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AN EU CORPORATE INCOME TAX AS A NEW OWN RESOURCE TO FINANCE THE EU BUDGET

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ABSTRACT

*The paper looks at the question if an European Union (EU) corporate income tax could become a new own resource of the Union to finance the EU budget. To overcome the *juste retour* thinking of the Member States and in order to get a direct relation with its citizens the EU wants new own resources. A tax directly paid tax by the EU citizens or corporations to the EU could be the answer. The tax would also give the EU a greater autonomy from the Member States.*

The article discusses, re an European corporate tax, the problems of the quality of the EU regulatory process, the cultural differences, and the fiscal sovereignty of the Member States. The article concludes that the autonomy of the Union is, on its own, no goal, and, an corporate income tax does not create a bond between the EU and its citizens. Besides that, the corporate income tax is hard to monitor by the European Court of Auditors and it will take, if possible at all, many years to harmonize the corporate tax base.

INTRODUCTION

On September 7, 2010, José Barroso, President of the European Commission of the European Union (EU), delivered his first State of the Union Address. As emphasized in the Preamble to the Treaty of Rome of 1957, one of the goals of the Union has been to create an ever-closer union among the peoples of Europe. Since the Treaty of Rome, and especially after the Treaty of Lisbon that entered into force on December 1, 2009, the EU has become a real legislator (Voermans, 2009a), thus making an annual address by its president appropriate.

Since matters relating to financing go to the very heart of the common undertaking, the revenues of the EU played a role in Barroso's Address. The present system has two major drawbacks. First, it leads to the infamous *juste retour* thinking by the Member States: emphasis is placed on net contributors and net recipients among the Member States. Member States do not look at the added value of expenditures for Europe as a whole. The EU, therefore, seeks a greater degree of autonomy *vis à vis* the states. Second, the EU has evolved from a mere union of states to a union of states and citizens. A direct bond between citizens and the Union is the next logical step. A EU tax, paid to the EU by its citizens, would solve both problems.

A EU tax is a bold idea, but a problematic one. It is bold because the EU shows courage in letting its citizens pay directly to the EU. It makes the burden of taxation visible to the citizens and makes the EU more accountable to its citizens and hence more democratic. Notwithstanding the fact that in history it was often the goal of governments to hide the burden of taxation as much as possible for its citizens, or at least give them the impression that other people do pay. It is problematic since it brings to the forefront the tension between those who want the EU to become the United States of Europe and those who want to maintain the *status quo*. In other words, a EU tax emphasizes the debate regarding the fiscal sovereignty of the Member States.

How can the EU cope with these problems regarding one of the recently proposed new EU tax by the European Commission ((Brussels, 19.10.2010; SEC (2010) 7000 final)): an EU Corporate Income Tax (EUCIT)? The paper takes a perspective on and tries to play a role in the public discussions on the issue of corporate income taxation in the multicultural environment of the EU. An EU tax is for the up-coming years for sure one of the biggest challenges public policymakers do face and of direct relevance to the EU business community.

The paper does not look at the question if corporations should (Bird, 1996) or even can be taxed in a real sense (Friedman, 1972). The first since corporations benefit from the one internal market in the EU. The last since only real persons do pay taxes. No matter the fact that companies are operating as legal persons, there is still a difference between artificial persons and real ones. As far as taxation of corporations go, it are either the corporation's employees, customers or stockholders that do pay taxes. The tax incidence will be different, also in time, and does depend on market conditions (Buchanan, 1999). In fact, the corporation is a pure intermediary through which the money is forwarded to the taxing authorities. For Friedman (Tax Reform Panel, 2005) the best tax would be a flat rate tax on consumption. This since it is the simplest and the most efficient system and it does not discourage savings. The greatest virtue, and also the reason that it will never exist, for Friedman, is that it limits what governments can do to influence the economy. This will probably also be the reason why it will be so hard in the EU to harmonize the tax base to apply the common EU tax rate on.

OWN RESOURCES OF THE EUROPEAN UNION

A long-held goal for the EU is to beget a genuine system of own resources. As Article 201 of the Treaty of Rome states, "the Commission shall examine the conditions under which the financial contributions of Member States provided for in Art. 200 could be replaced by the Community's own resources." Furthermore, as Article 311 of the Treaty of Lisbon states, "[w]ithout prejudice to other revenue, the budget shall be financed wholly from own resources." Nowhere does the Treaty define, however, what is meant by own resources. It merely states how the decision-making process regarding the own resources is to proceed: the Council, the European Parliament, and the Parliaments of the Member States, all must come to an agreement. Decision-making in the European Council, as a special condition, must be unanimous.

