Opinion of the Economic and Social Committee on 'Fiscal competition and its impact on company competitiveness'

(2002/C 149/16)

On 28 February 2001, the Economic and Social Committee, acting under Rule 23(3) of its Rules of Procedure, decided to draw up an opinion on 'Fiscal competition and its impact on company competitiveness'.

The Section for Economic and Monetary Union and Economic and Social Cohesion which was responsible for preparing the Committee's work on the subject, adopted its opinion on 25 February 2002 by a large majority with 4 abstentions. The rapporteur was Mr Morgan.

At its 390th plenary session (meeting of 25 April 2002), the Economic and Social Committee adopted the following opinion by 90 votes to 3 and 2 abstentions.

1. Introduction

1.1. The EESC has chosen to prepare an Own-initiative Opinion on Fiscal Competition and Company Competitiveness. The concerns which caused the opinion to be initiated were well justified. There was evidence of widespread abuse. However, as a result of recent EU and international initiatives, the whole spectrum of issues is now being addressed. Accordingly, in this opinion, we define the issues and present a progress report on the actions being taken.

1.2. By 'company competitiveness' we mean a company's ability to survive and thrive in face of continually changing market forces while fulfilling its responsibilities to shareholders, employees, customers and suppliers.

1.3. Amongst the range of market forces which represent opportunities and threats to companies are factors such as:

— changing consumer preferences;

— competitor advances;

— economic cycles;

— impact of the single market;

— impact of globalisation.

1.4. The whole range of government activity, policy and action in many fields also create factors which can affect the competitiveness of firms. Typical factors are employee social costs and social systems, environmental taxation and regulation, consumer regulation, transport infrastructure, workforce skills, education, health and the pattern of international agreements. Most direct, of course, is the basis and scale of company taxation.

1.5. By 'fiscal' we mean the national fisc of EU Member and non-Member States. In other words we mean the pattern of tax receipts and public expenditure. 'Fiscal competition' can arise in two ways. First, the overall fiscal posture of one country versus others can make that country more attractive to businesses. In this respect the basis and scale of company taxation is often the key determinant. Second, whatever their basic fiscal policies, states may make exceptions, derogations etc. with the specific aim of attracting and retaining company presence in the country. This is defined as harmful tax competition. These inducements may also take the form of state aids.

1.6. Company decisions relative to facility location for optimum competitiveness are not necessarily and certainly not only fiscally driven. Different factors will be more or less important for different companies in different industries.

1.7. In our review of current EU and international initiatives we have considered the following:

— EU tax priorities;

— EU Commission study of company taxation;

— EU Code of Conduct to eliminate harmful tax competition;

— EU actions to eliminate harmful state aids;

— OECD actions.

2. **Review of initiatives**

2.1. *EU tax priorities*

2.1.1. The Commission published a Communication dated 23 May 2001 entitled 'Tax policy in the European Union — Priorities for the years ahead'. An Opinion on this Communication has been presented [1]. The Communication gives a number of insights into the fiscal competition issue. This Communication is also discussed at 4.1.

2.1.1.1. In section 3.2.1 there is a reference to the international framework: '(...) The overall aim of the major world economies, including those of the EU Member States, has been to work towards a fiscal climate which promotes free and fair competition and is conducive to cross-border business activity, while at the same time ensuring that national tax bases are not eroded. The work on tackling harmful tax competition, both in the OECD and also in the EU through the tax package, has been central to this aim in the last few years.'

2.1.1.2. In section 1 there is a reference to harmful tax competition: 'The efforts to curb harmful tax competition through the Code of Conduct for business taxation and the proposals on the taxation of income from savings will allow Member States to consolidate their tax revenue raising capacities, thus offering scope for reducing the high average tax burden on labour. It is important therefore that the Community sees the various elements of the tax package through to their conclusion.'

