

# Harmonisation of the Corporate Tax Base in the European Union

Analytical study  
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## ***Foreword***

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Debates on harmonizing the corporate tax base in the European Union (EU) have been taking place since 1962. This issue was brought back again on the EU agenda at the threshold of EU enlargement in 2004. Currently, Germany and France, the main pushers for corporate tax harmonization, propose to consolidate only the corporate tax base stating that this measure has nothing to do with harmonizing corporate tax rates, the idea fiercely opposed by all new EU entrants.

The aims of this study are the following:

- a) to present a classification of tax harmonization opportunities and to elicit if harmonization of a corporate tax base is to be treated as tax harmonization;
- b) to work out if the proposed harmonization of the corporate tax base would be able to achieve the goals and solve the problems targeted by harmonization;
- c) to evaluate the impact of harmonization of the corporate tax base;
- d) to give recommendations as to how the goals, attached to harmonization of the corporate tax base, can be attained by alternative tools.

The following material will provide a definition of tax harmonization and display the ways it could be implemented, as well as the stages and the degrees of tax harmonization. It will look into the goals set for corporate tax harmonization and discuss their justification and relevance. The study will also analyze the arguments used to vindicate the proposed consolidation of the corporate tax base as the only suitable measure to reach these goals and will evaluate its appropriateness, effectiveness and potential negative implications. At the end of this document generalised implications of tax harmonisation, conclusions and recommendations will be provided.

## ***Tax harmonisation and its development in the EU***

At present, the VAT and excise duties are harmonised across the EU. Proposals to harmonise the corporate tax system, expressed for the first time in the Neumark Report in 1962, have been widely discussed until today and can be viewed as a centre-piece discussion among EU countries.

The Treaty establishing the European Community does not envisage any specific provisions regarding harmonisation of direct taxes. Article 94 of the Treaty stipulates that *“The Council shall, acting unanimously on a proposal from the Commission [...], issue directives for the approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the common market,”* and all initiatives towards harmonising the base of direct taxes stem from this particular article of the Treaty.

The European Court of Justice has ruled that direct taxes fall within the competence of EU member states, however, member states must implement this competence without infringing the law of the European Community. The EC prohibits restrictions on the free movement of workers, services and capital, the freedom of establishing business activity and state support which is incompatible with the common market.

In July 2004 the Commission presented a non-paper on developing a common consolidated EU corporate tax base. In September 2004 this document was discussed at an informal ECOFIN council. After this meeting a Common Consolidated Corporate Tax Base Working Group was established, which includes experts from the 25 member states of the European Union.

In 2004 to 2006 the Common Consolidated Corporate Tax Base Working Group analysed general issues and deliberated upon structural elements of a common consolidated corporate tax base. The Commission plans to issue a report on the achievements of, and the progress made by, this group. In 2006 to 2008 this group plans to examine the issues of consolidating the corporate tax base and a mechanism of sharing the base between the member states. In 2008 the Commission is to put forth a proposal for drawing up a legal document establishing a consolidated corporate tax base in the EU.

At present, as no official documents have been submitted to be either indorsed or countervailed, it is sometimes difficult to clearly identify the allies and opponents of corporate tax harmonisation. However, various supportive or critical comments made publicly on the activities of the-said working group allow drawing certain conclusions. France and Germany are the most ardent proponents of corporate tax harmonisation while the low-tax member states, and not just them, fight against this idea most vehemently. For instance, Denmark too says “no” to harmonization fearing that it might be forced to cut down its corporate tax rate. Ireland and the Great Britain are the countries which have so far succeeded in halting the initiative of tax harmonisation. The latter were also joined by EU newcomers – Estonia and Slovakia. Lithuania has not yet announced its official position on the issue.

An OECD study *“Harmful Tax Competition. An Emerging Global Issue”* (<http://www.oecd.org/dataoecd/33/0/1904176.pdf>), released in 1998, is likely to have also exerted some influence on spontaneous convergence of tax regimes. It provided recommendations on how to act with countries that apply tax rules engendering “harmful” competition. Although these recommendations are not obligatory, they have still built strong political pressure for countries to apply customary schemes of taxation.

In parallel to the OECD, the European Union displayed a similar initiative and on 1 December 1997 agreed on the Code of Conduct, according to which companies were taxed ([http://europa.eu.int/comm/taxation\\_customs/taxation/company\\_tax/harmful\\_tax\\_practices/ind\\_ex\\_en.htm](http://europa.eu.int/comm/taxation_customs/taxation/company_tax/harmful_tax_practices/ind_ex_en.htm)). Again, these rules institute political, not legal, obligation.