In 2009 a leaked draft report of the European Commission sparked a false start of the discussion on EU budget reform. In the autumn of 2010, as Barosso mentioned in his address, following a period of consultation with citizens, scientists, and politicians, the Commission has presented a new approach to the Union's own resources. Presently, 85% of the revenue is funded by direct contributions of the Member States, based on a percentage of their Gross National Income (GNI). Though all revenues, by definition, are called own resources, not all of the EU's own resources are created equal. In fact only custom duties and agricultural levies, which amount to 15% of the EU's revenue, are actually owned by the EU. Thus, the *juste retour* thinking makes its mark on GNI-based contributions of the Member States.

The European Commission states that own resources are revenue flowing automatically to the European Union budget, pursuant to the treaties and implementing legislation, without the need for any subsequent decision by national authorities. How this definition relates to the fiscal sovereignty of Member States remains unclear. For fiscal sovereignty is also by the EU an agreed on cornerstone principle for any future system of the EU's own resources.

The Treaty of Rome's choice to classify custom duties, and subsequently agricultural levies, as the EU's own resources was a logical one. Both revenues, which are now called traditional own resources, are directly correlated to EU policy. They relate to the EU's goals of becoming self-supporting with regard to food, as well as the creation of a common market with a unified border. Hence, it is said that any new EU resource too should be inherently linked to a fully developed central European policy. By which is meant those activities that could not feasibly exist outside the EU context.

QUALITY OF THE REGULATORY PROCESS

At present, the EU is thinking about direct taxes on consumption, transport, communications, financial services and corporate income (European Commission, 2010). One problem with the newly proposed taxes concerns the quality of the legislative process. Next to that, there is also the matter of legality: did all parties participate in the process and can their respective expectations be fulfilled (Voermans, 2009b)? More specifically, on the subject of the quality of the regulatory process, the problem is the long shopping list of criteria an EU tax would have to fulfill. Both the Commission and the European Parliament have mentioned visibility, simplicity, financial autonomy, efficiency, sufficiency, cost-effectiveness, stability of revenue, equity, and added value for Europe as potential criteria. Next to that there are some specific EU-criteria to take care of, like the existence of border crossing external effects, the mobility of the tax base, the volatility of the proceeds, and if it is hard to state the contribution of an individual Member State in the proceeds of a certain tax. With so many criteria, in fact anything goes. Hence, the tax actually chosen will, most likely, be an *ad hoc* political choice. A choice, that is probably based on an odd, spur of the moment, political compromise.

In order to facilitate a rational discussion that will fulfill the quality demands of both national and international law, the EU must arrive at a manageable list of criteria. For the problem is of course not only the sheer endless list of criteria but also that the Member States do give different weights to the criteria (Radaelli, 2004). The same goes for the European Commission (Cattoir, 2004) and European Parliament (1997), they, too, do give different weights to the criteria. Besides that it is an open door to state that criteria that do work in a country with a relative homogeneous population not automatically do work in a union as diverse as the European Union. As has been said, in the future it is no longer the primary goal to strengthen the unity of the Union, but, on the contrary, the diversity between the Member States should be emphasized and taken care of (Krüger, 2006).

In a cynical sense, though that even does give a norm by which to judge the budget, it can even be said that the budget is only lubricating oil to streamline the process of much more important political decisions. For that reason it is said that the EU budget makes compromises possible or that it is just a means to enlarge the popularity of the EU (Figueira, 2008).

FISCAL SOVEREIGNTY

The reasoning behind the EU's own traditional resources, the way how they belong to the EU is convincing. They are the direct result of the existence of the EU and its policies. The new European taxes proposed by the EU, however, are not the direct result of EU policies, unless one artificially strains the argument. Member States interpret these new resources as a, not to be taken, loss of fiscal sovereignty. Hence, in order to get agreement with the Member States, the EU emphasizes that full fiscal sovereignty will remain with the Member States. This is, however, not really convincing.

Firstly, how are own resources defined? In the Treaty of Rome of 1957 it was stated explicitly, Art. 201, that own resources would be the goal. In art. 311 of the Treaty of Lisbon it reads too that "[w]ithout prejudice to other revenue, the budget shall be financed wholly from own resources". However, what those own means are is nowhere to be told. It is only said that the Member States together with the European Parliament has to decide about them (Ehlermann, 1982). Own resources, however, are described as sources of income which belong to the Union forever and for which no decision of the separate Member States is necessary. At present only the custom duties do adhere to this description.

