IN-DEPTH STUDY OF EUROPEAN UNION FISCAL APPROXIMATION - BENEFITS AND LIMITS

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Summary

The current study presents a viewpoint on the EU fiscal policy *contents,* advocating the need for an in-depth understanding and acceleration of the 27 national fiscal system components and the creation of the EU Tax System that would enable the Single Market operation and the enforcement of the four fundamental liberties within the European Union. In the author's opinion, the extant *common* fiscal policy elements are only *marginal*, while the actions aimed at an in-depth understanding of a broad fiscal policy are essential to the extent they point at both direct and indirect taxation aspects whose approximation is a priority.

Key words: fiscal policy; deepening; tax harmonization; principles

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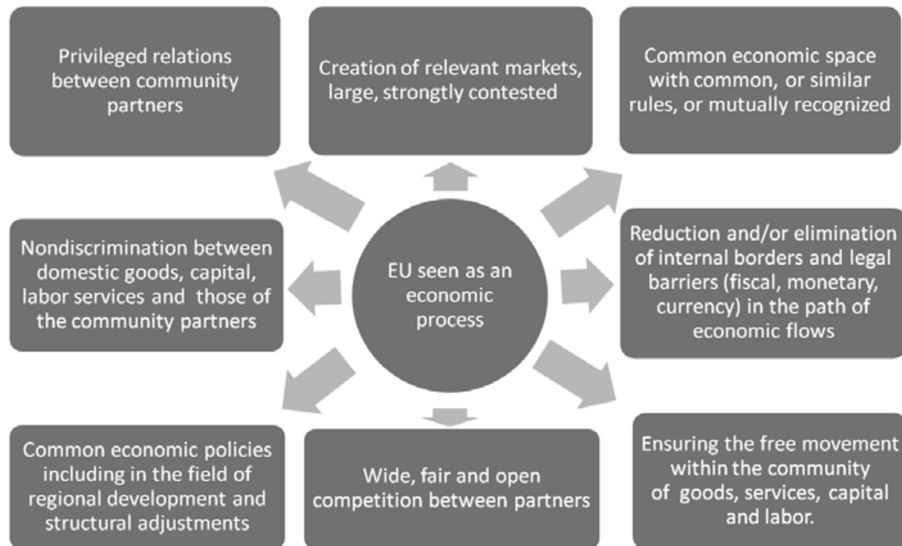
The European Union (EU) is the largest, most complex and most advanced international interstate integration, that was gradually built to become a *collection of norms in the spirit of the market* and the democratic mechanisms, with its main component – the economic one – being construed, on one hand, as a process that reached to the stage of Economic and Monetary Union (EMU), and on the other hand, as an economic and social purpose whose structures are presented in Chart 1 and Chart 2.

EU economic process

Figure 1



UE - finalitate economico-socială

Figure 2

The gradual construction of the European structures, the creation of the common economic area and the Single Market operation were based on the agreement on, and observance of, a number of principles (such as subsidiarity, non-discrimination, mutual recognition etc.) and on the creation and promotion of the *common policies* (in sectors such as competition, agriculture, environment, trade etc.) as well as the elimination, reduction or approximation, as the case may be, of *economic barriers* among Member States. Since there is a multitude of opinions and viewpoints regarding the economic barriers, we decided to look at them as tools (or levers) of economic policy (monetary, commercial, fiscal and currency policy etc.) implemented by the authorities in order to *support the economic borders* of the states and to influence the economic activity. Usually, these can become discrimination factors as to the goods, output factors and domestic (favored) and foreign (including Community) activities that are subject to discrimination, distorting competition abilities and geographic orientation of economic flows (of goods, investments, labor force).

Traditionally, the economic barriers were institutionalized by all states and played a national role. Over the past fifty years, alongside national barriers, many states set up common barriers, with the most relevant being those inside the EU, which appear as own barriers common to the Community organization.

This is a contradictory process: we have, on one hand, the intra-Community economic barriers which are subject to removal, reduction or approximation and, on the other hand, there are common barriers which have grown numerous and more significant. The European Integration came with a multitude of decisions as to the removal or gradual approximation of numerous intra-Community barriers that were an obstacle to the circulation of goods, services, labor and capital, which became basic components of the European Acquis. The decisions pertaining to the fiscal area are equally relevant.