In 1999, after it had analysed the existing tax rules in EU countries, the Code of Conduct Group announced a report where 66 tax measures applied in EU member states and their dependent or associated territories were recognised as having harmful features. Countries were obliged to eliminate these rules until 31 December 2005, with the exception of certain agreed-upon cases.

In September 2004 the Commission adopted a communicate on prevention and elimination of bad financial and business practices, which called on member states, *inter alia*, to exchange information about taxes applied in their respective jurisdictions, with a view to enhancing taxation of complex structures of corporations.

All the above-listed measures, although not to be treated as tax harmonisation, have forwarded the approximation of tax regimes. In essence, there is no juridical restriction to continue following the course of such “self-coordination” and “recommendations” towards a closer convergence and unification of tax systems. Opportunities for countries’ bilateral self-coordination have not been exhausted so far either.

### **What is tax harmonisation?**

Tax systems can become similar (or different) as a result of centralised or decentralised decisions, i.e. by imitating the most successful practices of taxation or adjusting to developing standards. An overview of the tax regimes in the EU confirms that EU countries apply quite similar tax systems, while only the VAT and the excise duties have been harmonised at EU level (by fixing the minimal tax rate, the base, etc.). However, tax harmonisation itself is understood as a centrally applied tax base across the EU and a procedure of unifying tax rates and the rules of tax payment.

The ongoing debates show that countries and their representatives differently perceive what tax harmonisation is. Some consider it as a complete harmonisation of the entire tax (consolidation of a base, rate and rules of payment at a single stage), while others see it also as harmonisation of separate fragments of taxation (only the base, the rate, etc.). Seeking to avoid further ambiguities regarding this issue, we present a classification of tax harmonisation based on different criteria.

It is worth to start by explaining that tax harmonisation can be:

1. External, i.e. when regulation and harmonisation are applied to tax regimes of EU member states in their activity with non-EU countries (in agreements with third countries or unilaterally).
2. Internal, i.e. when regulation and harmonisation are applied to tax regimes of EU member states for the activity among themselves, by retaining the countries’ right to decide what tax regimes to apply to third countries. Presently, the EU is contemplating this particular variant of harmonisation.

The degree (width) of tax harmonisation can also be distinguished. A tax can be harmonised:

1. Partially, when only one or several very important fields of taxation are harmonised. For example, in the case of the corporate tax, partial harmonisation occurs in harmonising

taxation of mergers across the EU by imposing a corporate tax, taxing parent companies, eliminating double-taxation and the like.

2. Completely, when differences are removed from all fields of tax application. In the case of the corporate tax it would be a thorough harmonisation of the entire application of the corporate tax (the base, rates and rules of payment).

Tax harmonisation can be carried out in the following components of taxation:

1. Harmonisation of an object of taxation. Such harmonisation would occur as an imperative prescription that member states all must tax a specified object, in the case under discussion, corporate profits.
2. Harmonisation of a tax base. Regulation is laid down for principles and rules which are applied to calculating the tax base.
3. Harmonisation of the rules of tax payment. Regulation is set for payment of the corporate tax. Harmonisation of tax payment rules is usually combined with harmonisation of a tax base and rates.
4. Harmonisation of a tax rate. In this case a minimal (uniform or maximal) tax rate is fixed. If harmonisation of a tax rate is implemented separate from harmonisation of a tax base, this is also called nominal harmonisation.

In the case of the corporate tax, harmonisation has not been launched at any of the said levels, except the enacted harmonisation of mergers, the tax base of parent companies, and interest and royalty payments. (Directive 90/434/EEC on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States, supplemented by Directive 90/435/EEB on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, and Directive 2005/19/EK partially replacing Directive 90/434/EEC on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States, as well as Directive 2003/49/EB on a common system of taxation applicable to interest and royalty payments).

Complete harmonisation of the corporate tax at all levels can be achieved in two ways, by implementing tax harmonisation at the starting point:

1. In one stage, when harmonisation takes place to the full degree and at all levels. It is believed that harmonisation "at one stroke" would be an overly sudden and sharp change for businesses causing a number of disastrous effects, hence this alternative is not seriously contemplated in the EU.
2. Gradually, when the tax is harmonised by certain stages settled. This type of harmonisation can be conducted in an array of various ways. The EU is currently deliberating gradual harmonisation of the corporate tax.

