



Red Lines, White Flag, White Lies, Blue Flag?

The truth behind Tax Harmonisation

By Damon Lambert

The Author

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This paper was written entirely in the author's leisure time and the views within are entirely his own.

About Global Vision

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This paper examines the case for EU-wide tax harmonisation, the European Commission's drive towards it and the UK government's response.

The report has 3 threads:

- It examines how the European Commission - despite the lack of evidence that tax harmonisation would benefit the EU and against the wishes of most Member States - seeks undemocratic methods to pursue its tax harmonisation goals, often regardless of the wider consequences.
- It investigates whether tax harmonisation would actually benefit the EU and whether its proponents use it as a mask for other objectives. It also looks at whether harmonisation has been applied equally to all Member States.
- Labour frequently protests how it has defended the UK from tax harmonisation. The paper compares the public protests with the silent actions.

Whilst writing this paper several conclusions became evident.

- There is no great desire for tax harmonisation from other EU Member States, and those who seek it often only want it in selective areas to suit their own separate agendas.
- The European Commission has no mandate for its tax harmonisation goals and is wasting considerable public funds in pursuing them. When it does harmonise taxes, it does so regardless of the knock-on effects.
- The EU remains intent to harmonise taxes and in 2006 increased the budget for its tax programmes by 137%.
- Labour's claims to have prevented tax harmonisation and a move to Qualified Majority Voting on taxation matters are empty - such changes were never feasible in the first place.

Before we start - What is tax harmonisation?

Tax harmonisation is the move to ensure that all EU Member States have identical tax laws. Due to concerns about the EU's profile in the UK, and the unpopularity of the issue in that country, a separate term appeared in the late 1990s:

"Our English friends have asked us not to use the word 'harmonisation' and instead use the word 'co-ordination'."¹

Tax harmonisation means the production of a uniform tax rate in the EU.

Tax co-ordination includes matters such as ensuring that the computation of taxable profits is similar and the same VAT rules apply so the same categories of service are VAT exempt.

The split is of limited use and tax harmonisation is often referred to in the context of both measures. Rates of tax on profits and income are only one factor in computing tax payable; the quantum of deductions and exemptions can impact the final bill considerably, especially in 'Old Europe'.

Tax competition refers to Member States, and indeed other countries, using their tax policies to increase tax revenues by having a regime more attractive to individuals and business.

Taxes are harmonised in 2 ways.

1. Unilateral measures replicated by other countries

These can be seen in the tendency of States to reduce the basic rates of corporate tax, whilst at the same time broadening the base and reducing the number of specific deductions aimed at precise activities (and, if you look at the statistics, generally increasing both economic growth and tax revenues).²

A good illustration is the Dutch and Luxembourg example of exempting capital gains and dividends from overseas subsidiaries from tax. Since the mid-1990s a number of other jurisdictions have followed and benefited from this example - e.g. Australia, Spain, Austria and Denmark. Harmonisation in this manner tends to encourage economic growth and lower the tax burden.³

2. Government pressures

Examples are:

- The minimum standard rate of VAT imposed across the EU community.
- The minimum rate of duty on fuels, the definition of which was recently widened to include natural gas and coal.

¹ Oskar Lafontaine, German Finance Minister, 1998.

² Anyone who doubts this should simply visit Eurostat and produce the figures themselves.
<http://epp.eurostat.ec.europa.eu>

³ The UK is the exception to the rule, having increased UK tax on dividends due to Pension Funds and on dividends paid by overseas subsidiaries of UK multinationals to the UK. This has resulted in lower pensions savings, an increased savings gap and the OECD commenting how UK groups especially keep overseas profits overseas rather than reinvesting them in the UK.

- Minimum duties on alcohol and cigarettes; however for other reasons these are often very minimal.
- The minimum VAT rate of 15%.
- The European Commission's project to calculate corporate tax in a uniformed manner across the EU.

This paper is especially concerned with this latter form of tax harmonisation.

A simple trend should be noted here. In each case the European Commission wishes to introduce a minimum rate but not a maximum. It wishes to impose a uniform system of taxation to suit its aims of a single government but not to protect its citizens from extortionate rates of taxation. This is despite the fact that of the 30 OECD countries, 14 of the 15 highest Tax:GDP ratios belong to the EU countries.⁴

⁴ The exception being EEA member Norway (based on 2003 figures).

The rationale for EU tax harmonisation

There are two key arguments behind the EU's drive towards tax harmonisation.

Argument 1 *The general lowering of corporate tax rates is lowering crucial tax revenues across the EU and Accession States are using EU structural funds to lower their taxes.*

Take the following discussion with Ivan Miklos, Slovakia's Deputy Prime Minister and Treasury Secretary,⁵ reported in *Der Spiegel*:

"Spiegel: ...German Chancellor Gerhard Schröder has accused you of tax dumping. He's suggested you're using your EU subsidies to finance your low tax rates.

Miklos: In our tax reform, the cut in direct taxes was offset by an increase in indirect taxes. Today we have a uniform tax rate of 19 percent. Our tax takings last year matched pre-reform revenues which shows that we aren't shortchanging the national budget in any way. The reform is designed to fuel growth, enabling us to shed our status as a net recipient of EU funds more quickly, the exact opposite of what our critics are alleging.

Speigel: Some people in Brussels have demanded a harmonization of European tax rates. Do you see this as an assault on your policies?

Miklos: It's definitely an assault on our competitiveness. That would be one major casualty. It would also reduce pressure in the EU to tackle critical structural reforms."

Cutting tax rates does not necessarily mean a cut in revenues. Cutting tax rates attracts inward investment; and flattening taxes by removing exemptions better enables genuine business decisions, due to the lack of market distortions that arise when the EU decides what business should do.

If there is still an over-receipt of EU structural funds, then it is structural funds which need to be reformed. Miklos is actually being modest; Slovakia has increased its revenues following its tax reforms.⁶ He has also identified that one of the key arguments proposed for tax harmonisation is to present the lower taxes of new Member States as a cause of the problems of the European social model rather than undertake a more challenging review and reform of that model. Why should Slovakia forego a tax policy key to its highly impressive economic growth just to please Germany? The OECD actually recommends that developing states have low rates and broad bases as these help genuine businesses whereas specific breaks, like those frequent in the German tax system, are used more for tax planning than the wider purpose behind their original intention.⁷

Even the European Commission knows that this argument is wrong. Its own Commissioner for Tax, Laszlo Kovacs, recently said:

⁵ "Assault on our competitiveness", interview with Ivan Miklos, *Der Spiegel Special*, International Edition, No.7, 2005, p 74.

⁶ The IMF is of the view that the tax cuts have been revenue-neutral, and improvements in collection have been the driver behind the increases in revenue.

⁷ *Fair Tax Competition - A Pillar of Positive Economic Reform* - Jeffrey Owens, Director, OECD Centre for Tax Policy and Administration, 18 March 2004.

“In general, we have seen reductions in corporate tax rates, accompanied by a broadening of tax bases. But we see no evidence at present of a ‘race to the bottom’ or a ‘beggar thy neighbour’-situation involving Member States trying to attract tax bases at the expense of the other EU Member States.”⁸

Gradually, Old Europe is seeking to replicate the superior tax systems of New Europe. In recent months, the French, German and Danish governments have all, unilaterally, proposed cutting their corporate tax rates and simplifying their tax regimes by removing existing incentives and exemptions.

Argument 2 The lack of tax harmonisation is preventing the Single Market from realising its full potential and that such obstacles (e.g. double taxation) should be removed.

