

# A COMMON CORPORATE TAX BASE IN ORDER TO IMPROVE THE EUROPEAN SMES BUSINESS ENVIRONMENT

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**ABSTRACT:** *The political and social preferences of each country require independence in creating national tax policy. The divergence in the tax systems of the EU Member States has created many obstacles and therefore incompatibility with the internal market. By eliminating these distortions the Community achieves its aim of a single market. Today, companies operate throughout Europe thanks to the common rules established in the internal market, but at the same time more distortions have been created because of differences in Member States' fiscal policy and interpretations of existing EU common tax rules. This is particularly important for the 23 million SMEs in Europe, which often have only limited resources and insufficient expertise to comply with complex juridical rules and procedures. Double taxation, the lack of tax harmonization, tax-related hindrance of business restructuring and enormous compliance costs are just some barriers to a more competitive and open European market. Removing these obstacles by adopting more clear and consistent common juridical rules would significantly spur investment and contribute to enhancing the competitiveness of the EU economy.*

**KEYWORDS:** *Common corporate tax base, common juridical tax rules, costs of compliance for SMEs*

**JEL CLASSIFICATION:** *K34, F36, H32*

## 1. INTRODUCTION

As the European Union heads down path toward a more complete integration, several economic policy questions have arisen and now remain without a definitive response. Among these, perhaps none are as contentious as the future of taxation within the Union. First, following the introduction of EMU and the "Europeanization" of monetary policy, fiscal policy including taxation remains one of the few tools left at the disposal of national governments in their effort to influence their own economies. Furthermore, even fiscal

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policy has been constrained by the introduction of the Stability and Growth Pact, making taxation perhaps the final component with which individual countries can deal with asymmetric shocks. This being said, it is no surprise that the debate over taxation within the EU is a heated one. The literature on the subject is fueled by one central question: Is regulated tax harmonization or is market driven tax competition the best solution to the awkward state of asymmetric tax rates that currently exists in the EU? Not surprisingly, the existing viewpoints run the gamut from entirely pro-harmonization to pure pro-competition stances. As a whole however, the literature simply reveals the ambiguity of the issue, as reflected by its increasingly complex attempts to convey the reality of the European situation.

Tax harmonization consists in coordinating the taxation systems of the European countries to avoid non-concerted and competing changes in national fiscal policies, which could have an adverse effect on the internal market. Full tax harmonization covering 27 countries is a difficult undertaking, since this area remains largely the prerogative of the Member States. However, a minimum degree of harmonization has been achieved, in the field of indirect taxation, e.g. VAT, excise and custom duties.

Administrative and regulatory obligations for tax purposes are a time and cost consuming burden for SMEs. Cutting red tape and creating a better business environment is a policy priority for the European Commission. Some Member States have recently made progress in reducing red tape. But there are still ample possibilities to improve tax compliance procedures which vary in the participating countries. The exchange of good practices can encourage national authorities to identify suboptimal procedures and to improve their regulatory and administrative framework for SMEs. It is true that governments must assess and collect sufficient revenue to meet their goals and obligations. However, it is important that the costs of compliance and administration for taxpayers be reduced wherever possible.

## **2. THE ACTUAL CONTEXT OF EU FISCAL HARMONIZATION POLICY**

The fiscal policy is an important tool for managing the economy because of its ability to affect the total amount of output produced that is, gross domestic product. Tax sovereignty is considered one of the fundamental components of national sovereignty, so tax systems differ widely as a result of differences in economic and social structures and different conceptions of the role of taxation in general or of one tax in particular. Different countries have different tax regimes for different reasons. For example, the duty on tobacco in the UK is much higher than that in Spain and France. The question of how such taxes could be harmonized triggers massive problems - for example, the UK might claim to have higher taxes to discourage smoking and to provide external benefits to health and welfare whereas the tobacco industry in Spain might be hit hard by any increases in tax causing unemployment.

But national tax systems have a negative effect on EU market integration and on business environment for European SMEs, remaining obstacles should be lifted to take full advantage of the single market. Tax harmonization is critical to the operation of the Single Market so that goods, services, people and capital can move freely around the EU.

Basically, harmonization of taxes means making the levels of taxation more consistent in each country.

Since the creation of the Single Market, many distortions in the tax field have been resolved by a coordinated action at EU level. In such cases the tax sovereignty has been limited. These situations have been mainly related to cross-border problems, actions that cause obstacles to the internal market, or to tax fraud and tax avoidance.

Despite attempts by the European Commission to push tax harmonization forwards, there is a relative lack of support for the regime from a majority of the member countries and individuals involved. This is mainly due to the negative consequences for local governments, and the imperfect nature of the regime.

