Harmonisation of European Taxation*

Professor Dr. Gerhard Laule, Rechtsanwalt und Steuerberater, Frankfurt/Main

1. Introduction

The basis for the harmonisation of taxes in the European Union with its 15 member states must be derivable from the Treaty Establishing the European Economic Community (EC Treaty; ECT), as amended by the Amsterdam Treaty 1997/98, which lays down the tasks of the organs of the EU - principally the Council, the Commission and the European Court of Justice (ECJ). All organs are subject to the principle of limited or enumerative (individual) competence[1]. The Community may take only such measures as are remitted to it by the Treaty. The community does not, therefore, have competence, i.e. the power to independently set its own tasks and authority without restriction[2].

Arts. 2 and 3 ECT are the starting points for tax harmonisation. According to Art. 2 ECT, the EU establishes a common market characterised by

* The exposé is an extended version of a lecture held by the author on 23.05.2002 before the Bundeskongreb der Bilanzbuchhalter und Controller 2002.

[1] *Lenz*, in: Lenz (publisher), Kommentar zu dem Vertrag zur Gründung der Europäischen Gemeinschaft in der durch den Amsterdamer Vertrag geänderten Fassung, 2nd Ed., Köln 1999, Art. 5. Rn. 4 ; Geiger, Kommentar zu dem Vertrag über die Europäische Union und Vertrag zur Gründung der Europäischen Gemeinschaft, 3rd Ed., München 2000, Art. 5, Rn. 2

[2] *Callies*, in: Callies/Ruffert (publisher), Kommentar zu EU-Vertrag und EG-Vertrag, 2nd Ed., Art. 5 Rn. 4, cf. also BVerfGE 89, 155, „Maastricht"

"a high degree of competitiveness and convergence of economic performance".

Art. 3 ss. 1 ECT provides for Community action in pursuit of this task, e.g. for

"(g) a system ensuring that competition in the internal market is nor distorted,

(h) the approximation of the laws of Member States to the extent required for the functioning of the common market."

The activities of the Community mentioned in Art. 3 ss. 1 ECT affect taxation, because the internal market is characterised especially by trade within and between the member states, so that differences in commercial taxation and tax collection regulations have a considerable influence on trade and competition.

The basis for tax harmonisation within the EU is laid down in the Treaty as a primary source of law. A Chapter

"Tax provisions"

(Arts. 90 to 93 ECT) is devoted to the issue. Art. 93 ECT expressly authorises the harmonisation of indirect taxes[3]. In addition, the provisions forbid the imposition by a member state of higher internal taxes on goods from another member state, and, in the case of goods exported to another member state, any repayment of tax in excess of the internal taxation[4].

Apart from this chapter, Arts. 58, 95 to 97, 175 and 293 EEC are also important to the issue of taxation.

Nowhere in the ECT is the concept of tax defined. The judgements of the ECJ have developed a definition[5], which is practically equated with the definition in § 3 ss. 1 Tax Code[6]:

"Taxes are payment liabilities, not in consideration of a particular service, imposed, in order to obtain income, by a public body on all who are in the factual situation with which the law connects capacity to pay,..."

---

[3] Tipke/Lang, 17th Ed., § 3 Rn. 9; ECJ, EuGHE 1996, I-505, Rn. 39 *(Socireté Bautiaa/Directeur des services fiscaux des Landes u. Societé française maritime/Directeur des services fiscaux du finistère)*; *Vob* in: Grabitz/Hilf, EGV-Kommentar, loose-leaf collection 2000, before Art. 90 Rn. 9, Art. 90, 91 ECT.

[4] Art. 90, 91 ECT

[5] ECJ, fn. 3, EuGHE 1996, I-105, Rn. 39; as to the scope of the term tax also ECJ, EuGHE 1997, I-6873, Rn. 26; ECJ, EuGHE 1994, I-3215; ECJ, EuGHE 1989, I-2671, Rn. 18.

[6] No taxes are customs duties acc. to Art. 23 ff., 25 WGV (customs union) and charges having the same effect (Art. 28 ECT). *Vob*, Steuerrecht, in: Dauses, Handbook of EU-Wirtschaftstrechts, Fach J, Rn. 1.

The Community has taken many measures, as secondary law, on the taxation front, applicable to indirect taxation.

For direct taxation, directives, proposed directives and the Double Taxation Agreement for the avoidance of double taxation of profits entitlement as between association companies, under Art. 293 ECT, are to be referred to.

The voluntary process of "silent harmonisation" of the taxation framework between member states, is also important.

2. The Present Position on Harmonisation of Indirect Taxes

Art. 93 ECT grants the power to harmonise indirect taxes, only, however,:

"to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market..."

Taxes so far harmonised are:

— Value Added Tax (VAT) in the member states under the "Common VAT System",
— special consumer taxes,
— tax relief on imports,
— tax on accumulated capital,
— transport vehicle tax,
— insurance tax,
— the proposed tax on carbon dioxide emissions and energy.

a) VAT in the member state

The Common VAT System has replaced the systems of the individual states. In the past, the system of so-called "cumulative turnover tax", as used in the Federal Republic of Germany until 1967, prevailed.

According to the 6th Directive, all member states of the Community charge VAT on a uniform basis, on the following principles[7]:

— the tax applies generally to all goods and services,
— the rate of tax is proportionate to the price of the goods or services,
— it is charged at every step in the production and sale process,
— it applies to the increased value of goods or services over the pre-paid tax,
— the consumer pays the tax.

7 ECJ, EuGHE 1989, I-2671, Rn. 18 ; ECJ, EuGHE 1997, I-372,1 Rn. 21; ECJ, EuGHE 1996, I-959, Rn. 19f.

The rates of taxes are:

States	Standard Rate in %
Austria	20
Belgium	21
Denmark	25
Finland	22
France	20.6
Germany	16
Greece	18
Ireland	21
Italy	20
Luxembourg	15
Netherlands	17.5
Portugal	17
Spain	16
Sweden	25
Gt. Britain	17.5

The standard rate in any EU member state should not be less than 15%. The lower rate must be at least 5%. The rate in each case is to be applied to the basis of assessment[8].

