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Brent D. Rose

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# Coordinating Taxes in the European Economic Community: What Can be Done by 1992?

## I. INTRODUCTION

When the European Economic Community (Community) was created in 1957, the six countries<sup>1</sup> (Member States) that signed the Treaty of Rome<sup>2</sup> (Treaty) were seeking to create "a single integrated market free of restrictions on the movement of goods, . . . persons, services, and capital."<sup>3</sup> The Member States recognized that their wide ranging systems of taxation presented a significant obstacle to this goal. Therefore, they requested that the Commission of the European Communities (Commission) determine how their tax systems could be "harmonized" and submit proposals to the Council of Ministers (Council).<sup>4</sup>

The Council was required to act unanimously on the Commission's proposals in issuing directives<sup>5</sup> seeking to "approximate" the Member States' laws and regulations that would "di-

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1. The six original countries were Belgium, France, West Germany, Italy, Luxembourg, and the Netherlands. Six more countries were added to the Community between 1973 and 1986. They are Denmark (1973), Greece (1981), Ireland (1973), Portugal (1986), Spain (1986), and the United Kingdom (1973). The twelve countries are hereinafter referred to as "Member States."

2. Treaty Establishing the European Economic Community, signed Mar. 25, 1957, 298 U.N.T.S. 3 (effective Jan. 1, 1958) [hereinafter cited as Treaty of Rome]. An English translation is located at 1 Common Mkt. Rep. (CCH) ¶ 151 (1971).

3. Cnossen, *Tax Coordination in the European Community*, 35 TAX NOTES 691, 692 (1987).

4. Treaty of Rome, *supra* note 2, art. 99 (prior to amendment by Single European Act, art. 17, BULL. E.C., Supp., Feb., 1986 [hereinafter SEA]). Although article 99 only required the Commission to submit proposals on indirect taxes, article 100 has been used to submit proposals on direct taxes that directly affect the Member States' goal of a single integrated (common) market. *Scope of Harmonization*, 2 Common Mkt. Rep. (CCH) ¶ 3026.03 (Sept. 10, 1974). For a definition of indirect and direct taxes, see *infra* notes 7-8. For a description of the roles of the Commission and Council, see A. DALTRUP, *POLITICAL REALITIES: POLITICS AND THE EUROPEAN COMMUNITY* 57 (2d ed. 1986); Revzin, *The Uncommon Market*, Wall St. J., Sept. 22, 1989, at R6 (Supp. on World Business).

5. The Member States chose to have the Commission use directives because, while binding them as to the result, directives allow the Member States flexibility in determining how to coordinate their tax systems based on their individual economic, political, and social circumstances. See General Note, *European Economic Community (EEC) Treaty Article 100*, BII ENCYCLOPEDIA OF EUR. COMMUNITY LAW (MB) ¶ B10-232 (1987); see also *Procedure for Legislative Approximation Under Article 100*, 2 Common Mkt. Rep. (CCH) ¶ 3302.11 (May 12, 1981).

rectly affect the establishment or functioning of the common market."<sup>6</sup> Such laws and regulations include indirect<sup>7</sup> and direct<sup>8</sup> tax systems because both systems distort competition by restricting (or encouraging) the movement of goods, services, capital, and persons within the Community.<sup>9</sup>

Although some directives coordinating the structure of indirect taxes were issued during the late 1960s and early 1970s, very little progress was made in coordinating indirect tax rates. The Commission also made many proposals seeking to approximate the Member States' direct tax systems, but no proposals were adopted as directives. Because the Council failed to obtain the required majority on most of the Commission's proposals, the Member States passed the Single European Act<sup>10</sup> (SEA) in 1987.

The SEA amended the Treaty's provisions and shifted the burden to the Council to act on the Commission's proposals in order "to ensure the establishment and [proper] functioning of the [common] market" by the end of 1992.<sup>11</sup> The SEA has had little to no impact, however, as none of the Commission's significant tax proposals since 1987 have obtained the required unanimity of the Council to be adopted as a directive. One reason is that the Commission has not adequately addressed the eco-

6. Treaty of Rome, *supra* note 2, art. 100. While the distinction between "approximation" and "harmonization" is sometimes difficult, "harmonization" generally requires less similarity among the Member States' laws and regulations than "approximation." See General Note, *supra* note 5, at ¶ B10-232. These terms are often used interchangeably with the term "coordination" which generally refers to "any change in the tax systems of [the] Member States intended to promote the aims of the Community." Cnossen, *supra* note 3, at 692. Therefore, the term "coordination" will be used when referring to any proposed changes in the Community's tax systems, unless the objective of the Commission has been specifically expressed as "approximation" or "harmonization."

7. Indirect taxes, such as sales taxes, value added taxes (VATs), and excise duties are taxes paid by an individual or entity other than the one on whom they are assessed. For a more complete definition and description of how VATs and excise duties operate in the Community, see *infra* notes 20-21 & 30.

8. Direct taxes, such as income taxes, are paid by the person or entity on whom they are assessed.

9. See Cnossen, *supra* note 3, at 692.

10. SEA, *supra* note 4, art. 8A. The SEA reflects "a renewed political will on the part of the Member States to fulfill the aims of the Treaty of Rome." The Single European Act, 3 Common Mkt. Rep. (CCH) ¶ 20,000 (May 1989). The Act seeks to accomplish this by providing procedures for increased economic and political cooperation among the Community's legal institutions and the Member States. See *id.*

11. Treaty of Rome, *supra* note 2, art. 99 (as amended by the SEA, *supra* note 4, art. 17).

conomic, political, and social policy objections of the Member States to changes in their tax systems.

Some Member States argue that no tax directives are needed because market forces will coordinate their tax systems once the Community's fiscal border controls are removed at the end of 1992. Other Member States, however, argue that the question is not whether tax directives are needed, but "how much diversity can" exist in their tax systems "without interfering with the establishment" and proper functioning of the "common market".<sup>12</sup>

This comment looks at the efforts the Commission has made in trying to answer that question, why those efforts have generally failed, and how the Commission can achieve the desired balance between diversity and interference through a selective market forces approach. Part II examines some of the existing and proposed indirect and direct tax directives in the Community. Part III surveys economic, political, and social policy objections that the Commission has to overcome to obtain the required unanimity of the Council to have any tax proposals issued as directives. Part IV discusses the advantages and disadvantages of using a pure market forces approach to overcome these objections and proposes the use of a selective market forces approach before extolling the benefits of such an approach.

This comment concludes that a selective market forces approach would allow market forces to coordinate the Member State's tax rates, while using directives to coordinate their tax systems and eliminate discriminatory tax provisions. The Commission should allow the Member States and the market to determine the appropriate range and combination of rates that should exist in their countries after 1992, and concentrate its efforts on drafting and obtaining approval on directives coordinating the Member States' tax structures. This selective market forces approach would ensure equal opportunity for all Community citizens and businesses to freely work, locate, and buy or sell goods or services in every Member State without fear of discrimination.

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12. *European Community: Many Unresolved Issues Remain in 1992 Plan for Uniform Value-Added Taxes, Analysts Say*, 5 Int'l Trade Rep. (BNA) 1481, 1482 (Nov. 9, 1988) [hereinafter *Unresolved Issues*].

