

# THE LEGAL SOURCES AND STEPS OF THE EUROPEAN TAX HARMONIZATION<sup>1</sup>

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**ABSTRACT:** *This paper tries to summarize the legal sources of the European tax law, the main developing station of the European tax harmonization. As we could mention the European tax law as the European tax harmonization, I collected the primary and secondary law sources of the EU taxation, including the political agreement as for example: the Code of Conduct for Business Taxation. This paper is about what the tax harmonization means, what are the methods and concepts of the tax harmonization, what was in the beginning of the legislation in the Rome Treaty, and now what are the newest challenges in the European taxation. I examined both the direct and indirect taxes' results in the EU, and showed the new Energy Tax Directive and Commission proposal of the Common Consolidated Corporate Tax Base.*

**KEYWORDS:** *European tax law, EU tax harmonization, legal sources of EU tax law, harmful tax competition, Energy Tax, Common Consolidated Corporate Tax Base (CCCTB)*

**JEL CLASSIFICATION:** *K 23*

## 1. OPENING THOUGHTS

The Roman Treaty, later the EC Treaty also in the Article 2 lays down the objectives of the common market, and still this article is the main base of establishing the objectives of the Community, and the economics of the European Union. The common market requires the freedom of goods, services, and free movement of persons and capital, normal conditions of competition, and harmonization of national law in as far as disparities between national laws impede the functioning of the common market. Tax differences cause market fragmentation along national border.

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The fiscal obstacles to a common market are:<sup>2</sup>

- fiscal burdens on the emigration of legal persons, persons, and on the internal border-crossing of goods, services, income or capital,
- differential tax treatment of domestic and imported goods and services,
- substantial differences between national tax law, leading to market distortions,
- differential tax treatment of residents and non-residents and of domestic and foreign investment or income, especially international double taxation of foreign source income.
- discriminative taxation of foreigners, with *positive discrimination*, like the tax favour of foreign investments, or with *negative discrimination*, like the differential tax treatment of residents and non-residents.

These tax differences distort economic neutrality as to where to trade, where to work, where to establish and where to invest. Therefore negative integration, or positive harmonization, tax integration, harmonization at least coordination between the member state's tax system, is indispensable for the establishment and the proper functioning of a common market.

Tax policy is essential to all Member States, and a country's actions<sup>3</sup> can have an impact not only at home but also in neighbouring countries. In the European Union's single market, Member States need to work together and not strike out in different directions on tax policy.

Positive integration (harmonisation measures at EC level) is not the sole, and for direct taxes not the most important factor in doing away with tax impediments to the proper functioning of the common market. Whereas most of extensive harmonisation of direct taxes, especially of customs duties, turnover taxes and excises, has been achieved by way of positive integration measures (EC regulations and directives), most of the modest integration of direct taxes is a result of negative integration.(integration through prohibitions).

Negative integration is especially important in direct-tax matters because national tax systems tend to distinguish between domestic-source income and foreign source income, and between resident taxpayers and non-resident taxpayers, whereas the EC Treaty forbids all over or covert discrimination of undertakings and nationals of other Member States.

Another harmonizing factor that may be more important - especially in direct-tax matters - than positive integration efforts, is *tax competition* between Member States. Tax competition has a sinister side: excessive (unfair) tax competition may easily lead to tax erosion or degradation, Member States outbidding each other with tax incentives in order to attract foreign investors, but in doing so sponging on each other's tax bases.

So the Member States take measures to obstacle the harmful tax competition.

<sup>2</sup> Ben J. M. Terra - Peter J. Wattel: European tax law, Kluwer Law International, Hague, 2005. p.1.

<sup>3</sup> Lucian Chiriac - Ximena Moldovan: Observations on the unconstitutionality of GEO no. 34/2009 regarding the 2009 budget rectification and the regulation of some financial-fiscal measures and the negative influences on small and medium-sized enterprises (SMES)", published in „Curentul Juridic” Journal, no. 3/2009, pp. 59-70; Ramona Mihaela Moldovan - Daniela Cristina Valea: The impact of the European Law on the national tax legislation regarding value added tax, published in „Curentul Juridic” Journal, no. 3/2009, pp. 107-118.