Closer reflection shows that most tax systems already seek to eliminate double taxation and the effective measures are already in place. Take the following:

- Virtually all EU Member States have tax treaties with other Member States that seek to prevent double taxation, and provide measures for resolving conflicts between tax authorities.
- Most EU Member States only tax domestic income, giving exemptions for profits earned in overseas branches, subsidiaries and overseas earnings by employees.⁹
- Double taxation can exist in certain Member States such as the UK which seeks to tax worldwide income, but the levying of additional tax when overseas profits are repatriated to the UK deters reinvestment of UK groups overseas profits back in the UK. A better UK government would simply reform this measure as it is damaging to the UK’s economy.
- £1 of marginal business profit taxed in say both Ireland and Slovakia attracts less tax than £1 of profit taxed only in Germany or Italy. Being taxed once is the problem harming many of ‘Old Europe’.
- The biggest example of double taxation in the UK is purely ‘Made in Britain’ - the £5 billion per annum hit on Pension Funds. First the pension fund suffers corporation tax at 30% on the dividends paid from its equity holdings, and then the pensioner is subject to income tax (of up to 40%) when the funds convert into pension payments.
- VAT and duties are already only levied once in the place where the supply is received. Lowering duties would reduce the impact of double taxation on imports far more effectively.
- Customs Duties are globally low and in the UK the Customs Duties are potentially lower than the costs of collecting them, being less than 1% of all taxes raised.¹⁰

All the necessary tax harmonisation at EU level already exists.

⁸ “The future of EU Taxation policy”, Laszlo Kovacs, speech to Tax Directors Institute, London, 8 December 2005.

⁹ Not the UK unfortunately, which still insists on taxing worldwide income.

¹⁰ *Ninety-three percent of UK imports do not bear Customs Duties*, Ian Milne, Global Vision Perspective, 2007, <http://www.global-vision.net/perspectives8.asp#>.

The European Commission's drive towards tax harmonisation - the policy with no mandate

Where is the mandate for the European Commission?

Even in the EU's halcyon days when serious commentators debated the benefits of the future euro, the Member State demand for tax harmonisation was limited.

"...the Prime Minister of Spain spoke out against what he called the 'dumbing down' of tax harmonisation and opposed a single rate of direct tax because it would be a recipe for inefficiency. There is no majority for the harmonisation of tax rates in Europe, never mind the unanimous agreement that would be required for action."¹¹

Unable to persuade the Member States to give in, the Commission has sought several other undemocratic measures to harmonise taxes across the EU. Most of these measures are ill-thought through as to the wider economic consequences. At best, these projects are simply a waste of taxpayers' money; at worst, they are moves by an unelected body to impose an unwanted and ill-thought through tax process on the EU.

Even an EU project designed to push forward tax harmonisation struggles to justify part of its existence:

"The underlying demand for joint actions in the area of direct taxation has still to materialise."¹²

France and Germany claim to support tax harmonisation. However, this is duplicitous. They support harmonisation of corporate tax rates as they seek to blame other states who made sensible free market tax reforms for their inability to grow their economies and levy profit taxes. When it comes to broader tax harmonisation - i.e. to harmonise duties on products so Member States cannot protect their own products - the French are likely to become suddenly silent. The European Commission also pushes the French and German line, rather than seek to harmonise duties, which of all taxes would appear to be the ones that most infringe a single market. Also, Germany may have high corporate tax rates, but its corporate tax revenues are smaller than Spain's and considerably smaller than the UK's, partly due a myriad of deductions and partly because people tend not to concentrate profits in jurisdictions with high tax rates. There is nothing to stop Germany and France reforming their tax systems to have a fairer, simpler and lower rate system rather than imposing their problems on others. Indeed, in the last few months Germany has introduced measures to do so, e.g. cutting its corporate tax rate by 10% and correspondingly removing certain exemptions and benefits.

Common Corporate Tax Base

A major Commission project is the move to a common corporate tax base (i.e. calculation of taxable profits in a uniform manner).

¹¹ *Hansard*, Stephen Byers, 8 December 1998.

¹² 7.1 of FISCALIS, 2005 Annual Review, found on the EU, www.europa.eu

The Commission's intention with the Common Consolidated Corporate Tax Base is clear:

"The current working methods and the work programme were endorsed *and the commitment to make a legislative proposal in 2008* - which will be an important step towards implementing the Community Lisbon Programme and removing tax obstacles to companies operating cross-border in the Internal Market was reaffirmed."¹³ [Author's emphasis]

The mechanism to implement this legislative proposal remains unclear. The actual Common Base now appears to require not just common legislation but also the ability to allocate taxable profits between Member States, in itself a method to effectively allow EU law to determine profit splits between States, and consequently tax revenues. One only has to take the example of funding of UK local government to see what a bad idea this is. Most of the funding of UK local government comes through central tax revenues and not through the local Council Tax. Subsequently, the current government has sought to cut funding to Conservative run authorities and increase funding to Labour authorities in order to make political capital through its power of distribution. This is undemocratic and unfair, and effectively penalises people financially for not voting Labour at local government elections. Given the European Commission's liking for EU political correctness, the risk that a tax allocated centrally by the European Commission to Member States might be used as political capital is considerable.

The European Commission insists that this is not a case of tax harmonisation but a sensible co-ordination measure to avoid 'obstacles' in the internal market.

However, even EU Commissioners do not believe this statement:

"Last week Charlie McCreevy, the Commissioner for the internal market, worried about any measure that might bring about the harmonisation of tax rates 'through the back door'. 'The issue of tax rates', he insisted, 'cannot be separated from the tax base'."¹⁴

There is also an admitted lack of support for the idea as admitted by Commissioner Schreyer:

"My colleague Mr Bolkestein launched a discussion paper in 2002 on corporate income tax, but it was not discussed in the Council at that time. It is therefore a little surprising that it has now come up again"¹⁵ and

"All Member States are relatively reluctant about it [the common corporate tax base]."¹⁶

McCreevy is of course correct - having a single base will increase the pressure for rate harmonisation. It also carries all the risks of a 'one system fits all' approach.

¹³ *Activities of the European Union (EU) in the Tax Field in 2006*, published by the European Commission 24 January 2007, p 3.

¹⁴ "Discord over harmony", *The Economist*, 12 November 2005.

¹⁵ *Hansard*, Examination of Witnesses, Select Committee on European Union, response of Michaele Schreyer, EU Commissioner, 25 October 2004. Schreyer added that Belgium was the most favourable.

¹⁶ *Ibid.*

Even FISCALIS, the EU's pet project for tax harmonisation, recognises the lack of enthusiasm for this project.

Tools of the European Commission

FISCALIS

This organisation exists, by its own description, to greater enable the internal market; to get tax authorities to work closer together; and to combat harmful tax competition and tax fraud. It also has experience in implementing directives.

Its budget is an incredible €156.9 million.¹⁷ A question arises as to how an organisation that collects no tax revenues, has no legislative responsibilities, has no legal requirements and reports to no Member State can actually spend a sum as large as €156.9 million. The Labour government was prompted in Parliament to explain why it agreed to this Budget, if it did not believe in tax harmonisation.¹⁸ No adequate answer was provided. If it was so important for Member States to co-ordinate activities then surely the cost-benefit analysis would cause them to do so without EU prompting, just as the UK, Australia, US and Canada have agreed to co-ordinate certain activities.

EU Tax

On 10 January 2005, the EU's Finance Commissioner, Joaquin Almunia, called for a 'Community Resource', better described as an EU Tax. This follows the EC's recent study into how to establish such a toll. Presently the EU is funded through a levy on VAT and direct Member State contributions. Sick of having to explain its budget and expenditure to Member States, and more genuinely worried that taxpayers should see transparency as to how money gets to the EU, the EU has sought to introduce its own separate tax and funding. Its preferred sources are personal income tax, modulated VAT, energy tax and then excise duties.¹⁹

A separate and linked proposal sought to introduce an EU tax to raise money for EU overseas development funds.²⁰ This has favoured the introduction of an aviation tax, which would obviously disadvantage the island Member States of Britain, Ireland and Malta compared to the Member States on the mainland. It also ignores the far more pragmatic issue that an organisation so incompetent that it has not signed off its own accounts for 12 years should really sort out the finances it has already prior to seeking more.

EU - Playing fast and loose with Member State tax law

With no direct action by Member States, the Commission has sought to harmonise taxes through other measures. Its favourite is to refer tax laws it dislikes to its pals in the European Court of Justice (ECJ) even though this

¹⁷ COM(2006) 202 final, 17 May 2006.

