common Transport Infrastructure Charging in*

piece of transport infrastructure should pay for its maintenance and for the cost of the environmental damage which their actions cause.[146] These are said to include the cost to society of congestion, air pollution, safety measures and accidents, noise and vibration.

But, as with so many supposedly green taxes, these proposals have little to do with the environment and more to do with devising new ways to tax people. Transport is already very heavily taxed. The European Road Users Federation estimates that motorists in the EU pay 270 billion euros per year in taxes.

There are severe practical problems with the proposals. For example, there are widely differing views as to how to estimate the environmental costs of transport use.[147] There are also fears that the 5% levy on motor insurance advocated by some[148] as part of the infrastructure charging package will push substantially more people over the edge into taking the criminal risk of driving without insurance. There is no proposal to exempt the disabled (who may be wholly dependent on car use for mobility) from charges. The proposals envisage tolling virtually all roads: applying such charges to rural roads would adversely affect isolated rural communities. Finally, the cost of collection is guaranteed to be high.

The new charging scheme would certainly involve EU institutions more deeply in the UK's tax structures and administration. Exactly what role these institutions would play is presently under discussion. The proposals contain a worrying lack of detail: they do not, for example, exclude the possibility that money left over after maintenance could go directly to the European Commission.[149] They specify no clear cap restricting the charge to the cost of

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the European Union (COM(1998)466; Commission Press Release 'Kinnock endorses user pays principle', Brussels 2nd June 1998, www.europa.eu.int/en/comm/dg07/press/ip98487en.htm Commission Press Release.

145 The charges would cover both private and business users.

146 And thereby to 'internalise externalities' by, for example, charging a driver for the marginal social cost of one extra car using the road. Some have suggested that the user pays principle might extend as far as charging motorists for the for the costs of road accidents such as NHS medical care or police time: European Transport Seminar, 29th February 2000, 1995 Commission White Paper *Fair Payment for Infrastructure Use: A Phased Approach to Transport Infrastructure Charging in the European Union* and Commission Press Release http//www.europa.eu.int/en/comm/dg07/press/ ip98679en.htm.

147 How does one measure, for example, the cost of air and noise pollution?

148 For example, the European Parliament's rapporteur on this matter, Mr Costa.

149 The European Parliament, in its resolution on this issue (the Costa Report, as to which, see above) specifically declined to confine access to any surplus to Member States and local authorities, with their rejection of an amendment tabled by Conservative MEP Phil Bradbourn.

maintenance and no guarantee that sums raised will be devoted to spending on transport or environmental projects. Although the Commission has denied that this is their agenda, Brussels insiders believe that the proposals could provide a way to bypass the restrictions on the EU budget and give the Commission a direct source of income by enabling it to levy taxes directly on citizens – tax harmonisation in its most extreme form.

ENERGY TAXATION

Energy taxes have been the subject of numerous declarations and proposals from the Commission and European Parliament.[150] Indeed they come within the remit of the demand for harmonisation of all indirect taxes contained in Article 93[151] of the EU Treaty. In addition, Articles 174 and 175 of the Treaty allow the EU to take action, including that 'of a fiscal nature' to promote 'the prudent and rational utilisation of natural resources'. In line with other tax harmonisation projects, the emphasis is always on levelling up energy taxes to the higher prevailing levels around Europe, rather than bringing them down.[152]

The EU Treaty allows the EU to take action, including that 'of a fiscal nature' to promote 'the prudent and rational utilisation of natural resources'.

The harmonisation process has already begun. The minimum level of fuel excise duties are already determined at an EU level,[153] though no top limit on fuel taxes has ever been agreed by Member States. The Commission has a significant involvement in the administration of these taxes, issuing guidelines for Member States for their preparation, assessment and execution. For example, the special concessions granted to the haulage industry in various EU Member States

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150 See for example the Commission survey of 1986 of vehicle excise taxes, fuel taxes and road tolls (COM(86)250) and Commission proposal concerning motor fuels for agricultural purposes (COM(92)36).

151 As to which see above.

152 See above under "Raising Taxes".

153 Directive 92/81/EEC defines those oils to be charged duty and directive 92/82/EEC contains the minimum rates:

- leaded petrol: ECU 337 per 1000 litres
- unleaded petrol: ECU 287 per 1000 litres
- gas oil: ECU 245 per 1000 litres
- heavy fuel oil: ECU 13 per 1000kg
- LPG and methane used as a propellant: ECU 245 per 1000 kg
- Kerosene used as a propellant (excluding its use as aircraft fuel): ECU 245 per 1000 litres

Exemptions and reduced rates are contained in Directive 95/510/EEC. See generally House of Commons Research Paper 00/69, 12th July 2000 pp25-29 for further details.

(resulting from the fuel tax protests) could not go ahead without the consent of the EU authorities.[154]

The twin advantages of energy taxation – the environmental pretext, and the fact that demand on such essential products can withstand large price rises – has not been lost on the EU. But harmonisation has not, until recently, been easy to achieve. In 1987 and 1989 the Commission demanded the absolute harmonisation of mineral oil duties, with a single rate applied across the EU. The reasons cited were 'the risks of competitive distortion'.[155] The Commission also observed that there were strong arguments in favour of increasing duties on domestic and other heating fuel. But in the face of opposition from Margaret Thatcher these proposals were dropped. A few years later, in 1992, the Commission proposed a community-wide tax on carbon dioxide emissions and energy use.[156] This was resisted by Member States and the proposal was shelved.
Since 1997, however, there has been a change of attitude with the Blair Government expressing its clear support for further harmonisation and increase of energy taxes. In March 1997, the Commission published a draft directive to restructure the EU framework for the taxation of energy products, effectively imposing an EU-wide energy tax. Its aim is to extend the EU's current competence in setting minimum levels of duty from mineral oils to include other energy sources such as natural gas, coal and electricity; and progressively to increase the minimum level of tax on all forms of energy.[157] The proposal was welcomed by the Blair government when it was elected later in the year, saying:

> There is a good single market case for increasing the minimum rates of duty on fuels.[158]

The government's position on the directive is straight forward. We are strongly in favour of high minimum rates on mineral oils, especially road fuels – HM Customs and Excise, December 1997.

It also said:

> The government's position on the directive is straight forward. We are strongly in favour of high minimum rates on mineral oils, especially road fuels...As for the taxation of coal, gas and electricity, we are prepared to see progress made on the

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154 Discussed at the Council of European Union finance ministers (Ecofin) on 19th January 2001 in Brussels. See *Wall Street Journal Europe*, 18th January 2001 'Gas Taxes – governments squabble over special rates for consumers.'

155 COM(87)327 and COM(89)260.

156 *Tax on carbon dioxide emissions, CO2 and energy* (COM(1992)0226).

157 Restructuring the framework for Taxation of Energy Product COM(97)30, EC draft 6793(97) 21 March 1997; House of Commons Research Paper 00/69, 12th July 2000 pp27; *Agence Europe*, Brussels 11/10/2000.

158 See also HM Customs and Excise Explanatory Memorandum, 10th December 1997, paras 5-6: 'there is a good single market case for increasing the minimum rates of duty on road fuels.'

> draft directive, subject to the inclusion of a permanent exemption for domestic consumption of all energy products.[159]

Under present rules the proposal would require the unanimous support of all 15 Member States. It is currently blocked by the Spanish government. But discussions on this proposal continue in the Commission's various tax working groups,[160] and Tax Commissioner Frits Bolkestein recently signalled the continuing will of the Commission to pursue this proposal.[161]

Such bold ambitions aside, the fuel tax harmonisation programme proceeds apace in the face of demonstrable public objections. Last year, protests across Europe reminded politicians that there is a limit to the tax that people are prepared to pay. But finance ministers, meeting in the midst of the protests in September 2000, pledged not to make across-the-board reductions in existing levels of tax.[162] A majority in the European Parliament, of course, is fully pledged: the Secchi report declared that the case for further harmonisation was particularly strong in relation to these taxes.[163] And the European Commission has put forward a range of proposals.[164] Environment Commissioner Margot Wallstrom recently suggested that groups of countries might wish to drive forward the energy tax harmonisation agenda by using the enhanced co-operation procedure outlined

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159 European Standing Committee B, 27th October 1999 cc2-3.

160 As to which see Annex II below 'EU Tax Working Groups'.

161 *Agence Europe*, Brussels 11/10/2000

162 Ecofin Council, Brussels, 29th September 2000 (confirming an earlier agreement at Versailles on 9th September); *Daily Telegraph*, 7th November 2000.

163 Secchi report on the communication from the Commission on *A package to tackle harmful tax competition* (European Parliament resolution A4- 0228/98, 1998) at paragraph 7; Olsson report on *Environmental taxes and charges in the Single Market* (European Parliament dossier PE 223.454); Christa Randzio Plath MEP, Chair of European Parliament Committee on Economic and Monetary Affairs: *Draft report to the Committee on Economic and Monetary Affairs on Progress in Tax Coordination in the European Union* (2000/2040(INI)), paragraph 35.