Harmonization of taxes, especially of direct taxes, is a politically highly sensitive area. Tax sovereignty is a fundamental part of national sovereignty. One of the most basic rights of national parliaments is the right to vote on taxes. Moreover, taxation is the most important instrument for economic and social policy of national governments. It may be used to redistribute income and wealth, to encourage investments or savings, to discourage the consumption or the use of certain goods. The further the harmonization process and, therefore, the loss of national sovereignty in the field of indirect taxation processes, the less the Member States will be inclined to forego their remaining tax sovereignty, that the sovereignty in the field of direct taxation.

## 2. THE DEFINITION, AIMS AND TYPES OF THE TAX HARMONIZATION

The tax systems in the Member States – as a consequence of the state sovereignty – are different. The tax system consists of the applied taxes in the same time. Every state has to declare own tax system, it is the tax sovereignty, tax independency of the states.

Every state can declare autonomously the following, and the Member States' tax systems differ from each other in the following:

- in the types of taxes (direct or indirect)
- in the set of the taxpayers,
- in the types of the assessable property
- in the base of the taxes
- in the rate of taxes
- in the tax exemption
- in the tax allowances.

### *Aims of the tax harmonization*

The aim of the tax harmonization is to do away with the hindrances of the free competition. The first step was the harmonization of the indirect taxes, because the different turnover taxes interfered the functioning of the single market. The harmonisation of the direct taxes started later, and moves on slower. The reason of the postponement is the Article 94. of the Treaty of Rome. The article 94 EC Treaty authorises the Council, acting unanimously on a proposal from the Commission and after consulting the European Parliament and the Economic and Social Committee, to issue directives for the approximation of such laws, regulations or administrative provisions of Member States as directly affect the establishment or functioning of the common market. This article prescribes the directives carried unanimously as the instrument of the tax harmonisation, and with this makes the changes difficult.

Therefore the Commission and the Council of the European Union create regulations, which are not legal sources, but having legal effect without legal sanction.<sup>4</sup>

The European Union Tax law consists of the primary and secondary legal sources and the regulations without sanction.

<sup>4</sup> For example the Code of Conduct for Business Taxation is a political commitment (gentlemen's agreement), not a legally enforceable rule. It defines harmful tax measures as "measures (including administrative practices) which affect or may affect in a significant way the location of business activity in the Community" and which provide for a significantly lower effective level of taxation than the general level of taxation in the Member State concerned

The aims of the tax harmonisation are to ensure the following:

- equal competition conditions in the EU member States
- the prohibition of the discrimination
- the establishment of the integrated internal market.

*Harmonization of taxes - definition*

Term used to refer to the process of removing fiscal barriers and discrepancies between the tax systems of the various countries comprising the European Union. To this end the European Union has issued directives in the area of indirect and direct taxation.

*The concept of the tax harmonization*

- the unification of the tax systems and taxes of the Member States, which ensures the same competition conditions to the taxpayer of the international market
- the establishment of the national tax systems, which promotes the unified functioning of the common internal market
- the unison of the internal and external conditions of the tax systems, which serves the purpose of the European union

*The types of the tax harmonization*

Identical with the methods of the legal harmonization<sup>5</sup>, but differentiate the adoption of the equalising and the differentiate method.

*The equalising method* preaches the standardisation, the equalising of the tax bases and the tax rates.

*The differentiate method* leaves the sovereignty of the Member States in the legislation of tax rules, the intervention is minimal. This method allows the choice of the most optimum tax regulations. It makes the harmonization with directives. The different regulations are possible.

The great question of the tax harmonisation, whose income has to increase: the income of the Member States or income of the European Union? We can't decide this question, but the tax liberty and sovereignty of the states is great and important for every member states.

So the tax harmonisation deals with the coordination of the taxes, which upset the single internal market and doesn't deal with all of the tax categories, tax rates.

### 3. THE STEPS OF TAX HARMONIZATION IN THE EEC AND EU

Experts of taxation examined the possible methods of the harmonization of direct taxes in the EEC. The first committee of the independent taxation experts' was led by Tinbergen.

The *Tinbergen-Report*, issued 1953, did not regard harmonisation of direct taxes as necessary for the implementation of a single market.

Professor Fritz Neumark was the leader of the second experts' committee. Almost ten years later the *Neumark-Report* stated that differences in corporate tax rates be an obstacle to the idea of a genuine single market. It recommended the introduction of a single corporate tax rate in the EEC, based on a split rate system (50 per cent on retained

<sup>5</sup> The methods of the legal harmonisation: total and optional, co-ordination with guidelines, mutual acknowledgement, directive legislation and the subsidiary principle.

earnings, 15-25 per cent on distributed profits) without giving credits to the shareholders when taxed for personal income. This was in fact equal to the German system in force at that time.