2.1.1.3. In section 2.1 the options for national fiscal strategies are discussed: 'The EU policy dialogue has promoted an integrated approach with a greater awareness of policy options and constraints for taxation. Tax cuts should be focused on areas where they have beneficial supply side effects and they should be accompanied by reforms to benefit systems in order to increase growth potential and employment. Emphasis has been put on the need to reduce the fiscal pressure on labour and non-wage labour costs, in particular on relatively unskilled and low-paid labour.'

And there is a further reference in section 2.4: '(...) The level of public expenditure is equally a matter for national preferences as long as this is adequately met by revenues in such a way that budget positions remain close to balance or in surplus (...).'

2.2. *EU company taxation study*

2.2.1. The Commission study on Company Taxation was published on 23 October 2001, in the form of a communication (COM(2001) 582) and a Commission staff working paper (SEC(2001) 1681). The EESC will examine these in a separate opinion. This study is further discussed at 4.2.

2.2.2. The Commission [2] notes that the results of the quantitative analysis for 1999 show that 'there is a large variation in the effective tax burden faced by investors resident in the different EU member countries, as well as in the way each country treats investments in or from other countries (...) The range of differences in domestic effective corporation taxation rates is around 37 percentage points in the case of a marginal investment (between -4,1 % and 33,2 %) and around 30 percentage points in the case of a more profitable investment (between 10,5 % and 39,7 %). (...) Across the range of domestic and cross-border indicators there is a remarkable consistency as far as the relative position of Member States, notably at the upper and lower ranges of the ranking are concerned.'

2.2.3. 'These high differentials may have an influence on the international competitiveness of EU companies located in different Member States and represent incentives for companies to choose the most tax-favoured locations for their investments, which may not be the most efficient location in the absence of taxes. If this is the case, differences in the effective levels of company taxation may imply an inefficient allocation of resources and, therefore, welfare costs. The study has not attempted to quantify the size of any efficiency loss or welfare cost that might be associated with existing differences in effective corporation tax rates in the European Union. Nevertheless, the size of tax differentials and dispersions deserves attention, considering that some externalities as well as the different legitimate goals of tax policy may justify a certain deviation from the objective of neutrality of taxation.'

2.2.4. In order to remedy the tax obstacles in the EU, the Commission [3] considers various targeted solutions. However 'Only providing multinational companies with a consolidated corporate tax base for their EU-wide activities will really, through a single framework of company taxation, systematically tackle the majority of tax obstacles to cross-border economic activity in the single market. Companies with cross-border and international activities within the EU should in future be allowed to compute the income of the entire

(1) OJ C 36, 6.2.2002.

(2) COM(2001) 582 final, p. 7.

(3) COM(2001) 582 final, p. 15.

group according to one set of rules and establish consolidated accounts for tax purposes (thus eliminating the potential tax effects of purely internal transactions within the group).'

2.2.5. 'It is important to note that this approach does not infringe Member States' sovereignty to set corporate tax rates. (...)'

2.2.6. 'The Commission (therefore) believes that it is only logical to steer its company taxation policy towards achieving a comprehensive solution to the existing cross-border tax obstacles in the internal market (...). The Commission believes that it is necessary to provide companies with a consolidated corporate tax base for their EU-wide activities; develop an appropriate apportionment mechanism which can be agreed by all participants; and, for Member States, to determine the applicable national corporate tax rates.' [1] Various approaches and technical possibilities are examined in the Commission services study.

2.3. *Code of Conduct*

2.3.1. The Code of Conduct (Business Taxation)/Primarolo Group report was published on 29 November 1999. At its session on 28 February 2000, the Council took no position on its content.

2.3.2. Paragraph 3 of the report defines harmful measures in the following terms: 'A. Without prejudice to the respective spheres of competence of the Member States and the Community, this code of conduct, which covers business taxation, concerns those measures which affect, or may affect, in a significant way the location of business activity in the Community. Business activity in this respect also includes all activities carried out within a group of companies.