164 See, for example, 2000 Commission communication *Environment 2010: our future, our choice* and 1997 Commission communication *Environmental taxes and charges in the single market*. See also, the comments of transport Commissioner Loyola de Palacio in 'Avoiding the tax cutting trap', *Financial Times*, 8th November 2000 and 'De Palacio wants to see fuel tax caps in Member States', *European Report*, 15th November 2000; 'Europe to make a welcome U-turn on tax harmony', *Evening Standard*, 1st February 2001; Speech of EU Tax Commissioner, Frits Bolkestein, 'Taxation and competition: the realisation of the internal market', Hoevelaken, 17th March 2000. In his speech to Barcelona University on 9th October 2000, Frits Bolkestein declared that the Commission's main harmonisation efforts would be focused on excise duties (which include energy taxes).

above.[165] In a speech in Barcelona in October 2000, Fritz Bolkestein re-emphasised the Commission's commitment to harmonisation:

> The recent oil crisis has not changed my point of view over the need to establish minimum levels of taxation for energy products…It is essential that a common [EU] framework for taxation be established. This will enable both the Community to fully benefit from the internal market and to respect its obligation in terms of the environment.[166]

Finally, the Commission, with the support of the Parliament,[167] is seeking to persuade Member States to apply fuel tax on domestic air flights and to conclude treaties with one another to impose such a tax on cross-border flights within the EU, which would undoubtedly push up the cost of budget airfares.[168] This proposal is inconsistent with the 1944 Chicago Convention, a global agreement exempting air fuel from taxation, and would have very damaging consequences for the competitiveness of EU-based carriers, not to mention for European tourism, as tax-free external flights become more competitively priced.[169] Nevertheless it was welcomed by John Prescott on behalf of the British government, and discussions continue in the Council of Ministers.[170]

CIGARETTES AND ALCOHOL

One area where only limited harmonisation has so far taken place is the duty on alcohol and tobacco, where wide divergences exist between Member States as regards both systems and rates. However, the huge amounts of tax-induced movements across frontiers is starting to trigger tax competition pressures.

A majority in the European Parliament has called for the harmonisation of tobacco and alcohol duties.

A majority in the European Parliament has called for the harmonisation of excise duties,[171] (which include tobacco and alcohol duties) and minimum rates of

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165 See *Independent*, 25th January 2001, 'EU signals retreat on harmonised tax plans'. This suggestion was endorsed by the full Commission in *Tax Policy in the European Union – Priorities for the years ahead*, Commission Communication COM(2001) 260 at p24.

166 *Agence Europe*, Brussels 11/10/2000.

167 Garcia-Margallo report on the Commission communication on taxation of aircraft fuel (A5-0334/2000). Adopted 14th December 2000 (Conservative MEPs voted against and Labour and Liberal MEPs in favour).

168 See *Sunday Express*, 19th March 2000. The Commission has admitted that the tax will increase the cost of flights: *The Times*, 13th March 2000.

169 As revealed by the Commission's own research in this area: *The Times*, 13th March 2000.

170 'Tax on aviation fuel to push up the price of flights', *The Times*, 12th March 2000.

171 Secchi Report on the communication from the Commission on *A package to tackle harmful tax competition,* (European Parliament resolution A4- 0228/98, 1998), (see paragraph 8).

alcohol and tobacco excise duty are already set by the EU.[172] There have been a number attempts to introduce further harmonisation of alcohol and tobacco duties, which have yet to succeed. For example, under the Single Market programme, the Commission proposed that there should a single community rate for each category of alcohol,[173] fixed at the average of national rates.[174] This was rejected, as was a subsequent proposal to set minimum and target rates.[175] It was hoped that this would lead to long term convergence.

The Commission has recently signalled its intention to revive harmonisation attempts, issuing a proposal in March on tobacco taxes.[176] As one would expect, its emphasis was not on bringing down levels of tax but ***raising*** taxes to "a reasonable minimum" to facilitate convergence between rates in different Member States.[177] A parallel proposal on alcohol is in preparation which is expected to contain the same message of levelling rates up rather than down.[178]

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172 Directive 92/84/EEC.

173 Wine, beer, spirits and intermediate products.

174 COM(87)328.

175 COM(89)527.

176 Commission report and draft directive on the Structure and rates of excise duty applied on cigarettes and other manufactured tobacco products (COM (2001)133 parts 1 and 2).

177 Discussed above under "Raising taxes".

178 Trailed by the Commission in *Tax Policy in the European Union – Priorities for the years ahead*, Commission Communication COM(2001) 260 at p15

CHAPTER FIVE
DIRECT TAXATION

INCOME TAX

Even the jealously-guarded area of direct taxation has not been immune from EU involvement. The German government, for example, has advocated co-ordination (although not harmonisation) of direct taxes.[179] As noted above, Belgian Prime Minister, Guy Verhofstadt, has called for the introduction of a direct EU tax on all citizens, with recent backing from Commission President, Romano Prodi.[180] The favoured structure for such a tax is a top up income tax on savings, which could add £235 to the income tax bills of the £17 million who hold savings in the UK.[181]

Belgian Prime Minister, Guy Verhofstadt, has called for the introduction of a direct EU tax on all citizens.

On personal income tax, the European Commission has recently signalled the need to "coordinate national tax systems".[182]

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179 Evidence to the House of Lords Select Committee, 15th Report of 1998/9 session: *Taxes in the EU: Can Coordination and Competition Coexist?* (HMSO, July 1999).

180 See above, Chapter 2, "The Will to Harmonise".

181 "Brussels plans new savings tax to pay for EU", *Independent*, 16th March 2001.

182 *Tax Policy in the European Union – Priorities for the years ahead*, Commission Communication COM(2001) 260 at p9.

There is no explicit provision in the EC Treaty for the harmonisation of direct taxes. This absence was recently deplored by Christa Randzio Plath MEP, chairman of the European Parliament's Economic and Monetary Affairs Committee, which has responsibility for tax matters.[183] The French government was unsuccessful in its attempt to insert a reference to direct taxation into the Nice Treaty. As a consequence, EU action on direct taxes is pursued by stealth, through other Treaty provisions. As the European Parliament's Directorate General for Research has admitted, 'action in this field has necessarily been based on more general objectives'.[184]

Income tax provides a very clear example of the stealth agenda in operation. The Commission's desire for further co-ordination of taxes is supposedly confined to instances involving cross border situations or trade. Other aspects of income tax, it is glibly declared, should be left to Member States.[185] However, the gradual extension of EU competence on income tax matters, via attention to cross border situations, provides the next increment in the progress of tax harmonisation – yet another building block for the creation of a EU tax system. Each measure helps provide a foundation on which the Commission will not hesitate to build.

The harmonisation agenda is being pursued by focussing on the irregularities arising from disparate income tax *systems* which impact on cross-border workers, leaving the actual rates for another day. This tactic has a long pedigree.[186] In 1980, the Commission proposed a draft 'Directive on the Harmonisation of Income Tax Provisions with Respect to Freedom on Movement'.[187] This would have applied a general principle whereby individuals would be taxed in their country of residence. The draft was rejected by the Member States and the Commission issued a recommendation with more limited guidelines on the income tax treatment of non-residents.[188] In 1993, the European Court of Justice ruled that a Member State could not give less favourable tax terms to the non-resident

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183 Presentation to the Economic and Monetary Affairs Committee, June 2000.

184 European Parliament Directorate General for Research: 'Tax Competition in the European Union', *Economic Affairs,* Series ECON – 105 EN rev, 10-2000. Treaty provisions which have been used in the direct tax field were then listed, including Article 39 on the free movement of workers, Article 43 on freedom of establishment, Article 56 on free movement of capital, Article 94 on the functioning of the common market, Article 96 on preventing distortions of competition, Article 293 on bilateral negotiations for abolition of double taxation and Article 294 on participation in the capital of companies.

185 *Tax Policy in the European Union – Priorities for the years ahead,* Commission Communication COM(2001) 260 at p9.

186 In a 1967 package of proposals on tax: see European Parliament Directorate General for Research: 'Tax Competition in the European Union', *Economic Affair,s* Series ECON – 105 EN rev, 11-2000, PE 167.812 at page 38. See also the Neumark Committee Report of 1963.

187 COM(79)737 (under Article 94 of the Treaty).

188 Under Article 211 of the Treaty.

nationals of another Member State than to their own nationals.[189] In January 1999, the European Parliament passed a resolution on the tax treatment of cross border workers.[190]

The personal tax harmonisation lobby is gaining in confidence.[191] As usual, the agenda is bolstered by the nebulous assertion that taxes affecting competition within the single market should be subject to Brussels' approval.[192] Last year Fritz Bolkestein claimed the right to intervene where tax measures entail 'discrimination, double taxation or unintended non-taxation in cross-border situations.'[193] The threat of harmonised income tax is not as immediate as for many other taxes but it is one which is genuine and which should not be ignored. Most tellingly of all, the expected attempt to expand the remit of the Code of Conduct has materialised with a Commission demand that the remit of the Primarolo Group be extended to cover personal income tax. If adopted, this will constitute a major step towards harmonisation of personal income tax.[194]

Most tellingly of all, the Commission has asked for the remit of the Primarolo Group to be extended to cover personal income tax.

THE WITHHOLDING TAX

Single-market arguments have also been deployed to involve the EU in another important area of personal income tax, the taxation of bank and other interest paid to non-residents. Because of the increasing mobility of savings (an effect intensified within the Euro-zone with the elimination of exchange rate risk), high-tax Member States started to worry about losing revenue to more competitively taxed jurisdictions.