Article 99 of the EEC Treaty instructed the EC Commission to consider “how the legislation of the various Member States concerning turnover taxes, excise duties and other forms of indirect taxation, including countervailing measures applicable to trade between Member States can be harmonised in the interest of the common market”

In 1960, the Commission responded to this instruction by appointing three working groups. Working group I., charged with the task of researching the possibilities of harmonising turnover taxes in the EEC, appointed three study groups: sub-groups A, B and C were composed of experts from the Member States and the Commission. The question of the possibility of the removal of tax frontiers and the need for physical inspections at borders to administer the system of border-tax adjustments in relation to turnover taxes was referred to sub-group A. Sub-group B was given the task of considering the adoption of a common single-stage general sales tax, to apply at a stage prior to the retail stage, and if necessary, to be combined with a separate tax on retail sales. Sub-group C considered the possibilities of a common single-stage tax at the production stage, with a separate tax at the retail stage if necessary. The results of the working groups were published as the ABC report.

Furthermore, in 1960, the Commission appointed the Fiscal and the Financial Committee to study the extent to which the tax systems of the Member States conflicted with the establishment of a common market. The conclusions of the ABC report and the report of the Fiscal and Financial Committee (chaired by Professor Fritz Neumark from Germany) are, in substance, in accord. Both recommend that Member States must abolish the *cascade tax* and adopt the value added tax in its place. (generally referred to as the Neumark report)

The Neumark report did not consider the retail sales tax as a suitable alternative, on the practical grounds of fiscal technicalities, particularly those relating to the large number of small retailer merchants, most of whom were thought to be unable to keep adequate books. In fact, the Neumark report considered the problem of applying the VAT in the retail stage so intractable that it recommended the exclusion of the retail stage from the value added tax.

The EEC Commission agreed with the findings of the ABC and Neumark reports and proposed, in a draft directive, that harmonisation should proceed in three stages. During the first stage, ending four years after the implementation of the directive, member States should abandon their multi-stage cumulative turnover taxes and replace them by a non-cumulative system of their choice. During the second stage the non-cumulative systems should be replaced by a common value added tax system. The third and the final stage should result in the abolition of intra-Community tax frontiers.

The proposal was submitted to the European Parliament. The Internal Market Committee of the Parliament, in a report named “the Deringer report” after the chairman of the Committee, M. Arved Deringer, advised that the envisaged three stages should be reduced to two.<sup>6</sup>

<sup>6</sup> Ben J.M. Terra – Peter J. Wattel: *European Tax Law*, Kluwer Law International, Hague, 2005. p.201.

1969 saw the issue of two draft directives by the Commission on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States and in the case of mergers, integration and division different Member States. These were eventually enacted in 1990 (Council directive 90/435 and 90/434 respectively).

In 1970 the *Werner-Report* contemplated a harmonisation of corporate taxation in two steps. In the first step the different tax systems of the member states should be harmonised while the aim of the second step was the harmonisation of tax base and rate. The first step was supposed to be completed until 1973.

In 1985 the Commission published a *White Paper* for the Council of the EC with the objective of setting out in more detail a program and a timetable designed to achieve a single market by 1992 thereby creating a more favourable environment for stimulating enterprise, competition and trade within the Community.

The White Paper focuses on the internal market and the measures which are directly necessary to achieve a single integrated market.

The White Paper classified the measures that need to be taken under three headings:

- Part I: the removal of the physical barriers
- Part II: the removal of technical barriers
- Part III: the removal of tax barriers.

In August 1987, Commission issued a series of proposals concerning the measures in the field of indirect taxation as follow up to the tax barriers in the White Paper. The Council, eventually, found that the system as proposed by Commission presupposed the fulfilment of conditions that could not meet before 1993. Therefore, it adopted rules that would be applicable for a transitional period.

