

## **Speech at the International tax symposium "Dynamics of International Tax Competition: Opportunity or Threat?"**

### **Tax policy coordination for more growth and employment the EU agenda**

#### **Introduction**

Ladies and gentlemen,

It is an honour and a pleasure for me to contribute to the discussion of today on "The dynamics of International tax competition" and in particular in this morning session on "national tax systems in competition".

I will do it from a European perspective. In particular, I will focus on issues of coordination and even a certain level of harmonisation of tax policies EU of Member States and on the contribution of EU tax policy to the Lisbon agenda of growth and jobs.

However, before that, I should like to say a few words on tax competition, a topic which – I am sure - will be discussed by various speakers, throughout this symposium.

- As you know, recent years, there has been a wave of tax reforms in Member States in. As a result, a decrease in corporate nominal tax rates can be observed as a long term trend in EU countries. This decrease in corporate tax rates has further accelerated with the accession of the new Member States.

- However, the decrease in nominal rates has been partly compensated by a broadening of the tax bases, consequently corporate tax revenues have until recently not followed a clear downwards trend.
- There is tax competition in the EU, and the corporate taxation area is one example of this. The question is whether this tax competition is desirable or not and whether there should be a coordinated response against this phenomenon.
- In order to answer to this question, we have to distinguish between acceptable and unacceptable tax practices, between "fair" and harmful tax competition; and also, the "grey area" of tax competition, that is, tax practices which are problematic, which can be harmful, and therefore may require some actions action in the future.
- Within the EU, there is one largely undisputed form of fair tax competition. That is competition regarding the overall level of taxation of Member States.
- It is up to governments to offer the best value for the money of domestic and foreign investors and to design tax systems that best suit the preferences of their voters.
- An overall high tax burden may not necessarily discourage investors. A high-tax country may have a promising market, first class infrastructure, qualified labour and investment friendly environment. On the other hand a low tax country may not necessarily attract investment if the market is not easily accessible, if the infrastructure and public services are poorly developed, and if the labour is not qualified.

- Finland is the most competitive economy in the world and tops the rankings for the third consecutive year in The Global Competitiveness Report 2005-2006, released by the World Economic Forum. Sweden and Denmark are also amongst the best five. "The Nordic countries share a number of characteristics that make them extremely competitive, such as the very healthy macroeconomic environments and public institutions that are highly transparent and efficient". But none of the Nordic countries can be called "low tax" countries.
- Competition based on the overall tax burden is generally seen as fair. But EU Member States have agreed that tax competition is harmful and unacceptable when it is aimed at attracting foreign tax bases, while protecting the national tax base with some "ring-fencing" mechanism. Similarly, opaque tax regimes or specific ad hoc arrangements with certain taxpayers are considered harmful.
- The main argument is that this "beggar-thy-neighbour" type of tax competition leads to a global and undesired loss of budget revenues, even if some smaller jurisdictions win in the short term.
- In addition, such tax competition may imply a distortion of tax structures towards immobile tax bases and have negative consequences on employment in some countries.
- In practice, the Community's efforts to tackle harmful tax practices in recent years have been focused on business taxation and on the savings income taxation of individuals. In the EU the Code of Conduct for Business taxation and the Savings Directive are important achievements.

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- Between harmful and fair competitive tax practices there is a large grey area. I believe that the European Union should be more pro-active in this domain.
- One of the most debated matters in this area is undoubtedly bank secrecy and the reluctance of some jurisdictions to exchange tax information with other countries.
- In the view of the Commission, bank secrecy is acceptable as long as it does not stand in the way of proper exchange of information, particularly for purely tax purposes. The rights of honest citizens can be adequately protected without fully-fledged bank secrecy. I firmly believe that in a world based on the rule of law, international cooperation between administrations is necessary.
- I believe that there is no absolute bank secrecy. Even the countries with the most restrictive laws on bank secrecy, such as Liechtenstein and Switzerland, have agreed to lift their bank secrecy in some circumstances, for instance in cases of money laundering.
- The core of the debate is not, therefore, whether it is acceptable to impose limitations on bank secrecy, but whether those limitations should also extend to tax related matters. In a time of increasingly integrated markets, exchange of information is also becoming increasingly important in the tax area. The limited access to bank information and the absence of effective exchange of information in some countries constitute an anomaly, which will inevitably need to be rectified in the coming years.