Further in this study, tax harmonisation will refer to corporate tax harmonisation by harmonising the tax base as a starting point.

It should be noted that tax harmonisation can be conducted by fixing both the minimal and the maximal level, that is:

1. Positively, when harmonisation involves the establishment of certain rules for minimal rates or a minimal base. In principle, this particular type of harmonisation is presently being debated in the EU.
2. Negatively, when a maximal level for the tax rate or the tax base, or other restrictions are set for member states in order to determine certain aspects of the tax. In this

respect, the activities of the European Court of Justice have been especially distinct and facilitate tackling the arising problems with tax-related barriers to the common market.

The planned harmonisation of the corporate tax base (a common consolidated corporate tax base) would encompass a set of general rules for computing the taxable profit, the rules for profit and loss consolidation in a group of companies for tax purposes and a mechanism for dividing the tax base between EU member states. The common consolidated corporate tax base would be founded on the development of the tax base by discarding special tax exemptions and observing the principles of simplicity, efficiency (neutrality), transparency and legal certainty. The position of EU authorities is becoming more articulate that the harmonised corporate tax base will not be linked to financial reporting, that it will not be compulsory, only alternative, and that the corporate tax base will be both common and consolidated.

## **Justification of the goals of corporate tax harmonisation and appropriateness of tax harmonisation in achieving these goals**

The arguments and counter-arguments disputed here pertain to tax harmonisation of all levels and degrees pursued both gradually and in a single stage.

Proponents of corporate tax harmonisation attach the following goals to corporate tax harmonisation (it should be pointed out that these goals carry different weight, are of different levels and usually inter-related):

1. Creating the common market and securing free trade by removing tax obstacles.
2. Guaranteeing even conditions for competition.
3. Ensuring the free movement of capital.
4. Encouraging effective distribution of resources.
5. Safeguarding countries' tax revenues and application of "fair" tax competition (in other words, diminishing tax avoidance opportunities).
6. Observing business logic.
7. Alleviating the burden of tax administration (both for tax payers and tax administrators).

Let us analyse these goals, their rationality and justification, as well as the arguments which will disclose if these goals can be attained by corporate tax harmonisation. Let us also evaluate what implications can be involved in seeking the set goals by harmonising corporate tax.

### **1. The common market and securing free trade by eliminating tax barriers.**

The common market is grounded on the removal of barriers to the free movement of goods, services, capital and labour. It is maintained that creation of the common market requires harmonising taxation because custom duties are not imposed, partially harmonised taxes are applied and countries act according to the principle of cooperation. It is believed that only this step would eliminate all hindrances for goods, services and capital to freely move (unencumbered by differing tax rules) in the EU territory.

Admittedly, the aspiration to create the common market and to ensure free trade is a plausible and economically advantageous policy. But do uniform tax rules contribute to building the common market and free trade?

First, unified tax rules can hardly at all contribute to trade liberalisation as their diversity is no roadblock to free trade whatsoever; rather to the contrary – they serve as a stimulus to trade. As taxes constitute a significant share of costs and a large share of the price of production factors, labour in particular, it is tax diversity (which is usually determined by the necessity to accommodate to local conditions and traditions) that frequently provides opportunities to produce cheaper goods and services and to offer them for the international exchange. If we were to picture an ideal situation, in which, if other circumstances were not altered, any sort of tax influence on free trade was eliminated (ideal harmonisation), then incentives for free trade would diminish equally the same as when setting any other types of uniform standards in the sphere of production, trade and services.<sup>1</sup> This would emerge due to a decreased necessity for the institutional environment to adjust to local needs and natural advantages of individual states. Thus, non-existence of centralised tax harmonisation encourages beneficial trade rather than undermine it.

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<sup>1</sup> Of course, this does not involve a situation, not discussed in this study, when the tax entirely dissipates in all countries.

The inference that centralised tax harmonisation has harmful effects on free trade should not imply and does not imply that tax differences ought to be artificially stimulated in one or other way to bolster active trade. Following the same line, however, it cannot be asserted that tax harmonisation would in general kick-start free trade and serve consumers that benefit from free trade.