The proposals of the Commission are largely based on the strategy provided for in the White Paper. The white Paper demonstrated that, in order to abolish fiscal frontiers, there must be a considerable measure of approximation of indirect taxes. The Commission proposes four major changes in the system of the taxation within the Community. First, the Commission proposes an approximation of the VAT and the main excise duties. Second, the Commission proposes the elimination of the distinction made between supplies within a Member State and supplies to another Member State. For intra-Community trade the system of relieving goods from tax at export and of imposing tax at import should be abolishing. Third, a revised VAT clearing mechanism is proposed. Fourth, for VAT purposes the Commission proposes to change the place of taxable transactions regarding the services.

In 1991 the ECOFIN COUNCIL finally agreed on the text of the Directive 91/680/EEC, the Directive on the abolition of fiscal frontiers. The Directive dramatically changed the VAT system within the Community and required persons liable to pay VAT to comply with new extensive administrative obligations.

When Directive 91/680/ EEC was adopted on 16 December 1991, the Council of Ministers had not yet reached a final decision on the rate structure. By Council Directive of 19 October 1992 (Directive 92/77/EEC) the following rules were adopted with regard to the approximation of VAT rates. From 1 January 1993 Member States must apply a standard rate which, until 31 December 1996, may not be less than 15%.

Member states may also apply either one or two reduced rates. The reduced rates may not be less than 5%.

The most recent issue of the EEC, the *Ruding-Report*, dates from March 1992. It drops the main idea of the 1975 draft directive, namely the quick harmonisation of the tax systems. The adoption of a common system of corporation tax is seen by the *Ruding-Committee* only as a long-term objective.

In detail, the report recommends measures on elimination of double taxation of cross-border income flows as well as measures on harmonisation of corporation taxes.

In the field of capital income taxation virtually nothing has happened so far. The Commission's proposal of a minimum withholding tax of 15 per cent on interest income and dividends has not been enacted.

In the field of the indirect taxes, mentionable, the Directive 99/85/ EC about the preferential VAT rates.

#### *The Package to Tackle Harmful Tax Competition*

In October 1997, the Commission communicated to the Council its ideas on how to tackle harmful tax competition, in a paper entitled "Towards tax co-ordination in the European Union". The *Code of Conduct for Business Taxation* is a political commitment (gentlemen's agreement), not a legally enforceable rule. It defines harmful tax measures as "measures (including administrative practices) which affect or may affect in a significant way the location of business activity in the Community" and which provide for a significantly lower effective level of taxation than the general level of taxation in the Member State concerned.

For the assessment of the harmfulness of national tax measures, the Code of Conduct lists the following characteristics as relevant:

- Off-shore characteristics: availability of the tax advantage only for non-residents, or only for transactions with non-residents
- Ring-fencing: protection of the domestic market against the tax advantage, so that the measure does not erode the domestic tax base of the State concerned
- Non-transparency: unpublished advance rulings, negotiability of the tax burden, lack of recovery.

With the Code of Conduct, the Member states committed themselves not to introduce any new tax measures which are harmful, and to repeal existing tax measures which, after review, labelled harmful.

The Council of the EU's Directive 2003/48/EC on taxation of income in the form of interest payments is part of a *package of tax measures*, designed to tackle harmful tax competition, and agreed by the finance ministers of the member states of the EU in June 2003. The Directive on Taxation of Savings Income (as part of a broader tax package including the Code of Conduct for business taxation and the Directive on Interest and Royalties<sup>7</sup>) was formally adopted on 3 June 2003.

Mention must be made of the regulation of the Common Consolidated Company Tax Base.<sup>8</sup>

<sup>7</sup> Council Directive 2003/49/EC on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States, should have been implemented in all Member States by 1 January 2004.

<sup>8</sup> Com. 2006/157. directive proposal of the European Commission

## 4. EUROPEAN TAX LAW – THE LEGAL SOURCES OF THE UNION’S TAX LAW

### 4.1. Primary legal sources of the tax law

The foundation Treaties of the European Communities i.e. the European Coal and Steel Treaty, the European Atomic Energy Treaty and the European Economic Treaty together with the various Annexes and Protocols attached to them are a *primary source* of European Union law. These Treaties have been amended and supplemented on a number of occasions since the foundation of the European Communities through the respective Treaties of Accession, through the Single European Act, the Treaty on European Union, the Treaty of Amsterdam, the Treaty of Nice and the Lisbon Treaty. The most significant regulations are in connection with the taxation in the Articles 90-92. (95-98.) of the Treaty of Rome, Articles 110-114. in the Lisbon Treaty<sup>9</sup>.