In 1989, the Commission proposed a draft directive on a common system of withholding tax on interest income paid to non-resident savers.[195] This was shelved after Mrs Thatcher made it plain that she would veto the proposal. The issue resurfaced 10 years later, with the election of a more euro-enthusiastic Labour government. The German government were concerned at the number of

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189 Case C-279/93. See also Case C-112/91 where the ECJ held that a Member State could not tax its own nationals more heavily, merely on the grounds that they lived in another Member State.

190 The Oomen-Ruijten Report on the situation of frontier workers (PE 286.201).

191 Fourcans Report on the coordination of fiscal and monetary policy (European Parliament resolution A4-0192/97), paragraph 3 of the Explanatory Statement.

192 In his paper *Is tax competition harmful?*, November 1998, published by the European Policy Forum, Keith Marsden adverted to the real danger posed by attempts to harmonise income tax.

193 EU Tax Commissioner, Frits Bolkestein's speech in Barcelona on 9th October 2000.

194 *Tax Policy in the European Union – Priorities for the years ahead* Commission Communication COM(2001) 260 at p18.

195 COM(89)60.

German citizens who banked their money in Luxembourg and illegally failed to declare the interest received. The Commission presented similar proposals to those of 1999, designed 'to ensure a minimum of effective taxation of savings income in the form of interest payments in the Community'.[196] A 'co-existance model' was put forward, whereby Member States were to have a choice between a 20% withholding tax on the savings of non-residents or providing the tax authorities of the saver's state of residence with information about the interest paid.

In what was described as 'an important step towards tax alignment in Europe', Tony Blair, Gordon Brown and other European leaders agreed that EU legislation should be introduced to deal with savings income.

The proposal raised severe technical and practical problems, the greatest of which being that there could be no guarantee that the amount of tax deducted would correspond to the amount due.[197] Moreover, under the coexistence model, those Member States which imposed the tax would obtain a windfall, since they would receive tax on the savings of non-residents, and receive information from other Member States on interest paid to their own residents.

Most importantly, the proposal would have devastated the $3.5 trillion dollar London eurobond market, resulting in huge capital outflows from the EU to

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196 COM(1998)295. Throughout the debates on the withholding tax and the various proposals put forward, a majority in the European Parliament has given enthusiastic support for harmonisation in this area of income tax. See for example Fourcans report on the broad economic guidelines of the economic policies of the Member States and the Community (COM(99)0143-C4-0208/99) (European Parliament resolution A4- 0222/99, 1999); Fourcans report on the coordination of fiscal and taxation policy (European Parliament resolution A4-0192/97, 1997); Secchi report on the communication from the Commission on *A package to tackle harmful tax competition* (European Parliament resolution A4- 0228/98, 1998); European Parliament resolution on the preparation of the meeting of the European Council in Helsinki (B5-0308, 0309 and 0312/1999) at paragraph 16 (Conservatives voted against); Katiforis report on the Commissions' recommendation for the Broad Guidelines of the Economic Policies of the Member States and the Community (European Parliament resolution A5-0134/2000) at paragraph 17 (Conservatives voted against).

197 Other problems include the definition of interest and the difficulty of identifying whether a particular fund was covered by the rules at any particular time. See evidence by the British Bankers' Association to the House of Lords Select Committee, 15th Report of 1998/9 session*: Taxes in the EU: Can Coordination and Competition coexist?,* (HMSO, July 1999).

financial centres such as Zurich.[198] Nor would the proposal deal with the illegal tax evasion about which the German government was concerned: those wishing to evade tax could easily switch their accounts from Luxembourg to Switzerland.

In what was described as 'an important step towards tax alignment in Europe'[199], Tony Blair, Gordon Brown and other European leaders agreed[200] that EU legislation should be introduced to deal with savings income, with the following provisions:

- the new measures should be based on the principle of exchange of information;
- for a transitional period, Austria and Luxembourg (both of which have strict banking secrecy laws) would introduce a withholding tax on interest paid to non-residents. The rate of tax would be 15% for the first three years and thereafter 20%. 75% of the revenue generated would be transferred to the saver's state of residence;
- the introduction of the legislation would be conditional on agreement being reached with key third countries (including Switzerland and the US[201]) to introduce 'equivalent measures' on provision of information;
- a decision (with unanimity) would be taken by the end of 2002 on implementation of the agreement within the EU.

In theory, the withholding tax proposal has been replaced by an agreement to move to exchange of information between countries. In reality, the scheme adopted has much in common with the coexistence model originally proposed by the Commission: for an indefinite period,[202] countries will retain the option of imposing a tax instead of providing information. Hence a number of the practical difficulties with the proposal remain. The scheme agreed by Member States also leaves a worrying number of questions unanswered:

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198 Ironically, this industry developed in London precisely because the US introduced a withholding tax.

199 By French finance minister, Laurent Fabius (*Agence Europe*, Brussels, 27th November 2000). These comments were echoed by German finance Minister, Hans Eichel (*Dow Jones International News*, 27th January 2000).

200 Initial agreement was reached at the Feira summit on 20th June 2000 with further details being finalised by EU finance ministers at the Ecofin Council meeting on 26th/27th November 2000.

201 Other jurisdictions to be approached include Monaco, Andorra, San Merino and the various dependent territories of the Member States such as Jersey and the Channel Islands.

202 In theory, this transitional period must come to an end 7 years after the tax is introduced. In reality, the Luxembourg and Austrian finance ministers have expressed doubt as to whether it will ever be possible to obtain equivalent measures from other jurisdictions, sufficient to persuade their respective governments to dismantle 50 years worth of banking secrecy laws (*Dow Jones International News,* 27th November 2000)

- there is no clear indication of what information the banks and financial services firms will be required to provide. If the information requirements are as heavy as some Treasury sources have suggested, they could devastate London's eurobond markets just has comprehensively as a withholding tax;
- there is no clear definition of what equivalent measures with third countries will suffice to enable the EU scheme to go ahead;
- press reports of the announcement of the agreement on the package record French Finance Minister, Laurent Fabius, asserting that the EU proposals could go ahead even if equivalent measures are not agreed with other countries: even if 'legally' a vote was required in 2002, 'from the moment we have entered a dynamic, it will be very difficult to turn back'. Implementation of the EU framework without the adoption of similar measures by other jurisdictions would mean that the eurobond market would be exported to Switzerland or the US resulting in major job losses.

For the first time Member States have agreed to revenue sharing – treating tax revenues as a single pot to be divided according to EU determined rules.

Probably one of the most significant aspects of the agreement was one which received little attention. For the first time Member States have agreed to revenue sharing – treating tax revenues as a single pot to be divided according to EU determined rules. Revenue sharing has always been strongly resisted by Member States: as we have seen, it was this objection which caused the proposals for full harmonisation of VAT to founder.[203] Although the agreement covers only certain tax revenues, Mr Brown has conceded an important constitutional principle which could un-block a number of harmonisation proposals.

CORPORATION TAX

The political pressure for tax harmonisation is probably stronger in relation to corporation tax than any other. Pronouncements in this area have not been confined to measures relating to tax systems but include clear demands for harmonisation of rates. Danish Prime Minister Poul Nyrop Rasmussen recently demanded the imposition of a minimum rate of corporation tax across the EU – anything else was, in his view, unfair tax competition.[204] French Prime Minister, Lionel Jospin, has stated that:

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203 Member States are, indeed, currently discussing extending revenue sharing to proceeds of VAT on digital services. The UK government is rumoured to be on the point of conceding the point on revenue sharing in this area as well.

204 Speaking at the World Economic Forum on Davos in January 2001: 'EU divided on its stance towards McCreevy', *Irish Times*, 29th January 2001. He also criticised the Irish government for its approach on tax.

Ultimately, the corporate tax system as a whole will have to be harmonised.[205]

The level of corporation tax is one of the most visible factors that an entrepreneur might take into account in deciding where in the European Union to do business. Hence corporation tax has come under the microscope of those who wish to harmonise those taxes which supposedly "distort" competition or significantly affect the location of business within the EU.[206]According to Frits Bolkestein, there is a treaty basis (he was presumably referring to Articles 94 or 96) for 'approximating' company taxes where they directly affect the establishment and functioning of the single market.[207] Use of either article circumvents the veto since both are subject to qualified majority voting.

According to Frits Bolkestein, there is a treaty basis for 'approximating' company taxes where they directly affect the establishment and functioning of the single market.

Corporation tax has been at the heart[208] of the work of the Primarolo Group on the Code of Conduct on Business Taxation. Aided by a more aggressive use of state aid rules, the Code of Conduct is creating a significant political impetus towards harmonisation of taxes, on the grounds of supposedly 'unfair' competition.[209]

The EU's attitude to corporation tax is most apparent in relation to Ireland. In 1980, the Irish government introduced a 10% rate of corporation tax for various sectors, including companies trading in international financial services from the Financial Services Centre in Dublin's Custom House docks area.[210] Both the Primarolo Group and the European Commission viewed the tax rate as a state subsidy to industry and requested that the Irish government scrap it. Smartly outmanoeuvring the Commission, the Irish response was to reduce company tax

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205 "Jospin fuels Europe row with Labour" *The Times*, 23rd May 2001.