Taxation within the European Community is a particularly complex issue. It begins with the main accepted definitions. The debate starts from the very concept of *taxation* which is, on one hand, a collection of taxation laws and other regulations (including the taxation role in the State and the social life) and, on the other hand, the total pecuniary contributions to public administrations, which are compulsory, final and with no immediate, nor direct counter-compensation (the reversibility principle) (6, p.1631). Hence, the financial support ins ensured to authorities for producing *public goods*. The taxation role and the attributions of the tax authorities are performed within a defined fiscal jurisdiction, while the policy and the levers (fiscal tools) have remained and continue to be *essentially national*, reflecting the autonomous

and sovereign nature of the 27 Member States. The European Commission considers the fiscal policy as „*a symbol of the national supremacy”*.

This is how we explain the significant differences among Member States in terms of taxable bases, tax rates, the share of fiscal revenues to GDP, the importance paid by different countries to direct and indirect taxes and social contributions, or the big dissimilarity between central and local taxes and contributions in various countries, as well as in the nature of the supporting decisions, the organization responsible for collecting the taxes and the destination of the collected amounts. While disparities in the National Fiscal Systems (NFS) of some Member States have somehow disappeared over the recent years, the 27 national fiscal systems (NFS) of the EU still accommodate a fragmented common economic area and the dysfunctions of the Single Market, inducing artificial competitive advantages/disadvantages to certain economic agents, putting barriers to economic and favoring the territoriality of economic activities mainly based on immediate fiscal benefits to the detriment of the essential efficiency criteria (economic, ecological, social) and the sustainable economic growth.

One can see here a contradiction that might become a conflict and a serious obstacle to the good functioning of Community structure in its high evolution stages:

- on one hand, the *national* fiscal systems and policies (with the corresponding tools) that are promoted by all states according to their interests and goals;
- on the other hand, the EU requirements, in its process and purpose, as common economic area imposing regulations, “rules of the game” and instruments (including fiscal) that are common (identical) or similar. This kind of contradiction cannot be removed as long as the “national” states persist, but with the appropriate measures it can be reduced to minimal levels, through concessions made by all independent states which voluntarily admit to surrender certain sovereign prerogatives to the benefit of the Community interest that represents “the common part” to any of the 27 states.

Reality shows that while EU Member States have committed to the Stability and Growth Pact and to the EU Treaties institutionalizing the above-mentioned principles, these are used especially in times of recession, according to the national interest, as a fiscal incentive for attracting foreign investments, securing jobs, stimulating exports, investments and entrepreneurship in order to “master” the government deficits on which the very existence of the single currency ultimately depends. Under these circumstances, the national system differences are all the more obvious, as are fiscal strengthening and cooperation in the fiscal area.

Different visions exist as to the contents and the scope of fiscal policy. The Anglo-Saxon literature and practice, for instance, define the fiscal policy concept in the broad sense of "*financial policy"* (s.n), including the objectives of the decision-makers of a state which are related to securing budget resources by means of taxes and fees and those coming from the public expenditure implementation to achieve social and economic purposes, that is, a process consisting of manipulating taxes and public expenditures to generate major economic and social effects". According to other opinions, the fiscal policy is viewed in a *restricted* sense as a policy of the state regarding the taxes, in other words „the art of disseminating and implementing the general features of taxation" being the work of the power of the state (national fiscal policy) or above the state (regional or global fiscal policy).

As far as we are concerned, we regard the fiscal policy, the national taxation, as a collection of orientations and decisions made by the central and local authorities focusing on *taxes and fees* and their double role:

a) an economic and financial instrument indirectly influencing and guiding the economy and the economic growth process;
b) a main source (means) to securing the fiscal revenues of the state. Here and below we regard the *budgetary policy* as a component – currently the most important one – of the general policy of the State, including the fiscal policy and the public spending policy, as well as the *options* regarding the *nature and size of the budget deficits* that allows the State to intervene in the economy and in the social sector in order to shape the actions of businesses and categories of individuals and achieve the overall purposes of the progress, the stage, as well as various national objectives, as envisaged by the political decision-makers and the leading interest groups.