Both the creation of the Single Market and the completion of Economic and Monetary Union have led to new Community initiatives in the field of general taxation. The removal of restrictions on the mobility of capital has created fears that tax competition will erode national tax bases, with adverse consequences for employment and social protection. Economic policies are suggested and implemented at both the national and European level. Indeed, economic policy is primarily a national responsibility, even if the Treaty declares that it should be regarded "*as a matter of common concern*" and coordinated within the Council.

The last enlargement greatly increased tax disparities within the Union. At the same time, adoption of the single currency in 16 European countries has made it necessary to establish genuinely common rates of VAT and common rules for business taxation in the Union. When the euro came into being, monetary policy became the responsibility of the independent European Central Bank (ECB), which was created for that purpose, and the national central banks of the Member States having adopted the euro. Fiscal policy (tax and spending) remains in the hands of individual national governments – though they undertake to adhere to commonly agreed rules on public finances known as the Stability and Growth Pact. They also retain full responsibility for their own structural policies (labor, pension and capital markets), but agree to co-ordinate them in order to achieve the common goals of stability, growth and employment.

To summarize the EU initiatives on tax harmonization, only the VAT rates and the excise duties have achieved a high degree of harmonization with the establishment of the Single Market and the abolition of intra-Community tax controls, following the article 93 (99) EC Treaty and therefore help preventing double taxation, tax avoidance and disturbing of tax competition.

In the field of customs duties EU obtained the most successful level of tax harmonization. Customs duties were abolished for the intra-Community trade, and in commercial relations with other countries the Member States practice a common customs tariff.

## **2.1 Objectives in the area of general taxation policy**

Since 1997, the Member States have been conducting a wide-ranging debate on the scope for coordinated action to try to control the negative effects of tax competition. This has centered on three areas: company taxation, taxation of savings income and taxation

of royalty payments between companies. With the “fiscal package” to combat harmful tax competition, the Council adopted<sup>1</sup>:

- a code of conduct for business taxation (December 1997);
- an instrument to reduce distortions in the effective taxation of savings income in the form of interest payments (“Savings Taxation Directive”, June 2003);
- an instrument to eliminate withholding taxes on cross-border interest and royalty payments made between associated companies (“Interest and Royalty Payments Directive”, June 2003).

In the field of business taxation the first measure was to introduce a Common Consolidated Corporate Tax Base for EU businesses (CCCTB), a strategy the Commission has been working towards since 2001. A second series of measures is aimed at simplifying the *tax environment*. In order to create a level playing field, corporate taxation obstacles have to be removed concerning VAT compliance obligations; A third series of measures is aimed at removing *cross-border tax barriers* faced by EU businesses. The fourth measure is aimed at creating a new *car taxation* strategy to replace Member State registration taxes. The fifth measure concerns a new policy to combat distortions due to *fraud* and tax evasion<sup>2</sup>. Because different *company taxation systems* co-exist, cross-border activities are treated differently to similar domestic activities.

In the area of general taxation policy, the Community is pursuing a number of objectives:

1. A first, long-standing aim has been to prevent differences in indirect tax rates and systems from distorting competition within the Single Market. This has been the purpose of legislation under Article 93 (99) on VAT and excise duties.

2. In the field of direct taxation, where the existing legal framework mostly takes the form of bilateral agreements between Member States, the primary objective of Community action has been to close the loopholes which permit tax evasion; and to prevent double taxation.

3. The objective of more recent moves towards a general taxation policy has been to prevent the harmful effects of tax competition, notably the migration of national tax bases as firms move between Member States in search of the most favorable tax regime. Though such competition can have the beneficial effect of limiting governments’ ability to “tax and spend”, it can also distort tax structures. In recent years the proportion of total taxation accounted for by taxes on relatively mobile factors like capital (interest, dividends, corporate tax) has fallen, while that on less mobile factors, notably labor – for example social charges - has risen.

4. The Maastricht Treaty provisions on Economic and Monetary Union introduced a new dimension to general taxation policy by severely limiting governments’ ability to finance public expenditure out of borrowing. Under the Stability and Growth Pact, UE Member States must not at any time run budget deficits at a level above 3% of GDP. The general aim of the Pact is for Member States’ budgets to be roughly in balance over the economic cycle. Higher public spending can therefore be financed only out of higher

<sup>1</sup> European Commission, Tax harmonization, glossary updated given the recent signing of the Treaty of Lisbon, 2010, in [http://europa.eu/scadplus/glossary/tax\\_harmonisation\\_en.htm](http://europa.eu/scadplus/glossary/tax_harmonisation_en.htm)

<sup>2</sup> [European Commission, Towards Tax Co-ordination in the European Union: a package to tackle harmful tax competition, 1997, in [http://europa.eu/legislation\\_summaries/customs/111027\\_en.htm](http://europa.eu/legislation_summaries/customs/111027_en.htm)

revenues. In this context, Fiscal Policy became a very special tool for the economic development of each state.