Second, in the context of taxation, the argument of the common market and free exchange could in principle be analysed only to the extent, to which tax rules would regulate taxation of the deals of cross-border trade. However, not all companies act on the common market. A large portion of them, especially small- and medium-scale enterprises, operate only within their own jurisdiction. Corporate tax harmonisation would pose no tangible effects on the common market and free trade if unified tax rules were imposed on companies, not involved in economic relations with other EU countries, while such businesses would also stand to incur costs while conforming to the new rules.

To sum it up, admitting that the common market and free trade are the virtues to be aspired, the conclusion is that tax harmonisation would not help to reach this goal.

## **2. Even conditions for competition.**

It is stated that different corporate tax rules in member states engender uneven conditions for competition for market players acting on the common market. However, conditions for competition are frequently understood too straightforwardly (as uniform rules) and their uniformity is viewed as an implicit virtue *per se*.

But conditions for competition can be looked at from another – the market agent's – angle. It is true, taxation rules are indeed relevant to market participants, yet, the possibility of free choice is no less important either. For if a market player sees he is being outrivalled due to high taxation in one country, there is no reason to think that the playing ground is unequal as long as the market player can freely transfer activities to another country applying lower tax rates. Evenness of conditions for competition can be secured by lifting restrictions to operate on the chosen market.

Every country has an interest that a tax payer acts and pays taxes within its own jurisdiction. So barriers to market entry are not typically applied in fixing corporate tax rules. Consequently, corporate tax harmonisation is simply unable to ensure the freedom of market entry and so guarantee equal preconditions to compete (as it does not restrict market entry). To the contrary, by eliminating the diversity of corporate tax bases, market agents operating in the common market are deprived of the opportunity to choose.

It is unclear how guarding equal footing for competition ought to be treated in terms of dynamics (time) when, as a result of tax harmonisation, conditions for tax competition would be altered not just to a different extent but also towards a different direction, i.e. the tax would be increased for some market participants and reduced for others. Tax harmonisation must not justify a deterioration of the tax environment because business needs good business conditions, not uniform taxes.

At a broader view to conditions for competition, competition should be estimated not just in terms of taxes, but also with respect to public services. Taking a consistent course towards creation of such even ground for competition, eventually government-rendered services would need to be harmonised as well. This would inevitably lead towards a completely centralised government.

Aiming at building equal conditions for competition, it is indispensable to remove obstacles to the companies of EU countries, enabling them to establish freely and (or) to pursue activities in any chosen territory of the EU.

### **3-4. Free movement of capital and effective distribution of resources.**

The EU acknowledges that different rules of calculating the corporate tax has hold over the movement of capital. Capital movement, which is determined by tax rules, is not considered to be “free,” and distribution of resources, conditioned by such capital movement, is not viewed as being effective. It is maintained that different tax rules inhibit an effective distribution of resources or the way they would distribute in line with differences in productivity when “other circumstances,” i.e. taxes, were equal.

This argument stands correct only if it is admitted that taxes hold sway on an effective distribution of resources. It can be added that the higher the taxes, the bigger the influence. If the tax-exerted impact on the effective distribution of resources was completely and consistently perceived, seeking effectiveness EU authorities would propose tax-reduction reforms, for instance, fixing a maximal level of distribution in the EU (the ratio of the tax burden to GDP).

As such initiatives have not been put forth so far, reasonable fears arise that the authorities are going to ignore the significance of tax size, emphasising only the importance of tax difference. Tax differences can be reduced both by cutting and raising tax rates. In the case of corporate tax harmonisation, there hasn't been a talk about the direction of harmonisation and aims at easing the corporate tax burden. Consequently, this leads to the conclusion that the objective is to achieve not absolute (smallness of taxes) but relative effectiveness of distribution of recourses, or, to put it vividly, to shift the existing ineffectiveness to a new (not necessarily better) level of ineffectiveness.

### **5. Security of national budgets and removing corporate tax planning opportunities (transfer pricing).**

It is thought that the free movement of capital builds strong and constant pressure to national governments to trim tax rates, which in the extreme case may translate into a situation when counties keep cutting tax rates down and race to the bottom. It is stated that low tax rates reduce revenues of national budgets, so tax harmonisation would allow safeguarding national budgets from the loss of revenues prompted by this pressure. In addition, with different tax rates in place, multinational corporations use certain pricing to decrease the corporate tax, i.e. they start planning their taxes and conduct a serious of transactions with a view to shifting profits to low-tax countries (transfer pricing). In this way, taxes become paid in the countries, other than high-tax countries, even though profits are earned there. For this reason, national budgets in high taxers stand to suffer losses.