So much for tax competition! Let me now turn to the issue of tax harmonisation and, more generally, to the various instruments of tax coordination in the EU.

- "Tax competition" and "harmonisation" are sometimes treated as complete opposites. The title of our panel discussion – "Tax harmonisation versus tax competition" also reflects this approach.
- However, there are various forms of tax competition, and there are also many forms of co-operation. Harmonisation of tax rules is only one of these forms, certainly the most radical one, as it involves the adoption of common rules eliminating national differences.
- Economists often stress that eliminating differences between the tax regimes of Member States is not ideal when such differences are justified by objective factors. For instance, it makes sense when more remote countries adopt favourable tax regimes to compensate for their handicaps. Furthermore, harmonisation is difficult to achieve when unanimity is required to take decisions.
- For these reasons EU tax harmonisation efforts have been focused on specific areas where there were strong arguments for it. This was particularly the case for indirect taxation of goods and services, where a degree of harmonisation was needed in order to complete the Internal Market and in particular to eliminate border controls.

- A large part of our tax policies in the direct tax field are not aimed at harmonising the tax rules of Member States. Rather, we try to ensure the coordination of tax policies. This means that we want to ensure that the tax systems of Member States are mutually compatible and that they respect the European Treaties.
- Exchange of information and co-operation between tax administrations are measures that allow for such a coordination. They respect the sovereignty of co-operating countries while allowing them to apply to their taxpayers the tax rules that they consider appropriate. This is probably why most Member States have preferred to opt for information exchange rather than applying a withholding tax as a means of implementing the Savings Taxation Directive.
- Speaking about exchange of information and administrative cooperation, I should like to inform you that the Commission intends to contact important financial centres outside Europe like Hong Kong and Singapore in the near future to see whether they are prepared to adopt measures equivalent to the Savings Directive. This would contribute to the proper taxation of the savings income of EU residents that is deposited in these countries.
- The European Commission also supports the OECD work on harmful tax practices. This is designed to promote the use of minimum standards of transparency and exchange of information for tax purpose in OECD Member States and other financial centres.
- Other forms of coordination, such as non-legislative measures, are becoming increasingly popular in some areas, for example in employment and social affairs. The idea is to agree on broad objectives, while leaving the Member States to decide on the best way of achieving the objectives.

- These non-legislative approaches could also be utilised in taxation areas. We have already had a positive experience in this area with the Code of Conduct for Business Taxation and in the field of transfer pricing.

It is my firm conviction that Member States could achieve much better results in important areas such as combating tax fraud and tax avoidance by improving their coordination. In fact, the low level of coordination of tax systems is an invitation to tax planning and tax avoidance. While closer cooperation would facilitate a decrease in tax rates and the re-balancing of taxation in favour of growth and employment.

So we can come to the conclusion that tax competition is not bad by definition and EU tax policy is not limited to tax harmonisation. We are faced with a number of issues and very different national perspectives on taxation in the EU. That is why EU policymakers must propose a pragmatic range of instruments if they want to obtain results.

Now, I would like to turn to the third part of my address and brief you on the contribution of EU tax policy to the Lisbon strategy of growth, jobs and competitiveness.