206 Discussed above.

207 Speech in Barcelona on 9th October 2000. The contrary view was expressed by Malcolm Gammie (chairman of the Tax Task Force of the Centre for European Policy Studies and research fellow at the Institute for Fiscal Studies) in his evidence to the House of Lords Select Committee, 15th Report of 1998/9 session, *Taxes in the EU: Can Coordination and Competition Coexist?*, (HMSO, July 1999). European legislation on the taxation of companies has usually been based on Article 94 of the EU Treaty which authorises 'directives for the approximation of such laws, regulations or administrative provisions of Member States as directly affect the establishment and functioning of the common market'

208 Discussed above under "The Code of Conduct and the Primarolo Group"

209 Discussed above under "Tax and the Single Market" and "Tax breaks as state aid".

210 The 10% rate was also introduced for companies trading from a designated area around Shannon airport.

across the board. They gave an undertaking to end the preferential treatment for the docks (and other areas) and to introduce a 12.5% rate for *all* companies, whether trading locally or internationally.[211]

Irish corporation tax is viewed with great hostility by many EU Member States.[212] For example, when addressing the World Economic Forum in Davos in January 2001, Danish Prime Minister Poul Nyrop Rasmussen attacked the Irish corporation tax regime and demanded EU rules to ensure a minimum level of corporation tax at a level above Ireland 12.5%. Irish Finance Minister Charlie McCreevy recently said:

> We have no friends in Brussels regarding our corporation tax regime, or in any European capital.[213]

The resentment of many EU Member States was plainly exposed during the late-night negotiations at the Nice summit, where French attempts to insert a direct reference to corporation tax into the new treaty apparently met with an apoplectic reception from the Irish delegation. The Irish knew exactly at whom the provision was directed. This resentment has also provided the subtext for the EU criticism of Dublin's 2001 budget.[214]

One can see why the Irish have so annoyed the EU. The attempt to harmonise corporation tax has being going on for 30 years.[215] In the 1970s and 1980s the

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211 The general 12.5% rate has already been introduced for small companies and is due to come into general effect from 2003, with transitional measures for companies already enjoying the reduced rates. The last elements of the preferential regime are expected to be completely dismantled by 2011.

212 See'Nobel economist defends McCreevy's strategy', *Irish Times*, 27th January 2001 and 'EU divided on its stance towards McCreevy', *Irish Times*, 29th January 2001 and 'EU divided on its stance towards McCreevy', *Irish Times*, 29th January 2001.

213 *Sunday Telegraph* 28th January 2001: 'Ireland fights the UK's battle'.

214 'Cabinet broke EU spend limits', *Irish Independent*, 29th January 2001.

215 Examples include:

- the Neumark Report of 1962,
- the van den Temple Report of 1970
- Commission paper 'Taxation in the European Union' of 20th March 1996 (SEC(96)487.
- Fourcans report on the coordination of fiscal and taxation policy (European Parliament resolution A4-0192/97, 1997); see particularly, paragraph 12.
- Secchi report on the communication from the Commission on *A package to tackle harmful tax competition,* (European Parliament resolution A4- 0228/98, 1998); see particularly paragraphs 5-7.
- Evidence to the June 2000 public hearing of European Parliament Economic and Monetary Affairs Committee of:
- Krister Andersson, Member of Board of Directors of the Swedish National Tax Authority and Director of the Stockholm Institute of

Commission made various legislative proposals, none of which were accepted by the Member States.[216] Presumably in the light of this, recent years have seen a change of tactic. Since 1990, the Commission turned from a general to an incremental approach,[217] designed to 'establish a more uniform and transparent tax treatment of corporate income, which would pave the way to a harmonisation effort along the lines of [earlier proposals].'[218] In the pattern which has emerged consistently in so may tax areas, more stealthy mechanisms (such as the Primarolo Group and the Code of Conduct) are now being employed to gradually expand the EU's competence in yet another tax area.

This process of incremental harmonisation was given a boost in 1992 with the publication of the highly influential Ruding Report,[219] which asserted that differing levels of corporation tax have the potential to 'distort competition' within the EU. The Report recommended a programme of action to:

- eliminate double taxation;
- ensure the full transparency of tax breaks given by Member States to promote investment;
- harmonise corporation tax within 30-40% band.

The Commission welcomed many aspects of the report (although it differed on the issue of corporation tax rates).[220] A number of proposals concerning individual aspects of company taxation have been subsequently adopted as EU legislation:

- the 'mergers' Directive[221] covering the treatment of capital gains when companies merge;
- the 'parent companies and subsidiaries' Directive[222] on the taxation for dividends paid by subsidiaries to parent companies;

Economic Research. Ms Andersson predicted that a single pan European corporation tax would eventually be introduced.

- Professor Ruding: 'there is a clear need, in certain well defined areas for harmonisation of company taxation, that is with legally binding and enforceable measures.'

216 For example in 1970, the Commission published a draft directive which would have aligned rates at between 45 and 55%. See also *Report on the scope for Convergence of Tax Systems* COM(80)139.

217 See Commission communication: *Guidelines for Company Taxation*, 1990, (SEC(90)601).

218 European Parliament Directorate General for Research: 'Tax Competition in the European Union', *Economic Affairs,* Series ECON – 105 EN rev, 11-2000, PE 167.812 p20.

219 *Report of the Committee of Independent Experts on Company Taxation*, March 1992.

220 See SEC(92)1118.

221 90/434/EEC.

222 90/435/EEC.

- the ‘arbitration procedure’ Convention[223] which introduced procedures for settling disputes over profits of associated companies in different Member States.

Further Commission proposals now pending before the Council include:

- amendments to broaden the scope of the ‘mergers’ and ‘parent/subsidiaries’ Directives;[224]
- draft directive on the carry-over of losses;[225]
- draft directive on the losses of subsidiaries situated in other Member States;[226]
- proposals for a common system of taxation for interest and royalty payments made between parents and subsidiaries in different Member States.[227]

Other aspects of the corporation tax debate cause significant concern. There are ongoing plans to introduce a unified European Corporate Income Tax (EUCIT).[228] In the same vein, after more than 40 years of wrangling, Member States recently agreed on a directive to give businesses the option of setting up as a Societas Europeae (European company). Such companies are to be governed solely by an EU company law framework, rather than being incorporated in a single Member State.[229] The issue of how and where such a company should be taxed has been extensively debated. The text agreed does not address the issue of taxation but many in Brussels have demanded that a new system of EU corporation tax be devised to cover the Societas Europeae.[230] Thus companies would be able to opt into a European corporate tax regime, as well as a pan-European company law regime.

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223 90/436/EEC.

224 COM(93)0293.

225 COM(84)404.

226 COM(90)595.

227 COM(90)571 (now part of the Monti package, as to which, see below). For further Commission proposals, see *Communication on the Improvement of the Fiscal Environment of Small and Medium Sized Enterprises*, (COM(94)206) and *Concerning the taxation of small and medium sized enterprises*, (94/390/EEC).

228 European Corporate Income Tax. See the evidence to the June 2000 public hearing of European Parliament Economic and Monetary Affairs Committee of Krister Andersson, Member of Board of Directors of the Swedish National Tax Authority and Director of the Stockholm Institute of Economic Research.

229 Council of Ministers, 20th December 2000.

230 See, for example, the debate on the European Company Statute in the European Parliament on 22nd January 1991 (debates No 3-398/48). More recently, see the evidence of Professor Ruding to the June 2000 public hearing of European Parliament Economic and Monetary Affairs Committee and the Gasoliba draft European Parliament report on the European Company Statute, amendment 22 (10th May 2001, PE 296.014).

The loss of national autonomy over corporation tax was threatened by a case in the European Court of Justice, Metallgesellschaft Ltd v UK.[231] Under a bilateral tax treaty between the UK and the Netherlands, Dutch companies are entitled to a benefit in relation to advanced corporation tax. There is no equivalent treaty with Germany. A German company argued that it had been discriminated against by the UK government[232] because the Dutch company was receiving more favourable treatment. The European Commission expressed support for this argument,[233] which would have a devastating impact on the network of bilateral double taxation treaties which exist between Member States. In its final judgment, the European Court of Justice left the issue open. It was not required to adjudicate on the point since other grounds determined the issue in favour of the German company.[234] On the same subject, Christa Randzio Plath MEP, the Chairman of the European Parliament's Economic and Monetary Affairs Committee, has argued that individual tax treaties should be replaced by one single EU-wide treaty.[235]

The Chairman of the European Parliament's Economic and Monetary Affairs Committee has argued that individual tax treaties should be replaced by one single EU-wide treaty.

A Commission working group with a wide-ranging remit to look into all aspects of corporation tax – including the effect of differing rates of corporation tax – was expected to report back in May.[236] Some months in advance, it was scheduled for discussion by EU finance ministers in early May. However, at two days notice, it was mysteriously withdrawn from the agenda, without explanation. This led to accusations that the British government were attempting to sanitise the EU agenda in the run up to a general election, by postponing decisions on unpopular tax harmonisation measures until after the poll.

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231 Joined cases C-397/98 and C-410/98, with an opinion of Advocate General Fenelly dated 12 September 2000.