When evaluating these arguments, it is worth to consider to what extent the assumptions are founded that counties will get involved in tax competition to “race to the bottom.” Competition for the corporate tax has been very evident in recent years (over the last 20 years, 18 OECD countries went on cutting their corporate tax rates, reduced the number of rates applied but expanded their tax bases). Despite that and even though no tax harmonisation was implemented during that time, the worst-case scenario was not fulfilled, the terrifying corporate-tax race did not take place and countries did not abolish their corporate taxes, although, admittedly, debates over its necessity continue to take place until today. Evidently, even as directive-based (centralised) harmonisation is not carried out, countries coordinate their activities (this is usually hidden under the argument of “global practice”) and governments

nevertheless conduct non-regulated (spontaneous) coordination of the corporate tax. The OECD efforts against “harmful competition” should not be left out of consideration either because they stand as one of the steps impelling tax harmonisation already today and exerting a bigger-than-substantial, if not redundant, influence on countries in selecting taxation schemes. To sum up, tax harmonisation, insofar as it is beneficial, is already taking place today at a decentralised level, and the OECD actions in this respect frequently do go far beyond the arguments of benefit whatsoever.

Proponents of corporate tax harmonisation argue that harmonisation of the corporate tax base would prevent countries from “racing to the bottom.” But this line of reasoning can be easily refuted as countries would still retain opportunities to compete for tax rates even in case of harmonisation. Let’s suppose the tax base was harmonised. Then, seeking to compete, countries would resort to “competition for tax rates,” thus heightening tax competition even more considerably. Hence, tax base harmonisation would only propel the tax-rate race as it would “purify” the only remaining difference – tax rates. On the other hand, a diversity of tax rates and tax-rate competition would force EU authorities to implement complete harmonisation of the corporate tax by setting a minimal rate.

The second question at issue is whether tax reduction should be feared in general. In the case under discussion, the only inarguable truth is that a zero-rate corporate tax would generate zero income to the budget. However, a reduction of the tax rate in itself and narrowing of the tax base *per se* (which is, by the way, not taking place in practice) definitely do not translate themselves into a decline of budget revenues. The Laffer’s Curve illustrates the statement that a certain optimal size of a tax rate exists which maximises budget revenues from the tax. Consequently, the fact that countries pursue corporate tax reforms, cut tax rates but expand tax bases may testify they are approaching to the optimal tax size. In other words, the presumption that tax rates have not been optimal so far and are coming up to the optimal size when lowered can be equivalently correct and even deeply credible because, ensuing the implemented reforms, neither budget revenues from the corporate tax in absolute terms nor a share of this tax in total tax revenues went down. Tax harmonisation would only undermine or even disrupt this process of optimisation. It may also mean that revenues from the corporate tax will shrink in response to tax harmonisation.

Finally, as regards transfer pricing adjustments, member states have already adopted rules (the so-called “arm’s length principle” also falls within these rules) in their sovereign and non-harmonised tax systems, which are used to prevent transfer pricing, or they impose taxes on profits, irrespective that profits have been transferred outside their jurisdiction and will be double-taxed there. In this case, referring to the security of budget revenues, it would be more favourable for countries if non-harmonised taxation was levied on profits because thus they would have more freedom in shielding their tax base. If tax harmonisation eliminated any possibility of double taxation, and with certain circumstances and preconditions being in place, such solution would be more attractive to tax payers. This is probably the reason why Denmark, a high-tax EU member state, also oppose the initiative of corporate tax harmonisation.

The problem of transfer pricing would not be tackled by harmonising either the tax base or the tax rate. Temptation to transfer profits from lucrative members of group-companies will continue to exist as long as there is at least one loss-making company in the group, and as long general guidelines (provided by the OECD), rather than formulae, will be needed.

Bearing in mind that each country chooses the level of taxation which best corresponds to its interests, it is evident that tax harmonisation will create uniform tax rules that in fact will not

suit any single country. If the corporate tax is unified, EU countries will be coerced to apply the same rules, imposed at a centralised level and not fit to meet their interests.

To conclude, safeguarding countries' budgets and eliminating transfer pricing opportunities cannot be seen as an integral and non-contradictory objective. Moreover, it cannot be affirmed that tax harmonisation would dovetail the interests of the state and the tax payer. Drawing on the above-mentioned arguments, it can be assumed that tax harmonisation will not assist in sheltering national budgets implicitly and in ruling out transfer pricing possibilities.