¹⁸ *Hansard*, November 2005, speech by Theresa Villiers MP.

¹⁹ Tax-based EU own resources, Working Paper No.1, 2004, Philippe Cattoir, p 42.

²⁰ Informal ECOFIN Meeting 14 May 2005

measure threatens government revenues retrospectively and denies taxpayers and governments certainty.

Even the EU's own Commissioner for Taxation, a great advocate of tax harmonisation, says that the ECJ is an imperfect method:

"In particular, I am not happy with the fact that EU tax policy is increasingly being made as a result of Court decisions rather than as a result of coordinated policy actions of Member States. I am convinced that the recent developments in this area could lead to a situation where it will become almost impossible for Member States to protect their tax bases at national level."²¹

The comment is ironic, given his own Commission's actions in referring so many cases to the ECJ. In fact in 2005 there was a considerable increase in such grassing-up. At the 6th European Insurance Tax Conference (attended by the Author) in Madrid on 5 October 2005, Peter Schonewille of the European Commission explained the desire of the Commission to find matters on which the Commission can bring infringement procedures and change Member State law.²²

The extent of the Commission's harmonisation agenda can be seen by the petty nature of some of the cases it has argued. For example:

- Attacking Portugal for charging the lower rate of VAT on tolls that apply to Lisbon bridges across the Tagus. Given that the bridges are entirely in Portugal, and that the methods of funding public highways is disparate across Europe, it is a mystery how this is somehow preventing the working of the Single Market.
- Seeking to prosecute the Netherlands for charging lower taxes on slurry dredged from public waterways, until the Commission realised that slurry travels downstream from rivers in other Member States.
- That a Tax Amnesty for unpaid VAT in Italy, where for a fixed sum the government would agree not to examine previous years VAT records, was against Community law.
- Referring Belgium to the ECJ for allowing deductions against inheritance taxes for contributions to Belgian charities (whilst not considering the inhuman nature of inheritance tax in the first place).
- Challenging the Polish treatment of taxing the producer rather than the distributor of electricity.²³
- Requesting information from Member States on the VAT treatment of Children's Diapers to Executor's services.
- Reporting Spain for exempting certain supplies to the Catholic Church from VAT.

²¹ "The future of EU Taxation policy", Laszlo Kovacs, speech to Tax Directors Institute, London 8 December 2005.

²² Peter Schonewille, presentation on "Tax Obstacles to the Intra-EU transfer of Pension Capital"

²³ IP 07/404, 23 March 2007.

Back of the Net

There are known dangers of referring tax matters to the ECJ:

“The ‘reluctance on the part of certain Member States to co-ordinate their tax systems,’ the Commission observes, ‘can only lead to more and more decisions by the Court which the Member States concerned might perceive as ‘destructive’.”²⁴

But still the European Commission persists, because it knows it will get the answer it wants.

Take the following example of ECJ judiciary from its head judge:

“By empowering the Court with jurisdiction over direct actions against Member States and Community institutions and by introducing the unique mechanism of preliminary reference, the drafters of the EC Treaty have managed to devise a system that, despite its shortcomings, *has proven to be one of the main tools for the advancement of European integration.*”²⁵ [Author’s emphasis]

So the guy in charge supports European integration. However, he is tame compared to Luís Miguel Poiares Pessoa Maduro, Advocate General to the ECJ in the recent *Marks and Spencer* case:

“In this essay, I argue that national constitutionalism is simply a contextual representation of constitutionalism whose dated and artificial borders are challenged by European constitutionalism. In themselves, constitutional ideals are not dependent nor legitimised by the borders of national polities.”²⁶ and also

“It is artificial to always take the parliamentary system as the default form of representation and its decisions as a simple expression of the *volonté générale.*”²⁷

This view that parliaments and nation states are dated is frankly extremist - far more than classic Euroscepticism which is the mainstream view of the UK electorate.

The UK’s last appointee to the ECJ was a new Advocate General, Eleanor Sharpston QC, famous for acting for the prosecution (and persecution) of the Metric Martyrs. With such judiciary it is clear that the ECJ is biased towards greater EU integration.

However, the UK government retains one leading Treasury Minister who fails to see the intention of the Brussels elite:

“However, I do not think that it is a matter for any Member State, having signed the treaty, then to question the authority and direction of

²⁴ *Tax Policy in the European Union*, Ben Patterson, Kangaroo Group Tax Working Party, September 2004.

²⁵ “The Position of the European Court of Justice in the EU Legal Order and its Relationship with National Constitutional Courts”, presentation by Vassilios Skouris (President of the European Court of Justice), at the *Position of the Constitutional Courts following Integration into the European Union Conference*, 1 October 2004.

²⁶ *Europe and the Constitution: What if this is As Good As It Gets?* Miguel Poiares Maduro, p 1.

²⁷ *Ibid*, p 25.

the ECJ. If hon. Members look at subsequent rulings, they will see that harmonisation is not the way that things are heading."²⁸

Funding Tax Harmonisation

Despite the general disinterest of Member States in tax harmonisation, the EU has considerably increased the funds directed towards such efforts.

The Budgets allocated to the two main programmes of the EU Commission - FISCALIS and the Customs Programme - were increased by 137% in 2006.

Increase to FISCALIS and Customs Programme Budgets

Project	Budget to 2008 (Fiscalis) / 2007 (Customs Programme Euros	Budget to 2013 Euros	Increase %
FISCALIS	67.5	156.9	132
Customs Programme	157.4	323.8 ²⁹	106
TOTAL	224.9	480.7	137

The rationale given for the increase was

"The rise is mainly due to the development of new computerised systems to support the new business and legislative initiatives in the customs and taxation area that are expected in the near future."³⁰

Given that the general cost of IT has reduced this indicates that the legislative measures may obtain most of the additional funding.

²⁸ *Hansard*, European Standing Committee, 6 March 2007, speech by Dawn Primarolo MP.

²⁹ COMMUNICATION FROM THE COMMISSION TO THE COUNCIL AND THE EUROPEAN PARLIAMENT, Community Programmes Customs 2013 and Fiscalis 2013 {SEC(2005) 423}.

³⁰ *Ibid.*

The EU's record on taxation - bureaucratic and politicised

The EU already prescribes a considerable amount of tax legislation. Most of its contribution has at best been ill-thought through leading to sub-optimal tax burdens and revenues, but it has also failed to be even-handed in how its measures impact different Member States.

Value Added Tax - The EU's only permissible Turnover tax and the worst one it could have chosen

No tax is more representative of the EU, driven by the EU, or even invented by the EU than Value Added Tax. It is a major revenue earner for many governments. The author does not dispute the fact that indirect taxation is often a far more effective method of raising taxation than direct taxation. It should be simpler to collect, it does not discourage growth like high rates of direct taxation, it is typically less subjective and it provides governments with more certain revenues. It can also be used to discourage harmful behaviours, e.g. excessive alcohol and tobacco consumption and waste creation. However, the current system of Value Added Tax illustrates how to make an indirect tax as bad as it could possibly be.

The bureaucracy of VAT

VAT is needlessly circular. Take the following example.

A produces raw materials. It sells them to B and charges VAT on those.

B manufactures raw materials. It sells the product to C, with VAT on it, accounts for the VAT and reclaims the VAT charged by A.

C distributes the product to D. C sells it in course and charges VAT on the price, accounts to Customs for it, and reclaims the VAT charged by B

D is a retailer who sells the product to the wider public, and of course charges VAT upon it, accounts to Customs for it, and reclaims the VAT charged by B.

Would this not be simpler if D simply charged a sales tax at a lower rate to the end consumer? This would miss out 3 transactions, 3 payments, 3 reclaims, many accounting entries and prevent the government from having to do VAT compliance checks on A, B and C.

The EU's own recent survey of tax shows:

"Four issues raise particular difficulties for companies in the domestic context, namely audits and litigations, record keeping requirements, the complexity of tax returns and listings and invoicing requirements."³¹

Given how key those issues are shows how burdensome the tax is.