- Soon after the Barroso Commission had been sworn in, it evaluated the achievement of the Lisbon strategy launched in 2000. In early 2005, we came to the conclusion that we are at half time in the 10 year long strategy but we are not at half way. So the Commission decided to re-launch the Lisbon strategy with less priorities and more concrete initiatives and with a much greater role for the Member States. The strategy is focused on policies and concrete actions to deliver growth and jobs, while maintaining the unique European social model and the overall approach of the EU to sustainable development.
- Taxation and customs policies have a significant role to play in this context. They can contribute to raising the efficiency of our economies, the competitiveness of our companies, and encouraging knowledge and innovation.
- The Commission is going to adopt a Communication on the key community taxation and customs policy measures that would contribute to reaching the Lisbon Objectives. Most of the measures will improve the functioning of the internal market. Specific measures will increase and improve investment in research and development and facilitate innovation and the sustainable use of

resources. These initiatives will boost growth and therefore will help to create more and better jobs.

Now, let me say a few words on the most important tax initiatives related to the Lisbon strategy.

- Today, there are 25 different methods of calculating the corporate tax base. If companies were allowed to apply a single EU-wide set of rules for calculating the corporate tax base, this would eliminate or reduce most of the current problems such as the administrative burdens and high compliance costs that they currently face when they do business across borders in the EU. The Commission is currently working with experts of Member States on this idea. The aim is to present a legislative measure within 3 to 4 years.
- Let me be clear: the purpose of the Commission is to harmonise only the corporate tax base. Tax rates should remain in the competence of the Member States. A couple of weeks ago, there was an interesting public hearing in the European Parliament on corporate taxation. An economist invited as an expert to the hearing suggested that a difference of 6 to 8 percentage points in tax rates between Member States could be sustained in the long run simply due to differences in proximity to markets and transport costs. This points at the fact that harmonisation in that area does not seem desirable.

- At the same time, the Commission is working on a number of more specific initiatives aiming at facilitating businesses. I should like in particular to stress our work on transfer pricing. The Commission together with representatives of the Member States and business are working together in a Joint Transfer Pricing Forum to achieve a more uniform application of transfer pricing tax rules within the EU. Bringing together all parties concerned to discuss the issues at stake has led to better common approaches and will allow the identification of non-legislative solutions to practical problems. This should reduce compliance costs and prevent disputes between taxpayers and tax administrations.
- In the VAT area, the Commission has named as a particular priority the simplification of compliance obligations relating to intra-Community activities. The Commission presented a proposal to the Council and Parliament last October for a one-stop shop system. This would allow a trader to fulfil all his VAT obligations for his activities in one single Member State, in the one in which he is established.
- Also in the VAT field, there is a proposal on the change of the place of taxation of services supplied business-to-business and business-to-consumers, so as to simplify life for traders and to ensure that the VAT accrues to the country where the service is consumed. While a great majority of Member States are in favour of this change, the unanimity rule for tax matters means that businesses cannot yet benefit from the proposed rules which would make the application of VAT to services simpler and fairer. I hope that the Council will adopt both these VAT proposals in the near future.
- Enhancing the environment for honest and legitimate operators must be coupled with the suppression of the activities of fraudsters who can undermine the competitiveness of legitimate traders as well as eroding the revenues of Member States. That is why it is equally important for the

Commission to help Member States in their efforts to combat tax fraud. The Commission has a valuable role to play in improving co-operation between Member States and providing fora in which tax authorities can exchange their experience and best practices, enhancing their knowledge and operational capacities.

- I would also like to express my conviction that EU taxation policy can play an important role in boosting knowledge and innovation for growth. An EU framework for Research and Development tax incentives would be particularly useful.

Ladies and gentlemen,

- The discussion that will follow my introductory remarks will certainly reveal differences in views concerning tax competition and tax harmonisation. But it is my firm conviction that a debate on taxation in Europe can only be productive if conditions for the proper functioning of the internal market and the concerns of governments in terms of investments, employment, tax revenues and equity are duly taken into account.
- My concluding remark is that the question is not whether we prefer tax competition, tax harmonisation or tax policy coordination. The answer is the proper mix of policies.

Thank you for your attention.