The tax rates of the member states vary over a broad spectrum. Spain and Germany with 16% are at the lower end of the scale, while Denmark and Sweden with 25% are at the upper end. The simple average of these rates is 19.44%. The wide spread of rates applicable to goods and services in the individual member states is the source of the problem which the EU has to solve in the interests of realising the internal market and a uniform tax system. This objective is unlikely to be realised "directly" by a decision of the Council on a proposal of the Commission - the member states are unwilling to surrender sovereignty over VAT - but rather "indirectly", by transformation from the country of destination to country of origin principle[9].

[8] Art. 12 III lit. a) 6th Value Added Tax Directive. Cf. also Directive on the Harmonisation of VAT rates, OJ 1992, L 316/1, supplemented by the Directive on the standard rate, OJ 1999, L 139/27.

8 Vob, (fn. 6), Rn. 190; see also below. One obstacle on the way to a uniform tax rate in all member states is that the VAT revenue is also used, especially in Denmark and Sweden, to finance the public social assistance for citizens in case of illness and in old age. Such states do not know the system applied in other states (including Germany), i.e. payment of social security contributions by employer and employee, and must therefore make use of the general VAT revenue.

Questions for preliminary decision affecting the VAT system which, under Art. 234 EC Treaty, reach the ECJ, refer to the extent of the deduction of pre-paid tax or the interpretation of exemptions.[10]

The ECJ effectively applies its position that the conception of the 6th VAT Directive is to be interpreted autonomously under European law. We know the cost neutrality of VAT from § 40 Tax Code[11]. The tax is charged even if the activity is illegal or in breach of good morals, provided the charging situation under the VAT Act exists. This is not the position of the ECJ, which has developed the following formula:

— imports of prohibited goods are duty-free and not taxable, while
— prohibited imports of goods are taxable.

In the first case, goods are concerned which are not marketable for legal reasons: morphine,
— cocaine,
— other drugs,
— counterfeit money.

In the second case, the absence of an official license for the relevant transaction may be involved[12].

[10] ECJ, IStR 2002, 21, 23: Authorisation of a member state to consider the usufruct in a real estate as delivery of physical goods, relevant for the deduction of pre-paid tax; German Federal Fiscal Court (BFH) IStR 2002, 57: Deduction of pre-paid tax for consultancy services of a partnership under the German Civil Law (GbR) in connection with the admission of a person as partner in the GbR against payment of a cash contribution, order of reference to the ECJ acc. to Art. 234 ECT; ECJ, IStR 2002, 96: Subsidy as part of the basis of assessment; ECJ, IStR 2002, 97, 98, Rn. 71 ff.: No deduction of pre-paid tax in case of allowances of the employer, reimbursing costs of the private car of an employee used for professional purposes; ECJ, IStR 2002, 131: Consideration for goods is excluded from deduction of pre-paid tax in order to decrease budget deficits, only possible after having heard the VAT Committee. Cf. Robisch, UStB 2002, 97 ff.; acc. to Art. 17 (1 6.) of the VAT Directive the right to deduct pre-paid tax arises at the time of delivery or performance of the service; acc. to German principles, however, the invoice is relevant, ECJ, UR 2002, 208 and UR 1995, 404. Thus the German administrative practice is in contradiction to EU law, as acc. to German practice the right to deduct pre-paid tax arises only at such time when an invoice showing VAT separately is received by the person for whom the services are intended; possession of such an invoice by the person for whom the services are intended is, however, not a requirement for deduction of prepaid-tax.

[11] Cost neutrality is one of the principles of the 6th VAT Directive; Voss, (fn. 6), Rn. 199. Such principle does not allow any differences between permitted and not permitted business transactions in case of cross-border deliveries or other services. For reasons of competition illegal imports and prohibited services from other states have to be burdened in the same manner as legal business transactions.

[12] ECJ, EuGHE 1981, I-385; ECJ, EuGHE 1982, I-3681; ECJ, EuGHE 1982, I-3699; FG Hamburg EFG 1980, 191; ECJ, EuGHE 1988, I-3655, Rn. 29; ECJ, EuGHE 1988, I-3627, Rn. 18; ECJ, EuGHE 1990, I-4477, 4479f; ECJ 1993, I-4677, Rn. 12-17, 20; ECJ, EuGHE 1998, I-3257 (3259); ECJ, EuGHE 1998, I-3257, Rn. 16; ECJ, EuGHE 1998, I-3369, Rn. 19-23; ECJ, EuGHE 1999, I-3971; ECJ, EuGHE 2000, I-4993.

This position in the judgements of the ECJ is controversial, especially because of its reasoning. It would be more easily acceptable if the court based its argumentation on Art. 93 ECT. Harmonisation of indirect taxes must be necessary for the establishment and functioning of the internal market - from this principle, the connection to competition on the internal market can be made. The position of the ECJ on cost neutrality can be deduced from Art. 93 ECT. Cost neutrality does not arise if transactions, whether legal or illegal, are not in competition with one another.

For cross-border commerce, the country of destination principle, according to which goods and services are sent to the country of destination tax free, originally applied without restriction. The latter applies its tax rates to the imported goods or services.

On the introduction of the "internal market" (Art. 14 ECT) at the turn of the year 1992/1993 the conditions for increasing transformation to the states of origin principle were created.

— For taxation of companies in trade within the Community, the receiving states principle was maintained at first (§§ 1a, 6a VAT Act). Tax exemption of the exporting company is subject to the following conditions:

> the supplier is a business,

> the goods are either sent or transported to another member state,

> the recipient acquires the goods as either a business or a legal person.

— For other services of a business in the internal market, § 3 A VAT Act applies:

> provisions as to the place where the services are provided, demarcate the tax sovereignty of the country of origin from that of the country of destination,

> accordingly, the location of the services is usually in the member state in which the services are provided to the business.

— for the taxation of private persons, the country of origin principle applies, if they, e.g., buy goods in Germany, export them to another member state where such imports are not taxed; if services are provided to such persons in their home states, or if they acquire an object in their home states, this is subject to the tax laws of the exporting states.