The *Article 90 EC Treaty (110)* prohibits any Member State to impose directly or indirectly excessive taxation, or internal taxation to the products of other Member State, and/or any internal taxation that would form an indirect protection to other products. The Article 90 (110) EC Treaty therefore forbids tax discrimination that gives a Member State advantage to its domestic products. In case of non respect by a Member State, the matter may be subject to infringement procedure before the Court of Justice. The following Articles, 91-93 EC Treaty (111- 113) abolish export subsidies in form of repayment of internal taxation.

### 4.2. Secondary legal sources of the tax law

Law made by the European Union institutions in exercising the powers conferred on them by the Treaties is referred to as *secondary legislation*. Secondary legislation consists of the legal acts listed and defined in *Article 249 (288)<sup>10</sup> of the EC Treaty* i.e. *regulations, directives, decisions, recommendations and opinions*.

*Regulations* are legislative instruments of general application. Regulations are binding in their entirety. This means that a Member State has no power to apply regulations incompletely or to apply only those provisions of which it approves. Regulations are also directly applicable. This means that regulations do not need to be transposed into national law by the respective Member States in order to take effect.

*Directives* are binding on Member States as to the result to be achieved but leave it to the respective national authorities to decide how the Union objective set out in the directive is to be incorporated into their domestic legal systems before a specified date. A directive does not acquire legal force and effect until the date for implementation of the directive has expired. The directives are the instrument of the tax harmonisation.

<sup>9</sup> 2010/C 83/01 Consolidated version of the Treaty on European Union and the Treaty on the Functioning of the European Union, in: Official Journal of the European Union C83, Volume 53., 30 March 2010. <http://eur-lex.europa.eu>

<sup>10</sup> 2010/C 83/01 Consolidated version of the Treaty on European Union and the Treaty on the Functioning of the European Union Article 288.



A *decision* is an individual act addressed to a specified person or persons. Decisions are binding only on those to whom they are addressed without any need for implementation into national law.

*Recommendations and opinions* are non-binding instruments of the Union's law. They are of persuasive value only

### 4.3. The case law of the Court of Justice of the European Union

By examining the case law of the Court of Justice of the European Union<sup>11</sup> as a source of law, I deal with its function in connection to the tax harmonization.

The ECJ's practice is outstanding in the field of community, Union's tax law. Most of the ECJ's decisions, regarding the Articles of the Treaty of Rome and the secondary legislation concerning taxation, have been made during preliminary hearing.

The indirect taxation, including the regulation of VAT the court applies the *theological* method in the interpretation of the secondary legislation. This means, that the common VAT system based upon VAT Directive Article 2, and the principles laid down in the Directive's Preamble are applied, with special regard to the installation of neutral tax regarding export and import within the Community. The ECJ declared it many times that the neutral taxation depends on the general application of provisions regarding the new tax.

The ECJ applies the *systematic* interpretation also, because some rules of the community VAT legislation are part of a complex taxation system; and the role of each regulation can be defined by the simultaneous examination of other provisions. Regarding the ECJ's practice about direct taxation the main aim is the realization of the prohibition of discrimination between the taxation of people with foreign taxation competency.

ECJ has to compromise between the principles of the international taxation law and the free freedom of the Treaty of Rome. The ECJ realized that the international taxation practice endanger the security of law and the legal principles, because the foreign and not foreign people are not and can not be in the same taxation position. Therefore the ECJ tries to reduce the practice of member states in this field as much as possible.

The case law of ECJ concerning taxes has got a value of being source of law in connection to the taxation of companies and to the realization of the freedom to settle down.<sup>12</sup>

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<sup>11</sup> Formerly in the EEC Treaty the name of the Court was European Court of Justice, in abbreviation: ECJ, in the Treaty on European Union and the Treaty on the Functioning of the European Union the name of the Court is: the Court of Justice of the European Union ( ECJ).

<sup>12</sup> The cases which are connection with Hungary, are in front of the ECJ (on preliminary ruling) e.g.: case of the local business tax in Hungary (HIPA case) common case C-283/06 and C-312/06., case of Cartesio Bt. C-210/06., case of PARAT Automotive Kft. v. APEH (Central Tax Office) C-74/08., case of CIBA Speciality Chemicals Central and Eastern Europe Kft. v APEH C-96/08.