The tax measures covered by the code include both laws or regulations and administrative practices.

B. Within the scope specified in paragraph A, tax measures which provide for a significantly lower effective level of taxation, including zero taxation, than those levels which generally apply in the Member State in question are to be regarded as potentially harmful and therefore covered by this code.

Such a level of taxation may operate by virtue of the nominal tax rate, the tax base or any other relevant factor.

When assessing whether such measures are harmful, account should be taken of, inter alia:

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

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

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

4. 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

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

2.3.3. Paragraph 4 of the Report seeks to eliminate future abuses: 'Member States commit themselves not to introduce new tax measures which are harmful within the meaning of this code. Member States will therefore respect the principles underlying the code when determining future policy.'

2.3.4. Paragraph 5 discusses the specific issue of islands and dependent territories: 'Insofar as the tax measures are used to support the economic development of particular regions, an assessment will be made of whether the measures are in proportion to, and targeted at, the aims sought. In assessing this, particular attention will be paid to special features and constraints in the case of the outermost regions and small islands, without undermining the integrity and coherence of the Community legal order, including the internal market and common policies.'Member States with dependent or associated territories or which have special responsibilities or taxation prerogatives in respect of other territories commit themselves within the framework of their constitutional arrangements, to ensuring that these principles are applied in those territories.

2.3.5. The report classified harmful measures into the following groups:

a) financial services, group financing and royalty payments;

b) insurance, re-insurance and capital insurance;

c) intra group services;

d) holding companies;

[1] COM(2001) 582 final, p. 19.

e) exempt and offshore companies;

f) miscellaneous.

In total, nearly 300 measures have been identified and classified as either acceptable or harmful and unacceptable. It has been broadly agreed that there are 66 harmful measures which should be rolled-back for 2003 and a report was submitted to the 4 December ECOFIN Council but there were no clear conclusions. The Council asked the working party to continue its work in accordance with the timetable set for the fiscal package.

2.4. *EU Action on State aids*

2.4.1. Mario Monti, EU Competition Commissioner, recently stated ([1]): Progress is being made; however there is still room for manoeuvre to reduce aid further. The Commission therefore strongly supports the Member States in their quest to reduce overall amounts of aid, in line with the Stockholm European Council's conclusions of spring 2001. Member States should continue to make all efforts to carefully rethink their aid spending. Every single reduction of aid clearly reduces the distortion of competition in the internal market and increases the benefits of Economic and Monetary Union. On the Commission's side, I will maintain strict state aid control as a priority.

2.4.2. Whilst the EUR 28 billion spent in the manufacturing sector are less than the EUR 36 billion in the preceding period from 1995 to 1997, the overall decrease is not EU wide and still mainly depends on the two countries Italy and Germany. In both Member States aid amounts fell substantially. In Belgium, Greece, Spain, Luxembourg, the Netherlands and in the United Kingdom levels of aid to manufacturing also dropped but were offset by increases in other Member States.

2.4.3. Substantial differences between individual Member States remain. Aid levels in relation to value added are highest in Greece and lowest in the United Kingdom and Portugal. A comparison shows that in Greece, aid as a percentage of value added is over seven times higher than in the UK. Member States like Sweden, the Netherlands, the UK or Portugal have maintained their low levels of aid whereas Italy, Germany and Spain are rapidly reducing their aid levels.

2.4.4. The Commission announced in July 2001 that it is taking further action along the following lines:

a) increasing transparency, via the State Aid Register and Scoreboard;

b) monitoring the State aid control rules;

c) enforcing state aid control effectively in candidate countries;

d) faster recovery of illegal aid. Particular importance will be attached to a more speedy recovery of aid which the Commission has declared incompatible with EC State aid rules.

2.4.5. On 11 July 2001, Commissioner Monti launched a large scale state aid investigation into business taxation schemes. This concerned 11 corporate tax schemes in eight Member States, and also existing fiscal advantages in four other Member States that are no longer justified following the economic changes of the EU single market (see press release IP/01/982).