³¹ European Tax Survey, Working Paper No.3 2004, Taxation Papers, p 6 published by the Directorate-General, Taxation & Customs Union, European Commission, found at http://ec.europa.eu/taxation_customs/taxation/gen_info/economic_analysis/tax_papers/index_en.htm

VAT creep - A tax on luxuries that became a tax on basics

As part of the Lisbon Agenda the Commission wishes to levy VAT on all products at a standard rate. Yet there remain Member States, who for good reason exclude tax on certain products. For example, the UK persists in not charging VAT on foodstuffs, rightly as given the additional tax burden effectively charged on food due to the Common Agricultural Policy, to levy VAT on foodstuffs would result in double taxation of an item which arguably should not be taxed once.

This method also harms the poorest hardest. Originally, Purchase Tax, and then Value Added Tax, were luxury taxes - and actually were progressive taxes. The more that VAT is applied to basic goods, the harder it's impact on lower-earners and the less progressive it becomes. There appears to be no great reason, other than the perceived advantage of uniformity across the EU, for the Lisbon Agenda's goal of adding VAT to everything.

VAT - A system that does not work

VAT also suffers an increasing disadvantage in that by being chargeable at every layer of the supply chain, it is one of the most prevalent to fraud. Most tax fraud basically involves non-declaration of income. VAT can actually include making illegitimate reclaims of tax from the government. A sales tax levied on the final consumer not only reduces complexity and administration for business, but is far easier to police due to the fact it is concentrated in fewer hands.

An example is Missing Trader Intra-Community Fraud (MTIC), whereby VAT is charged but the benefit not passed onto the consumer. In the EU as a whole, MTIC fraud is estimated to be 10% of VAT revenues. Within the UK the estimated extent of MTIC fraud has increased to an estimated £3bn to £4.75bn per year,³² which is basically double the size of the fraud in 1999-2000 fiscal year. The Eurocanet project estimated the figure as £8.4 billion.³³ Using the lower figure for MTIC fraud produced by the UK government, an estimate is reasonably unreliable where the difference between the lowest and highest figures totals £1.75bn. By contrast the annual bill for the problems with Working Family Tax Credits in the UK is thought to be less than £2 billion; Beer Duty raises £3 billion and Stamp Duties raise £11 billion at present. Overall, Fiscalis considers that VAT fraud may be as high as 1% of European GDP. (1% of UK GDP is approximately £12 billion.)

However, the EU actually blocked German and Austrian attempts to counter the level of fraud, on the basis that these would be an unjustified breach "from the harmonised general rules of VAT", showing that the EU puts the dogma of its harmonisation agenda above tackling large-scale criminal activity.³⁴

The European Commission has proposed two systems of dealing with intra-community fraud. Its preference was to apply VAT at a uniform rate of 15% in the country of departure (i.e. place of supplier). Despite "about half of the Member States"³⁵ favouring this consideration, the EU has decided to explore

³² Estimate for 2005-2006, Table 1, House of Lords, Session 2006-07, European Union 20th Report.

³³ Select Committee on European Union: Twentieth Report, Chapter 1: The Development of Missing Trader Intra-Community Fraud, itself quoting The Eurocanet Project's Report "Tentative d'évaluation de la Fraude a la TVA transfrontaliere"

³⁴ IP /06/1023, 19 July 2006.

³⁵ Provisional Version of the Press Release of the 2804th Council Meeting, Economic and Financial Affairs, Council of the European Union, 5 June 2007, p 17.

this system further. It has also proposed a general reverse charge system whereby the liability to pay VAT to the revenue authorities would lie with the customer and not the supplier. Despite the majority of Member States expressing reservations against this option,³⁶ the Council has requested the Commission to explore this option in more details, including addressing “the coherence and harmonisation of VAT law in the EU”.³⁷

Invisible VAT - why VAT is a tax on savings

Most financial products are exempt from VAT. This means that there is no VAT on their supply, although there may be other taxes, such as capital duty, stamp duty and Insurance Premium Tax.

However, to say that there is no VAT on financial products is untrue. VAT is levied on goods and services bought by financial services suppliers, which then cannot be recovered. Therefore this is an expense to such organisations which, following basic economic theory, is then passed on to consumers through higher prices on basics like home insurance, retail banking, and pension fund savings. VAT is hence a poorly constructed tax, not apparent to the ultimate end-user, and able to impede the blocking of the savings gap. Also, as non-EU services are standard rated in the UK, the corresponding VAT on supplies can be recovered. This achieves the bizarre distortion of giving financial service suppliers a tax benefit for aiming their services at non-EU citizens.

The alternatives to VAT - if only the EU permitted them

Despite its many problems, the EU’s VAT laws prohibit any other turnover taxes. On this basis, the Commission has sought to prosecute the Hungarians for levying a local sales tax. Preferable alternatives would include:

- Sales taxes akin to the US states, avoiding the in and out, in and out, method of VAT collection and making the tax more transparent to the end user. Note that the US has no desire to move to a VAT system.
- Tobin tax - i.e. a tax that is charged at a small percentage on financial transactions. Whilst some of the reasons given for a Tobin Tax can best be described as left-wing confusion as to how financial markets operate, such a tax would be more transparent to the end-users, easier to administrate (as it would avoid the issues of ‘partial-exemption method’ and ‘reclaims’) and hence a reasonable alternative to VAT for city institutions. However, when Belgium proposed such a tax the European Central Bank claimed it was illegal and opposed it.³⁸
- Similarly, Stamp Duty and Stamp Duty Land Tax in the UK carry disadvantages, but are fundamentally simple and effective to collect. Stamp Duty on shares is potentially illegal however as the Capital Duty Directive prevents a tax on transfer of shares rather than incorporation of companies.³⁹

³⁶ *Ibid*, p 18.

³⁷ *Ibid*, p 18.

³⁸ ‘Other Tasks and Activities’, Chapter 6 European Central Bank Annual Report 2004, p 107. The Tobin tax was opposed as its usefulness was questioned and it was contrary to the Freedom of Capital Article of the EU Treaty.

³⁹ A number of other Member States are being referred to the ECJ for having capital duties that are apparently contrary to the EU Capital Duty Directive.

The EU Savings Directive - Germany gets its way on uniformity, but at whose expense?

In 2001 the EU passed an EU Savings Directive. What the Directive does is compel countries to either:

- Pass information on savings income to the Member State the investor resides in, or
- Withhold tax on savings, a method preferred by those States that wish to maintain long-established reputations for client privacy.

The drive behind this was the German concern that most of its population was involved in tax evasion, particularly through investing in Luxembourg savings accounts. If the purpose was to end evasion, then this Directive would at least have had some justification. But the author finds this distinctly at contrast with his own personal and work experience of Germans, who he regards as fundamentally honest people.

The impact of this directive is to:

- Compel certain jurisdictions to withhold tax on income on savings, being the least bad solution to the directive. This will increase the cost of capital to European business and also reward spending as opposed to saving.
- As with other EU tax measures, it places a compliance burden on savings banks. This burden converts into a cost, being an effective increase in the cost of debt, and hence makes capital raising harder.

Why could the harmonisation not have been the other way around - i.e. why could Germany simply not adopt similar measures to the UK (e.g. ISAs) or the Flat Tax Countries (lower marginal rates) - to reduce taxation on savings, especially given that like most of Europe, Germany faces a massive shortfall in long-term savings. If Germany really did have a serious compliance problem then surely the best manner would be for the Germans to strengthen their own systems rather than seek to impose a uniform measure across Europe. The most effective method for Germany to have reduced tax avoidance would have been to reduce its high tax rates on savings.

Too often with EU tax policy, the EU's uniformity forces everyone to adopt the policy of the lowest common denominator.

The Manninen Case

This paper does not seek to investigate each individual ECJ case. However the *Manninen* case is of particular interest as, without change to the EU treaty, it potentially prevents necessary reform to the taxation of pensions in the UK.