## II. EXISTING AND PROPOSED TAXES IN THE EUROPEAN COMMUNITY

Many groups and individuals have studied the problems related to taxes in the Community. The most notable studies are (1) the 1963 Neumark Committee Report,<sup>13</sup> (2) the Commission's 1980 "Report on the Scope for Convergence of Tax Systems in the Community",<sup>14</sup> and (3) the Commission's 1985 White Paper (the White Paper) on "Completing the Internal Market".<sup>15</sup>

According to the Commission, the White Paper "remains a valuable yardstick for assessing the progress made towards a [fiscally] frontier-free Europe."<sup>16</sup> The White Paper contained many proposals seeking the approximation and harmonization of indirect taxes. However, the Commission has made many changes in its original proposals and none have obtained the required unanimity of the Council to be adopted as a directive. The 1985 White Paper contained no proposals seeking the coordination of direct taxes. These proposals were to be addressed in a later White Paper.<sup>17</sup> However, no White Paper addressing direct taxes has been issued and the proposals on direct taxes have never been finalized.<sup>18</sup>

Although some coordination of indirect tax structures in the Community has been accomplished,<sup>19</sup> the structures for direct taxes are still in the proposal stage and none of the Commission's tax rate proposals have been adopted as a directive. Therefore, all of the tax rates and most tax structures of the Member States vary considerably. Just how much they vary and

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13. The Neumark Committee report led to the introduction of a common VAT system in 1977.

14. 1980 EUR. COMM. DOC. (COM No. 139) 1 (1980). The report called for the elimination of border controls and approximation of direct taxes.

15. *Completing the Internal Market*, WHITE PAPER FROM THE COMMISSION OF THE EUROPEAN COMMUNITIES TO THE EUROPEAN COUNCIL 1985 EUR. COMM. DOC. (COM No. 310) 1 (1985) [hereinafter THE WHITE PAPER]. The White Paper called for the elimination of border controls, the approximation of VAT rates, and the harmonization of excise duties. Clossen, *supra* note 3, at 693.

16. *The Implementation of the Commission's White Paper on the Completion of the Internal Market*, FOURTH PROGRESS REPORT OF THE EUROPEAN COMMISSION TO THE EUROPEAN COUNCIL AND THE EUROPEAN PARLIAMENT, 1989 EUR. COMM. DOC. (COM No. 311) 5 (1989).

17. THE WHITE PAPER, *supra* note 15, at ¶ 150.

18. Goldsworth, *Tax Harmonization in the EEC and 1992*, 1 TAX NOTES INT'L 587, 593 (1989).

19. See *infra* notes 29-33, 49-51 and accompanying text.

how much coordination has been accomplished is discussed below.

### A. Indirect Taxes

In the White Paper, the Commission called for the drafting of directives approximating value added taxes (VATs)<sup>20</sup> and harmonizing excise duties<sup>21</sup> so that the common market would not be affected by trade distortions which adversely affect competition.<sup>22</sup> The Commission also called for a standstill directive to ensure that the differences in the Member States' VAT and excise duty systems were not increased before the directives were adopted and implemented.<sup>23</sup>

The standstill proposal was submitted to the Council in 1985.<sup>24</sup> The Commission replaced it, however, with a proposed convergence directive in 1987, which has a similar purpose.<sup>25</sup> In 1987, the Commission also presented the Council with seven other draft directives calling for approximation of VAT rates and harmonization of excise duties.<sup>26</sup> The Commission's next objective was to encourage the Council to intensify its efforts to adopt the proposals so that a significant adjustment is not re-

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20. VATs are consumption-type taxes similar to sales taxes in the United States. The major difference, however, is that a credit is generally given for VATs paid on earlier purchases whereas a sales tax is generally only imposed at the final retail stage with no credit (other than a deduction as part of the price of the purchase) for sales taxes previously paid by the retailer. Because the full burden of a sales tax is imposed on the final purchaser, the rates for sales taxes are generally lower than VAT rates. For a description of how the VAT system works in the Community, see *infra* notes 30, 34-35 and accompanying text.

21. Excise duties are a form of indirect tax generally imposed on specific goods either to discourage their use or to raise revenue to offset the costs of their use.

22. THE WHITE PAPER, *supra* note 15, at ¶ 185.

23. *Id.* at ¶¶ 208, 214. The proposed standstill directive would have "prohibit[ed] the Member States from making any changes in [either] the number [or] level of [VAT or excise duty] rates which they appl[ied], allowing them, however, to take steps to narrow the gap between [the proposed] rates and the number of rates currently applied in the Community." *Standstill for Value-Added Tax and Excise Duties Proposed*, [1985-1988 Transfer Binder] Common Mkt. Rep. (CCH) ¶ 10,736 (Nov. 21, 1985).

24. *Proposed Standstill Directive*, 30 O.J. EUR. COMM. (No. C 313) 5 (1985).

25. 30 O.J. EUR. COMM. (No. C 254) 1 (1987) (draft directive COM(87)324). No further action on the proposed convergence directive has been taken by the Council.

26. The seven other draft directives were COM(87)320 (general); COM(87)323 (clearing mechanism); COM(87)321 and 322 (VAT); and COM(87)325-328 (excise duties). 30 O.J. EUR. COMM. (No. C 250-58) 1 (1987). For more details on these proposals, see J. PELLKMANS, L. WINTERS & H. WALLACE, EUROPE'S DOMESTIC MARKET, 94-95 (Chatham House Papers No. 45, Royal Inst. Int'l Aff. 1988) (Table 5.1) [hereinafter EUROPE'S DOMESTIC MARKET].

quired when the Community's border controls are removed in 1992.<sup>27</sup>

This objective soon proved to be very difficult to attain because of the "considerable political sensitivity"<sup>28</sup> of the Member States to changes in taxes. When the Commission realized that it could not obtain the required unanimity for its 1987 proposals, it withdrew them and submitted new proposals in July and October of 1989 calling for a single standard VAT rate, a band of reduced VAT rates, and minimum rates or bands of rates for excise duties. There is some optimism that the new proposals will achieve the required unanimity. However, there is also a great deal of opposition from those who feel that the Member States, not the Commission, should coordinate indirect taxes.

### 1. Value added tax rates, structures, and proposals

In 1967, two VAT directives<sup>29</sup> were adopted requiring the Member States to replace their turnover tax systems with a common VAT system.<sup>30</sup> Ten years later, the Council adopted a sixth VAT directive<sup>31</sup> implementing the common VAT system "with a uniform basis of assessment."<sup>32</sup> The directives sought to coordinate the Member States' VAT structures "so that the application of [a] Community rate to taxable transactions," as defined by the directive, would "lead to comparable results in all the Member States."<sup>33</sup>

The problem the directives were seeking to solve is the discrimination that occurs when a supplier is in a different Member State than its purchaser and the ultimate consumer. This is a problem because the supplier will charge the VAT rate applicable where it is located. The purchaser, upon resale, will charge the ultimate consumer the VAT rate applicable where the purchaser is located. The purchaser will then receive a credit for the VAT previously paid based on the rate applicable in the Mem-

27. THE WHITE PAPER, *supra* note 15, at ¶ 203.

28. *Id.* at ¶ 218.