If we put the fiscal policy in the context of European integration and its underlying principles, we underline that its different elements have been the focus of permanent concern by the Community structures, the Member States and the experts.

First question is: is there a common fiscal policy (sn) of the EU since the Treaties view the EU fiscal policy as essentially national?

Before expressing an opinion, we need to clarify what we understand by *common EU fiscal policy.*

Starting from the above meaning of the fiscal policy, we understand the EU *common fiscal policy* as the rights and actions of the Community authorities to *consistently* implement and regulate taxes within the European Union. It is perfectly obvious that this kind of policy is of a *totally marginal* nature and

will not become inclusive and actual even if the European integration could evolve to a tangible federal structure. In our opinion, a *common fiscal policy* and a compulsory fiscal policy of the EU (in terms of taxable base, rates and the way of imposing and earmarking tax collections) only relates to:

- customs duties imposed to third parties under the Common Customs Tariff (CCT), the customs duties on goods imported from third parties and presenting the features of a community tax; these are no longer under the jurisdiction of the MS authorities. MS negotiated the Common Customs Tariff and the removal of intra-Community customs duties when the Customs Union was established (and the Community Acquis was taken over by those who joined the Community later on). Any changes in the CCT elements need to be decided by *the European Organizations* (even when these are enforced through conventions of the Trade World Organization to the rules of which the European Community is subject by right). In addition, the customs duties (while collected by tax authorities of the entry state to the common area of imports from third parties), become a source of revenues to the Community budget (after deduction of management costs);
- Community budget taxes on farming goods imported from third parties and determined by the difference between the *threshold price* and the world price;
- the taxes collected from the EU employees becoming EU Budget revenues source;
- the interpretations given by the European Court of Justice to a number of tax provisions in the EU Treaties.

With no prejudice to this type of elements of the fiscal policy *common* to the EU, we consider that so far the actions have been focused on supporting EU fiscal regulations, that we see as synonym to *common* fiscal policy.

EU fiscal policy is seen in a *restricted* sense and in a *broad* sense. In a *restrictive* sense, it refers to how the EU own pecuniary resources are obtained (and used) to be built into the EU Budget. The multi-criteria supporting of Member States' contributions to the EU Budget is, in our opinion, a very actual topic. Transfers made by MS to the European Union, currently established based on the national GDP, must be dependent primarily on the Gross National Product (total and per inhabitant) with different tax brackets for different indicators.

In a *broad* sense, the EU fiscal policy refers to actions that have been so far *jointly* performed by the Member States, in full compliance of unanimity

principle, in order to influence the national fiscal systems by reducing dissimilarity in order to achieve in due time the objectives provisioned in Article 2 of the Treaty and lay the basis of the Single Market and the good functioning thereof.

Perhaps this is the only way to construe the EU *fiscal system* as a collection of decision jointly and unanimously adopted to facilitate *coherence, compatibility and approximation elements.* The purpose of such decisions is to reach a reasonable compromise related to national objectives targeted by the fiscal policy of all states, the reasonable resolution of fiscal issues occurred between Member States (avoid double taxation, unfair fiscal competition, attrition of domestic fiscal bases etc.), as well as the fundamental objectives of the European organization.

In a consolidate manner, the EU *fiscal system* may be followed at the following levels:

- the existence of basic fiscal rules in the EU. To this end, the Treaty provisions embodied in Articles 12, 58, 90, 91, 93, 94, and 293 are relevant;

- the rules of loyal and fair fiscal conduct (Code of Conduct), the mandatory exchange of information and mutual assistance provided by national fiscal authorities, the MS commitment to not allow fiscality matters to hurt competition within EU and the position of European companies in the European competition;

- *the common system* for a generalized application of VAT, (achievement of an uniform taxation base, the obligation to preserve the rate between minimum and maximum thresholds, remove fiscal frontiers to allow the intra-Community circulation of goods and services, implement actions to reduce fraud and evasion, as agreed in Directive Six and the subsequent Directives);

- the introduction of a set of common rules on excise duties (goods that must be subject to excise duties, chargeability, minimum mandatory excise rates, exceptions, suspensive regimes, exemptions and other);

- the actions aimed at direct taxes approximation by reaching a reasonable compromise between their function as financial *lever* and source of budget revenues.