The objective of the reforms is, in any event, to completely replace the receiving states principle with the principle of the states of origin. The trader in the "importing states" (receiving states), would have to deduct the VAT paid by him to the trader or producer in the exporting states (states of origin) from his tax liability. This system would simultaneously ensure that the end consumer would bear the tax at the rate applicable in the consumer country, thus ensuring the maintenance of the consumer character of VAT[13].

The concept "states of origin principle" is appropriate at the level of the business, in relation to the cross-border deduction of pre-paid tax; at the level of the consumer in the completed internal market, the receiving states principle, according to which the consumer will be charged, will apply unchanged; it is undisputed that the consumer should not pay tax as applied in the states of origin, unless he personally purchases the goods there.

On the revenue side, this "internal market principle" has the effect that the next exporting states receive the tax on the added valued created there, while the importing states receive only the tax on the lesser value increase after import. The revenue from VAT, therefore, is transferred as between member states. Balancing-out by means of a clearing procedure has been found to be unachievable because of practical difficulties. Balancing-out of revenue is under review, but not yet agreed. The best solution would be a European financial compensation system, as generally applied between the federal German states.

b) Harmonisation of Special Consumer Taxes

Consumer duties - cf. Art. 33 6th VAT Directive - on

— mineral oil,
— alcohol and alcoholic beverages, and
— tobacco goods,

are levied on trading in the affected goods on the open markets within the Community[14].

For trading in goods of this nature, the receiving states principal applies, while private purchases cross-border within the Community are taxed under states of origin principle.

[13] Cf. *Vob*, (fn. 6), Rn. 190 ff., in particular Rn. 191.
[14] Cf. *Vob*, (fn. 6), Rn. 274 ff., 276-297, 268 ff., 305 ff., 309 ff.

There are separate directives for consumer duties on tobacco goods, mineral oil and alcohol including alcoholic beverages. They harmonise the taxation system for each, and set down minimum rates, so that the rates will gradually be harmonised. For each of the three kinds of goods involved, system guidelines, structural guidelines and tax rate guidelines have been issued, which are meanwhile implemented in national law.

c) Tax Exemption on Import

Special relieving regulations apply to imports into the member states of the EU[15]. The objective is to facilitate trading in goods and services by EU citizens with third states, to the benefit of the consumer, and throughout the Community, if the purchaser is a business.

Reference is made to

— *Council Regulation (EC) No 355/94 of 14 February 1994 amending Regulation (ECT) No. 918/83 setting up a Community system of reliefs from customs duty*[16],

— Council Directive 91/680/ECT of 16 December 1991 supplementing the common system of value added tax and amending Directive 77/388/EEC with a view to the abolition of fiscal frontiers[17],

— *Council Directive 69/169/EEC of 28 May 1969 on the harmonisation of provisions laid down by La w, Regulation or Administrative Action relating to exemption from*

turnover tax and excise duty on imports in international travel[18],

— *Council Directive 78/1035/EEC of 19 December 1978 on the exemption from taxes of imports of small consignments of goods of a non-commercial character from third states*[19],

— *Council Directive 94/4/EC of 14 February 1994 amending Directives 69/169/EEC and 77/388/EEC and increasing the level of allowances for travellers from third states and the limits on tax-free purchases in intra-Community travel*[20] - Art. 28 k of which referred to Tax Free Shops and which is no longer applicable since 01 July 1999. Tax free shopping in Tax Free Shops is no longer admissible, likewise not for cruises on the high seas of more than 8 hours duration, under German control.

[15] More details e.g. in *Vob*, (fn. 6), Rn. 260 ff.
[16] OJ 1983, L 105/1 adjusted by VO EWG No. 355/94, OJ 1994, L 46/5
[17] OJ 1983, L 105/38 most recently amended by Art. 2 Directive on the internal market OJ 1991, L 376/1

International treaties also provide exemption from import VAT. Under the terms of Art. 307 ECT, such treaties have priority of application.

The Community customs law also provides reliefs or exemptions from import VAT.

d) Tax on Accumulated Capital

Corporation tax and stock exchange turnover tax are also among the taxes harmonised. The 1969 *Directive concerning indirect taxes on the raising of capital, (amended by Council Directive 85/303/EEC of 10 June 1985 amending Directive 69/335/EEC concerning indirect taxes on the raising of capital)*, included authorisation to completely abolish both, which the Federal Republic of Germany did as of 1 January 1992[21].

These Community measures of 1969 were intended to facilitate the movement of capital. The objective of the directive, in particular, was that indirect taxes levied in member states on accumulated capital should be unified in their structure and rates, in so far as member states still imposed them.

The following is an example:

The ECJ has categorised Portuguese notary and registration charges on corporate transactions as taxes on the raising of capital, under certain conditions. These charges accrue to the state, and their amount is not related to the value of consideration provided by the state. This decision[22] has recently caused the federal government to revise the German fees system, by imposing upper limits.

e) Vehicle Tax

Harmonisation of motor vehicle tax is intended to redress competitive distortions as between means of transport in member states. The taxation of the individual means of transport should correspond to the cost to the member states of providing roads and other transport infrastructure. The ECJ has declared this directive *(Council Directive 93/89/EEC of 25 October 1993 on the application by Member States of taxes on certain*

[18] OJ 1969, L 133/6 as amended
[19] OJ 1978, L 366/34, the most recent amendment is evidenced in OJ 1985 L 372/8/30
[20] Version dated 14.02.1994, OJ 1994, L 60/14, most recent amendment acc. to OJ 1998, L 358/105
[21] *Vob*, (fn. 6), Rn. 314-325; The measure is set by the Directive concerning indirect taxes on the raising of capital dated 17.07.1969, OJ 1969, L 249/25, most recently amended by Directive 85/303/ EWG, OJ 1985, L 156/23.
[22] ECJ, RIW 2000, 960; ECJ, EuGHE 1999, I-6427, 6459 f.; see also *Vob*, (fn. 6), Rn. 1 and there 2 with further evidence

vehicles used for the carriage of goods by road and tolls and charges for the use of certain infrastructures) to be null and void, although it continues to apply until new provision is made[23].

f) Insurance Tax

Insurance tax, which is an established feature in the German tax system, is intended to be harmonised. Not every member state has such a tax.

g) The proposed tax on carbon dioxide emissions and energy

The Commission is proposing a tax on carbon dioxide emissions and energy. Art. 175 ss. 2 (first indent) ECT provides the basis for doing so. It is proposed that this tax should be charged under the states of origin principle. Germany already has an energy tax -mineral oil tax - with the controversial exemption that by-product heat (Prozesswärme) is not taxable if it is used for industry. This raises the question as to whether this is inadmissible subvention.