29. Directives 67/227 and 67/228, 10 J.O. COMM. EUR. (No. 71) 1301 (1967).

30. The common VAT system imposes "a general consumption tax . . . in proportion to the price of the goods or services" at the place where the goods are consumed or services performed with a deduction for prior VATs paid. *First Council Directive*, 2 Common Mkt. Rep. (CCH) ¶ 3101.11 (Sept. 5, 1979); *Second Council Directive*, 2 Common Mkt. Rep. (CCH) ¶ 3101.15 (Sept. 5, 1979).

31. *Directive 77/388*, 20 O.J. EUR. COMM. (No. L 145) 1 (1977).

32. *Sixth Council Directive*, 2 Common Mkt. Rep. (CCH) ¶ 3101.27 (Sept. 5, 1979).

33. *Id.*

ber State where the supplier is located.<sup>34</sup> Any differences between the tax rates or structures in the supplier's and the purchaser's Member State will affect the amount of revenue the purchaser's Member State receives from the resale.<sup>35</sup> These differences are at the heart of the movement towards tax coordination in the Community.

Although all Member States have now implemented the common VAT system, the discrimination problem has not been solved because the directives provide a "common list of exemptions" that allows for some variation in the Member States' tax rates and structures.<sup>36</sup> The sixth VAT directive has since undergone a few minor changes, primarily to define the scope of its application and to abolish certain exemptions.<sup>37</sup> However, the discrimination problem still exists because most of the Member States still have tax structures that are divided into three categories (1) a reduced rate generally applicable to "necessities," such as food and clothing; (2) a higher rate generally applicable to "luxury" items, such as jewelry and furs; and (3) a standard rate applicable to all other items subject to the common VAT system.<sup>38</sup> In addition, the rates they apply to the items included in the common system vary widely from a zero rating on "necessities" to a 38% rate on "luxury" items.<sup>39</sup>

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34. Goldsworth, *supra* note 18, at 591; M. EMERSON, M. AUJEAN, M. CATINAT, P. GOYBET & A. JACQUEMIN, *THE ECONOMICS OF 1992: THE E.C. COMMISSION'S ASSESSMENT OF THE ECONOMIC EFFECTS OF COMPLETING THE INTERNAL MARKET 60* (1988) [hereinafter *THE COMMISSION'S ASSESSMENT*].

35. For example, if a Luxembourg supplier sells a camera worth 100 European currency units (ecus) to a French purchaser, the Luxembourg VAT rate of 12% (12 ecus) will be charged to the French purchaser. If the French purchaser then resold the camera for 150 ecus to a French consumer, the French VAT rate of 33 1/3% (50 ecus) would be charged to the French consumer. The French purchaser would then take a credit for the 12 ecus previously paid and remit the remaining 38 ecus to the French government. If both Luxembourg and France charged the 12% VAT rate on cameras, the French government would have only received 6 ecus. See, e.g., *THE COMMISSION'S ASSESSMENT*, *supra* note 34, at 60 (Table 3.5.2).

36. *Sixth Council Directive*, *supra* note 32, at ¶ 3101.27. Despite the exemptions, the Commission feels that the exemptions still allow the VAT "to be collected in a uniform manner in all the Member States." *Id.*

37. See General Note, *EEC Treaty Article 99*, BII *ENCYCLOPEDIA OF EUROPEAN COMMUNITY LAW* (MB) ¶ B10-229 (1988). The most recent of these changes, known as the eighteenth VAT directive, was adopted on July 18, 1989. See *Directive 89/465*, 32 O.J. EUR. COMM. (No. L 226) 21 (1989).

38. For differences in the Member States' VAT rates and structures, see *THE COMMISSION'S ASSESSMENT*, *supra* note 34, at 60 (Table 3.5.2).

39. The reduced rates currently vary between the zero rate applied in Denmark, Portugal, and the United Kingdom, and the 10% rate applied in Ireland. The standard



In 1987, the Commission examined the tax rates and structures of the Member States and proposed a two-tier system. The proposal called for a reduced VAT rate between 4% and 9% for necessities and a standard rate between 14% and 20% for all other goods and services.<sup>40</sup> The proposal also called for a clearing mechanism which the Commission felt was "necessary to ensure that" a VAT collected on exports is credited to the Member State "in which final consumption takes place."<sup>41</sup>

The proposal provoked such protests that the Commission proposed a compromise in May of 1989.<sup>42</sup> The compromise proposal replaced the bands of VAT rates with a minimum standard rate of 15% on most goods and services, a reduced rate of 4% to 9% for six categories of goods and services, and a zero rate for a very limited number of necessities.<sup>43</sup> The proposal also called for a transitional phase to give the Member States time to implement the proposal and retained the 1987 proposal for a clearing mechanism.<sup>44</sup>

Some feel that the new proposals allow the Member States

rates currently vary between the 12% rate applied in Luxembourg and Spain, and the 25% rate applied in Ireland. Only six of the Member States impose a luxury rate, which currently varies between 25% in Belgium and 38% in Italy. For a more detailed description of the VAT rates currently applied in the Member States, see *id.* at 59 (Table 3.5.1); *Business Operations in France—Taxation*, 39-7th Tax Mgmt. (BNA) C&A-12 (Mar. 13, 1989); *Business Operations in the Republic of Ireland*, 125-3d Tax Mgmt. (BNA) C&A-9 (May 8, 1989); *Business Operations in Italy*, 84-5th Tax Mgmt. (BNA) A-42-43 (1989); and *Business Operations in the Netherlands*, 150-5th Tax Mgmt. (BNA) C&A-5 (Aug. 28, 1989).

40. See 30 O.J. EUR. COMM. (No. C 251) 1 (1987) (COM(87)321); 30 O.J. EUR. COMM. (No. C 252) 1 (1987) (COM(87)322); see also THE COMMISSION'S ASSESSMENT, *supra* note 34, at 59.

41. *European Commission White Paper Supports Two Standard VAT Rates for EEC*, 36 TAX NOTES 961 (1988) (quoting PRICE WATERHOUSE, EC BULLETIN No. 78 (Dec. 1987/Jan. 1988)). The Commission's proposed clearing mechanism would allow the VAT to "be charged by the taxable vendor in the exporting Member State at the rate [applicable] in that country and [to be] deducted at [the same] rate by the purchaser in the importing Member State." *Id.* This proposal is an attempt by the Commission to eliminate some of the discrimination that occurs in intra-Community transfers by providing a mechanism to refund the tax collected by the exporting Member State to the Member State where the goods are consumed or services provided. See *id.*; see also THE COMMISSION'S ASSESSMENT, *supra* note 34, at 61. However, a clearing mechanism would merely replace one form of fiscal border control (detaxing exports and taxing imports) with another.

42. 1989 EUR. COMM. DOC. (COM No. 260) 1 (1989).

43. *Commission Amends Plans for Harmonization of Indirect Taxation*, 4 Common Mkt. Rep. (CCH) ¶ 95,177 (June 1989); see also *Compromise May Break EC Deadlock on VAT*, Financial Times, May 18, 1989, at 2 [hereinafter *EC Deadlock*].