While the approximation of direct taxes raised a concern only after the creation of the Common Market, this is only at the beginning and so far it has been focused on those taxes and tax bases that go beyond the national interest to affect, in one way or another, the interests of other Member States (taxes on revenues from savings, the common taxation system applicable to

interest and royalties transferred from one state to another, taxes on dividends and companies that operate overseas and the fiscal arrangements on splits and mergers, transfer of assets and asset exchange schemes etc.).

The European Union is currently at a crossroads where it either take action to improve the common area operations and recover the positions in the world competition and restore the stability of the single currency, including through firm measures aimed at federalization, or it heads towards a dissolution. Fiscal aspects prove essential when it comes to achieving the objectives set in the EU Treaty; all it takes is for the fiscality to be dynamic, flexible and work in concert with the common monetary policy. To us, the following components are a priority:

VAT. The transitory system compromise has grown into a disadvantage.

VAT perception based on origins will prompt the states to reduce the VAT rates, therefore this similarity among Member States in terms of rates will appear as a decision made by the national authorities. VIES operation remains essential (VAT. Information Exchange System), as well as the fact of levying a minimum tax on goods originating in a specific territory of fiscal residence to be consumed in a different fiscal residence area.

The minimum rates on excisable energy products must differ substantially, depending on the nature of these products, in order to discourage the production and consumption of those produced by environmentally harmful sources, to the benefit of "clean" renewables.

in the fiscal area, the dispute between the *unanimity* and fiscal *sovereignty* needs to be alleviated, on one hand, while, on the other hand, it is necessary to amplify the EU fiscal system elements to ensure the Single Market *defragmentation*.

Consideration is being given to:

- Firmly promote the „intensified cooperation" (soft-law)

- In the spirit of Articles 43 to 45 of the Treaty of Nice it is necessary to set up rules to be *mutually accepted* by a number of States, still non-mandatory and non-standardized at EU level, *without changing the acquis in this area.*

We consider the introduction, in certain areas, of some "stronger" norms that will be adopted using the *qualified majority* rule (as compared to the unanimity rule); the expected effect will be a "*Double-Geared Europe*" in the fiscal sector as well, which is obviously a risk.

In order for the "intensified cooperation" to become an element of the EU fiscal system, the following must be achieved:

the rules (agreements) must be the result of the participation of a significant number of Member States, not necessarily eight, depending on how deep the understanding will be;

- The Ministerial Council must approve these rules by a qualified majority, in line with the Community Treaties and the Community Acquis;
- They must not affect the competencies, rights and obligations of the Member States not involved in the respective agreements;
- The participation should not be denied to the Member States that did not initially announce on their intention to cooperate;
- The intensified cooperation mechanism must be used only as *last ratio,* after the Council decides that the targeted objectives may not be reached within a reasonable deadline by capitalizing on the provisions and the spirit of Community Treaties.

The "intensified cooperation" could lead to:

- More firm *codes of conduct* in different sectors, that should be agreed upon at inter-government level, and not Community level – in specific areas such as fiscal fraud, prevention of double taxation, taxation aimed at environment protection, actions to support the SMEs, increase the range of excisable goods;
- *Pilot projects* assumed voluntarily by the states and the interested (very large) taxpayers which allows the *mutual recognition* of the rules in the taxpayer's *country* of origin.

Germany and France seem determined to take a major step in this direction, by *unifying* the taxation bases and rates imposed on *businesses'* profits which is a first step towards the *full* approximation in this area.

The European Court of Justice (ECJ) is an important source of pressure put on the national fiscal systems when it comes *to taxation of companies*. In case of *disputes* with regard to the *interpretation* of the primary legislation in the area (including decisions made by the states which presumably violate this legislation – the cases of *infringement* brought before the ECJ). The Court's rulings are mandatory and represent *means to implicitly achieve direct taxation* and generate components of the EU fiscal system. Any dispute or unclear situation of the similar kind "judged" and ruled by the ECJ will be, in the future, solved "by rebound" through statute law. The start point is the

principle according to which the ECJ is *the only one capable to interpret* the Community Treaties.