3. The Position with Harmonisation of Direct Taxes

The requirement under Art. 93 EEC to harmonise taxes does not apply to direct taxes. Apart from Art. 293 EEC on the abolition of double taxation within the Community, the Treaty contains no provisions on direct taxation. The sovereignty of the member states remains intact in this respect. Legislation in this area could be introduced only within the provisions of Arts. 94 and 95 ECT.

— Directives intended to achieve approximation of laws for the internal market, must have direct effect on the establishment and functioning of the common market.

— Decisions, after consultation, as to whether it is possible to approximate laws or administrative provisions of the member states which have as their object the establishment and functioning of the internal market, are to be unanimous.

The tax regimes of member states may not, however, conflict with other provisions of Community law. The basic freedoms are relied on, and the judgements of

[23] Cf. Directive on the application by Member States of taxes on certain vehicles used for the carriage of goods by road and tolls and charges for the use of certain infrastructures, OJ 1993 L 279/32, and with respect to proceedings for judicial review of legality ECJ E 1995, I-1827; current basis of European law is Directive 1999/62 OJ 1999, L 187/42

[24] Cf. Judgement of the ECJ on the basic freedoms in connection with direct taxes, described impressively by Kellersmann/Treisch in their book "Europäische Unternehmensbesteuerung" as from p. 329.

the ECJ show the effect the basic freedoms – because of their Community-wide application – have on direct taxation[24]. Freedom of movement (Arts. 39, 48 EEC) is a predominant consideration. Infringement of this freedom is usually connected with discrimination.

— If French taxpayers can set-off corporation tax on dividends, this must also apply to a recipient of dividends which is a branch of a German company[25].

— A tax regulation in Gt. Britain is discriminatory, if holding companies can take advantage of losses, only if the holding participates predominantly in subsidiaries registered in Gt. Britain[26].

Natural persons are equally protected by the basic freedoms.

— A Luxembourg regulation according to which excess tax paid was forfeited to the state if the taxpayer was resident there for only part of the year of assessment, was found to be discriminatory[27].

— It was also found to be discriminatory that a Belgian citizen could not avail of German income splitting, although he derived all his income in Germany while living in Belgium[28].

The basic freedoms effect also improved freedom to provide services.

— The cost of a Danish participant in a further training event in Greece can be deducted from his taxable income. The Danish restriction to such events within its territory was found to be inadmissible[29].

Examples of grounds submitted by member states as justification for discriminatory measures are[30]:

— national balancing measures are based on material circumstances,

— the parties voluntarily submitted to the regulations,

[25] ECJ, EuGHE 1986, 273, in particular 299 f.
[26] ECJ, EuGHE 1993, I-4017, in particular 4018 ff., 4040 f
[27] ECJ, EuGHE 1990, I-1779
[28] ECJ, DStR 1995, 326
[29] ECJ, IStR 1999, 694
[30] Cf. Jacobs, Internationale Unternehmensbesteuerung, 4th Ed., 191; Laule, Harmonisierung der Steuersysteme in Europa. Die Rechtsprechung des EuGH, Kommentierung dieser Entscheidungen. IWW Institut für Wirtschaftspublizistik, Nordkirchen 2000, p. 26

— tax harmonisation in the relevant sector did not exist,

— there was no reciprocity (Tax Treaty reservation),

— tax refuge,

— difficulty in establishing situations abroad[31],

— securing national revenue,

— coherence of the tax system.

By coherence was meant that the exemption of certain insurance contributions and the later taxation of benefits out of this insurance, was logical[32].

a) Developing Tendencies

Within these restricted powers, Europe is nevertheless quite advanced in relation to corporate taxation.

The Commission originally aimed at comprehensive harmonisation of corporate taxation including withholding taxes. To this end, the Commission made a proposal in 1975 which was subsequently withdrawn. Now, the corporate taxation guidelines of 30 April 1990 are the means by which the taxation framework for companies in the Community is to be regulated[33] in so far as required for the establishment and strengthening of the internal market. Action is, however, required to[34]:

— remove taxation disadvantages arising from cross-border activity, and

— avoid double taxation, in so far as this still exists in spite, or because, of existing agreements between member states (cf. Art. 293 ECT second indent).

According to the principle of subsidiarity, the member states are free to further develop their taxation systems in so far as they see that additional action is required, after such measures have been taken, in order to complete the establishment of the internal market[35]. On this issue, the experts of the Ruding Commission encourage concentration on certain points:

[31] The ECJ impressively overruled such argument in its decision Futura and Singer, ECJ, 1997, I-2492.
[32] ECJ, EuGHE 1992, I-249
[33] SEK (90) 601 finally, cf. BR-Drucksache 360/90; Meinicke, BB 1992, 969
[34] *Vob*, (fn. 6), Rn. 105 with further evidence
[35] Ruding Report (1992), Commission of the European communities: Report of the committee of independent experts on company taxation, Luxembourg 1992

— removal of competitive distortions caused by national taxation systems, which treat cross-border investments and participations by businesses unfavourably,

— agreement on a minimum corporation tax rate,

— common rules for determining profit, in order to prevent excessive tax competition between the member states,

— transparency of all tax-based investment incentives,

— abolition of double taxation of foreign income,

— approximation of corporate tax systems and rates, and

— approximation of tax allowances and the basis on which they are calculated.

b) Position Achieved

The question may be asked; what stage have the efforts of the EU reached?