232 Under Articles 43 and 48 on freedom of establishment.

233 This support was expressed in court by the Commission's legal representatives. It was repeated with enthusiasm by high ranking Commission civil servant, Paul Farmer, at a conference of Confederation Fiscale Europeene in Brussels on 27th March 2000.

234 Dated 8th march 2001: see http://europa.eu.int/jurisp/cgi-bin/form.pl?lang= en&Submit=Submit&docrequire=alldocs&numaff=c-397%2F98&datefs =&datefe=&nomusuel =&domaine=&mots =&resmax=100.

235 *Draft report to the Committee on Economic and Monetary Affairs on Progress in Tax Coordination in the European Union,* (2000/2040(INI), paragraphs 17-19.

236 Their report will be presented to EU finance ministers at the Ecofin Council meeting on 7th May 2001. See Annex II for further information on EU Tax Working Groups.

CHAPTER SIX
THE EURO

POLITICAL AND ECONOMIC UNION

If harmonisation is currently being driven forward by stealth, peer pressure and 'moral suasion', the great project of political unification, openly avowed by European politicians, would deliver the goal in one fell swoop. The creation of a federal European State would inevitably lead to tax harmonisation. It is certainly possible to have a federal system where component Member States have a wide degree of individual discretion on tax: the United States is the obvious example of where a single state can embrace multiple tax systems and rates. For European federalists, however, tax harmonisation is a key component of political unification.

This wide ranging topic lies beyond the scope of this paper[237] but it is increasingly clear that the federalist agenda is alive and well in Europe, as illustrated by the recent statement of Commission President, Romano Prodi:

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237 Further reading on this subject includes *The Tainted Source*, John Laughland, Little, Brown (1997); '*Europe; Démocratie ou super-Etat*', published Francois-Xavier de Guibert; *The Rotten Heart of Europe*, Bernard Connolly, Faber & Faber; *Separate Ways*, Peter (Lord) Shore, Duckworth; *Britain Held Hostage*, Lindsay Jenkins, Orange State Press; *The Abolition of Britain*, Peter Hitchens, Quartet Books; *Like the Roman* (Biography of Enoch Powell), Simon Heffer, Weidenfield & Nicolson; *While Britain Slept*, Douglas Evans, Victor Gollancz; *Straight Talking on Europe*, Roger Helmer MEP, privately published; Callanan, Martin. 'Can the EU be Flexible Enough?' *The European Journal*, Vol.

> The single market was the theme of the Eighties. The single currency was the theme of the Nineties. We must now face the difficult task of moving towards a single economy, a single political unity.[238]

In a similar vein, German Foreign Minister, Joschka Fischer, recently called for a debate on whether the EU should have a directly elected President with far–reaching executive powers. He also demanded:

> ...the transition from a union of states to full parliamentarization as a European federation... And that means nothing less than a European Parliament and a European government which really do exercise legislative and executive power within the Federation.[239]

German Chancellor Gerhardt Schroeder has brought forward similar plans for the creation of a federal Europe with the Commission becoming a European government, with the Council of Ministers becoming a second Chamber in a bicameral European Parliament.[240] French Prime Minister, Lionel Jospin does not go quite as far but has advocated the creation of an "economic government" for the EU.[241]

THE EFFECT OF THE EURO

If political unification is the ultimate goal of many European leaders there already exists a powerful driving force for its attainment. History discloses no examples of a lasting monetary union which was not also accompanied by political union. European leaders have openly expressed the view that monetary integration is a milestone on the road to a political union, with a harmonised tax system. Commission President, Romano Prodi, has commented that:

> Economic and monetary union and political union are two sides of the same coin.[242]

7, No. 4, Jan./Feb. 2000; Heath, Allister. 'No, No, No: Thatcher's Grandchildren Reject the Superstate.' *The European Journal*, Vol. 8, No. 1, October 2000; Slysz, Dr. Gregory. 'Even Closer Union and the Search for a European Identity.' *The European Journal*, Vol. 8, No. 1, October 2000; Bruges Group publications, www.eurocritic.demon.co.uk; Conservatives Against a Federal Europe, www.cafe.org.uk; European Foundation, www.europeanfoundation.org.

238 April 1999, quoted in the *Daily Telegraph*, 14th April 1999. See also the Annex 'What They've Said' setting out some of the many demands for tax harmonisation by leading European politicians.

239 'From confederation to federation – reflections on the purpose of political integration', speech at Humbolt University, 12th May 2000. See also the recent comments of Belgian Prime Minister, Guy Verhofstadt: "some countries want an intergovernmental Europe; others, like us, want a federal Europe. We have to choose, once and for all", reported in *The Times*, 13th January 2000.

240 "The real rift in Europe is not the Channel," *The Times,* 29th May 2001.

241 "Jospin fuels Europe row with Labour", *The Times*, 23rd May 2001.

242 20th June 1995.

German Chancellor Schroeder declared, at the launch of the euro, that

> ...the era of solo national fiscal and economic policy is over.[243]

The link between monetary union and political union is not just ideological however; there are important practical reasons why adopting the euro is likely to accelerate political integration. The political pressure to limit the freedom of Member States to make their own tax and spending decisions stems not just from a general desire to further European integration. When you share a joint bank account with your neighbours, you are affected by their spending decisions and many would see it as reasonable to ask for some say over those decisions. One of the many all time lows, to which the euro has slumped since its launch, was blamed by the German finance minister, Hans Eichel, on the UK's reluctance to agree to the withholding tax.[244]

"The era of solo national fiscal and economic policy is over" – Gerhard Schroeder.

It seems clear that the markets have been nervous of a currency without a country – a monetary authority which is not backed by political institutions. The response of the French EU Presidency to these concerns and to the euro's exchange rate difficulties was an attempt to bolster the euro-zone's political institutions. The French government raised the profile and powers of the "Eurogroup", the committee of Euroland finance ministers. Originally set up as a purely informal gathering, meeting on the eve of the Council of EU finance ministers, some now see the Eurogroup as an embryonic economic government for Euroland. The French government stated that achieving the EU's economic objectives:

> ...implies a stronger role and greater political visibility for [the Eurogroup] as an operational instrument for the coordination of economic policies, enrichment of the contents of the broad economic policy guidelines... and progress towards tax harmonisation and unification of the financial markets.[245]

Eurogroup President, Belgian Finance Minister, Didier Reynders, equated the group's role in Euroland to that of the Treasury in the US.[246]

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243 *Guardian*, 1st January 1999.

244 *Daily Telegraph,* 30 November 1999, "EU threatens 'heavy price' if Brown uses veto on tax". Mr Eichel also stated: "It would be harmful for the internal market and harmful for the common currency if we cannot agree on tax". (Quoted in *The Times*, 30th November 1999).

245 Priorities of the French Presidency, 10th July 2000, www.presidence-europe.fr.

246 See above under "EU taxes from and EU Treasury". Further reading on the euro and political integration includes William Hague, "Britain and the Single Currency", speech to the Confederation of British Industry, 10 November 1997 (www.keepthepound.org.uk); Bell, Lord. "Saving the Pound and Winning the Election." *The European Journal*, Vol 8, No. 1, October 2000 ; Burkitt, Dr. Brian. "The Mirage of

Outflanking unanimity, Euroland countries could drive forward with tax harmonisation amongst themselves as a group, using enhanced cooperation (as discussed above).[247] Their finance ministers could reach agreement on issues before they are fully discussed in the EU Council. Proposals could then be presented to Ecofin as a *fait accompli*. Pressure would then be piled on to persuade the 'out' countries to go along with the proposals agreed.

Monetary and fiscal policies are inextricably linked. The loss of monetary powers has massive implications for governments seeking to influence their economies. In particular, the power to set tax rates is constrained by the loss of monetary sovereignty. Without the ability to manipulate interest or exchange rates, taxes are one of the few major tools available to Member States to inflate or deflate their economies. For example, in the Republic of Ireland, centrally set euro interest rates have led to inflation rate highs of as much as 6.2% (the highest for 15 years). The Irish government is unable to stem the inflationary boom by raising interest rates. The only means they have at their disposal to cool their overheated economy would be to raise taxes.[248]

Euro membership could require significant spending cuts.[249] Euro-zone members are subjected to the Stability and Growth Pact; a fiscal straitjacket which limits the circumstances in which they can cut taxes. This pact is backed by legal sanctions. Euro-zone members with budget deficits above 3% are required to

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Euroland Convergence." *The European Union*, Vol. 7, No. 7, May/June 2000; Knight, Angela. "City Thoughts on the New Millennium." *The European Journal*, Vol. 7, No. 4, Jan./Feb. 2000; Lea, Ruth. "Why We're All Right Jacques." *The European Journal*, Vol. 8, No. 1, October 2000; Bordo, Michael and Lars Jonung. *Lessons for EMU from the History of Monetary Unions*. IEA, 2000; Issing, Otmar. *Hayek, Currency Competition and European Monetary Union,* IEA, 2000; Lilico, Andrew. "Rehearsing the Euro Myth." *The European Journal*, Vol. 7, No. 9, Summer 2000 ; Keep the Pound Campaign, www.keepthepound.org.uk/; Business for Sterling www.bfors.com.