44. *EC Deadlock*, *supra* note 43, at 2. The transitional phase is to extend through the end of 1992, when the border controls are to be removed. *Id.*

greater flexibility in determining VAT rates and in simplifying the proposed clearing mechanism.<sup>45</sup> However, major opposition continues from the Member States. For example, "the British . . . question the need for legislated VAT harmonization [because they] believe the differences in rates will not distort the 1992 single market."<sup>46</sup> Other Member States, such as France, oppose the clearinghouse mechanism and have proposed an alternative calling for national rather than centralized tax checking.<sup>47</sup> Because of this opposition, the Community finance ministers "failed to make any progress on proposals" seeking to coordinate the Member States' VAT systems when they met in Brussels in November of 1989.<sup>48</sup> Even less progress has been made on proposals seeking to coordinate the Member States' excise duty systems.

## 2. *Excise duty rates, structures, and proposals*

In 1972, the Commission proposed the harmonization of excise duty structures on alcoholic beverages, tobacco, and petroleum products and the abolishment or phasing out of all other excise duties. These products were selected because the revenue derived from them substantially exceeds the expenses incurred in collecting them and their consumption has undesirable effects.<sup>49</sup> Only one proposal has been adopted as a directive,<sup>50</sup> and it has only been implemented in stages.<sup>51</sup>

The 1972 proposals were still being considered in 1987 when the Commission issued a proposal for harmonizing excise duty rates.<sup>52</sup> The 1987 proposal "met with almost unanimous opposi-

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45. *Id.*; see also *Europe's Internal Market*, THE ECONOMIST, July 18, 1989, at 19 (survey) (arguing that the proposals will remove the border controls created by the differences in indirect taxes, but still allow competitive pressures to bring VAT rates into line).

46. *European Community: EC Finance Ministers Fail to Agree on Ways to Improve Tax Administration*, 6 INT'L TRADE REP. (BNA) 1523 (Nov. 22, 1989) [hereinafter *EC Ministers Fail to Agree*].

47. See Culp, *Harmonizing the European Economic Community's VATs Through the Market*, 1 TAX NOTES INT'L 8, 11 (1989).

48. *EC Ministers Fail to Agree*, *supra* note 46, at 1523.

49. See *Outline for Excise Tax Harmonization*, 2 COMMON MKT. REP. (CCH) ¶ 3201.07 (Oct. 26, 1982); see also General Note, *supra* note 37, at ¶ B10-230/1.

50. *Directive 72/464*, 15 J.O. COMM. EUR. (No. L 303) 6 (1972) (excise duties on manufactured tobacco).

51. See 23 O.J. EUR. COMM. (No. C 264) 8 (1980) (proposal for a third stage).

52. THE COMMISSION'S ASSESSMENT, *supra* note 34, at 61 (Table 3.5.3) (Commission's 1987 proposals).

tion from the Member States"<sup>53</sup> because excise duty rates still vary widely among the Member States.<sup>54</sup>

On October 25, 1989, the Commission made "new proposals" calling for minimum excise duties for tobacco, alcohol, and most petroleum products; a band of rates for some petroleum products; and target rates toward which the Member States' rates should evolve in the long term.<sup>55</sup> The excise duty rates proposed by the Commission in October, 1989, are as follows:<sup>56</sup>

Product	Minimum Rate (ECU)	Target Rate (ECU)
Pure alcohol (per hl)	1118.5	1398.1
Intermediate alcohol (per hl)	74.8	93.5
Still wines (per hl)	9.35	18.7
Sparkling wines (per hl)	16.5	33.0
Beers (per hl)	9.35	18.7
Cigarettes (per 1000)	15.0	21.5
Leaded petrol (per 1000 l)	337.0	Future
Unleaded petrol (per 1000 l)	287.0	Future
Liquified petrol (per 1000 l)	84.5	Proposals
	Rate Bands	
Diesel (per 1000 l)	195-205	
Heating oil (per 1000 l)	47-53	
Heavy fuel-oil (per 1000 kg)	16-18	

53. *Commission Proposes New Approach on Excise Duties*, 4 Common Mkt. Rep. (CCH) ¶ 95,292 (Nov. 1989).

54. The excise duty rates in the Community range between 1) 48 and 3499 ecus per hectoliter (hl) for pure alcohol; 2) 0 and 279 ecu per hl for wine; 3) 3 and 82 ecu per hl for beer; 4) .6 and 77.5 ecu per 1,000 cigarettes; and 5) 209 and 557 ecu per 1,000 liters for petrol. *THE COMMISSION'S ASSESSMENT*, *supra* note 34, at 61 (Table 3.5.3).

55. *European Community: New Proposals Offered for Harmonizing Excise Taxes Among 12 EC Member States*, 6 Int'l Trade Rep. (BNA) 1428 (Nov. 1, 1989) [hereinafter *New Excise Tax Proposals*].

56. *Commission Proposes New Approach on Excise Duties*, *supra* note 53, at ¶ 95,292.

The 1989 proposals offer "a more flexible approach," but allow variations only in the direction of the "target rates."<sup>57</sup> By using target rates, the Commission seems to have conceded that it cannot harmonize excise duty rates by 1992, but expects market forces to approximate them after 1992.<sup>58</sup>

### B. Direct Taxes

While the Commission has achieved some degree of coordination of indirect taxes, it has failed to achieve the required unanimity of the Council for any of its direct tax proposals. Nevertheless, the Commission feels that some coordination of the Member States' direct tax systems is necessary for the establishment and proper functioning of the common market.

In 1960, the Commission organized a Fiscal and Financial Committee (Committee) to study the rates and systems applied in the various Member States.<sup>59</sup> In 1962, the Committee reported that coordination was necessary for corporate income taxes but not for individual income taxes because they were not perceived as a significant obstacle to the establishment and proper functioning of the common market.<sup>60</sup>

The Commission's proposals for approximating corporate tax rates and its plan for coordinating corporate tax structures followed closely the Committee's report and further studies. Despite the Committee's report, however, the Commission felt that some coordination of the individual taxes was needed and proposed a directive intended to encourage the free movement of Community workers. None of the direct tax proposals have been adopted by the Council even though direct taxes "drastically alter economic life" in the Community and, thus, hinder the establishment and proper functioning of the common market.<sup>61</sup>

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57. *Id.*

58. *Excise Duty Update*, 45 TAX NOTES 1100 (1989).

59. *Direct Taxation Barriers to Unified Market*, 2 Common Mkt. Rep. (CCH) ¶ 3211.01 (May 20, 1975).

60. *Report of Fiscal and Financial Committee*, 2 Common Mkt. Rep. (CCH) ¶ 3211.03 (May 20, 1975).

61. Waters, *The Evasive Goal of Company Tax Harmony*, Financial Times, Sept. 19, 1988, at 6 (direct taxes "drastically alter economic life" in the Community by offering incentives to change "the location of business activity, the flow of capital" and the place of residence or employment of individuals).