Despite broad acceptance of these objectives, national governments have been reluctant to make any major steps towards the harmonization of taxation within the Community, and to adopt the tax harmonization measures by unanimity in Council, as is required. Any proposal for Community action in taxation must take full account of the principle of subsidiary<sup>3</sup>. According to the subsidiary principle, the EU Member States have independence in creating policy and legislation, which is advantageous to the new policy developments, while finding a European solution would be very long. Moreover, the tax sovereignty gives countries direct control over the tax rules and the tax revenues. Although the reform of corporate tax systems in the European Union is necessary in order to comply with the requirements of the internal market, harmonization of direct taxes would be incompatible with the subsidiary principle. Moreover, harmonization of direct taxes (for example corporate tax rates) would have a negative impact on business activities, especially on the small and medium-sized enterprises.

### 3. IMPLICATIONS FOR EUROPEAN SMES BUSINESS ENVIRONMENT

In order to achieve the goals of the re-launched Lisbon Strategy, Europe must improve European and national regulation. Better regulation has a significant positive impact on the framework conditions for economic growth, employment and productivity. This is particularly important for the 23 million SMEs in Europe, which often have only limited resources and insufficient expertise to comply with complex rules and procedures. Compliance with tax rules in particular can be challenging for small businesses. Tax legislation is in many cases rather complex. Tax laws are drafted in a way that allows their application to businesses of all sizes and to all types of economic transactions, even for operations that are only carried out by large corporations.

Small and medium-sized enterprises (SMEs) constitute the backbone of the European economy: There are approximately 23 million SMEs in the European Union, which account for 99% of all enterprises and provide around 75 million jobs<sup>4</sup>. It has been recognized that an SME-friendly business environment, both at Community level and in the Member States, is crucial for growth and jobs in Europe. Tax obligations (which comprise not only the actual payment of taxes, but also activities such as registration, documentation, reporting and recording) constitute some of the most important obligations enterprises have to comply with. For the various tax compliance procedures, enterprises require either internal resources and/or need to call in external resources, e.g. tax consultants and accountants.

Taxpayers have to meet a variety of tax obligations. Tax compliance procedures include all formal procedures and related activities that taxpayers have to observe to comply

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<sup>3</sup> European Parliament, Taxation in the European Union: Report on the Development of Tax Systems<sup>3</sup>, in [http://www.europarl.europa.eu/parliament/expert/displayFtu.do?language=en&id=74&ftuId=FTU\\_4.18.1.html](http://www.europarl.europa.eu/parliament/expert/displayFtu.do?language=en&id=74&ftuId=FTU_4.18.1.html)

<sup>4</sup> European Commission, Simplified Tax Compliance Procedures for SMEs, 2007, in [http://ec.europa.eu/enterprise/newsroom/cf/itemshortdetail.cfm?item\\_id=3327](http://ec.europa.eu/enterprise/newsroom/cf/itemshortdetail.cfm?item_id=3327)

with tax obligations. Although tax obligations may vary depending on the country and the taxpayer, four broad categories of obligations have been identified by the OECD<sup>5</sup>:

1. Registration in the system,
2. Timely filing or lodging of the required taxation information,
3. Reporting of complete and accurate information (including good recordkeeping),
4. Payment of taxes on time.

The expert group of European Commission agreed to add a fifth point<sup>6</sup>:

5. Becoming and remaining informed on tax obligations and tax procedures. *Report*

Thus, tax compliance represents an important cost factor that must not be underestimated. The regulatory and administrative burden in general and tax compliance in particular represents a significant cost element in relation to the turnover of enterprises and also the taxes they pay, especially for SMEs.

The own equity base of many companies, especially of smaller companies, is rather weak. This makes companies vulnerable during recessions and also aggravates the problems of structural changes and re-orientations of the businesses and of obtaining credit. Current tax rules can have an important impact on business owners' decisions whether or not to retain earnings. The increasing regulatory and administrative burden not only results in significant problems for enterprises themselves, but may also have a negative impact on the tax compliance of taxpayers in general and on the cost of the tax system for the tax administration. National tax legislations do not, at least in principle, distinguish between SMEs and larger enterprises. This means that tax laws are drafted so that they can be applied to enterprises of all sizes - distinctions between small and large enterprises are rare. The problem became even more complicated when enterprises are doing business abroad. Different tax rules and different tax rates in addition being difficult to assimilate create real obstacles to real competitiveness. Since tax provisions need to cover all kinds of transactions that are carried out by enterprises, they need to be comprehensive enough to cover even the very complex business transactions of larger multinational enterprises. As a consequence, small enterprises often struggle to apply such provisions.