The judgement in *Manninen* was that where a Finnish individual obtains a tax credit in respect of Finnish dividends he receives, such tax credits cannot be restricted to dividends paid by Finnish companies, but must apply to dividends from all EU countries. (E.g. the Finnish government should give tax credits for dividends from overseas companies, which have suffered no Finnish tax.) This applies even where the credit is a fixed proportion of the dividend and the

underlying tax paid in say Ireland would be considerably less than the Finnish tax credit obtained.

The ECJ, in its desire for tax harmonisation, is insisting that a system that for very good policy reasons wishes to make pension funds tax-free is illegal unless its scope is illogically widened. Applied to the UK, should the damage done by Labour's termination of pension tax credits be reversed by a future government, unless the system gave credit for overseas dividends it would be illegal under EU law. This may be sufficient to either weaken the benefit of the credit or prevent this fundamental reform being carried through. It is notable that in its Tax Harmonisation crusade the European Commission is making no effort to correct the anomaly of its ECJ ally.

The Random Nature of the European Commission

What makes everything worse is inconsistency. How does the Commission reasonably find that:

- A special tax regime for the Canary Islands is permissible, but one for Sicily is not.
- Tax incentives for parts of France are within EU law, but lower real estate tax in Berlin to make housing more affordable is illegal state aid.
- Measures to subsidise Film Production and Research & Development are fine, but more limited measures in Italy to allow the public listing of small capitalised firms are banned.

There are also key contradictions in European Community tax policy and how it interprets the overused phrase "distortions of the internal market".

For example, the Commission:

- Opposes state aid in respect of bridges, but wishes to impose a Pan-Euro aviation tax that would obviously distort competition in the transport sector by favouring rail, road and sea transport over air transport. Plus it would also impact the island states of Ireland, Malta and the UK more than it would the central European states.
- Attacks countries for having turnover taxes and capital duties greater than the permitted EU levels but itself advocates an Aviation Tax, itself a turnover tax of sorts.
- Favours tax relief for films and R&D⁴⁰ but not for other activities that could have intended wider benefits, e.g. sports clubs or health insurers.

⁴⁰ UNICE (of which the Confederation of British Industry is the UK's member) indicates in comments of 21 November 2005 that EU State Aid has actually restricted the harnessing of R&D and innovators, and hence reduced the competitiveness of the EU.

The UK approach to the EU

Who actually wants tax harmonisation - the 'War with Europe' scare

Anyone living in the UK since 1997 would have been of the impression that the EU Member States would have already harmonised tax, but 'Red Lines' inserted due to the Thatcherite intransigence of Tony Blair prevented this.

Hang on Tony, just who were you fighting?

Labour's own Ministers know that the risk of tax harmonisation via multilateral agreement has been over-egged:

"Britain is not alone among Member States in insisting that direct taxation is a matter for the national state. There is no proposal - nor any prospect of one - for the harmonisation of income tax in the European Union. No Member State believes that there is a case for a European rate of corporation tax."⁴¹

"Last autumn [1998], when British ministers talked of vetoing Mr Lafontaine's schemes, he hit back by calling for EU decision-making on tax to switch to qualified majority voting (QMV) ... Since no more than four of them [Member States] are likely to support the introduction of QMV on tax matters, it will not happen."⁴²

The European Commission knows that Member States won't play its tax harmonisation game:

"There was little support for minimum corporation tax rates or bases at this stage, although some representatives favoured a minimum level of taxation on interest income to prevent tax competition in this area."⁴³

So the Commission's current method is to just ignore those more vocal in their objections, and note it is not just the UK:

"Although the UK, Ireland, the Czech Republic, Estonia and Slovakia are opposed to any move towards corporate tax harmonisation, Mr Kovacs [EU Tax Commissioner] stated that he is prepared to leave them outside the scheme [for a single European corporate tax base]."⁴⁴

Blair's 'heroic' defence of UK tax laws is one of New Labour's best bits of pure spin. Ireland, Spain, Czech Republic, Estonia, Slovakia, Latvia, Lithuania and Hungary have all have reformed their tax regimes in a major manner in the last 10 years. The Netherlands is also proposing a wide range of reforms to recapture the tax-friendly regime that it had until the late 1990s. Each of these countries is almost certain to veto any move by the EU to harmonise tax. As the Slovakian Deputy Prime Minister indicates (see page 5), why would they risk surrendering the benefits of their own successful and popular reforms, just because France and Germany refuse to make domestic reforms? Blair's

⁴¹ Stephen Byers, *Hansard*, 9 December 1998.

⁴² *Ibid.*

⁴³ *Hansard*, European legislation, 5th Report précis of European Commission Report: *Taxation in the European Union - Report on the development of tax systems*, 4 December 1996.

⁴⁴ "McCreevy Takes A Stand Over EU Corporate Tax Plans", Ulrika Lomas, *Low Tax Intelligence Reports*, 8 November 2005.

positioning that he has fought alone in Europe to preserve the UK's veto on taxation matters is pure posture. Even if he wanted to move to Qualified Majority Voting he would not be allowed to, as there would be between 4 and 10 vetoes from other Member States. The real concern is that if Blair has negotiated away UK powers in other areas to protect this veto, then he has simply made unnecessary concessions to other Member States, as the risks of QMV on tax was non-existent.

Red Lines - can you find them?

Labour has claimed to have inserted Red Lines into the EU treaties. It would have been simple to insert short lines into Articles 43 and Articles 56 of the EU Treaty stating that the Freedom of Establishment and Capital Articles could not be used to override domestic direct tax laws (a well-known threat since at least 1998). However, the 2001 Treaty of Nice and the European Constitution were not in any way amended. There is no known proposal to do so on the post-Constitution discussions taking place at present.

Such a measure would have had the support of many Member States.⁴⁵ For example, the Marks & Spencer group relief case was opposed by not just the UK, but Germany, Greece, France, Ireland, Netherlands, Finland and Sweden.⁴⁶ Denmark, Italy and Portugal have also joined in the defence of other Member States in other cases. That leaves only Luxembourg, Belgium, Austria and Spain who have not sought to defend other Member States cases in the ECJ, and that is probably due to laziness or indifference rather than positive support for tax harmonisation. Plus, the Accession States are increasingly concerned that the simplicity of their Flat Tax Regimes may be impinged by decisions made in Brussels.

Labour - fighting for whom in Europe?

Labour has been notoriously bad at protecting the UK's interests in the tax sphere. This is despite the fact that Gordon Brown and Dawn Primarolo both held Treasury positions for a decade from 1997 to 2007, an unusually long period of tenure in such roles; plus Primarolo was even Chair of one of the main EU taxation working parties.

Germany was successful in arguing for what eventually became the EU Savings Directive, which was aimed at preventing German citizens from holding savings accounts outside Germany (including UK accounts or UK bonds) because Germany was unable to tax the interest arising on those savings accounts. The Directive finally agreed possibly a poor situation for the UK; interest on savings is now fully taxed in Germany, at least under the withholding basis that the UK would have kept a proportion of that tax by deducting tax at source on interest paid on those savings or bonds. Yet there has long meant to have been a harmonisation of alcohol and tobacco duties. The UK has amongst the highest duty rates in the EU and hence has much to gain from such harmonisation. For example,

- Rates of duty on wine and beer are typically lower than those on UK products, e.g. spirits.

⁴⁵ Not least as the ECJ cases could cause certain Member States to meet the requirements of the EU Stability and Growth Pact.

⁴⁶ Not every country has group relief and the Danish system does not contain the 'harmful clauses'.

- The higher UK rates result in a considerable shortfall of UK tax collection due to cross-channel shopping and smuggling. Harmonised rates would reduce the incidence of this, and increase UK revenues.
- 8 Member States apply separate rates on wine and sparkling wine, often to favour their own producers.
- The UK taxpayer already subsidises foreign wine producers via the Common Agricultural Policy, the biggest distortion that exists to forming a true Common Market.