### 1. *Corporate income tax rates, structures, and proposals*

After studying the Committee's report and making further comparisons, the Commission adopted a draft program for coordinating corporate taxes in 1967.<sup>62</sup> In accordance with the 1967 program, the Commission submitted a proposed directive to the Council in 1975.<sup>63</sup> The Commission's proposal called for a single tax rate of between 45% and 55% to be applied to both distributed and undistributed corporate income.<sup>64</sup> However, the Commission's proposal has never been adopted as a directive by the Council and is considered by some to be "dead, killed off by [the Member States' opposition,] tax reforms and further analysis of the consequences."<sup>65</sup>

Since attempting to coordinate the Member States' corporate tax systems in 1975, the Commission has not made any other formal proposals seeking to coordinate corporate taxes. Therefore, the Member States' corporate income tax systems still vary widely between 34% and 50% percent.<sup>66</sup> This indicates that the Commission's proposed rates may be too high and may create an incentive for companies to move operations to lower tax Member States when the border controls are removed after 1992.

The Commission did indicate in 1988 that it would issue a preliminary draft proposal calling for the approximation of corporate income tax rates and a common approach to calculating

62. *Commission's 1967 Program for Company Tax Harmonization*, 2 Common Mkt. Rep. (CCH) ¶ 3211.05 (May 20, 1975).

63. *Proposal for a Council Directive Concerning the Harmonization of Systems of Company Taxation and of Withholding Taxes on Dividends*, 18 O.J. EUR. COMM. (No. C 253) 2 (1975).

64. *Alignment of Corporation Tax Rates*, 2 Common Mkt. Rep. (CCH) ¶ 3217.10 (Oct. 7, 1975).

65. Goldsworth, *supra* note 18, at 593.

66. The current corporate income tax rates in the Community can be found in *Business Operations in Belgium*, 93-6th Tax Mgmt. (BNA) A-60 (1987) (43%); *Business Operations in Denmark*, 181-2d Tax Mgmt. (BNA) C&A-1 (Nov. 25, 1985) (50%); *Business Operations in France—Taxation*, 39-7th Tax Mgmt. (BNA) C&A-4 (Mar. 13, 1989) (39%); *Business Operations in Germany*, 174-5th Tax Mgmt. (BNA) A-37, C&A-4 (May 8, 1989) (56% on retained, 36% on distributed); *Business Operations in Greece*, 194-4th Tax Mgmt. (BNA) A-25 (1986) (49%); *Business Operations in the Republic of Ireland*, 125-3d Tax Mgmt. (BNA) C&A-2 (Oct. 23, 1989) (43%); *Business Operations in Italy*, 84-5th Tax Mgmt. (BNA) A-37 (1989) (36%); *Business Operations in Luxembourg*, 164-4th Tax Mgmt. (BNA) C&A-5 (Feb. 12, 1990) (34%); *Business Operations in the Netherlands*, 150-5th Tax Mgmt. (BNA) A-18 (1989) (35%); *Business Operations in Spain*, 273-3d Tax Mgmt. (BNA) C&A-9 (May 8, 1989) (35%); *Business Operations in the United Kingdom—Taxation*, 68-8th Tax Mgmt. (BNA) A-33 (1989) (35%).

corporate taxable income.<sup>67</sup> No specifics were given, however, and no formal proposal had been made as of February 1990.<sup>68</sup>

## 2. Individual income tax rates, structures, and proposals

While the Committee did not recommend any changes in the Member States' individual tax systems, the Commission proposed a directive in 1979 seeking to coordinate the Member States' income tax provisions concerning the free movement of non-resident workers.<sup>69</sup> The proposal divided non-resident workers into two groups, "frontier workers" and "other non-resident workers."<sup>70</sup> It defined "frontier workers" as non-resident workers who return to their resident Member State daily.<sup>71</sup>

The proposal, if adopted by the Council as a directive, would require the Member States to apply the same withholding tax rate to frontier workers as is applied to resident workers.<sup>72</sup> The frontier worker would then be given a credit by the resident Member State for individual income taxes paid in the non-resident Member State.<sup>73</sup> This would reduce the effects of double taxation on frontier workers and make them freer to work anywhere in the Community.

The adverse effects on frontier workers is apparent from the 0% to 70% range of individual income tax rates currently applied in the Member States and the different systems of taxation currently used in the Community.<sup>74</sup> Unlike most states in the

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67. See *EC Recommendations to Harmonize Corporate Tax Rates Expected in Late Summer*, 39 TAX NOTES 100 (1988); *EC Sets Date for Corporate Tax Plan*, Financial Times, Mar. 16, 1988, at 26; *EC Moves Closer to Corporate Tax Harmony*, 38 TAX NOTES 1514 (1988); *Brussels Corporate Tax Harmonization Plan Set to Hit Fierce Resistance*, Financial Times, Mar. 15, 1988, at 1.

68. Goldsworth, *supra* note 18, at 593.

69. *Proposal for a Council Directive Concerning the Harmonization of Income Taxation Provisions with Respect to Freedom of Movement for Workers Within the Community*, 23 O.J. EUR. COMM. (No. C 21) 6 (1980) [hereinafter *Individual Income Tax Proposal*]; see also General Note, *supra* note 37, at ¶ B10-230/2.

70. *Individual Income Tax Proposal*, *supra* note 69, at 6.

71. *Id.* at 7.

72. *Id.* at 8.

73. *Id.*

74. The individual income tax rates currently applied in the Community can be found in *Business Operations in Belgium*, 93-6th Tax Mgmt. (BNA) C&A-5 (Oct. 23, 1989) (25% to 55%); *Business Operations in Denmark*, 181-2d Tax Mgmt. (BNA) C&A-1 (Nov. 25, 1985) (50% to 74%); *Business Operations in France—Taxation*, 39-7th Tax Mgmt. (BNA) C&A-9 (Mar. 13, 1989) (0% to 56.8%); *Business Operations in Germany*, 174-5th Tax Mgmt. (BNA) C&A-6 (July 3, 1989) (19% to 53%); *Business Operations in Greece*, 194-4th Tax Mgmt. (BNA) A-21 (1986) (10% to 63%); *Business Operations in*

United States, no Member State gives credit for individual income taxes paid to another Member State in the Community. Therefore, frontier workers currently have taxes withheld by the Member State in which they work and are taxed on that same income by the Member State in which they reside.<sup>75</sup>

For other non-resident workers, the Commission only proposed that certain items of income, such as pensions and social security, should not be taxed any greater than for residents.<sup>76</sup> For all other items of income earned by "other non-resident workers," the Commission would leave it up to the Member States to choose whether to offer "exemptions, deductions, and other general tax relief."<sup>77</sup>

Despite the discriminatory tax provisions currently used by the Member States, however, no action has been taken on the 1980 proposed directive and no other directives have been proposed to coordinate individual income taxes.<sup>78</sup> This is because non-resident workers have little political clout in the Community and do not have access to the legislative process in the Member States where they work.<sup>79</sup>

### III. THE MEMBER STATES' ECONOMIC, POLITICAL, AND SOCIAL POLICY OBJECTIONS TO THE COMMISSION'S PROPOSALS

The effort to achieve tax coordination in the Community is based on the presumption that the Member States have "similar per capita tax revenue and proportionate government expenditures."<sup>80</sup> On the contrary, the Member States have very different revenue and expenditure allocations depending on their individ-

*the Republic of Ireland*, 125-3d Tax Mgmt. (BNA) C&A-7 (Oct. 23, 1989) (32%, 48%, 56%); *Business Operations in Italy*, 84-5th Tax Mgmt. (BNA) A-32 (1989) (10% to 50%); *Business Operations in Luxembourg*, 164-4th Tax Mgmt. (BNA) C&A-4 (Feb. 12, 1990) (10% to 56%); *Business Operations in the Netherlands*, 150-5th Tax Mgmt. (BNA) C&A-5 (Dec. 18, 1989) (14% to 72%); *Business Operations in Spain*, 273-3d Tax Mgmt. (BNA) C&A-6 (Feb. 12, 1990) (25% to 56%); and *Business Operations in the United Kingdom—Taxation*, 68-8th Tax Mgmt. (BNA) A-84 (1988) (25% and 40%).