— The Merger Directive facilitates the transfer and restructuring of businesses within the internal market, including mergers, in which businesses - predominantly companies - from two or more member states, participate. They may adjust their businesses as a group of independent companies in a tax neutral manner by relating book value to the market conditions. Mergers, in which a company takes over the assets of another, without liquidation are treated favourable: otherwise, the formation of a new company would be required. Divisions into new companies are also tax neutral, although in such cases - as in merger cases - the consideration consists of company rights. Contribution of operations, operating units, permanent establishments and the exchange of shares can be implemented without incurring direct taxation. Cross-border transfers of registered offices or the "taxable disjunction" of individual assets are not privileged. Up to 10% cash payment of residual fractional amounts are non-taxable[36].

[36] Council Directive on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different member states of 23.07.1990, OJ 1990 L 225/1-5

Germany has adopted corporate law elements into national law, e.g. by §§ 4 ff., 60 ff., 36 ff. and 123 ff. Transformation Act (UmwG). Cross-border mergers or divisions are not yet open to German companies, because the necessary corporate law pre-conditions are still absent[37].

— The *Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States* applies to cross-border dividend payments by a subsidiary to a parent company. Prior to this directive, the member state in which the subsidiary was resident assessed corporation tax on the profit and, in addition, withholding tax on the dividends paid to the parent. The parent company was liable - a third time - to its national tax authorities for tax on the dividends it received. This multiple taxation should be avoided by tax exemptions or tax credits. Withholding tax no longer arises, if the participation of the shareholder in the subsidiary is 25%. Sub-subsidiaries are not included in this system, with the result that the tax credit for loses of sub-subsidiaries is not taken into account under the tax exemptions method in the subsidiaries' states[38].

— The *Convention 90/436/EEC on the elimination of double taxation in connection with the adjustment of profits of associated enterprises - Final Act - Joint Declarations – Unilateral Declarations* has the object of avoiding double taxation of cross-border profit adjustments between associated enterprises[39]. This Convention applies to enterprises participating directly or indirectly in enterprises in another member state, whatever their legal form. It should ensure, by economical double taxation, that such adjustments, e.g. adjustment of transfer prices, match[40].

— Any increased profit should, for tax purposes in one state, correspond to the identical profit reduction in the other state.

[37] As a result cross-border mergers and divisions are not possible in Germany as the necessary corporate law pre-conditions are still absent. Thus corporate law provisions for cross-border restructuring on an EU level exist for contributions and exchanges of shares; no corporate law provisions exist for a transfer of registered offices, mergers, divisions or amalgamations. Cf. Kellersmann/Treisch, Europäische Unternehmensbesteuerung, 228, 229.

[38] Council Directive on the common system of taxation applicable in the case of parent companies and subsidiaries in different member states of 23.07.1990, OJ 1990, L 225/6 - 9, corrected by OJ 1990, L 266/20; Proposal of the Commission for a Council Directive to amend the Council Directive of 23.07.1990 and of 26.07.1993 OJ 1993, C 225/5 - 6

[39] Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises, OJ 1990, L 225/10 - 24; Ratification by the Federal Republic of Germany in BStBl. I 1993, 818

[40] Cf. also BFH, IStR 2001, 745 with respect to the adjustment of transfer prices in an international group of companies.

— The code of conduct[41] *(Resolution of the Council and the Representatives of the Governments of the Member States, meeting within the Council on 1 December 1997 n a code of conduct for business taxation OJ C 002, 6/01/1998, p. 0002-0005)* is also relevant to the measures introduced. This code of conduct combats damaging tax competition in relation to corporate taxation, which should be as neutral as possible as far as the competition for locations is concerned. A measured co-ordination of taxation should work to defeat the national tax sovereignty of the member states.

The code of conduct is a political agreement, which is not legally binding. It has identified damaging effects such as:

> whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents, or

> whether advantages are ring-fenced from the domestic market, so they do not affect the national tax base, or

> whether advantages are granted even without any real economic activity and substantial economic presence within the Member State offering such tax advantages, or

> whether the rules for profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably the rules agreed upon within the OECD, or

> whether the tax measures lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way.

Older provisions which are open to objection are to be removed, the introduction of any new "unfair" provisions is forbidden.

In November 2000, the finance ministers of the EU member states reviewed the situation. They complained of the German holding regulation under § 10 Foreign Trade Tax Act (AStG), because the tax assessed under ss. 5 and 6 thereof is not sufficiently wide[42].

---

[41] Resolution of the Council and the representatives of the governments of the member states in the Council on a code of conduct of 01.02.1997, OJ 1998, C 2/2 Appendix 1 with conclusions of 01.12.1997, OJ 1998, C 2/1 and of 09.03.1998, OJ 1998 C 99/1

[42] Kellersmann/Treisch, Europäische Unternehmensbesteuerung, November 2001, p. 240; Werra, IStR 2001, 438 ff.

§ 10 ss. 5 Foreign Trade Tax Act (AStG) prevents additional taxation in the event that a Tax Treaty exists; as a result only 80% of income from asset group financing is affected (§ 10 ss. 6 AStG). Furthermore, the AStG is applicable only to passive income (in the meaning of the AStG), so that the tax advantages in the case of active income (in the meaning of the AStG) are not taxable even if they are based on abusive tax regimes in other states. Without doubt, the Foreign Trade Tax Act requires reform, which is a subject we cannot go further into here.

— The code of conduct is part of a package which includes proposals for a *Council Directive on a common system of taxation*[43] *applicable to interest and royalty payments made between associated companies of different Member States (OJ C 123, 22/04/1998 p. 9)* which should deal with tax harmonisation for companies, as well as a proposal for a *Council Directive to ensure a minimum of effective taxation of savings income in the form of interest payments within the Community (OJ C 212 08/07/1998 p. 13)*[44].