Minimum duty rates were agreed in 1992, at a level set so low as to have no effect. These have not even been increased by inflation since that date, whilst the European Commission has undertaken a wide range of other activities on the taxation front.

What Labour says, and what Labour believes - so who precisely in Labour opposes Tax Harmonisation?

Labour's biggest fear on tax harmonisation is that its ruse gets rumbled. In 1998 New Labour was compelled to invent a new phrase. To once again repeat the words of Oskar Lafontaine, then German Finance Minister:

"our English friends have asked us not to use the word harmonisation' and instead use the word 'co-ordination'."

For some time, the Treasury team's Stepford Wife-style response to questions on tax harmonisation has been:

"Fair tax competition rather than tax harmonisation is the way forward for Europe."⁴⁷

However, dig deeper into Labour and you find a different answer.

Labour's own thinking and actions

"Last month [November 1998] Labour sought to lay down a template for reformed social democracy in a document, originally drafted by Ed Balls...It ended, though, with a passage on 'tax policy co-ordination', which is at the heart of the growing divergence. This section noted that tax was rising rapidly on labour and falling on capital; that harmful tax competition between states was intensifying and should be ended and that savings and corporate taxation should be 'co-ordinated'."⁴⁸

Ed Balls MP was of course Chief Economic Adviser to the Treasury and is known as Gordon Brown's spare brain. This report was quickly suppressed due to the embarrassment factor.

⁴⁷ Respondents who have used this phrase or one very similar include Dawn Primarolo MP, 11 and 15 November 2005, 21 July 2004, 15 November 2000, 31 October 2000; Jacqui Smith, 7 June 2004; Stephen Timms MP, 8 November 2004, Treasury Paper of 24 November 2003 presented to the Select Committee on European Scrutiny Committee, and Trade and Industry paper of 11 January 2001; Lord McIntosh of Haringey, 13 March 2001; Stephen Byers, 9 December 1998.

⁴⁸ "Third way? They'll do it *their way*" by John Lloyd, *The New Statesman*, 4 December 1998.

Labour Members are highly reluctant to press the government on tax harmonisation. Since the Maastricht Treaty, a search of *Hansard* revealed not a single question on the subject from a Labour politician, other than from Lord Shore of Hackney. This compares to many from Conservative Members, both before and after 1997.

Just who is Labour in bed with in Europe?

Peter Skinner, Labour MEP and the Government's European Monetary and Economics Affairs spokesman, said:

"There are obvious difficulties where some countries are offering lower rates of corporate tax, so I would advocate a methodology for calculating as level a playing field as possible without the intrusion into domestic fiscal policy."⁴⁹

Mr Skinner does not solve the puzzle as to how you can increase a country's tax rate without intruding into its domestic policy.

Labour MEPs belong to the Parliamentary Group of the Party of European Socialists (PES). PES's official policy is to introduce Qualified Majority Voting for taxation matters, and to harmonise the rates of VAT, a matter with the known support of Labour MEPs.⁵⁰ So why does a Labour Party allegedly opposed to tax harmonisation not distance itself from comments such as:

- "Nowadays the risks are twofold. On the one hand, low tax rates may poison international relations, because low tax rates applied by poorer Member States would be seen as unfair by richer states applying high taxes."⁵¹
- "That is one reason why the Single Market needs a coordinated approach to corporate taxation – not a single rate, but a progressive coordination of corporate tax bases, leading eventually to an approximation of European corporate tax rates."⁵²

The PES also rejected an Estonian candidate for the role of EU Tax Commissioner because:

"On taxation issues Ms Udre clearly does not follow the political line of the Socialist Group. She wants low taxes for big business. She does not seem to grasp the importance of the taxation debate in the EU which clearly exists."⁵³

Like so many advocates of tax harmonisation, the Socialist group only wishes to increase tax rates and not to protect citizens from unfair taxation. The most puzzling thing is that the PES wishes to use the EU to prevent poorer countries using their tax regimes to effectively take money that would otherwise accrue

⁴⁹ Peter Skinner MEP, 13 September 2004.

⁵⁰ *European Tax Harmonisation - the impending threat*, Centre for Policy Studies, Theresa Villiers MEP, June 2001, p 64.

⁵¹ Party of European Socialists - Social Europe, October 2005, Kinga Goncz, Minister of Youth, Family, Social Affairs, and Equal Opportunities (Hungary).

⁵² A Europe of Excellence, THE LISBON STRATEGY: GETTING FROM DECLARATIONS TO RESULTS, Adopted by the Socialist Group in the European Parliament, January 2005, p 27.

⁵³ Press Release of Socialist Group in the European Parliament, 7 October 2004.

to rich countries. Most people would expect socialists to support measures that redistribute of wealth from rich to poor.

Recently, Kitty Ussher MP was appointed as Economic Secretary to the Treasury. In 1999 she wrote a detailed paper entitled "The spectre of tax harmonisation."⁵⁴ The basic premise of the paper was that tax harmonisation, especially the concern over threats that the higher income tax rates of Continental Europe could be imposed upon the UK, was a tactic of the right-wing media being used to dissuade the British populace from membership of the euro. In what is often an articulate and intelligent paper, Ms Ussher called for a number of tax harmonising measures including:

- The harmonisation of tax bases across Europe so that taxable profits are computed on a common basis.⁵⁵
- Qualified Majority Voting to determine the tax base of companies within the EU.⁵⁶
- The European Commission should set minimum rates of environmental taxation, and should adopt Qualified Majority Voting in this area too⁵⁷
- An EU-wide tax on aviation.⁵⁸

This despite Ms Ussher's opening comment that, "Europe's citizens, generally speaking, do not want their taxes set by Brussels."⁵⁹ What she wrote was a cleverly constructed paper which steered away from the politically sensitive topics of tax rates, and instead sought to create tax harmonisation via tax laws created in more technical and less high-profile areas. Indeed the intention was that such reforms, together with the author's perceived benefits of euro membership, would create an environment where Member States would harmonise taxes by unilateral action. So the Government Treasury team now includes a Minister responsible for tax law who has a long-term belief in surrendering the veto on taxation affairs in key areas.

⁵⁴ Curiously enough, sponsored by Philip Morris, Europe's leading tobacco manufacturer - sponsorship that the Labour Government has denied the UK sports scene.

⁵⁵ "The spectre of tax harmonisation" by Kitty Ussher, 1999, pages 17 and 44.

⁵⁶ *Ibid*, p 17.

⁵⁷ *Ibid*, pages 34 and 39.

⁵⁸ *Ibid*, p 38.

⁵⁹ *Ibid*, p 1.

The Labour Government in action - stealth taxes and stealth tax harmonisation

Labour's attitude and the role of the EU are increasingly shown in new tax legislation. Look at the following examples.

Reform of Leasing Taxation (2006)

Asset financing is one-third of investment in the UK's plant and equipment⁶⁰. The government first announced changes to its taxation basis in August 2003, followed up by a December 2004 Technical Note, and again in December 2005. Not once in either document is EU law mentioned.

Compare this to the view of the leading Accountancy Practice in the leasing field:

"The main driver for these changes is the stream of judgments on company taxation from the European Court of Justice."⁶¹

This is despite the fact that leasing increases investment, helps make the working of the capital market more efficient, and the changes will reduce investment by SMEs, businesses making losses and the voluntary sector.⁶²

Abolition of Stamp Duty Land Tax Relief for Disadvantaged Areas (2005)

In 2002 Labour, at some volume, introduced measures that exempted property in disadvantaged areas from Stamp Duty Land Tax. In the 2005 Budget this measure was suddenly repealed. By more than coincidence Germany is now being referred to the ECJ for granting similar reliefs in Berlin to seek to make housing more affordable, on the basis that this is illegal state aid.

Vehicle Taxation

The Commission in 2002 made proposals to harmonise vehicle taxation, principally by moving towards a system of taxation levied by reference to carbon dioxide levels. These tie in with the UK's movement towards such a system.