247 See "Enhanced Cooperation" above and also the speech of EU Tax Commissioner, Frits Bolkestein, "Taxation and competition: the realisation of the internal market", Hoevelaken, 17th March 2000. The Commissioner was anxious to make clear that enhanced cooperation would not be permitted in tax where it would give non-participating countries would obtain a clear economic advantage.

248 This is a strong argument for opposing euro-zone tax harmonisation since tax and fiscal measures are two of the few economic safety valves left to Eurozone governments and which can be used to meet the specific needs of their individual national economies, ravaged by a one-size-fits-all interest rate policy: see the evidence of Graham Mather (former MEP and President to the European Policy Forum) to the House of Lords Select Committee, 15th Report of 1998/9 session, *Taxes in the EU: Can Coordination and Competition Coexist?* (HMSO, July 1999).

249 See "How the euro could put a stop to spending", *The Times*, February 2001.

provide non-interest bearing deposits which are forfeited if the deficit is not reduced.[250] The rules are designed to ensure that Member States' budgets are roughly in balance over the economic cycle. This impacts on tax as Member States' freedom to fund higher public spending by borrowing has been curtailed. Such spending must be financed out of higher taxes if it takes the budget outside the confines of the Stability Pact rules.

Member States have also signed up to "Broad Economic Policy Guidelines". The European Commission and EU finance ministers recently criticised the UK for its tax and spending plans.[251] They also formally censured the Irish government over its tax cutting budget of December 2000, under Article 99(4) of the Treaty.[252] They requested that Ireland alter its tax and spending policy, which they deemed to be inconsistent with the Broad Economic Policy Guidelines. The Commission President stated that:

> Sometimes the teacher has to punish the best pupil.

Economic Commissioner, Pedro Solbes, stated that the potential spill over effects that economic policies in one country can have for the euro-zone as a whole, meant that it was essential to increase policy coordination between the Member States. He recommended that joint action be stepped up on a wide range of economic issues, including budgets and problems flowing from an aging population, stating:

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250 All Member States have signed up to this pact but the legal sanctions are confined to euro-zone countries. The Pact is contained in (a) Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (Official Journal L 209, 02.08.1997); (b) Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure (Official Journal L 209, 2.8.1997); (c) Resolution of the European Council on the Stability and Growth Pact, Amsterdam, 17 June 1997 (Official Journal C 236, 2.8.1997).

251 "Comission provides a preview of life under the euro" *Guardian* 13th February 2001 and "Brown says euro rules will damage Britain", *The Times* 12th February 2001.

252 Ecofin meeting, Brussels, 13th February 2001, reports in the *Daily Mail*, *Financial Times* and *The Times*, 14th February 2001. Treaty of European Union Article 99.4 was inserted by the Maastricht Treaty. The Commission's comments were contained in its press release of 24th January 2001 "Commission puts forward recommendations on budget policy for Ireland" and were reported in the *Financial Times* (24th January - "Commission to seek greater coordination in the Euro-zone" and "Dublin closes ranks around finance minister" – and on 25th January "Brussels censures Irish over budget", ""Brussels to seek greater unity over economic policy" and "Ireland gets a ticking off"). Similar warnings were issued in relation to countries applying to join the EU and the euro ("'Inflation risk' as euro-zone expands", *Financial Times*, 30th January 2001).

> Member States cannot be allowed to pursue whatever tax and spending policies they want after joining the euro.[253]

Sr Solbes' comments are a warning that monetary union can be expected to rob Member States of more than just their power to set interest rates. At present the sanctions available are political rather than legal but forceful nevertheless: when 'le moral suasion' is brought to bear, it can be hard to resist, especially when the editorial of the *Financial Times* weighs in on the side of the Commission, as it did over the rebuke to Ireland.[254]

As we have seen, this is more than just a dispute over appropriate Irish macro-economic policy. The row was fuelled by deeply felt resentment over low levels of Irish corporation tax.[255] The dispute is more fundamental than a difference of view over economic policy. This was aptly put by Kevin Myers in the *Daily Telegraph:*

> The real question is whether by joining Euroland, a country permanently forfeits the power to translate its economic culture into national policy. By trading sovereignty for the euro, the ability of the Irish to create their own economic policy certainly seems to have been compromised. The clash between Dublin and Brussels – we have only heard the opening shots so far- is not just a conflict over inflation between the centre and the wayward westernmost margin. Rather it asks the key questions about the European project, relevant to any EU country which wishes to retain its own taxation regime.[256]

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253 Reported in the *Sunday Telegraph* 28th January 2001 by Christopher Booker.

254 "Ireland gets a ticking off", *Financial Times*, 25th January 2001.

255 Discussed further below under "Irish corporation tax".

256 "Ireland fights the UK's battle", *Daily Telegraph*, 28th January 2001.

CHAPTER SEVEN
CONCLUSION

The Commission's dispute with the Irish Government has confirmed for many the suspicion that the goal of the harmonisation lobby is not so much the achievement of similar taxes across Europe, but the creation of a unitary tax authority in Brussels. Graham Mather, the much-respected former MEP and President of the European Policy Forum, has argued that the Commission's centralised approach to taxation has less to do with anxiety about the single market than with a desire to develop its own competence in the tax area.[257] The project is predominately a political one, in which economic arguments – especially the fallacy of 'harmful' tax competition, and the need to 'embed' the single market – are marshalled purely for the political implications they carry.

Two academics once criticised Margaret Thatcher's 'obstructive attitude' on tax harmonisation.[258] The election of a Labour government saw a step-change: the Commission has noted that a 'new wind has been blowing' on tax.[259] Although at the Nice summit Tony Blair prevented the extension of qualified majority voting in taxation matters, it is clear that this stance was based on a calculation of British public opinion rather than a reflection of his true opinion. The

257 See his evidence to the House of Lords Select Committee, 15th Report of 1998/9 session, *Taxes in the EU: Can Coordination and Competition Coexist?* (HMSO, July 1999), noted at paragraph 59.

258 McDowell and Thom, *Tax Competition and the Internal Market*, University College Dublin Department of Economics', May 1993.

259 Commissioner Frits Bolkestein after final agreement on the tax package at Ecofin in November 2000, quoted in *Agence Europe*, Brussels 27th November 2000 'Fifteen reach agreement on savings'.

Government has explicitly accepted the claims of the EU for a greater role in tax matters:

> We do not think that what is known as harmonisation is necessary to complete the single market, but we think that there may be, particularly on the indirect tax side, some areas where a further approximation stopping short of full harmonisation is necessary… We think there are some aspects of direct tax where collective action would be sensible – in particular tackling harmful tax competition and tax evasion.[260]

The Government here adopts the rhetoric of the harmonisation lobby: apparently committed to national tax-setting powers, it nevertheless employs those innocuous arguments by which the harmonisation agenda is being furthered – indirect taxes, tackling evasion, preventing 'harmful' competition, and so on. Consistent with this, is Gordon Brown's acceptance of the Code of Conduct on Business Taxation. The Commission recently praised British Treasury Minister, Dawn Primarolo for her work on implementing the Code.[261] This, more than anything else, indicates that Labour has accepted the principle that further EU involvement in tax would be desirable. Ominously, it has never defined where the line should be drawn. It is this uncertainty which could give Labour dangerous leeway in signing up to tax harmonising measures.

Between January 1997 and March 2000 63 measures relating to tax were formally adopted by the EU, together with a further 18 'preparatory acts' and 28 communications, reports and other documents.

There is a powerful momentum here. Between January 1997 and March 2000 63 measures relating to tax were formally adopted by the EU, together with a further 18 'preparatory acts' and 28 communications, reports and other documents.[262] The EU already has considerable powers over VAT, fuel taxes, energy and transport taxes. Member States have agreed to the vital principle of revenue-sharing. There are significant harmonisation plans covering personal direct taxation, indirect taxation, corporation tax, alcohol duty, tobacco duty and the whole range of energy and transport taxes. Now, the Belgian Presidency of the EU is demanding the introduction of an EU top-up income tax on savings levied directly on all EU citizens.[263]

The agenda marches on; and, despite Mr Blair's tough rhetoric at Nice, Labour is marching with it. Labour MEPs have given enthusiastic support to new EU taxes

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260 Evidence of Colin Mowl (of HM Treasury) to the House of Lords Select Committee, 15th Report of 1998/9 session: *Taxes in the EU: Can Coordination and Competition Coexist?* (HMSO, July 1999).

261 *Tax Policy in the European Union – Priorities for the years ahead,* Commission Communication COM(2001) 260.

262 *Tax Harmonisation in the Community, Measures Adopted and Proposed,* 01/01/1997 to 01/03/2000' (Document reference TAXUD/2204/2000-EN).

263 *European Voice,* 1st February 2001.

on transport,[264] aircraft fuel,[265] e-commerce[266] and, on occasion, even the withholding tax.[267] Most controversially of all, Labour MEPs recently demanded the full scale harmonisation of VAT.[268] Most important of all, Labour's support for the euro will give a further green light to tax harmonisation, if Mr Blair succeeds in bouncing the UK into joining.

The ultimate logic of the plans documented in this paper is the EU's total competence in tax matters. As we have seen, the process is mostly an incremental one, but none the less ambitious for that. The Treasury currently receives £59 billion in VAT receipts per year, £32 billion in corporation tax and £23 billion in fuel duties.[269] This £114 billion represents 35% of the total UK tax take, and the EU already has extensive powers in these areas. The prospect of 35% of tax revenue being controlled by the EU is a chilling one, particularly in the light of the tax rises which are likely to follow harmonisation.