## 5. THE MOST IMPORTANT SECONDARY LEGAL SOURCES IN THE HARMONIZATION OF INDIRECT AND DIRECT TAXES

### *Indirect taxes:*

The common system of the value added tax was set out in the Second Directive (Directive 67/228/EEC), which provided that the value added tax should apply to:

- the supply of goods and the provision of services within the territory of the country by a taxable person against payment
- the importation of goods (Art. 2.)

The expressions “territory of the country”, “taxable person”, “supply of goods”, “provisions of services” were further defined (Arts. 3-7.), albeit that only services, listed in the Annex B, were compulsory subject to VAT.

The Sixth Directive which was adopted in 1977 is the basis of the Community’s VAT system. The aim of the Sixth Directive is to further harmonize the various national laws.

Council Regulation (EC) No 1777/2005 of 17 October 2005 laying down implementing measures for Directive 77/388/EEC on the common system of value added tax.

Article 90 (110) of the EC Treaty prohibits any tax discrimination which would, directly or indirectly, give an advantage to national products over products from other Member States. Article 93 (113) of the Treaty calls for harmonization of turnover taxes, value added tax (VAT), excise duties and other forms of indirect tax. VAT was the first tax to be harmonised, in 1977. It was adapted in 1992 to meet the requirements of the new single market, together with excise duties, which were also harmonised at the same time. These developments were accompanied by a partial alignment in the rates of the two types of indirect tax, and by arrangements for closer co-operation between national authorities. The single market, however, is only fully effective in areas where Community harmonisation of national legislation is complete.

### *Main features – characteristics - of Value Added Tax<sup>13</sup>*

VAT is a general consumption tax which is directly proportional to the price of goods and services. It is collected fractionally, i.e. on each transaction in the economic chain, and is neutral.

- It is a *general* tax applying in principle to all commercial activities involving the production and distribution of goods and provision of services.
- It is a *consumption* tax because it is borne ultimately by the final consumer. It is not a charge on companies.
- It is *charged as a percentage of price*, which means the actual tax burden is visible at each stage in the production and distribution chain.
- It is collected *fractionally*, via a system of deductions whereby taxable persons (i.e. VAT-registered businesses) can deduct from their VAT liability the amount of tax they have paid to other taxable persons on purchases for their business activities. This mechanism ensures the tax is *neutral* regardless of how many transactions are involved.

<sup>13</sup> See it on the judgement of the Court in HIPA case of Hungarian local business tax C- 283/06 and C-312/06 common case.

*The work programme on a new common VAT system presented by the Commission in 1996*

Following the Council's adoption of the transitional VAT system the Commission, in July 1996, proposed a package of measures which would be introduced in stages to deal first with immediate problems and then move towards a common origin-based VAT system.

To improve on the transitional system and meet the needs of the single market, the new VAT system must:

- put an end to the segmentation of the market into 'national' tax areas;
- be simple and modern;
- ensure equal treatment for all transactions within the Community;
- guarantee effective taxation and controls to maintain the level of VAT revenue.

The programme focuses on three areas of Community action:

- uniform application;
- modernisation of VAT;
- a change to origin-based taxation.

*Direct taxes:*

They are paid and borne by the taxpayer and include income tax, corporation tax, wealth tax and most local taxes.

Secondary law sources of direct taxes:

- Parent Subsidiary Directive 90/435/ECC about the taxation of the dividend between the parent company and the affiliated firm. The aim is to ensure the free movement of the capital.

Modification: 2003/123/EC.

- Directive 90/434/EEC (the so-called "*Merger Directive*") of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States.

Modification: 2005/19/EC.

The types of the transformation:

- merger
- de-merger
- transfer of branch of business
- exchange of shareholdings

„Tax package” 1997-2003

- The Code of Conduct for Business Taxation<sup>14</sup> is a political commitment (gentlemen's agreement), not a legally enforceable rule. The Member States should terminate the harmful taxation practice till 2013 and it is forbidden for them to introduce new ones. There are continuous examination of the new rules.

It envisaged four categories of measures, one of which concerned distortions in the area of indirect taxation. The three other categories concerning direct tax measures envisaged:<sup>15</sup>

- a non-binding Code of Conduct to curb excessive tax competition, coupled with a Notice of the Commission on how the EC state aid rules must be understood and applied in the field of company taxation.

<sup>14</sup> Official Journal of the European Union No.c 2 of 6 January 1998. p.1.