75. For other adverse effects on frontier workers and their effect on the establishment and proper functioning of the common market, see *infra* notes 100-01 & 127 and accompanying text.

76. *Individual Income Tax Proposal*, *supra* note 69, at 8.

77. *Id.*

78. *Unresolved Issues*, *supra* note 12, at 1481.

79. Discussed *infra* note 127 and accompanying text.

80. *Europe 1992 and U.S. Tax Policy: U.S. Firms Back Into the Future*, 45 TAX NOTES 1407 (1989) [hereinafter *U.S. Firms Back Into the Future*].

ual economic, political, and social policies which makes coordination of their tax systems very difficult.<sup>81</sup>

It would be very difficult to fully evaluate the prospects for coordinating taxes in the Community without considering the economic, political, and social policies underlying the tax systems in the Member States. Widely varying tax rates and structures are considered a major obstacle to the free movement of capital, goods, people and services, and the creation of the common market.<sup>82</sup> Any attempt to bring the tax systems closer together is seen as an infringement on the "sovereign rights" of the Member States to determine the tax system "necessary" to satisfy their individual economic, political, and social needs.<sup>83</sup>

Although the Commission drafted its proposals with the recognition that taxes "are areas of considerable political sensitivity,"<sup>84</sup> it has nevertheless encountered stringent political opposition to many of its proposals. The opposition has come mainly from Member States, like the British, who argue that the Commission's tax proposals are "too threatening to [their] national sovereignty"<sup>85</sup> because they would "subordinate market forces to a centralized, political bureaucracy."<sup>86</sup>

Opposition has also come from Member States with high taxes or those that impose little or no taxes on certain goods and services. These Member States oppose attempts to coordinate their tax systems because significant changes would have to be made in their tax systems and because their tax systems are based on "deep-rooted" policies which rely on taxes either to discourage or encourage the consumption of certain goods or to support a comprehensive social welfare system.<sup>87</sup>

These policies are so historically and culturally important to the Member States that no Community tax proposal should be made without fully considering their impact on the establish-

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81. See *id.*

82. *European Community: Proposal to Harmonize Indirect Tax Rates Approved by Commission, Now Goes to Council*, 4 Int'l Trade Rep. (BNA) 944, 944-45 (July 22, 1987).

83. See Culp, *supra* note 47, at 11.

84. THE WHITE PAPER, *supra* note 15, at ¶ 218.

85. *Is EC Tax Harmony Off Key?*, 45 TAX NOTES 865 (1989); *Harmony Must Wait Awhile*, Financial Times, Oct. 26, 1989, at X (special supp.).

86. Culp, *supra* note 47, at 10. Instead, the British have proposed an alternative that would rely on market forces to coordinate the Member States' tax systems. See *infra* text accompanying notes 106-08.

87. *Indirect Taxes Are the Focus for 1992, Scrivener Tells American Enterprise Institute*, 46 TAX NOTES 1435 (1990).



ment and proper functioning of the common market. Therefore, the Commission needs to take a closer look at the social policy concerns of the Member States before it makes further tax proposals. The Commission must also consider the economic effects of the Member States' tax systems which have been imposed to either discourage or encourage certain types of companies or individuals from crossing the Member States' borders.

A. *Economic Policies Underlying the Member States' Tax Systems*

The main opposition to the Commission's 1987 indirect tax proposals<sup>88</sup> from an economic standpoint came from France. In France, it is feared that the proposals for approximating VAT rates would result in "heavy losses for the French treasury."<sup>89</sup> The heavy losses would come from the elimination of a VAT rate on luxury items and the fact that VATs account for almost 10% of the gross domestic product and 45% of the total revenue in France.<sup>90</sup>

France and the other five Member States<sup>91</sup> that impose a high VAT rate on luxury items do so either to discourage the purchase of those items or to raise a large amount of revenue from the sale of a relatively few luxury items. This either reduces the consumption of those goods or brings more money into the Member State's treasury with fewer transaction and collection costs. For example, France "fear[s] that diminishing the power of one of their most effective means of revenue collection, the VAT, would prove disastrous."<sup>92</sup> Luxembourg also fears that coordination of indirect taxes would be detrimental to its economy by causing a reduction in tax revenues.<sup>93</sup>

On the other hand, some Member States want more coordination of direct taxes in order to avoid competition for location of businesses. Competition for location of businesses causes sub-

88. See *supra* notes 40-41 & 52 and accompanying text.

89. See *Harmonization of VAT and Excise Tax Rates Meets Opposition from British and French Governments*, [1985-1988 Transfer Binder] Common Mkt. Rep. (CCH) ¶ 11,023 (Oct. 6, 1988).

90. See THE WHITE PAPER, *supra* note 15, at ¶ 198; Goldsworth, *supra* note 18, at 590.

91. The other five Member States that impose a luxury VAT rate are Belgium, Greece, Italy, Portugal, and Spain. See THE COMMISSION'S ASSESSMENT, *supra* note 34, at 59 (Table 3.5.1).

92. Culp, *supra* note 47, at 10.

93. Goldsworth, *supra* note 18, at 590.

stantial reductions in tax revenues because the Member States are forced to either reduce their corporate income taxes or provide other incentives to discourage businesses from shifting their operations to Member States with lower taxes.<sup>94</sup> While these Member States want more coordination to discourage individuals and businesses from moving to other Member States, they also want less coordination to allow them to discourage certain individuals, goods, and businesses from entering their Member State for social policy reasons.

### *B. Social Policies Underlying the Member States' Tax Systems*

The most visible example of the importance of considering social policies before attempting to coordinate the Member States' tax systems is the "opposition from all [the] member states and industry" to the Commission's 1987 excise duty proposal.<sup>95</sup> The proposal did not take into consideration that some Member States impose high excise duties on such products as cigarettes because they consider such products socially unacceptable and want to discourage their use.<sup>96</sup> The proposal also did not reflect the fact that some Member States impose little or no excise duties on products they consider socially acceptable to encourage or maintain neutrality toward their use.<sup>97</sup>

The Commission's 1989 excise duty proposals do allow a greater degree of flexibility by using only minimum and target rates on most products to be included in the excise duty system.<sup>98</sup> The proposals also "reflect increased health awareness in the Community" because the Commission increased the rates it proposed in 1987 on alcohol and tobacco products.<sup>99</sup> However, the proposals face an uphill battle in obtaining the approval of

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94. Giersch, *EC 1992: Competition Is the Clue*, 3 *EUR. AFF.* 10, 17 (1989).