Film Relief - (2006)

The UK has long had tax reliefs aimed at encouraging the production of cinematic releases.⁶³ The UK is currently in the process of altering its tax rules to concur with EU law.

Page 12 of HM Treasury report announcing the new measures shows that the proposed new Film Tax Reliefs are "a form of State aid and have to be notified and cleared by the European Commission." Clearly, the UK government regards the European Commission as having a veto over this part of the UK's direct tax regime and a right to influence UK film productions.

⁶⁰ THE ECONOMIC IMPACT OF PROPOSED CHANGES IN THE CORPORATION TAX TREATMENT OF FINANCE LEASES, Commissioned by the Finance & Leasing Association (FLA), p 8.

⁶¹ Quote from Jonathan Vines, KPMG Leasing Taxation Partner, KPMG Pre-Budget Report Predictions (for 2005), http://www.kpmg.co.uk/services/t/b/pbr_detail.cfm

⁶² THE ECONOMIC IMPACT OF PROPOSED CHANGES IN THE CORPORATION TAX TREATMENT OF FINANCE LEASES, 26 January 2004, Commissioned by the Finance & Leasing Association (FLA), p 4.

<http://www.fla.org.uk/downloads/listings.asp?pid=144>

⁶³ The author disagrees with the wider policy.

The European Commission's concerns are not so much concern about removing distortions in the market, but more about encouraging films that fit with their own propaganda:

"Audiovisual works, and cinema in particular, play an important role in shaping European identities, both in common aspects shared across Europe and in the cultural diversity that characterises our different traditions and histories" and

"They [films] are also cultural goods which at the same time mirror and shape our societies. This is the reason why the development of this sector has never been left solely to market forces."⁶⁴

Measure by measure, the UK system is moving towards a system determined by the EU.

The Discussion Document on the Taxation of Overseas Profits

In June 2007 the UK government introduced a Discussion Document outlining the future legislative proposals for the taxation of overseas profits. This focussed on two key areas, the taxation of overseas dividends and the taxation of anti-tax haven vehicles. In order to make the rules EU compliant the government has proposed an exceedingly cumbersome system where UK companies can be taxable not just on their own profits but also on passive income of both overseas and UK subsidiaries. Some strands of these rules need not be so problematic, but the driver for change appears to have been EU law rather than a taxation system to encourage investment in the UK and reduce the administrative burden on business.

EU rules prevent sensible reform to the UK tax system

Not only does the government amend UK tax laws to fit with EU dictates, but the actions of the EU are also blocking the UK government's ability to act in certain areas

Example 1: Disclosure of Tax Avoidance Schemes

This legislation was introduced in 2004. It requires tax planners to register certain qualifying tax planning ideas which the government rightly or wrongly classifies as 'avoidance'. A number of corporate tax and bonus planning structures have since been closed. However, despite over 800 VAT schemes being disclosed, not a single one has been shut down, because, it is thought, of concerns that this would be contrary to EU law, costing the UK revenue. Similar concerns apply to the well-publicised offshore sales of CDs and DVDs to avoid VAT.

⁶⁴ *Ibid*, p 1.

Example 2: Reform of the Schedular System

UK taxes corporate profits after streaming it into separate types of income. The government sought to simplify this by reducing the number of streams to two. But in the responses to consultation, a number considered this was not worthwhile whilst the uncertainty caused by the ECJ cases continued.

Future examples: Tax reforms that would be illegal under EU law

Under EU law the following future reforms would all be illegal, despite the fact that the introduction of all of them could benefit the UK:

- A reduction in Scottish tax rates by 3% as permitted under devolution (illegal State Aid).
- The introduction of a local sales tax to replace or sit alongside Council Tax (turnover taxes other than VAT are not permitted).
- A Tobin tax on financial services, as it is a turnover tax (turnover taxes other than VAT are not permitted).
- The reintroduction of Pension Tax Credit, unless the credits were extended to cover dividends where the distributed profits had suffered no underlying UK tax ('Discrimination' under the Freedom of Capital and Establishment Articles of the EU Treaty).

Labour's white flag and white lies

The Labour Party constantly claims to oppose tax harmonisation and to have inserted Red Lines into EU treaties. Yet Labour has failed to limit the ECJ's powers, failed to put Red Lines in Tax Treaties, failed to stop EU projects on tax harmonisation and failed to change the policy of the Party of European Socialists that advocates harmonisation. But, is this failure or acquiescence? Labour has been deceptive on two fronts, claiming victories in defending the UK veto on tax in battles that never existed, whilst introducing stealth tax harmonisation.

Conclusions

Tax is the price of government. Less tax means less government and greater individual liberty. Therefore a uniform level of taxation must by necessity mean a uniform level of government; if the EU obtains tax harmonisation the impact will not be limited to the fiscal sphere.

The EU's tax harmonisation is a fundamentally illiberal measure.

- "Tax harmonisation addresses mainly one aspect of the entire choice set for EU citizens' tax planning activities...The problem is formulated from a government perspective - how to maximize tax revenue when economies integrate. The obvious alternative would be to formulate it from the individual citizen's perspective: as a safeguard against government tax opportunism. Tax competition has another advantage from the government point of view: it will in a simple way inform governments on the quality of their fiscal policy - whether they are over-taxing people in their jurisdiction or not."⁶⁵

One system would not fit all, or indeed anyone.

- Diversity allows new tax experiments to be made. With EU tax harmonisation, the successful cutting of corporate tax rates by Ireland, Slovakia, Estonia, Czech Republic would not have happened, nor would the corresponding increases in economic growth, investment, and tax revenues. Nor would the benefits of simpler tax law arising from the Flat Tax States have become evident. Tax harmonisation could only sensibly work if there was a known perfect way of raising tax.
- A uniform tax rule causes the EU to move at its slow speed, so that the EU will be unable to change its system to react to the ever increasing risks and opportunities of globalisation. Again, if corporate tax law had been harmonised across the EU then much of the growth arising across Eastern Europe would not have occurred. The harmonisation of VAT is preventing effective local action against large-scale fraudulent activity.

There is neither a desire nor a need for tax harmonisation.

- The EU's push for tax harmonisation is undemocratic; there is no great evidence that the populace desire such a move. Also, if Irish and Slovakian electorates choose to vote for less tax and less state, whilst France and Germans vote for more tax and more state, why should one group interfere in the democratic choice of the other?
- Tax harmonisation would not exist as an issue if it was not for Brussels lobbying. The US has separate tax regimes in addition to federal tax in all of its 50 states and further differences at county level. Yet failure to harmonise tax there is not seen as a problem, it's not even regarded as an issue.

⁶⁵ "Is harmonisation of tax policies between different EU countries a good idea?" Stockholm Network, Kurt Wickman, Gefle College University, March 1999, p 12.

- Tax harmonisation ignores the problems that in certain Member States a considerable proportion of tax is raised at local rather than national level, partly for the rationale that this makes government closer to the people.
- Successful tax measures get adopted by other governments as their results bear clearer fruit. Eg. several states have reduced their corporate tax rates and sought not to tax dividends, following the Irish and Dutch examples.⁶⁶

The EU is neither competent nor consistent.

- The EU's record is constantly one of harmonising the wrong thing, harmonising it badly, always setting minimum not maximum tax rates, and introducing bureaucratic taxes (e.g. VAT).
- The push for EU tax harmonisation is uneven, and aimed at favouring those states most in need of domestic tax reform. The current drive is to harmonise corporate tax rates, which would benefit France and Germany as business seeks to avoid their punitive rates of corporate tax. However, harmonising duty levels far more fundamental to the Single Market and agreed treaty texts is ignored. This allows France, for example, to set low rates for its own products (wine) and discriminatory rates on UK products (whiskey).

Labour's record on tax harmonisation is one of acquiescence hidden by spin.

- The New Labour government has claimed false victories on reverting tax harmonisation in Europe. On closer reflection its actions do not meet its words. Just as it creates stealth taxes, it is now creating stealth tax harmonisation.
- The EU Treaties should be rewritten to make absolutely clear that direct tax is a Member State issue, and to stop the ECJ and the European Commission using their powers to harmonise a tax system when they have no popular or Member State mandate for doing so. The UK government should adopt such a policy immediately and obtain support from other Member States.