2.5. *OECD*

2.5.1. In the global context the OECD has been working on harmful tax competition, and in particular the existence of so-called tax havens, and has arrived at a list of 35 tax havens. So far 28 territories have made commitments and will be removed from the OECD black list. The USA has expressed concern about the ethics of imposing OECD views on sovereign states. However, since the events of 11 September 2001, the political support for combating tax fraud and money laundering has increased and so-called tax havens have come under greater scrutiny.

2.5.2. The deadline for the havens to agree to cooperate with the OECD is 28 February 2002. For havens which fail to comply, it is likely that sanctions will be imposed.

3. **Characteristics of national taxation**

3.1. The characteristics of national taxation have their basis in historic and cultural choices by government and citizens.

3.2. This reflects the role assigned to government in different countries. Countries choose their economic and social policies and politics, in the knowledge that such policies will have a particular effect on the fiscal regimes they must impose.

3.3. For example, the tax disadvantages created in high tax countries may be compensated for by superior public infrastructure, or by a higher skills base. Host countries and companies located there are fully aware of the trade-off between levels of taxation and consequent government expenditure.

([1]) Commission press release on 'State Aid movement in the right direction', 19.7.2001 (IP/01/1033).

3.4. It is the conclusions of the study on company taxation that company tax rates are a matter for Member State governments.

4. **Company competitiveness and taxation**

4.1. The following issues affecting company competitiveness are discussed in the parallel ESC Opinion on Tax policy in the European Union ([1]).

4.1.1. Employment costs, or non-wage labour costs, are so high in some Member States that they may potentially discourage inward investment.

4.1.2. Cost of raw materials can represent a significant proportion of total costs. For energy intensive industries, the effective rate of taxation of energy may be an important factor.

4.1.3. The EU has a common VAT regime, yet applicable rates vary within a given band, and with some derogations in certain Member States. The VAT regime in any one Member State may be an attraction or a deterrent to new companies, as may be seen, for example, in the current debate over VAT and e-commerce, where there is a concern that non-EU companies required to register within the EU will choose a country where a low VAT rate applies.

4.1.4. Taxes and levies on labour vary among Member States, and may have an impact on the company's ability to employ the workers it requires.

4.1.5. The difficulty of transferring pensions from one Member State to another is a barrier to the mobility of labour, particularly for managers and professionals.

4.2. The following issues are among those addressed by the Company Taxation Study which was presented by the Commission in October 2001.

4.2.1. Transfer pricing refers to the price charged by individual parts of one economic entity for transactions of goods and services between themselves, for example within a multi-national corporation. Within the EU, the Arbitration Convention is a means of resolving transfer pricing disputes.

([1]) COM(2001) 260.

4.2.2. Inter-company payments of interest and royalties are subject to withholding taxes by Member State tax authorities, which can result in double taxation. Should this occur, companies face time-consuming administrative procedures, and may incur financial costs between payment and reimbursement of these taxes.

4.2.3. Cross-border loss compensation is the possibility for a company to offset losses across borders, i.e. if a company makes a loss in one market it can offset this against profits made in another. There is no mechanism for this within the single market. This represents a serious cost to business, and may deter a business from investing in new and untried markets.

4.2.4. Cross-border business integration can be expensive even within the single market, preventing companies from restructuring in an optimal way. The problems encountered include transfer taxes due upon transfer of taxes to a branch structure, loss of pre-conversion losses that cannot be transferred to a new branch structure, and the obligatory release of provisions which have up to that point reduced taxable profits. The 1990 Mergers Directive went some way to improving the situation, but the existing obstacles place EU companies at a disadvantage compared to non-EU companies which start a Greenfield operation in the EU.