95. *New Excise Tax Proposals*, *supra* note 55, at 1428; *see supra* notes 52-54 and accompanying text.

96. The Member States might also impose high excise duties on such products in order to offset the increased health costs of those using such products. For example, Denmark imposes the highest excise tax on cigarettes in the Community. *See THE WHITE PAPER*, *supra* note 15, at ¶ 201. It also has an elaborate social welfare system. With such high excise taxes on cigarettes, it might be trying to offset the costs imposed on that system by cigarette smokers.

97. For example, Germany does not impose any excise duty on wine and has one of the lowest excise duty rates on alcoholic beverages, except for hard liquor. *See id.*

98. *See supra* notes 56-58 and accompanying text.

99. Goldsworth, *supra* note 18, at 592.

those Member States who prefer to impose no excise duties on some products in the proposed excise duty system.

Another social policy concern is that individuals will work and pay taxes in the Member States with the lowest individual income taxes, while taking advantage of the health benefits in their resident Member State when the Community's internal borders are opened at the end of 1992.<sup>100</sup> This social policy concern has made it very difficult for the Commission to obtain the unanimous approval of the Council for its individual income tax proposal for non-resident workers because it "touch[es] the sensitive nerve of a [Member State's] right to determine its own health policies."<sup>101</sup> Both the resident and non-resident Member State feel the need to tax frontier workers to offset the costs of providing employment or health benefits to such workers.

The Commission's primary concern should be overcoming the economic and social policy objections of the Member States when it makes proposals concerning Community taxes. While the Commission should not ignore the political policy objections, it can overcome the strongest political objections by allowing the Member States to determine their own tax rates based on their individual economic and social policies.

The Commission should concentrate its efforts on determining "how much diversity" in the Member States' tax structures can be allowed "without interfering with the establishment" and proper functioning of the common market.<sup>102</sup> Concentrating on proposing and implementing directives that seek to coordinate the Member States' tax structures would allow the Member States flexibility in determining their own tax rates but would ensure that goods, services, individuals, and businesses from other Member States are not discriminated against.

#### IV. THE SELECTIVE MARKET FORCES ALTERNATIVE

Although "[m]ajor disagreements persist as to the method to be used," there seems to be "general agreement on the need" to coordinate the Member States' tax systems in order to ensure the establishment and proper functioning of the common mar-

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100. *Dutch Worry That High Social Taxes Will Jeopardize Competitiveness*, 45 TAX NOTES 599 (1989); *Debate Over Big Tax Burden*, Financial Times, Oct. 19, 1989, at 3 (survey section).

101. EUROPE'S DOMESTIC MARKET, *supra* note 26, at 128.

102. *Unresolved Issues*, *supra* note 12, at 1482.

ket.<sup>103</sup> The Commission has recognized that the question is not whether coordination is needed, but "how close" do the Member States' tax systems have to be to ensure that "the operation of the common market is not affected [by] distortions of trade, diversion of trade, and effects on competition."<sup>104</sup>

The Commission's method of directed coordination, described in detail in Part II, has been significantly developed and refined since its original proposals in the 1985 White Paper. As noted in Part III, however, the Commission's proposals have encountered significant opposition from the Member States who recognize the need for coordination but do not want to be subject to a "centralized, political bureaucracy."<sup>105</sup>

An alternative to the Commission's approach, known as the pure market forces alternative, has been proposed by the British. Although some Member States and the Commission have rejected this proposal, it remains the most likely alternative if the Commission and Council cannot agree on how much coordination is needed before 1992.

#### A. *The Pure Market Forces Approach and its Critics*

The pure market forces approach would rely on market forces to determine the amount of coordination that is necessary for the proper functioning of the common market once the Community's border controls are removed after 1992.<sup>106</sup> The most outspoken advocates of the pure market forces approach are the British who argue that coordination of the Member States' tax systems is not necessary for the completion of the common market.<sup>107</sup> The British feel that coordination is unnecessary because

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103. Goldsworth, *supra* note 18, at 591.

104. THE WHITE PAPER, *supra* note 15, at ¶ 185.

105. Culp, *supra* note 47, at 10. The Member States are "reluctant" to allow the Commission to determine how much coordination is needed because of the fear that it will be "unresponsive" to their individual economic, political, and social needs. *Id.* at 11. This fear appears to be justified as "one might ask what would have happened to the current wave of tax reform if the Commission's [proposed] directive" seeking to approximate direct tax rates had been adopted. Goldsworth, *supra* note 18, at 593. The answer is that the Member States' efforts to reduce their tax rates "would have been inhibited by the need for the Council to give unanimous approval to tax reduction below the [45%] minimum rate." *Id.*

106. *European Community: U.K. Proposes Market-Based Customs Taxes to Achieve Goal of Single EC Market by 1992*, 5 Int'l Trade Rep. (BNA) 1254, 1255 (Sept. 14, 1988) [hereinafter *U.K. Proposes Market-Based Customs Taxes*].

107. *Id.*

the Member States would adjust their tax systems where necessary to compensate for losses in revenue.<sup>108</sup>

Such losses would occur when the difference in taxes between the Member States is sufficient to outweigh the factors of distance and service that usually prevent cross-border buying and selling.<sup>109</sup> The Member States would have to strike a balance between these market forces and their economic, political, and social policies.<sup>110</sup> Some feel that this approach would gradually eliminate cross-border buying and selling and allow market forces to determine the most efficient allocation of resources regardless of the Member States' policies.<sup>111</sup>

Other proponents of the pure market forces approach argue that "the optimum tax system" cannot be determined through Community wide legislation.<sup>112</sup> The current mix of indirect and direct taxes is the result of a long and tedious process that has taken place in each of the Member States over many decades based on their individual economic, political, and social policies. Therefore, determining the proper mix for the Community as a whole is too difficult to determine in order to achieve the unanimity of the Council required to adopt the Commission's tax proposals as directives.

Critics, however, argue that "the adjustment that will be required when internal frontier controls are abolished in 1992" will be "too abrupt" if some coordination of the Member States' tax systems is not accomplished before the end of 1992.<sup>113</sup> A pure market forces approach, they claim, would create a substantial incentive for "tax avoidance" once the Community's internal borders are opened after 1992.<sup>114</sup> This would occur because individuals and businesses would be free to cross the Community's internal borders to buy goods and services in countries with lower taxes.<sup>115</sup>

Such free movement is a problem because it could create

108. Culp, *supra* note 47, at 11.

109. THE WHITE PAPER, *supra* note 15, at ¶186.

110. U.K. Proposes Market-Based Customs Taxes, *supra* note 106, at 1255.

111. *See id.*

112. Giersch, *supra* note 94, at 17.

113. THE WHITE PAPER, *supra* note 15, at ¶ 203.

114. Culp, *supra* note 47, at 11.

115. This dilemma, known as the "Martelange Factor," is "named for a town . . . on the border of Belgium and Luxembourg" where the main street is divided by the border creating a situation in which the stores in Belgium, which has a higher VAT rate, "have a hard time staying in business." *Id.* at 9.