> The first mentioned proposed directive is intended to ensure once-off taxation in the member state where the lender or licensor is resident. It provides for exemption from withholding or similar taxes on interest and license payments between associated enterprises which are in corporate legal form. Interest includes income from claims of all kinds, even if such interest is subject to profit performance. License fees are payments for all kinds of use of copyrights, patents, brands, designs, know-how and/or experience or equipment.

The proposal addresses both creditor and debtor of such services. Both companies are, as parent and subsidiary, associated companies; the minimum participation is intended to be 25% in the capital or voting rights of the subsidiary. The directive should also apply if cross-border profit distributions are concealed in such payments.

Permanent establishments are equated with companies whether as recipients or service providers.

> The proposed *Council Directive to ensure a minimum of effective taxation of savings income in the form of interest payments within the Community* provides a so-called "co-existence model". A choice between two systems is available, between,

— imposition of a withholding tax of a minimum of 20%, which will be credited on the tax in the state of residence of the creditor, or

[43] Directive on interest and royalty payments, proposal of the Council of 06.12.1990, OJ 1991 C 53/26-29, and of 06.03.1998, OJ 1998 C 123/9-13

[44] Directive on interest 1989, 1998 and 2001, OJ 1989, C 141/5-7, OJ 1998, C 212/13-18 and BR-Drucksache 675/01 of 30.08.2002 or KOM (2001) 400

— the establishment of an automatic reporting system.

States which have a withholding tax system derive tax income, by means of withholding tax, in addition to that from the party resident in their jurisdiction which owes the interest. States with a system of reporting are limited to the tax collected from "their" taxpayers. Withholding tax produces income in the source state, reporting produces tax income in the state of residence.

In addition, withholding tax is a factor likely to drive capital from the internal market, because capital markets rely on net income after all taxes. Withholding tax therefore also means increased gross interest rates offered by an issuer.

The acceptability of a control system with automatic reporting of profits by the banks, conflicts with bank confidentiality, and the national legislator is called upon to resolve this conflict.

The ECOFIN[45] in November 2000 amended the proposed directive *C212 of 08/07/1998.* It should now apply to interest and income from investment funds (40% of the assets in fixed-interest-securities). This threshold is intended to be reduced over the coming years. The taxation of financial investments and insurance yields is intended to be regulated at a later time and outside the application of the interest directive. The system of information exchange will be refined and the net woven more tightly. The ECOFIN specified the information to be reported.

Double taxation will be avoided.

States, which impose a withholding tax, will have to transfer 75% thereof to the state of residence of the creditor. The object is that interest be taxed only in the state of residence under the interest directive.

The intended taxation of interest should combat tax avoidance and damaging tax competition.

— The proposed corporation tax directive of 1975[46] had the objective of reducing variations in the taxation of company profits in the member states. It was sought to achieve competitive neutrality as far as possible. In addition, dividend flows should not suffer discrimination by double taxation, or complicated administrative formalities, which could lead the financial markets becoming insulated.

[45] Proposal for a council directive on ensuring an effective taxation of interest income within the EU, KOM (2001) 400, Council document 11205/01, BR-Drucksache 675/01 of 30.08.2001

[46] Corporation tax directive 1975, BT-Drucksache 7/3981 of 18.08.1975; corporation tax directive 1978 of 23.08.1978, BT-Drucksache 8/2051

The draft directive therefore proposed a partial tax credit system of dividend taxation, following, by and large, the French system:

— one rate applicable to retained and distributed profits, within the range 45 - 55%,

— distributed dividends give rise to a tax credit in favour of the recipient,

— dividends and tax credits increase the recipient's capital yield. The tax credit should be in the range of 45 - 55% of the corporation tax of the company paying the dividend.

According to this concept, tax balancing between the member states supplemented this system. The source state of the dividend should make up the cost to the state of residence of the tax credit. Withholding tax on dividends was also intended, which would be credited against tax in the state of residence, or refunded, as the case may be. Instead of the withholding tax, a member state can establish a reporting system. The harmonisation of corporation tax provides, therefore, the connection to taxation of interest.

The directive did not meet with the approval of the European Parliament, due to the absence of harmonisation of determination of profits for tax purposes. The draft directive is no longer on the agenda of tax harmonisation. Tax experts, whether in the academic world, business or administration, are in favour of the implementation of this directive.

The German legislator decided, as is well known, for the half-income system in regard to the taxation of dividends and thereby against any form of tax credit system.

The rates of corporation tax in the individual member states of the EU vary widely. The need to co-ordinate the rates of direct taxes as between the member states is obvious[47].

[47] Illustration 11 in Kellersmann/Treisch, Europäische Unternehmensbesteuerung, p. 118

Income Tax

State	Basic Rate	Highest Rate	Rate of Corporation Tax
Belgium	25%	55%	39%
Denmark	39%	59%	32%
Germany	19.9%	48.5%	25%
Finland	23%	55.5%	29%
France	9.5%	54%	33.33%
Greece	5%	45%	35%
Gt. Britain	10%	40%	30%
Ireland	22%	44%	24%
Italy	19.65%	46.65%	37%
Luxembourg	6%	46%	30%
Netherlands	33.9%	60%	35%
Austria	21%	50%	34%
Portugal	14%	40%	32%
Sweden	31%	56%	28%
Spain	18%	48%	35%

The corporation tax rates are to be contrasted with the burden of income tax. They communicate a broad and widely spread field. The tendency shows that the burden of corporation tax is lower than that of income tax. Does this imply a trend towards companies, because they are subject to corporation tax and not income tax?

A comparison only of the tax rates does not provide any valuable information. The variations in tax rates is due rather to the various methods of calculation[48]. The member states of the EU have structured the various elements by which a comparison of tax systems in accordance with the tax base and rates could be made, very differently. Usually, the taxation of business income achieved by a company is connected with the taxation of dividends, to state only one example. Caution is therefore advisable in order to avoid confusion between tax burden, and tax rates. Rather, all elements in the national tax systems have to be evaluated[49].