<sup>15</sup> Ben J.M. Terra – Peter J. Wattel: European Tax Law, Kluwer Law International, Hague, 2005. p.283.

- measures to eliminate distortions in effective taxation on capital income, especially interest on savings, and
- measures to eliminate withholding taxes on cross-border payments of interest and royalties between companies.

The next sources of law: The EU Directive on Interest and Royalty Payments between associated companies of different Member States (2003/49/EC) – harmonisation of taxation of interest and royalty transfers between the associated companies in the different Member States.

- Council Directive 2003/48/EC on taxation of savings income in the form of interest payments – exchange of information about the paid dividend citizens who are individuals resident in another Member State or obligation of assessment of interest tax in the interest of termination of tax evasion. (*Tax evasion*: illegal methods used in order not to pay tax one really ought to pay. *Tax avoidance*: legal methods used in order not to pay more tax than one has to.) – International agreements in order the extension of the regulations of the directive.

- Efforts to the creation of the Common Consolidated Company Tax Base. (2004- and present day).

#### *Direct taxes*

Indirect taxes require some degree of harmonisation because they affect the free movement of goods and freedom to provide services. This is not true to the same extent of direct taxes, and the EC Treaty does not specifically call for them to be aligned. Some aspects of direct taxation do not in fact need to be harmonised or co-ordinated at all and are left to the discretion of the Member States, in accordance with the principle of subsidiarity. The situation is somewhat different where direct taxation has an impact on the four freedoms provided for by the EC Treaty (free movement of goods, persons, services and capital) and the right of establishment for individuals and companies. National tax law must respect these fundamental freedoms. Community legislation on taxation has also been adopted under wider provisions, such as Article 94 (114) and Article 308 of the EC Treaty.

## **6. THE NEWEST CHALLENGES IN EU TAX LAW**

### *Energy and environmental taxation*

#### *The background of the new Directive on Energy Taxation*

In its communication on the tax policy in the European Union of 2001, the Commission mentioned the following with regard to energy and environmental taxation:<sup>16</sup>

Generally taxation has proved to be an efficient economic instrument for tackling environmental problems. Currently, the taxation of energy builds on three pillars: a.) excise duties, b.) VAT and c.) specific levels. Whereas excise duties on mineral oils and VAT constitute community systems of taxation, no EU-wide framework is applicable to energy products other than mineral oils. As regards mineral oil products, since 1992 an unanimously agreed Community system has provided for a minimum excise rate for each

<sup>16</sup> Ben J.M. Terra – Peter J. Wattel, (2005), p. 446.

product according to its use (propellant, industrial and commercial uses, heating purposes). In the excise duties are often levied at rates that are higher than the minimum rates, and it hasn't been updated since 1992. Effective excise rates thus differ substantially between member states. Zero taxation is compulsory for some activities and national derogations can also be granted for specific policy reasons in favour of, for instance, environmentally friendly products, or particular economic sectors as agriculture, public transport. In many cases, these mentioned derogations are granted in order to maintain the competitiveness of local companies when higher energy or environmental taxation schemes are implemented. The increase in the number of national taxes that differ in their scope, methods of calculations, rates might negatively affect the functioning of the liberalized gas and electricity markets.

This mechanism at both national and Community level thus lead to distortions in the consumer choices between energy sources or products and in the conditions of competition. That's why in 1997 the Commission proposed a Council Directive for restructuring the Community Framework for the taxation of energy products, with a view to extending the scope of the Directives on mineral oils to others energy sources, as coal, electricity, natural gas, and to increasing the Community minimum excise duties on energy products. One key element of the proposal is the recommendation that member states, when implementing the Directive, should avoid any increase in their overall tax burden. After a four year stalemate in the Council, it is essential that progress should now be made on the proposal, even if unanimity cannot be achieved. A common framework including differentiated rates according to environmental objectives could be very useful. The Commission communication on an EU Strategy for Sustainable Development calls on the Energy Products Directive to be adopted by 2002. An agreed Community framework for energy taxation could help to pave the way for more ambitious environmental targets for energy taxation within two years of the adoptions of the Directive, aiming at the full internalization of external costs.<sup>17</sup>

At its meeting the ECOFIN in April 2003 finally reached political agreement on the text of a Directive on taxation of energy products and electricity. This is the Directive 2003/96/EC replaces the excise on mineral oils by taxation on energy products and electricity. For this taxation there is no longer a separate structure and rates directive.