“economic inefficiencies by stimulating resource flows and activities motivated by tax policy, rather than fundamental economic realities.”<sup>116</sup> These tax motivated incentives occur when a Member State removes a tax on domestic businesses or individuals and offsets the revenue loss by leaving the tax or imposing a new tax on businesses or individuals residing in other Member States. This creates a substantial economic inefficiency by protecting domestic businesses and individuals, which may be inefficient and noncompetitive, and discourages the free movement of goods, services, capital and people.

A problem with the critics' argument is that it is unsure whether the efforts “necessary” to eliminate the substantial economic costs “justify the political [and social] upheaval” that would result from infringing on the sovereign rights of the Member States to determine the appropriate tax system for their country.<sup>117</sup> Even some of the Member States, such as France and Denmark, are uncertain as they favor some kind of tax coordination to prevent substantial losses to their treasuries but do not want a tax system that will infringe on their ability to support their social welfare system.<sup>118</sup>

Therefore, the Commission needs to evaluate these costs and fears and determine what degree of coordination is necessary to reduce the economic costs to a manageable level and still respect the sovereign rights of the Member States to determine their own tax systems based on their individual political and social policies. Such a system can be devised by combining a degree of coordination with a measure of market forces.

### *B. The Selective Market Forces Proposal*

In its 1985 White Paper, the Commission suggested a possible approach to Community tax coordination when it noted that the states' experience with sales taxes in the United States indicates that a five percent range of rates could be determined by market forces “without undue adverse effects.”<sup>119</sup> The Commis-

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116. *Id.* at 8.

117. Goldsworth, *supra* note 18, at 592.

118. Culp, *supra* note 47, at 10; *see also* Goldsworth, *supra* note 18, at 590.

119. THE WHITE PAPER, *supra* note 15, at ¶ 185. Although there is only a five or six percent difference in sales tax rates between the states, some impose no sales taxes so the rates are bunched at the low end of the rate scale. For a thorough listing of the sales tax rates in the United States, see *Table of Rates*, 2 State Tax Guide (CCH) ¶ 60,000, at 6021 (Aug. 1989).

sion indicated that this could occur in the Community if competition were severe enough to allow minor differences in tax rates to be absorbed by trade and place pressure on the Member States to change their tax rates to prevent the "tax leakage" from large differences from becoming unbearable.<sup>120</sup>

Although a tax rate differential of more than five percent would cause the Member States to "either lose revenue" or force them "to implement rigorous legal restrictions on cross-border buying," such restrictions would occur as "a result of market forces, not [as] a political mandate" from the Community's legislative bodies.<sup>121</sup> Like the states' experience in the United States, market coordination of tax rates would be "a slow, arduous process" and could, therefore, be expected to continue even after most of the border controls are removed after 1992.<sup>122</sup>

Because tax rates can be expected to be coordinated by market forces over time, and the Commission has already proposed the five to six percent range in which it would like to see VATs and excise duties fall, the Commission should concentrate its efforts on ensuring that the tax structures of the Member States do not present an undue burden on individuals and businesses from other Member States. As explained above,<sup>123</sup> this occurs when a Member State creates a tax incentive (or disincentive) by reducing (or eliminating) a tax on domestic businesses, goods, individuals, or services and increasing (or creating) a tax on the businesses, goods, individuals, or services being provided by other Member States.

Although the Commission has recognized that such tax incentives are a problem that need to be addressed because of their distortion on competition within the Community, none of the Commission's proposals have directly addressed this problem.<sup>124</sup> The Commission has the authority under the Treaty<sup>125</sup> to prevent such tax incentives and has announced that it will examine whether such incentives will be allowed or be eliminated

120. Culp, *supra* note 47, at 9. See also THE WHITE PAPER, *supra* note 15, at ¶ 186.

121. Culp, *supra* note 47, at 9, 11-12.

122. Cnossen, *supra* note 3, at 698.

123. See *supra* note 116 and accompanying text.

124. Goldsworth, *The EEC, State Aids, Tax Incentives, and Harmonization*, 1 TAX NOTES INT'L 467, 467 (1989).

125. Treaty of Rome, *supra* note 2, art. 92. Article 92 states in relevant part that "any aid granted by a member state . . . which distorts or threatens to distort competition . . . shall . . . be incompatible with the Common Market." *Id.*; Goldsworth, *supra* note 124, at 468.

along with other fiscal border controls at the end of 1992.<sup>126</sup> However, this is a problem that warrants more of the attention of the Commission because the residents of one Member State do not have an equal opportunity to influence the tax legislation of the other Member States.<sup>127</sup> The only avenue of influence they have is through the directives imposed by the Community's legislative bodies. Therefore, the Commission should move quickly to present specific proposals designed to prohibit tax incentives for resident individuals and businesses and eliminate tax discrimination against goods, services, capital and persons from other Member States.

### C. *The Benefits*

Under a selective market forces approach, tax coordination in the Community would not occur at the expense of economic efficiency or the political and social sovereignty of the Member States.<sup>128</sup> It would allow the Member States to "retain their sovereign rights to [impose] whatever [tax] rates they deem necessary" to satisfy their economic, political, and social policy objectives<sup>129</sup> but prohibit them from applying their tax structures in a manner that discriminates against businesses, goods, individuals, or services from other Member States.

Unlike a pure market forces approach, the Member States would not be allowed to seek revenue through less visible sources just because an individual or business is located in another Member State or involved in cross-border buying.<sup>130</sup> This would allow tax coordination to occur as the Member States "saw it as in their interest to bring it about," but ensure that this did not occur at the expense of individuals and businesses who did not have an equal opportunity to influence the tax system applied to them.<sup>131</sup> Although the Member States would retain considerable flexibility in formulating their individual tax systems, any changes would have to be consistent with the primary goal of the Community to create a "single integrated mar-

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126. *U.S. Firms Back Into the Future*, *supra* note 80, at 1407.

127. See Cnossen, *supra* note 3, at 697.

128. See Culp, *supra* note 47, at 12.

129. *Id.* at 11; see also Cnossen, *supra* note 3, at 694.

130. Culp, *supra* note 47, at 12.

131. Cnossen, *supra* note 3, at 697.



ket free of restrictions on the movement of goods, . . . persons, services, and capital."<sup>132</sup>

#### V. CONCLUSION

The European Commission has made significant progress in proposing tax directives, but has failed to obtain the unanimous approval of the Council to put most of them into effect. The Commission has been unable to achieve the required unanimity for at least two reasons. First, the Commission has infringed too much on the sovereign rights of the Member States to determine their own tax systems based on their individual economic, political, and social policies. Second, the problem of determining and establishing a tax system that will not impede the establishment and proper functioning of the common market, but which will prevent decisions to move capital or labor from one Member State to another from being based solely on tax considerations, has proven too difficult. The Commission could never discover the appropriate range of rates or target rates that would satisfy the Council sufficiently to attain the required unanimity.

Therefore, the Commission should allow Member States to determine the appropriate range of rates based on the considerable market forces that will exist in the Community after 1992, as well as their own economic, political, and social policies. The Commission should concentrate its efforts on drafting proposed directives seeking to coordinate the tax structures of the Member States. This would ensure equal opportunity for all Community citizens so that they will be able to freely work and locate in any Member State without fear of tax discrimination.

*Brent D. Rose*

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132. *Id.* at 692; see also Goldsworth, *supra* note 18, at 594.