[48] Cf. e.g. Lutz Fischer, Zur Methode und Aussagefähigkeit zu internationalen Steuerbelastungsvergleichen als Grundlage für steuerrechtliche Gestaltungsüberlegungen des Gesetzgebers, Cagianut Francise and Vallender, Klaus A. (publisher): Steuerrecht. Ausgewählte Probleme am Ende des 20.Jh. Festschrift zum 65. Geburtstag von Ernst Höln, p. 34.

[49] Cf. also Kellersmann/Treisch, Europäische Unternehmensbesteuerung, p. 117 ff., 127-130

The achievement of the objective is more likely by means of plans to conform the tax base for corporation tax and to include this model in proposals for a consolidated tax balance sheet, which, in addition, admits cross-border set-off of losses, as between headquarters and branches as well as between parent and subsidiaries, in the various member states of the EU.

c) Proposals for loss deduction

On the path to conforming the tax base, the Commission has brought forward proposals for the losses:

— One proposal deals with the loss set-off[50] within the state. This should strengthen the investment and competitive capacity of the companies. This proposal applies only to taxpayers obliged to produce balance sheets. Losses could be carried backwards for two years or carried forward for an indefinite number of years. Several member states allow this unlimited carry forward since this proposal was announced. Whether the EU is competent to bring in such a regulation, is doubtful since the introduction of the principle of subsidiarity in 1990.— A further proposal[51] refers to the offsetting of foreign losses. Activity at the level of the common market should not be subject to tax treatment less favourable than activity limited to one member state. The member states admit offsetting of losses of permanent establishments and subsidiaries abroad only to a limited extent, a disincentive to foreign investment. The proposal of the Commission is a step towards the more distant goal of comprehensive, cross-border consolidated financial statements.

The concept addresses enterprises in the member states which are liable for income or corporation tax, and is therefore favourable to German sole traders or unincorporated business. The loss off-setting of subsidiaries is not contained in the present wording of the draft. Only losses of permanent establishments are referred to. Its subject matter is

[50] Directive on Losses OJ 1984, C 253/5 - 6 and OJ 1985, C 170/3 of 25.06.1985

[51] Directive on foreign losses of 06.12.1990, OJ 1991, C 53/30 - 34 and Directive on foreign losses 1992, OJ 1992, C 94/152 - 153 Acc. to § 2a ss. 3 of the German Income Tax Act (EStG) German taxpayers had the possibility to claim a tax deduction in another state pursuant to the scheme "loss deduction with back taxation". This provision was repealed in 1999. Acc. to the BFH an offsetting of such losses against profits of the undertaking in Germany is not possible if profits of the permanent establishment would not be subject to taxation acc. to a double taxation treaty (DBA) with per country limitation, which is common practice of German DBAs. In a judgement with respect to the DBA Germany-Austria the Austrian Administrative Court (VwGH) has for the first time permitted that losses of permanent establishments can be taken into account for tax purposes and is thus in contradiction to the rulings of the BFH, VwGH, IStR 2001, 754; cf. also Wassermeyer in IStR 2001, 754 and Vogel in IStR 2002, 91. Also the ECJ doubts the ruling of the BFH in its AMID decision, ECJ, IStR 2001, 86, with the result that the cross-border loss offsetting between a company and a permanent establishment must be admissible even if a DBA with per country limitation exists between the states concerned. The ECJ confirms the judgement of the Austrian Administrative Court.

the horizontal balancing of losses within a legal person as between permanent establishments and the group headquarters.

Losses of permanent establishments are taken into account by two methods:

— According to the tax credit system[52], positive and negative results of all permanent establishments in another member state are taken into the results for the headquarters of the business. Logically, the profit achieved in the internal market will be taxable in the home state, and profits or losses of permanent establishments abroad will be directly taken into account in the determination of profit analogously to home profits or losses. If permanent establishments in other member states pay taxes, these will be creditable against the tax payable by headquarters. If a permanent establishment can, in its state, set-off profit in a coming year against losses, no foreign tax will be payable. In the headquarters' state, the profits of permanent establishments for the next year will be ascertained. In so far as no foreign tax arises because of losses carried forward, no tax credit occurs.

— The deduction of losses and deferral of tax is an alternative[53] for the national legislator in addition to the tax credit system. This deferred tax process was introduced in Germany in 1997 by § 2a ss. 3 and 4 Income Tax Act. Subsequent profits of the permanent establishments were, as affecting the headquarters, to be added back, up to the amount of previously deducted losses. Headquarters therefore received assistance with its liquidity, because the tax was only deferred, although no double taxation was possible in one year. The losses to be balanced out by the headquarters were calculated according to the tax provisions of the state where the permanent establishment is resident.

Withdrawal of this deferred tax procedure is, when viewed correctly, a breach of the freedom of movement which entitled a business to operate outside its home state in other member states of the EU without incurring financial disadvantage.

The loss offsetting as between legally independent group companies within the internal market is necessary, so that no discrimination exists between permanent establishments on the one hand and subsidiaries on the other, but that rather neutrality is maintained as between legal forms[54]. The draft directive of 1990 in this area opted

[52] Cf. *Vob*, (fn. 6), Rn. 177
[53] Cf. *Vob*, (fn. 6), Rn. 178; cf. also 51.
[54] Overview of the tax regulations of the member states concerning losses of subsidiaries and permanent establishments abroad, Grother, with further evidence to the separate presentations of the EU, RIW, 1994, 1017 ff., cf. also Laule, Generalbericht, Der Einflub von Verlusten in einem Land auf die einkommen-oder körperschaftsteuerliche Behandlung von international tätigen Unternehmen oder verbundenen Gesellschaften in anderen Ländern, Cahiers de Droit Fiscal International 1979, p. 15 ff. it is also set out in such Cahiers how the individual states deal with such foreign losses.

for deduction of losses with deferred taxation. Partial depreciation of the holding in the subsidiary is excluded by this model, as otherwise losses would be availed of twice. There are good reasons for connecting this solution for subsidiaries with a proposal for consolidated accounts within the member states of the EU.

d) Consolidated Tax Balance Sheet[55]

The consolidated tax balance sheet for groups with companies or permanent establishments in other member states of the EU is a special point of concentration as far as harmonisation of taxes from income or profits is concerned. The income from all permanent establishments and from associated companies is calculated in accordance with one set of rules, and a consolidated balance sheet prepared for tax purposes. This includes the elimination of possible tax implications of group intern transactions (elimination of internal profit).