It is clear how this is to be done. Once EU competence has been established in a particular tax area, the next goal of tax harmonisers is to remove the veto and introduce qualified majority voting[270] between Member States, as illustrated at the

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264 Voting in favour of the Costa Report on Transport Infrastructure Charging(European Parliament resolution 2000/2030(INI)), adopted 18 January 2001. See above 'Transport taxes: infrastructure charging'.

265 Voting in favour of the Garcia-Margallo report on the Commission communication on taxation of aircraft fuel (European Parliament resolution A5-0334/2000). Adopted 14th December 2000. See above under 'Energy taxes'.

266 Voting in favour of the Garcia Margallo report on the proposal for a Council directive amending Directive 77/388/EEC as regards the value added tax arrangements applicable to certain services supplied by electronic means (COM(2000) 349 - C5-0467/2000 - 2000/0148(CNS)) - Committee on Economic and Monetary Affairs VAT arrangements applicable to services provided by electronic means (amendment of Directive 77/388/EEC) (European Parliament resolutions A5-0362/2000). See above under 'Other VAT issues'.

267 European Parliament resolution on the preparation of the meeting of the European Council in Helsinki (B5-0308, 0309 and 0312/1999) at paragraph 16; Katiforis report on the Commissions' recommendation for the Broad Guidelines of the Economic Policies of the Member States and the Community (European Parliament resolution A5-0134/2000) at paragraph 17.

268 Voting in favour of Torres Marques report on the proposal for a Council directive amending Directive 77/388/CEE on the common system of value added tax, with regard to the length of time during which the minimum standard rate is to apply (European Parliament resolution A5-0366/2000). Adopted 14th December 2000. See above under 'Zero rates'.

269 Red Book, 2001.

270 Christa Randzio Plath MEP, Chair of European Parliament Committee on Economic and Monetary Affairs: Draft report to the Committee on

Nice Summit.[271] The most extreme scenario would involve inserting a provision into the EU treaties removing the competence of Member States and granting legal power to the European Union (acting through its three ruling institutions, the Council of Ministers, the European Parliament and the Commission) to levy and collect taxes as well as to determine tax systems and rates. The European Commission, or the Eurogroup of euro-zone finance ministers, would then act effectively as a central EU Treasury, running a unified fiscal, budgetary and tax policy for the whole of the EU or the euro-zone.

The response to such fears has often been that these measures cannot be introduced without the consent of all Member States. Leaving aside the attempts to by-pass the veto set out above, one must ask whether Labour is firm enough to use that veto. Given Labour's actions on tax in its four years of office, it looks as if British taxpayers may eventually pay a heavy price for Tony Blair's euro-enthusiasm.

Economic and Monetary Affairs on Progress in Tax Coordination in the European Union (2000/2040(INI)), paragraph 3.

271 Many MEPs have also consistently demanded the introduction of co-decision in tax matters. In matters where the co-decision procedure applies, the European Parliament has the power to amend, or in the last resort, veto, EU legislation.

ANNEX I WHAT THEY'VE SAID

"The debate is whether, with increasing cross-border activity, tax obstacles can continue to be tackled by piecemeal approaches that leave national company tax systems intact... a more ambitious approach might be a more comprehensive solution such as a common set of rules for company taxation".

Communication from the Commission, (COM 2001) 260, 23 May 2001

"As far as taxes on personal income are concerned, the view is that such taxes may be left to Member States.... Nevertheless... even in this area it may be necessary to co-ordinate national tax systems in order to prevent discrimination in cross-border situations or to remove obstacles to the exercise of the four freedoms"

Communication from the Commission, (COM 2001) 260, 23 May 2001

"While it remains the Commission's view that a move to qualified majority voting at least for certain tax issues is indispensable, the legal basis will, for the present, remain unanimity. Given the difficulties in reaching unanimous decisions on legislative proposals, which will be compounded by enlargement, the Community should now consider the use of alternative instruments as a basis for initiatives in the tax field."

Communication from the Commission, (COM 2001) 260, 23 May 2001

"To balance the structure of the Union, we now need economic government of the euro zone. Co-ordination of economic policies must be considerably enhanced.... We must finally take action to stop any behaviour detrimental to the general European interest. Combating 'tax dumping' is one immediate priority; it is not acceptable for certain Member States to practice unfair tax competition in order to attract international investment and offshore headquarters of European groups. Ultimately, the corporate tax system as a whole will have to be harmonised."

Lionel Jospin, Speech, 28 May 2001

"In the run-up to enlargement, the introduction of a European tax (to be defined) in place of the current system of national contributions that generate endless conflicts between Member States has often been put forward and could well be a sound solution."

Romano Prodi, Speech, 29 May 2001

"It would be harmful for the internal market and harmful for the common currency if we cannot agree on tax."

Hans Eichel, German Finance Minister, quoted in *The Times,* 30th November 1999

"One way or another, the tax systems in the this European space (which is more and more integrated) must move closer to each other."

Statement by the French government, noted by the House of Lords Select Committee, 15th Report of 1998/9 session, *Taxes in the EU: Can Coordination and Competition Coexist?,* HMSO, July 1999

"The need for an increased level of tax co-ordination, and the willingness of Member States to go down that road, is now clear."

Mr Vanden Abeele, Deputy to Mario Monti,
Speech in Brussels 26th May 1999

Europe needs "a co-ordinated monetary, financial and wages policy."

Gunter Verheugen, German Minister for Europe, 5th May 1999

"The absence of a common economic and fiscal policy appears to be completely incompatible with the unified management of monetary policy. With regard to fiscal policy, it would be desirable for the Member States in the euro area to bring their tax systems into closer alignment, particularly with regard to the tax treatment of savings and corporation tax, which it ought to be possible to decide by qualified majority."

Barros Moura Report on the Constitutional Implications of EMU,
January 1999, EU Parliament Committee on Economic & Monetary Affairs and Industrial Policy, p11

"Establishing monetary union would require a 'federal-style' budgetary system, or at least an institutional and financial mechanism to enable action to be taken to deal with a crisis affecting one or more Member State."

Barros Moura Report on the Constitutional Implications of EMU,
January 1999, EU Parliament Committee on Economic & Monetary Affairs and Industrial Policy, p11

"It is necessary to harmonise tax policy. The unified currency area needs a fair and equal tax framework."

German Finance Minister, Oskar Lafontaine, *The Sun*, 20th November 1998

"We are pushing for the first steps forward on harmonisation... we are pushing hard for the first results during our presidency."

Oskar Lafontaine, *Daily Telegraph*, 24th November 1998

"[Monetary union will] make it imperative to start co-ordinating the sphere of taxation. The social democrat governments will also have to look at harmonising prices and wage policy."

Austrian Finance Minister, Rudolf Edlinger, *The Times*, 23rd November 1998

"We will campaign for stronger co-ordination in economic policy, particularly in the framework of the 11 euro-countries, for rapid progress in harmonisation of taxes and for the formation of a real European social model."

Joint German-French declaration, *The Guardian*, 2nd December 1998

"It will inevitably happen that the market will impose co-ordination in budgetary policy, fiscal policy, monetary policy and tax policy on the governments of the Euro."

Gunter Verheugen, German Minister for Europe, *Today Programme*, 4th December 1998

"The era of solo national fiscal and economic policy is over."

Gerhard Schroder, *The Guardian*, 1st January 1999

"On all these fronts [including tax] Europe is handicapped by the unanimity requirement. It is like a soldier trying to march with a ball and chain around one leg. I hope that Helsinki, by launching the reform process, will clearly show we have the ambition and the political will to rid ourselves of this encumbrance and to tackle the other crucial issues before us."

Romano Prodi, quoted on *PA News*, 1st December 1999

"The next intergovernmental conference to reform the EU treaties must make it the general rule that votes are by qualified majority. The United Kingdom must not stop progress in the Europeanisation of tax."

Christa Randzio-Plath, German MEP, quoted on *PA News*, 30th November 1999

"It is my personal view that we eventually must go to qualified majority voting on the sensitive issue of taxes"

Oskar Lafontaine, *Daily Telegraph*, 2nd December 1998

"The principle of unanimity must be broken."

Oskar Lafontaine, *Daily Telegraph*, 2nd December 1998

"I must stress that the finance minister has the backing of the Government when he demands steps in this direction. We know that there are different opinions in Europe but that doesn't mean it is not sensible in a single market with a single currency to have better tax co-ordination."

Gerhard Schroeder, speaking in support of Oskar Lafontaine, *The Guardian*, 4th December 1998

Q.: "Do you support Mr Lafontaine?"
A: "Absolutely. Either you want fiscal harmonisation or you don't. These are all matters that should be subject to majority voting."

Domenique Strauss-Kahn (then French Finance Minister), *Daily Telegraph*, 2nd December

"Majority voting on taxation is not a question of if but of when."

Finnish Government spokesman, reported in *The Times*, 3rd December 1998

"With regard to fiscal policy, it would be desirable for the Member States in the euro area to bring their tax systems into closer alignment, particularly with regard to the tax treatment of savings and corporation tax, which it ought to be possible to decide by qualified majority."