4.2.5. Corporate taxation also varies widely among Member States, both in terms of the taxable base and of the corporate tax rate. Governments determine how they wish to tax companies in their jurisdiction, and may be able to use this, for example, as a tool to encourage new start-up companies, or to attract foreign investment. In some cases, companies are able to offset investments against their tax bill, through capital allowances.

4.2.6. In addition to the difficulties of multi-country operations described above, companies active in other Member States where they have no corporate presence often face administrative difficulties with fiscal and social arrangements which are not imposed on national companies. These problems represent distortions of competitiveness.

4.3. Within the EU, companies should be able to operate efficiently across borders, thus benefiting from the creation of the internal market. The difference in efficiency of operation between a multi-country and a single country enterprise is a measure of the obstacles that affect the competitiveness of a company operating within the internal market.

4.4. The elimination of fiscal distortion between Member States can either be formal or informal. The Company taxation study has the scope to achieve a considerable degree of formal convergence between corporate tax systems. However convergence of tax rates will only be achieved informally by Member States reacting accordingly.

5. Conclusions and further actions

5.1. Company tax rates will remain subject to Member State autonomy. Accordingly, since the systems will differ, they will naturally remain in a state of latent competition. This situation will persist, but following the Commission study on Company Taxation, many inconsistencies should be removed. Overall the Lisbon European Council conclusions invited all Member States to improve the competitiveness of their fiscal systems.

5.2. In the meantime harmful measures affecting company location need to be acted upon. The EESC calls on the Council to commit itself to a political follow-through to the problems treated in the Primarolo report, since the issues which it addresses are central to the question of fiscal competition, without, however, losing sight of the Verona Agreement of December 1997 [1] on a package of fiscal measures ('tax package') and the fact that a parallel timetable has been drawn up [2] for work to implement the key parts of the package. The preparation of the Report was a great step forward. Failure to act would be two steps backwards.

5.3. The EESC is encouraged by the recent Commission activity in the area of state aids. In the Tax Priority Communication the Commission indicates that for taxation generally it intends to pursue non-conforming Member States through the ECJ. The ESC urges the Commission to use this route to eliminate illegal state aids.

5.4. The EESC encourages the Commission and the Member States to ensure that the OECD study is brought to a fair and honourable conclusion, after the 28 February 2002 deadline.

5.5. As far as companies are concerned, the first priority must be to complete the programme outlined in the Tax Priority Communication. VAT, personal pensions and transfer pricing are just some of the issues involved.

5.6. Most important for company competitiveness when operating in the EU will be the outcome of the study on company taxation published in October 2001, although it is important to note that rates of corporate tax would remain the responsibility of Members States. The Commission's two-track strategy includes immediate action on targeted measures and the launch of a wider debate on general comprehensive measures with the objective of providing EU businesses with a consolidated corporate tax base for their EU-wide activities.

5.7. There are many issues but priority must be given to the tax dimension of the European Company Statute. The full benefits of establishing a European Company (SE) will only be achieved if existing companies can form such an entity without incurring additional tax set-up costs, and avoid some of the existing tax obstacles of operating in more that one Member State. As things stand neither of these are provided for and its success could therefore be jeopardised. At the same time the implementation of the SE statute should not lead to new fiscal distortion vis-à-vis companies registered in Member States

5.8. Although fiscal arrangements and fiscal competition are important contributors to company competitiveness, the defining issues would not normally be fiscal unless the fiscal arrangements are unreasonable and harmful. Fiscal arrangements are political and reflect public choice. Many market forces affecting company competitiveness are, in effect, uncontrollable. Companies look to politicians to control fiscal arrangements sensibly and logically and to maintain stability over time.

Brussels, 25 April 2002.

The President

of the Economic and Social Committee

Göke FRERICHS

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[1] ECOFIN Council Conclusions, OJ C 2, 6.1.1998.

[2] Presidency Conclusions from the meeting of the European Council of Ministers in Santa Maria da Feira. Press release (19/6/2000) No 200/1/00.