Secondly, from an economic perspective, the eternal socialization of an asset's return is the same as the socialization of the asset itself. *Mutatis mutandis*, the same goes for the temporary pooling of taxation revenue, which also entails a loss of fiscal sovereignty for Member States.

For the Union, however, it is a fact, as just-said, that as far as new own resources of the Union go, the fiscal sovereignty of the Member States have to be respected. The right to collect taxes remains with the Member States. The Union is mandated by the Member States to profit from a national tax for a limited time period. A decision that can be recalled at any moment (European Parliament, 2007). However, how all this relates to the definition of own resources and the temporary pooling of taxation revenue and hence means for the fiscal sovereignty of the Member States remains unclear.

CULTURAL DIVERSITY

In introducing a one size fits all EU tax the existing divergence of national tax preferences is not taken into account. On the basis of the data of the European Values Study Foundation & World Values Survey Association, real differences in value judgments related to tax system preferences can be shown. Southern Europe Member States, for instance, give a relatively low weight to efficiency compared to equality. At fields where competition is the driving force, e.g., corporate taxation, there is some convergence in tax rates, in other fields, however, e.g., inheritance taxation, there is evidence of continuing tax preference heterogeneity (Heinemann, cs, 2008). The present system of national contributions does give Member States free choice of how to finance their contributions to the EU budget based on their own value systems.

In line with this, it is also said that if the goal is to make the EU more visible to its citizens it is not necessary at all to introduce one common EU tax. It is enough just to show to the citizens the amount paid by a Member State to the Union in a national tax. Every Member State can choose its own "Euro" tax; this is called a declaratory tax (Ceasar, 2001). For instance, in one Member State, when shopping, on each receipt the national contribution as a certain percentage of the value-added tax to the EU is visible to every citizen. In another Member State, however, it can be shown as a part of the income tax paid by its citizens. The advantage is that no time-consuming process of harmonization with regard to the tax base between the Member States is necessary. Besides that there are no extra EU collection costs. Also the quality of the tax authorities in a Member States is of no importance. The national contribution of a Member State is independent thereof, since the amount to be paid is fixed. In short, with a declaratory tax, the form to collect the required amount is not prescribed by the Union to the Member States. Member States can choose the national EU tax that works best for them. Member States do have the best knowledge of what works and does not work in their country.

EU CORPORATE INCOME TAX

An EU Corporate Income Tax (EUCIT) would, for the European Commission (2010), first require a common corporate tax base. A uniform EU corporate tax rate could then be applied to the common corporate base. Member States could continue to apply a national rate to this new base, or the EUCIT could be a percentage of each national company tax.

Corporate income tax represents on average between 2% and 3% of GDP in the EU so that in the scenario of a new compulsory base for all companies with part of the revenues accruing to the EU, there would be enough revenues to finance the EU budget with an EU tax rate of about a quarter or less of the harmonized tax base. This since the goal of the EU is that own resources would furnish about half of the EU budget of about one percent of total GDP. However, the amount raised would fluctuate with the taxable profits of the EU private sector and would be difficult to predict.

If a common basis replaced current national rules and bases, this could, as the Commission states, lead to substantial efficiency gains (fewer tax distortions in investment decisions) and help to reduce compliance costs for companies operating cross-border in the internal market. In addition, it could contribute to a "clearer" distribution of tax bases for multinationals across Member States.

The challenges to implement an EUCIT are considerable. The work on a possible EU common tax base, which was first suggested in 1962, is notoriously difficult. This given the competences of Member States in taxation, as it relates to essential differences in Member States. Even the completion by the European Commission (2011), this year, of a for corporations optional Common Consolidated Corporate Tax Base (CCCTB) has proved to be very controversial. This base, however, has not been conceived as a possible basis for a new corporate EU income tax. It is meant for companies operating in more than one Member State in the Internal Market. In this way companies would benefit from a one-stop-shop system for filling their tax returns and would be able to consolidate all the profits and losses they incur across the EU. Member States, however, would maintain their full sovereign right to set their own corporate tax rate. This however is, as just-said, an optional choice for companies operating in more than one Member State. It is to be chosen for at least a period of five years.

Besides that, given the different qualities, and--not the least--morality, of the tax institutions and payers in the EU Member States, an EUCIT as an percentage of the proceeds of corporate income taxes would

hardly do justice to horizontal (fiscal) justice between the corporations in the Member States. Hence a surcharge, a declaratory tax also, that would furnish the by the EU required contribution to the EU, on the proceeds of the existing corporate income tax in the Member States could be in this regard be a better solution.