The new Directive contains:

- the scope
- levels of taxation
- exemptions and tax refunds
- holding and movement of products
- chargeable event and chargeability
- final provisions.

The minimum levels of the taxation as referred are set out in the Directive, while the reduced rates and exemptions which member states may continue are also set out in it.

The Directive prescribes that member states must inform the Commission of the levels of taxation which they apply and of measures taken with regard to differential rates, limitation or exemption on energy products for air navigation, and navigation within

<sup>17</sup> Ben J.M. Terra – Peter J. Wattel, (2005), pp. 447-448.

Community waters, facultative exemptions, reductions for business purposes. Member states were to bring into force the laws, regulations and administrative provisions necessary to comply with the Directive not later than 31 December 2003. The provisions with regard to biofuels and other products produced from biomass and the transitional arrangements may be applied by the member states from 1 January 2003.

On 2004 the Commission presented a proposal to amend the Energy Tax Directive so as to allow the EU accession countries temporarily to apply excise duty exemptions or lower rates of duty than the EU –wide minimum rates normally required on all energy products ( mineral oils, coal, natural gas) and electricity. The varying arrangements proposed cover nearly all the accession countries. The arrangements would be along the lines of those allowed to existing member states. The likely price increases if excise duties had to be raised by 1 May 2004 in the accession countries could negatively affect their economies and could constitute a heavy burden for small companies and for poorer households. The proposal came into force on 1 May 2004. This is the date by which the accession countries were required to apply the Energy Tax Directive.<sup>18</sup>

*The Common Consolidated Corporate Tax Base (CCCTB)*

On March 16 2011 the European Commission proposed the introduction of the Common Consolidated Corporate Tax Base – a common system for calculating the tax base of businesses operating in the EU.<sup>19</sup>

*Background of the proposal*

The 27 different member state have 27 different national tax systems within the EU, the Commission acknowledged that the EU market remains highly fragmented, and ultimately at a serious disadvantage with regard to potential investors and businesses.

Specifically, the Commission identifies three tax obstacles apparent in the internal market as a result of the numerous taxation systems:

- additional compliance costs related to international activities,
- instances of double taxation , and
- over –taxation in cross-border situation.<sup>20</sup>

What is the solution of the CCCTB:

The CCCTB aims to overcome some of these obstacles by providing companies with a single system of corporate tax base rules. Under the proposal, it would be possible for companies to file one consolidated tax return covering all of their activities within the whole EU. On the basis of this single tax return, the company's tax base would then be shared out amongst the Member States in which it is active, according to a specific formula. This formula will give equal weight to three factors: sales, labour and assets. After the tax base has been apportioned, Member States will be allowed to tax their share of it at their own corporate tax rate.

The CCCTB would be optional for companies. This means that those that felt that they would benefit from harmonised EU system could opt-in, while other companies could continue to work within their national systems.

<sup>18</sup> Hungary was adopted the Energy Tax Act which is based on the above mentioned Energy Tax Directive (2003/96/EC) on 2003.(Act 2003: LXXXVIII.)

<sup>19</sup> Tax & Legal Alert , PWC ( Pricewaterhousecoopers ) , Hungary, Issue 451. 12 May 2011. tax.alert@pwc.com

<sup>20</sup>Tax & Legal Alert , PWC

The CCCTB has been identified as an important initiative in the context of the Europe 2020 Strategy.<sup>21</sup> The Commission hopes to have the Directive proposal unanimously adopted by member states meeting in the Council – in consultation with Parliament – by 2013. This is however, unlikely given the fact that several member states – including Hungary – have expressed reservations.<sup>22</sup>

If there is no unanimous support among the member states, the CCCTB Directive proposal may be discussed under the enhanced cooperation procedure. However it is hard to assess the level of support there really is among the 27 member states for the CCCTB, even under the enhanced cooperation procedure. This makes it difficult to predict the likelihood and timing of the CCCTB being adopted. It is estimated that states would then have 2-3 years after the adoption to ensure that the proposal is transposed into national law.<sup>23</sup>

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<sup>21</sup> see as above Tax & Legal Alert , PWC

<sup>22</sup> Hungary has another opinion: primacy of tax sovereignty and tax competition: it is the opinion the Hungarian Prime Minister connection with the Europactum.

<sup>23</sup> Tax & Legal Alert , PWC