#### **6-7. Business logic and alleviation of the administrative burden.**

It is affirmed that a consolidated corporate tax base will be advantageous and accommodating for businesses as they will no longer need to scrutinise different rules of computing the corporate tax base and will be able to get a handle on the tax law much easier. It is believed that real comparability of tax burdens will also emerge (after tax base harmonisation, the tax rate will turn to be a more powerful carrier of information as the tax base will differ only insignificantly). It is also declared, and this is correct, that different rules of calculating the corporate tax base increase the administrative burden of the corporate tax, especially its share which falls on the tax payer, SMEs in particular. It is said that if the corporate tax base was consolidated in the common market, companies functioning EU-wide would spend less time and less financial resources on studying different legal acts, as compared to the current differing tax rules.

Disputes over the compatibility of business logic and taxation rules are rather longstanding. If countries thought that the corporate tax ought to be absolutely congruous with business logic, rules of computing the corporate tax in general would not need regulation and taxation would fall on profits computed international accounting standards. (It is true though that in such a case a serious danger would emerge that financial reporting would be modified and would no longer serve as a reliable reflection of companies' financial status.) In financial reporting, which is compatible with business logic, the effect of spontaneous harmonisation has been achieved by way of accounting standards. So seekers of business logic in business and accounting should have enough common sense and target their attempts at setting each country's rules of computing corporate tax closer to financial reporting standards, rather than at creating a logical parallel accounting system (for corporate tax). In other words, countries would be able to harmonise their tax bases to a larger or smaller extent even without directive-based harmonisation in work. However, such attempts have been very feeble until now, and this prompts suspicion about the "transparency" of this reasoning. A reverse argument is used more frequently, according to which tax accounting should not be mixed with financial reporting as their objectives are different.

The argument of administration costs is very compelling and attractive at first glance, but only until we start evaluating the ENTIRE base of the corporate tax. As it is known, the tax burden consists of several elements (direct and hidden tax burden), and the administrative burden is just one of them under evaluation. The argument of costs is valid only if, first, tax harmonisation does not create other burdens, i.e. an increase in the direct tax burden (the amount of taxes paid); second, if the costs of complying to new tax rules are comparably low (i.e. the share of administration of the same costs); and, third, if the new (harmonised) tax system contains a lower hidden tax burden (which results from regulating economic processes by tax rules). To round up all the above-mentioned arguments, it can be expected that a reduction of the administrative burden will be swayed by an increase in other burdens (and costs). This presumption is reinforced by other goals that are attached to tax harmonisation, namely the one of safeguarding national budgets.

When harmonising the corporate tax base, the aspired simplification of tax rules may well remain unattained as countries may encounter severe difficulties in agreeing on a uniform mechanism of calculating the corporate tax base. That is why it is quite likely that the rules of the harmonised tax base would encompass an array of “exemptions” and “possibilities” regarding every important domain of computing the taxable profits, such as amortisation, provisions, etc., which would inhibit, not alleviate, tax calculation. In addition to that, it is various tax favours and exemptions that provide opportunities for “unfair” competition, corruption and non-transparency, and thus aggravate the collection of budget revenues.

In the end, ideal harmonisation of taxes is simply unfeasible. Differences will still remain – member states are usually given some leeway even in the case of the strictest harmonisation – that is why countries will nonetheless need to familiarise with national rules and procedures. If tax harmonisation were implemented, companies would have to master not only local requirements, as it is at present, but also EU-imposed rules. Knowing that cross-border business activity is related not just to computing the taxable profits, but, in general, to operating in an overly foreign environment (traditions, language, relations with tax authorities, etc.), the argument of costs falls short of its primary significance.

Yet again, tax harmonisation will inflict tax-compliance costs on ALL tax payers in ALL member states, while a potential benefit from cost-reduction would fall only upon those acting on an international scale.

In summary, admitting that the principle of business logic should in principle be observed and business costs should be calculated, it can be concluded that tax harmonisation, as a means to reduce costs, is highly questionable from the point of view of both the benefit to every tax payer and the overall benefit (if such is recognised). Harmonisation of the corporate tax base would not diminish companies' costs, but is likely to increase them.

## ***Implications of harmonisation of the corporate tax base***

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The following part presents generalised implications of harmonisation of the corporate tax base.