The autonomy of the European Union

For the Commission, EU taxes would be the answer to the problem of the *juste retour* behavior of the Member States. Member States do focus on their net budget position with regard to the Euro budget. They do look at what they do give and what they get back in money from the Union. The victims of this behavior are the real European collective goods; they do become underfinanced.

But a greater autonomy can never be a goal on its own for the EU. Though this seems to be the case for the Union (European commission, 2004; European Parliament, 2007). Autonomy can be a means to secure typical European collective goods like an EU policy against illegal immigration. Financial autonomy can be of help to ascertain these goals that otherwise would not be accomplished (Cieślukowski, 2006). However there is no direct link between the goal of securing European collective goods and financial autonomy.

Besides that, even in the recent history of the Union, in the eighties of the last century, when direct financial contributions from the Member States to the Union were almost completely absent, there were fierce fights over the EU budget. With, as the absolute climax, the words of Margaret Thatcher, the English Prime Minister, *I want my money back* at the 1984 EU-summit in Fontainebleau

The bond between EU citizens and EU institutions

The Union, at least for the European Commission, has developed from a union among nations to a union among nations and citizens. So, in taxing too, there should be a direct bond between citizens and the EU institutions. The bond would also make the EU more accountable to its citizens and hence would raise the democratic level of the EU. Though it is also said that the real problem is not that there is no bond between EU citizens and the EU institutions, but that because the EU budget at present is not used to finance real European goods, citizens do not support the EU. If, however, the EU would supply real European collective goods, citizens would feel connected with the EU and be in favor of European taxes (Iozzo cs, 2008). Though, on the other hand, since taxes are never popular, a visible EU tax, it is said, would diminish the support for the Union (Mutén, 2001).

In a sense, however, the Union shows a lot of courage to introduce a visible European Tax. Though in the case of a corporate income tax, by not taxing individuals directly by their income or consumption, the EU is probably relying on the misleading common wisdom of citizens that others do pay by taxing corporations. This, whatever the often heard equity reasons for taxing corporations are. For the EU, it follows from the benefit principle that those benefiting from current policies ought to pay for the policies. As far as the EU and corporations go, in the present case, corporations benefit from the Single Market and from the euro. The former through the expansion of the domestic market and the latter as a result of price transparency and enhanced competition (European Commission, 1998).

The present way of financing the Union, in fact, concurs to this old ideal of making taxes as invisible as possible. Custom duties give 15% of the EU budget. Direct contributions of the Member States do furnish the remaining part of the budget. A contribution that is *grosso modo* based on the Gross National Product of the Member States. For 2011, the total budget is 126.5 billion euro. That is about 1.24 percent of the total GNP of the 27 Member States. Both of these resources are not related to the daily life of the average European citizen. A situation that will not be improved with a corporate income tax. A corporate tax would not be visible to citizens as consumers but only as owners of firms. Probable the accountability of the EU to its citizens would not be enhanced.

Time path of implementation and control by the European Court of Auditors

A practical problem for the introduction of an EU corporate income tax is that the harmonization of the base will take a long time. In all previous reports of the EU (e.g., European Commission, 1998) the severest difficulty for corporate taxation to become a new own resource is the diversity of the existing national tax bases upon which the tax is going to be levied. This pertains to the diverse accounting rules, depreciation rules, and rules re loss compensation in the Member States. The harmonization process for the EU value-added tax base lasted more than ten years. Though differences do still exist. A problem too is that for the European Court of Auditors the tax is difficult to verify. The tax receipts depend on the tax habits and morals in the different Member States. Not every Member State in the EU collects the tax revenues it should with regard to the existing tax rates. One EU tax rate would also not automatically mean equality of payment to the EU for its citizens or corporations (Schneider, 2007).

CONCLUSION

The ability of the EU forerunner, the European Coal and Steel Community (ECSC), to collect its own taxes with its own tax administrators on steel and coal producing companies is still an unattainable ideal for the European Union. An EU corporate income tax, however, might not be the ideal own resource the EU seeks. Firstly, it does not create a bond between citizens and the Union. Secondly, though it will enable the growth of EU autonomy, and with that the possibility of EU policies with a real added value to Europe as a whole, the lessons of history do not support that expectation. Severe negotiations about the EU budget are of all times, no matter how the budgets are financed. Given the fact that, at present, a harmonized base for corporate income taxes is virtually non-existent, to create one, will at least for its short-time introduction be an insurmountable hurdle. Besides that Member States do not want to lose their fiscal sovereignty given the wish to fine-tune business taxation based on national interests and cultural differences.

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