The sovereignty of the member states to fix the tax rates, is not compromised. The objectives however, are:

— reduction of follow-up costs, which arise both to the companies and to the tax authorities by having to deal with the 15 tax systems within the internal market,

— solving the transfer pricing problem within the EU,

— setting-off and consolidating profit and losses within the internal market,

— simplifying cross-border restructuring,

— avoidance of double taxation,

— combating discrimination and restrictions.

Such a system would lead to greater efficiency, effectiveness, simplicity and transparency.

However, how does one arrive at such a uniform bases of calculation? The Commission's ideas apply the calculation of profit, according to the Commercial Code, towards further harmonisation, and examine the authority of such calculation for the tax balance sheet.

---

[55] Kellersmann/Treisch, Europäische Unternehmensbesteuerung, p.92 with reference to statements of the European Commission (2001 a), executive summary, p. 1; European Commission (2001 c), p. 16 ff., 27 with the possibility for the companies to choose between a possible (to be newly prepared) common calculation of profit and an acknowledgement of e.g. the existing home state taxation. Cf. also Kellersmann/Treisch S. 263 ff. and 291 ff.

[56] Kellersmann/Treisch, Europäische Unternehmensbesteuerung p. 267 f.

Of the 15 EU member states, Denmark, Gt. Britain, Ireland and the Netherlands do not recognise this authority. They are influenced by the Anglo-Saxon tax system, while the others (those states of the EU which have developed their tax systems under French or German influence) apply the principle of consistency[56] (*"Maßgeblichkeit"*: the principle that the tax balance sheet follows the Commercial Code balance sheet), to a greater or lesser extent.

This principle presupposes proper accountancy within the business, the basis of which is no longer to be interpreted as previously understood in Germany, but rather according to European understanding. The influence of the ECJ over the tax laws of states in which the principle of consistency applies[57], is thereby increased by means of the Balance Sheet Directive (*Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54 (3) (g) of the Treaty on the annual accounts of certain types of companies*). The ECJ could once again function as a motor for legal uniformity.

A major influential factor may, however, not be overlooked.

Capital market transactions are conditioned by:

— increasing globalisation,

— increasing international involvement of companies,

— increasing competitiveness on the capital markets,

— significant new issues,

— increasing financing of medium sized business through international capital markets, and

— increasing investment on the international capital markets by small investors.

The capital markets, therefore, generate pressure for international uniformity of accounting extending beyond the EU. IAS appear to be on the advance. From the point of view of taxation, this could mean for the German economy that IAS have to be taken into account in the tax balance sheet. The well known problem areas are:

— extension of the concept of asset items, with results e.g. increasingly regarding leased assets as the lessees own property,

[57] Disputed; the ECJ claims that it has jurisdiction, ECJ, EuGHE 1999, I-5331, 5357 ff.; ECJ, EuGHE 1997, I-4161, 4198; ECJ, EuGHE 1996, I-3133, 3151; Weber-Grellet holds a different view in Schmidt, EStG, 21st Ed., § 5 Rn. 4

— restriction of permitted creation of reserves,

— capitalization of intellectual property of assets,

— capitalization of development costs shown as assets,

— obligatory realisation of profits in the case of long-term projects according to the percentage of completion method,

— reporting of financial investments as current assets at (higher) values (fair value), and

— increasing application of projected values, e.g. in the case of pension reserves[58].

According to the ideas of the Commission, quoted parent companies should apply IAS in their group accounts from 2005[59].

If one follows this trend to its logical conclusion, the principle of consistency must be given new content for purposes of the tax balance sheet, or the majority of member states would have to abandon the connection between the Commercial Code and tax law in their accountancy. The provisions of § 292 a Commercial Code already admit of satisfactory annual group accounts, e.g. according to IAS.

If a uniform consolidated basis for European corporation tax is achievable, its development will be based on the considerations dealt with here, which are to be further teased out, and which, according to the position of the Commission, do not yet allow a specific technical solution to be chosen and realised. It is clear, however, that the German principle of caution no longer commands majority support.

[58] With respect to approach and evaluation pursuant to IAS cf. e.g. Oestreicher/Spengel, DB 1999, 593-600; Thiele, Stille Reserven in der Rechnungslegung. Vergleich von HGB, US-GAAP und IAS Diss. Linz 1999; Gabler Edition Wissenschaft Deutscher Universitäts-Verlag 1999; Herzig, Harmonisierung der steuerlichen Gewinnermittlung in der EG, Ahlert, Franz, Göppel: Finanz- und Rechnungswesen als Führungsinstrument. Herbert Vormbaum zum 65. Geburtstag; Herzig, WPg 2000, 104 ff.; Happe, DStZ, 2002, 360, in particular as to provisions which can pursuant to IAS inter alia only be made if the amount can be stated with a high degree of accuracy. Buchholz/Weis, DStR 2002, 512 ff. (Good-bye principle of consistency?)

[59] Communication of the European Commission to the European Parliament and the Council: Harmonisation in the field of accounting. A new strategy for the international harmonisation of 14.11.1995, KOM 1995, 508; Schön, Wolfgang, ZGR 29 (2000), p. 706 -742 failed in the preliminary phase. The harmonisation of tax accounting offers new opportunities to establish a common basis of assessment, at least for the corporation.

4. Conclusion

The first draft of a directive[60] on the conforming of profit determination has failed at the preliminary stage. At present, the opinion seems to be that consideration of group tax balance sheets at European level could resurrect the discussion. Each impediment to stronger harmonisation of direct taxation and, in particular, uniform methods of establishing the tax base for corporation tax, would be a reverse, damaging to Europe and its economy.

[60] Zeitler and Jüptner, Europäische Steuerharmonisierung und direkte Steuern, BB 1988, enclosure 17 to issue 32, p. 4a f.