TAXATION POLICY IN THE EUROPEAN UNION

Marina KESNER-ŠKREB, MSc
Institute of Public Finance, Zagreb

Glossary*

Tax policy plays a significant role in the internal market. However, the EU has relatively little competence in taxation. Direct taxation is regulated almost entirely through bilateral agreements, while the EC Treaty contains a few provisions concerning indirect taxation and the harmonization indirect taxation.

Despite the introduction of a single market and economic and monetary union, there is still no genuine Community policy on taxation. What the EU does is to ensure that national tax rules are consistent with the Union's goal of job creation and that they do not give businesses from one country an unfair advantage over their competitors in another country. EU tax policy is about upholding the principles of the single market and free movement of capital.

National governments raise tax to finance their expenditure. Different member states have different spending priorities and the EU does not stand in the way of those priorities providing member states stay within reasonable spending limits. If they overspend and become too indebted, they could jeopardize the economic growth of other EU countries. However, providing they are prudent in their economic policy, they have considerable discretion on how to spend their money and, therefore, what taxes to raise to fund their spending. Member states' governments are free to set tax rates on corporate profits and personal incomes, savings and capital gains. The EU as a whole merely keeps an eye on these decisions to see they are fair to the EU as a whole.

Company taxation. EU pays particular attention to corporate taxation because of a risk that taxes could create obstacles to the smooth movement of goods, services and capital around the EU's single market. For example, member countries are bound by a code of conduct to prevent them providing tax breaks which distort investment decisions. As part of a tax package aimed at countering harmful tax competition, the Council of the European Union has adopted:

- a Code of Conduct on business taxation (December 1997);
- an act to remedy distortions in the effective taxation of savings income in

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the form of interest payments (Directive on the taxation of cross-border income from savings – June 2003);

- a common system of taxation applicable to interest and royalty payments made between associated companies (Interest and Royalty Payments Directive – June 2003).

Individual taxation. Personal taxation rules and rates on the other hand are matters for individual EU governments, unless an individual's cross-border rights are affected. So the European Commission has taken action to ensure that EU citizens are not deterred from working in other EU countries by problems linked to the transfer and taxation of their pensions and pension rights.

The EU also has a role in avoiding cross-border tax evasion. While EU citizens can place their savings where they think they will get the best return, they cannot use this as a means of avoiding paying tax. EU governments lose legitimate revenue if their residents do not declare interest income on savings held abroad.

EU countries and some other European governments have agreed to exchange information on non-residents' savings. The only exceptions are Austria, Belgium and Luxembourg and some other countries, which for the time being impose a withholding tax instead. They then transfer a large part of the money to the home country of the saver. As this is a bulk payment, the individual saver's anonymity is not breached, but the tax is still paid where it is due.

Value-added taxation. The adoption of the single currency is making the establishment of truly common rates of value-added tax (VAT) in the European Union a matter of increasing urgency.

Value added tax rates require a degree of EU involvement as they are fundamental to a properly functioning single market and fair competition across the EU. The EU has therefore set upper and lower limits on the VAT rates: the standard rate of VAT may not be less than 15%. Member states may apply one or two reduced rates of not less than 5%.

This nevertheless leaves considerable liberty for national differences in VAT rates. Exemptions can be allowed if a country so wishes, for example, for goods and services not in competition with goods and services from another EU member, or for the necessities of daily life, such as food and medicine.

Moreover, VAT rules and rates respect the EU principle that decisions on tax matters can only be taken if countries are unanimous. This rule safeguards national independence.

Excise taxation. Changes and differences in excises on petrol, drinks or cigarettes can very easily distort competition across EU borders. This is why they too are subject to some common rules. Nevertheless, they leave plenty of room for cultural differences. That is one reason why beer and wine prices vary so widely from one EU country to the next. Economic differences are another. A country with healthy public finances cannot be forced to tax for taxation's sake and Luxembourg's low excise duties offer bargains for motorists and shoppers from neighboring countries or for those passing through.

It also makes sense for the EU to have common rules on taxing energy products. This makes it possible for the EU to take a single approach to using them as incentives to energy efficiency, but again rules are flexible enough to accommodate special national circumstances.

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