⁶⁶ There is usually an exception to the rule, in this case the UK's current Labour government has increased tax through stealth and especially sought to tax dividend income.

APPENDIX 1 - UK History of Tax Harmonisation

- 1972 - The Conservative government introduces Value Added Tax and abolishes Purchase Tax. The level of Value Added Tax is effectively higher than Purchase Tax as the government raises indirect taxation and reduces direct taxation correspondingly, prior to then increasing direct taxation in later years.
- 1979 - The Conservative government increases VAT to 15% and cuts income and corporate taxes immediately after the election. This was not announced in the election manifesto.
- 1989 - Conservatives reject harmonisation of duties.⁶⁷
- 1991 - VAT is increased to 17.5%.
- 1992 - Maastricht Treaty introduces Articles 43 and 56, Freedom of Establishment and Capital. No consideration is given at the time that these Articles could be used to override parts of domestic tax law. Article 93 permits harmonisation of VAT law "to the extent that such harmonisation is necessary to ensure the establishment and functioning of the internal market".
- 1992 - Minimum rate of VAT of 15% is introduced, to be reviewed four years later. This was agreed with the EU as part of a compromise package in ending fiscal controls on borders, "With a review after four years, that would have ensured that the rate was not set in stone for all time."⁶⁸
- 1992 - Minimum rates of duty set on alcohol and tobacco, largely irrelevant to the UK whose duty rates are amongst the highest of Member States.
- 1997, 2001 and 2005 - Minimum rate of VAT kept at 15% without any parliamentary discussion. In 2005 the EC simply placed a letter on its website extending the period of the minimum rate to 2015, and the European Parliament voted to support the move. There was no debate in the UK Parliament.
- 1997 onwards - The UK government introduces a number of measures to effectively harmonise UK tax with European Commission requirements under the garb of other rationale.
- 1997 - The UK abolishes tax credits on dividends, and in 1999 abolished advanced corporation tax - making the UK system more EU friendly, although this may be purely an unintended side-affect.
- 1997-1999 - 10 'harmful' tax effects of the UK tax system are abolished to avoid embarrassment for the 'Primarolo' group.
- 1998 - The term 'tax co-ordination' invented to prevent Labour government being seen to be in favour of 'tax harmonisation'.
- 2000 - UK government changes group relief rules to fit with the ECJ decision in *ICI v Colmar*.
- 2001 and 2004 - At the Treaty of Nice and in the European Convention on the EU Constitution the government declares 'Red Lines' on taxation whilst not altering a word of the previous articles that enable the ECJ to harmonise UK taxes.
- 2004 - UK government introduces UK-UK transfer pricing to deal with the ECJ decision in *Lankhorst*, quite possibly the most pointless piece of administrative burden produced by Brown's doubling of the size of UK tax legislation.
- 2005 - UK abolishes Stamp Duty Land Tax for disadvantaged areas.
- 2006 - Film Tax Relief and Leasing Taxation reformed to make them EU friendly.
- 2007 - UK government proposes highly bureaucratic changes to taxing worldwide profits (Taxation of the foreign profits of companies: a discussion document, HM Treasury / HMRC June 2007) mainly to fit the UK corporate tax system within the UK rules.

⁶⁷ *Hansard*, response to written question by Rt Hon Peter Lilley MP, 4 April 1989.

⁶⁸ *Hansard*, speech by then Chancellor of Exchequer, Norman Lamont MP, 2 July 1992.

APPENDIX 2 - European Commission attacks on Member States Taxation policies made during 2005⁶⁹

Country	Area	Attack
Sweden Portugal	Capital gain exemption on homes	Only applies to Swedish property and if proceeds reinvested in Swedish / Portuguese property
Italy	Supply of goods by Roman Catholic Church are exempt	Against 6 th VAT Directive
Germany	Real Estate Transfer tax exemption for Berlin based housing companies	Not all areas covered by the exemption require regeneration
Hungary	Vat on second hand cars	Hungarian tax applies to all cars in the same manner, and does not take account of wear and tear Charge levied on 2 nd hand cars coming into Hungary
Italy	Lower rate of tax for collective investment vehicles	Illegal state aid for small caps and financial intermediaries. This does not seem to be limited to Italian investments. Commission has ruled that the change must be made retrospectively and the tax benefits recovered from intermediaries
Italy	Fiscal incentives in Sicily that exempt certain business from Italian corporate tax and regional tax in Sicily	Potentially illegal State Aid
Germany	Fees paid to German schools are tax deductible, fees paid to non-German schools are not	Breach of Freedom of Services and Establishment Articles as it deters schools outside of Germany
Finland	Deductions offset against overseas income are limited to the proportion of total income that is Finnish. Most overseas income is exempt in Finland!	Deters Finns from working abroad - Freedom of Services
Czech Republic, Greece, Ireland, Luxembourg, Italy	Failure to implement a variety of EU Directives	EU Directives should be brought into existence in domestic law
Belgium	Deductions against Inheritance tax for Belgian charities	Discriminates against non-Belgian charities
Italy	Taxes on certain energy products, e.g. coal, natural gas, and electricity are below the EU minimum	Should be increased to the EU minimum
Spain	Capital Duty is levied in Spain on branches of overseas companies, and on companies moving their residence to Spain	Capital Duty cannot apply differently in different cases

⁶⁹ Source: Taxation and Customs Union pages of the European Commission website, <http://ec.europa.eu/>

Spain	R&D expenditure is only fully deductible when incurred in Spain. For information, Spain does not tax overseas branches of Spanish companies anyway!	Breach of Freedom of Establishment as it deters Spanish companies undertaking R&D abroad
Spain	Different tax rates for non-residents as for Spaniards, partly to deal with issues like personal allowances. In many cases these rates are lower than the highest Spanish rates	Discourages Spanish business from employing non-Spaniards
Italy	VAT amnesty where past is wiped on payment of a lump sum is illegal	Illegal because: <ul style="list-style-type: none"> • Obligation to charge and collect VAT under EU law • Ignoring of obligations under EU law • Threatens the EU's own finances
Portugal	VAT is charged at a lower rate on crossing 2 bridges over the Tagus	VAT should be charged at a higher rate
Greece	Capital Duty is chargeable on the transfer of shares and certain industry sectors are exempt	Contrary to capital duty directive which does not allow exemptions or allow capital duty to be charged on anything but the formation of companies
Italy	Reduced corporate tax on companies obtaining their first public listing	Distorts competition
Italy	Sports clubs had a longer period to use tax losses	Illegal State Aid as it favoured sports clubs over other business. Italy has changed its rules to confirm.
Britain	Tax is withheld on interest and royalty from Gibraltar, which generally has a lower tax rate, subject to a separate State Aid case.	Breach of EU Directive
France	Exempts mutual and provident societies from tax on health insurance policies and other insurance policies	Illegal State Aid
UK	Gibraltar companies get an exemption for corporate tax if an annual fixed fee is paid	Illegal State Aid
Italy	Exemption from duty on fuel to heat greenhouses	Illegal State Aid
UK	Business rates charged on telecoms property is calculated differently from other businesses.	Illegal State Aid

The following measures were held to be permissible by the European Commission		
COUNTRY	ALLOWED	WHY ALLOWED
Spain	Canary Islands - State Aid with tax exemptions for Canary Island business	Necessary apparently
Denmark, Poland, Hungary	Tax deductions for contributions to preservation of historical and cultural monuments	Preserve heritage
Netherlands	Tax exemptions for sludge dredged from public waterways	Legal state aid as large quantities of sludge flows from rivers based in other Member States
France	Tax breaks exist to take over loss-making firms. The amount of break depends partly on the region	OK as fits within the EU Treaty on permissible State Aid
Denmark	Taxes phosphorous in animal feed and reduces land tax on agricultural land accordingly	Environmentally friendly