Barros Moura Report on the Constitutional Implications of EMU, January 1999, EU Parliament Committee on Economic & Monetary Affairs and Industrial Policy, p11

" 'Target zones', in which bottom and top limits are set on what member states could levy, 'could be a solution' to the Corporation Tax issue."

Gunther Verheugen, Germany's Junior Foreign Minister, reported in *Daily Mail*, 2nd January 1999.

"I wouldn't say tax rates are concerned. What we have in mind are the loopholes, such as off-shore banking, what we call tax oases."

Gunther Verheugen, Germany's Junior Foreign Minister, reported in *The Daily Telegraph*, 2nd January 1999. Asked whether the Channel Islands would be included in this category, he replied: `Certainly, yes'.

"The EU needs economic policy co-ordination in Europe. National policies at the expense of other states would jeopardise the success... A code of conduct to eliminate unfair competition over business tax should be implemented `as soon as possible."

Werner Muller, German Economy and Technology Minister, *The Daily Telegraph*, 1st January 1999.

"It is an illusion to believe that the States will retain their independence in fiscal policy."

Hans Tietmeyer, October 1995

When Viktor Kilma, the Chancellor of Austria, took over the EU presidency last Autumn he stated that his top priority was more "European tax harmonisation" to help the single currency.

"The major common objectives (are) a desire for social and tax harmonisation."

Lionel Jospin, speaking in Paris, December 2 1998

"The single currency will speed up the need for tax harmonisation."

Rudolf Edlinger, Austrian Finance Minister, *Daily Telegraph*, 2 July 1998

"The times of individual national efforts regarding employment policies, social and tax policies are definitely over."

Gerhard Schroder, speaking at The Hague, 19 January 1999

"To harmonise economic and financial policies would certainly be helpful for the external exchange rate."

Ernst Welteke, Bundesbank President, *Financial Times*, 20 September 2000

Q: "Does logic of tax harmonisation mean that it would eventually extend to VAT and personal taxes?"
A: "Why not?"

Yves-Thibault de Silguy, On BBC Radio 4's *The World at One*, reported in the *Daily Telegraph*, November 27 1998

"After 2006...no more decisions can be taken by unanimity."

Romano Prodi, *La Stampa,* 1 November 2000

"The recent fuel crisis has not changed my view on the need for minimum levels of energy taxation."

Fritz Bolkestein, *Daily Telegraph*, 10 October 2000

France would endeavour to "make headway on the tax harmonisation necessary for the proper functioning of the single market."

Lionel Jospin, speech to the National Assembly, 9 May 2000

"We must also pursue the efforts towards harmonisation of taxes and, eventually, social protection."

Pierre Moscovici, French European Affairs Minister,
French Government web-site

"In the next few months, the Eurogroup's role should be developed and generate a common economic culture among the EMU member States, conducive to better coordination of fiscal policies and a better alliance between monetary and budgetary policies."

Laurent Fabius, French Minister for the Economy, Finance and Industry,
National Assembly Delegation for the European Union, November 2000.

"Tax harmonisation presupposes the extension of qualified majority voting to fiscal matters. If this were not the case, member States would risk an alignment on the basis of the lowest rates. With a proposed corporation tax of 12.5%, Ireland is attractive to firms and this fiscal competition is leading to relocations. As Ireland is greatly benefiting from EU structural funds, it is achieving a budget surplus which is allowing it to have low tax rates."

Laurent Fabius, French Minister for the economy, Finance and Industry,
National Assembly Delegation for the European Union, November2000.

"In the French authorities' view, QMV should be used to decide measures to combat fiscal dumping and fraud, and the level of direct taxation where this affects the workings of the single market. On the other hand the setting of rates and determination of bases of assessment must continue to be decided by unanimity. In the sphere of indirect taxation, qualified majority voting must become the rule for the rights to deduction, measures of coordination and simplification and the fight against fraud."

Laurent Fabius, French Minister for the Economy, Finance and Industry,
National Assembly Delegation for the European Union, November 2000.

"In the area of taxation, building on the long-term priorities of stopping the erosion of certain classes of tax revenues, removing fiscal barriers within the single market and making tax systems more employment friendly, the Commission will continue efforts to modernise and simplify the VAT and excise systems. It will also seek further progress on the co-ordination of tax policy. The Commission will propose Communications on its future strategy on taxation and on the customs union. It will also bring forward amendments to current VAT legislation to adapt it to electronic commerce."

Commission Work Programme for 2000, p. 8.

"Economic and monetary integration is largely completed with the introduction of the euro. Only a few areas are lacking, such as closer harmonisation of tax policies as advocated by Germany."

Joschka Fischer, German Foreign Minister, *The Independent*, 13th January 1999.

"That's why we need to move towards fiscal harmonisation. It won't happen immediately but we are talking about five or 10 years' time."

Pierre Moscovici, France's Europe Minister,
Daily Telegraph, 21st November 1997.

"...direct taxation of corporations is increasingly seen as an essential component of the single market...... Coordination efforts and tax competition are likely to lead eventually to the introduction of a European Corporate Income Tax"

Krister Andersson, Member of Board of Directors of the Swedish National Tax Authority and Director of the Stockholm Institute of Economic Research, evidence to the public hearing of European Parliament Economic and Monetary Affairs Committee, 19th June 2000.

"...I consider it quite unfair when, as a result of tax dumping, a country accepts revenue losses, which will then be neutralised by financial support from the Union"

Hannes Farnleitner (then Austrian Minister for Economic Affairs), referring to Irish tax policy, at a conference on "Emu, Employment and Taxation", London 26th-27th November 1998.

"...unfair tax competition is of key importance as regards the coordination of economic policies, and we clearly can't have a single market, a single currency, the determination to liberalise public services – as we are being asked to do – without having regulations in the tax sphere."

President Chirac, Feire Council, 20th June 2000.

"... a minimum degree of tax harmonisation is required to prevent economic distortions and to ensure a level playing field for competition within the single market."

Fourcans Report on the coordination of fiscal and monetary policy, European Parliament resolution A4-0192/97

"...fiscal (and social) dumping must be averted either through a code of conduct on taxation or by a minimum degree of tax harmonisation, particularly with regard to savings, taxes on companies and transfrontier taxation;"

Fourcans Report on the coordination of fiscal and monetary policy European Parliament resolution A4-0192/97

"For Europe, I believe that it will be necessary one day to vote with QMV on fiscal matters and social issue... British opinion needs to move... It is very hard for Britain to claim to have a leading role... and refuse some major economic and social advances",

Pierre Muscovici, French Europe Minister, commenting on the UK's refusal to extend QMV to tax at the Nice Summit, *Independent* 13th December 2000.

Commission President Prodi described the refusal to give up the veto on tax as demonstrating a lack of openness and understanding. He went on to say that "Anyone who sees Europe merely as a clearing house to approach when necessary and stay away when it does not suit them...is not just making an error of historical analysis but is a cheating future generations."

Independent 13th December 2000

"The launch of the euro contributed to and underlined the necessity of continuous and strengthened coordination of taxation policies at the European Union level"

Christa Randzio Plath MEP, Chairman of the Economic and Monetary
Affairs Committee of the European Parliament,
presentation to the committee, June 2000.

"...in the wake of globalisation of markets, sovereignty, especially as regards tax matters, can no longer be organised within the framework of the nation-state"

Christa Randzio Plath MEP, Chairman of the Economic and Monetary
Affairs Committee of the European Parliament,
presentation to the committee, June 2000.

ANNEX II EU TAX WORKING GROUPS

A number of low profile groups and projects are underway, which are examining tax matters. Other meetings are occasionally organised with heads of customs and tax administrations. In response to a parliamentary written question in March 2000[272] the Commission revealed that there are eight formal groups and committees currently active in the field of taxation policy:

- Value Added Tax Committee;
- Excise Committee;
- Standing Committee on Administrative Cooperation;
- Taxation Policy Group;
- High Level Working Group on 'consistency between tax and customs policies';
- Working Party No 1, assists on legislative measures in the VAT field;
- Working Group No 2, collects information on indirect taxes other than VAT;
- Working Group "Structures of the Taxation Systems".

It is difficult to gauge the activities of these groups in any detail as meetings appear not to adopt formal conclusions or publish minutes. In the case of the Taxation Policy Group, however, it was stated in a parliamentary written question[273] that meetings have covered VAT strategy, the Monti tax package, the taxation of supplementary pensions and life insurance, electronic commerce and the taxation of energy products. An agenda from 2 March 2000 also showed that company taxation was on the agenda.

The Council requested the Commission undertake a study of company taxation in which led the Commission to set up two expert panels. One panel is examining the differences in effective corporate tax rates in the Community, while the other is devoted to consideration of the remaining tax obstacles to cross-border economic activity in the internal market. The conclusions of these studies has been delayed by some months and is now expected in the early part of 2001.

There are also a number of groups set up by the Council:

- Code of Conduct Group
- Working Party on Financial Questions
- High level group on withholding tax
- Ad hoc working group on tax fraud

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272 European Parliament Written Question E-0920/00 by Theresa Villiers to the Commission.

273 European Parliament Written Question P-0899/00 by Theresa Villiers to the Commission.