#### 4. SOLUTION: CONSOLIDATION OF THE TAX RULES

Given that tax harmonization is an almost impossible goal for European Union, and on the other hand so many national different tax regulations pose problems for all companies doing business abroad, the solution would be consolidation of the tax rules.

Already in 2001, the European Commission, in the Communication COM (2001) 582, presented its view on a common consolidated corporate tax base CCCTB, considering that it is the only way of eliminating obstacles from the cross-border activities of the EU companies<sup>7</sup>. The idea of a common tax base for the EU companies was accepted neither by all Member States nor by the whole business area. 20 countries out of 25 supported the

<sup>5</sup> OECD Guidance Note, Managing and improving tax compliance OECD, 2004, p. 7

<sup>6</sup> European Commission, Simplified Tax Compliance Procedures for SMEs, 2007, in [http://ec.europa.eu/enterprise/newsroom/cf/itemsshortdetail.cfm?item\\_id=3327](http://ec.europa.eu/enterprise/newsroom/cf/itemsshortdetail.cfm?item_id=3327)

<sup>7</sup> International Chamber of Commerce, An optional Common Consolidated Corporate Tax Base in Europe: implications for businesses worldwide, 2007, in <http://www.iccwbo.org/policy/taxation/id7743/index.html>

idea. Germany and France have largely supported the implementation of a common corporate tax base given that this would end “tax dumping” of Member States with very low company taxes<sup>8</sup>. The small and medium entrepreneurs Union, (SME Union), oppose tax harmonization, saying that it would have negative impact on tax competition.

Today a common consolidated corporate tax base seems to be the only solution for the simplification of the complex and different national tax regulations. There are still some obstacles: First, the unanimity vote of the Council of Ministers could be an obstacle, but would possibly be resolved by closer cooperation of Member States in form of enhanced cooperation. Second, complicated technical implementation of the Common Consolidated Tax Base made the Member States’ governments more reluctant. Moreover, some Member States fear that a common corporate tax base could imply harmonization of tax rates. For many countries the competitive tax policy is a comparative advantage. A competitive European tax policy is beneficial to the SMEs which are considered as the biggest growth and employment creators<sup>9</sup>.

The priority must be given to the problem of reducing compliance costs and the problems with cross-border loss-offset which are due to the divergence of corporate tax systems between the Member States. These problems are more significant in the small and medium-sized enterprises’ activities.

Some of the important benefits of the implementation of a common corporate tax base are: reducing the number of associated cross border disputes, enhancing economic efficiency of cross-border activities and reducing the risk of double taxation.

To overcome the reluctance of some member states, it should be underlined that the objective is not to harmonize tax rates, but the tax base and rules in order to obtain uniform tax regulation, simplicity and transparency of national tax systems. On the contrary, tax sovereignty with respect to tax rates is instrumental to ensure sound tax competition among Member States and thus to promote efficiency. The objective is, rather, to create a more efficient market and tax system for companies operating within the EU by providing for a common and competitive tax base.

Also to overcome the reluctance of some national governments, it is better that only some Member States in the EU will initially introduce the common tax base. Other Member States can then join the regime at a later stage. Anyway, Member States control the EU tax legislation because the Treaty requires unanimity vote (articles 93, 94 EC Treaty) and because the principle of subsidiary allows Member States keeping taxation under national legislation.

Tax coordination under the principle of subsidiary refers to the compatibility of national legislation with treaties. The tax consolidation rules must be based on mutual recognition of the Member States’ tax rules. This is the only solution to more harmonize measures on company taxation in the EU, without affecting tax rates.

<sup>8</sup> Parker George, EU Tax harmonization plan “ready in three years”, 25 May 2005, Financial Times

<sup>9</sup> SME Union of the European People’s Party, Special Report: Tax Time, The Entrepreneur newsmagazine No 10, March 2010, p.3e in <http://www.entrepreneur.com/tax/index.html>

## 5. CONCLUSIONS

Compliance with tax rules in particular can be challenging for small businesses. *Tax legislation* is in many cases rather *complex* and *large differences* from country to country rise problems to enterprises doing business abroad. Tax laws are drafted in a way that allows their application to businesses of all sizes and to all types of economic transactions, even for operations that are only carried out by large corporations. Better regulation will help to create more conducive conditions for economic growth in order to achieve the objective of making Europe a more attractive place to invest and work. Improving European and national fiscal regulations comprising measures such as simplification, well shaped legislation and efforts to reduce administrative costs. This is crucial especially for SMEs, which are disproportionately affected by regulatory and administrative obligations.