The quality of this kind of fiscal approximation is appreciated by those who would like to see the pace of the approximation process speeding up towards the "fiscal federalism". In our opinion, while this mechanism is largely seen these days, it needs optimization by:

- Reducing the negative approximation elements undermining the coherence of the national fiscal systems through one-off decisions;
- It has a certain degree of insecurity. The decisions are relevant for the cases under review, still a high insecurity rests as to their impact and significance, for the situations based on circumstance that are not identical (though very alike);
- *The legitimacy* of the regulations, since the aspects associated with national supremacy (defended by the veto right) are restricted by a supranational authority (ECJ) which is not liable before the EU citizens and may sometimes be illegitimate in their case. This matter is escalated since ECJ has a tendency to rule in favor of taxpayers. Playing on this kind of rulings, the multi-national companies (MNC) initiate cases before the national courts and ask for tens of millions of Euros in damages for fiscal measures adopted at a national level, in full compliance with constitutional laws and having the benefit of good faith; therefore, the potential impact of ECJ rulings on the MS budgets is major considering the reimbursements, with the solutions given in individual and small cases likely to encourage a high number of other taxpayers to ask for damages. This phenomenon is all the more serious when MNC form groups of litigators asking for this kind of damages.

Speed up decisions aimed at corporate taxable base approximation

Given the difficulties of the approximation process, the European Commission appointed an expert group to identify a set of alternatives to allow Member States to choose among different *corporate* taxation options. The starting point was the belief that the *corporate taxation rate* must remain, in principle*, an option* to be made by the respective state; but the key issue is how to determine the *taxable base and allocate* it to fiscal residences of the states of operation of trans-European corporations (transfer prices – an not only – are a strong disturbing factor).

These process resulted in a document that was presented to the European Parliament and the Social and Economic Committee in 2001, on behalf of the European Commission, and introduced four alternatives (principles):

- The mutual recognition principle;
- The common consolidated base principle;
- Introduction of a federal European tax on corporations;
- The introduction of a consistent and mandatory system for the establishment of a taxable base for corporations, to replace the current national systems.

We will not tackle here the benefits and limits of the above alternatives, but given the Romanian reality and the fiscal interests of our country, we recommend to the Romanian representatives to the specialized EU bodies to support the *common consolidated base,* and afterwards any entity belonging to a trans-European company should set its own taxable base and profit based on rules (including accounting rules) that are *identical* although applicable in different countries. The base such determined is *aggregated* at parent company level and is distributed afterwards to fiscal jurisdictions, taking into account the activity of the entities operating in the respective jurisdiction, with every individual state to apply its own tax rate to the taxable base that has been allocated to the entity under the respective state jurisdiction. In principle, this solution is convenient to Romania, since:

- Corporations are taxed based on *the source* (location) of the revenue, which is in line with the economic rationale, stimulates creation and production activities, to the detriment of fiscal "engineering";
- Generates low compliance costs;
- Casts out double taxation and any related disputes;
- The profits (income) tax rate remains the only element of fiscal competition;
- The states are interested in consolidating their own taxable bases by setting up public goods to stimulate as many efficient economic operations as possible;
- It encourages mergers and trans-European concentrations, which become beneficial to small and medium-sized enterprises as well, as they are presented with more opportunities, which is very convenient to a country like Romania with no resident multi-national firms; moreover, the performing domestic SMEs are usually components of the international production system, integrated to multi-national companies and to which certain activities of the MNC value system were outsourced based on the specific competitive advantages of the respective SMEs, especially of first and second degree.

Conclusions

Still, the main issue relates to the criterion (criteria) of distribution of the taxable base set up at corporation level based on common rules broken down on component units.

As far as we are concerned, we militate for a criterion that is established as a mix of number of employees, turnover and corporal capital (that can be assessed with a reasonable diligence).

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