### **1. An increase in the amount of taxes to be paid.**

As tax harmonisation aims at shielding national budgets, it is almost undoubted that after corporate tax harmonisation the amount of taxes to be paid will grow, at least in those countries, which currently apply lower tax rates.

### **2. A decline in budget revenues from the corporate tax.**

Differently from targeted goals, tax harmonisation may reduce budget revenues collected from the corporate tax because, when taxation rules change, companies are likely to seek to alter their tactics and relocate activity to other countries (including transferring business, or profits, outside EU jurisdiction).

### **3. Emerging tax-compliance costs.**

Corporate tax harmonisation will spawn considerable compliance costs in the transition period, especially for SMEs operating within the market of only one member state.

### **4. Violation of countries sovereignty.**

Direct taxes are a basic source of national budget revenues. Harmonisation of these taxes would mean intervention into member states' fiscal sovereignty. On the other hand, this sovereignty has already been interrupted after harmonising the VAT and excise duties.

### **5. A decrease in the region's competitiveness.**

Fiscal centralisation would undermine competitiveness of the entire region. The region's competitiveness would decline as the centralised tax system, erected inside the region, would force companies to take opportunity of the competitive advantage outside the region's territory. To put it in other words, those companies which are keen on competing in the EU under the current circumstances would be impelled to shift their activities or at least the most profitable elements of activity to other countries. This would mean that the so-called evening of conditions for competition through taxes could in general undersell competition in the country. For example, if the corporate tax rate in Ireland was raised to, say, the EU-required minimal level, under other conditions being equal, companies which previously selected this country for its low taxes would now seek to transfer activity, however, not other EU member states but to territories applying lower tax rates.

### **6. Violation of neutrality.**

With a possibility to choose other forms of activity (non-corporate) in place, corporate tax harmonisation may provoke distortions in selecting forms of activity and taxing other income.

### **7. Jeopardy of a complete centralisation of the tax policy.**

Corporate tax harmonisation would serve as an additional argument and build preconditions for a complete harmonisation of taxes across the EU because, based on analogous arguments

and pursuing analogous goals, it would be possible to vindicate the need for harmonising any other tax.

### **8. Potential elimination of tax defects.**

Depending on how it will be designed, tax harmonisation may eliminate unfavourable corporate tax rules in certain EU countries. This effect of tax harmonisation may occur as a positive “secondary” impact. However, it should not become the circumstance to justify and encourage tax harmonisation because tax defects may and need to be amended where they have been created – in the national tax law.

## ***Conclusions and generalisations***

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1. Harmonisation of the corporate tax base is one of the ways of tax harmonisation which entails the same consequences as does harmonisation of the tax rate or a complete tax harmonisation. After harmonising only the corporate tax base, all implications discussed in this study would arise, only their extent might differ, if at all.
2. Harmonisation of the corporate tax base is not an appropriate measure to achieve the aimed-at objectives, that is, to ensure a smooth operation of the common market and free trade, to create even conditions for competition, to secure the free movement of capital and effective distribution of recourses, to safeguard national tax revenues, to guarantee that business logic is regarded and to decrease tax administration costs.
3. Harmonisation of the corporate tax base would not only fail to attain the targeted goals but would also engender a number of negative consequences: it would increase the tax burden, potentially diminish tax revenues, create tax-compliance costs, infringe countries' sovereignty, undercut the region's competitiveness, violate neutrality in selecting the form of activity and centralise the tax policy.
4. In certain cases harmonisation of the corporate tax base may be advantageous to individual tax payers or tax payers in certain countries. However, this would not occur as a systematic reduction of the tax burden but rather as a side effect of tax harmonisation on individual tax payers.

## ***Recommendations***

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1. EU member states should oppose the initiative towards harmonising the corporate tax base and further moves aimed at creating a tax cartel among EU member states.
2. High-tax EU member states advocating tax harmonisation should undertake practical steps towards harmonisation – to move their tax systems closer to those competitive tax regimes that bolster economic growth.
3. The business community should bear in mind that harmonisation of the corporate tax base would not tackle, and would not even build preconditions to tackle, the defects of corporate taxes existing in national laws (which abound in all member states), but would inflict new administrative costs instead. Therefore, the business community should not endorse the idea of harmonising the corporate tax base, but should use this opportunity to call on their national governments to eradicate the deficiencies of national corporate taxes. The business community should also announce publicly its position on harmonisation of the corporate tax base.