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VIEWPOINTS

EU Tax Commissioner Šemeta's Tax Policy May Spell Success

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It has been said that new EU Tax Commissioner Algirdas Šemeta's tax policy program for 2010-2014 lacks any new proposals or any plan of action beyond the mere expression of intent. Taking into account the difficulties in adopting tax measures within the European Union because of the required unanimity vote, if Šemeta achieves a common agreement related to the most relevant ongoing tax proposals, his mandate could be considered successful.

Šemeta is supported by extensive experience in taxation, having been the finance minister in Lithuania.[1] That has not impressed all parliamentarians, though, and some have declared that the new commissioner does not have enough experience in EU policy.

Since his appointment, he has made several speeches regarding his priorities for future EU tax policy.[2] There are not many new proposals, but Šemeta may have success with ongoing proposals submitted by previous commissioners.

This article analyzes Šemeta's priorities for the coming years.

Tax Fraud

Šemeta has said he intends to continue fighting against tax evasion, emphasizing the role that the European Anti-Fraud Office (OLAF) has been playing for years. Šemeta said one of the commission's priorities is to maintain OLAF's independence regarding EU institutions.

OLAF's mission is to protect the financial interest of the European Union, and to fight tax fraud, corruption, and any other irregular tax activity, including misconduct within European institutions.[3]

To guarantee OLAF's independence in internal and external investigations, the OLAF director-general may not seek or take instructions from any government or any institution (including the European Commission). If the director-general of OLAF determines the commission has taken a measure that challenges OLAF's independence, he may bring a case against the commission before the European Court of Justice.

Despite the above, some member state representatives do not consider OLAF sufficiently independent, and they agree that its autonomy should be reinforced. Šemeta agrees this is a priority.

Savings Tax Directive

Šemeta said it is urgent that the proposed amendments to the EU savings tax directive be approved. Mainly, the amendments refer to the definition of savings income, to accommodate developments in savings products in recent years. The proposals are intended to cover not only savings income in the form of interest payments, but also other substantially equivalent income from innovative financial products and from life insurance products comparable to debt claim products. Also, the application of the directive has been extended

[1] Algirdas Gediminas Šemeta is a 48-year-old economist and mathematician who served as Lithuania's finance minister between December 2008 and June 2009 and between February 1997 and June 1999. He is affiliated with the European People's Party. He served as director-general of the Department of Statistics from 2001 to 2008; government secretary of the Office of the Government of the Republic of Lithuania from 1999 to 2001; and vice president of the company Nalsia in 1999.

[2] These are available at http://www.europarl.europa.eu.

[3] *See* http://ec.europa.eu/anti_fraud/index_es.html.

to fiscally transparent entities (trust, partnership, and so forth), but it does not apply the look-through approach to all legal forms.[4]

The ultimate aim of the directive[5] is to enable savings income in the form of interest payments made in one member state to beneficial owners resident in another member state to be made subject to effective taxation in accordance with the laws of the latter member state.

This can best be achieved by targeting interest payments made or secured by economic operators established in the member states to, or for the benefit of, beneficial owners who are individuals resident in another member state.

Because of structural differences, a transitional period was approved for the application of automatic exchange of information for Luxembourg, Austria, and Belgium.[6] During that period, those countries may ensure a minimum level of effective taxation through the application of a withholding tax in lieu of exchanging information at a rate progressively increasing to 35 percent.

A key role in the success of the directive has been the conclusion of agreements between the EU and 10 dependent/associated countries and those signed with Switzerland, Liechtenstein, Andorra, San Marino, and Monaco to provide for measures equivalent to those in the savings tax directive.

Šemeta, continuing with the policy established by his predecessor László Kovács, maintains the goal of increasing the number of agreements signed with other non-EU states, preferably with major financial centers such as Singapore, Hong Kong, and Macao.

Perhaps the savings tax directive is not a perfect measure and there are still some loopholes to be closed, but the directive and its amendments have curbed tax fraud and tax evasion.

Harmful Tax Competition

Another important way to tackle tax fraud is to maintain and improve commission policy of eradicating all harmful tax competition within the European Union, regulated by a code of conduct signed for all member states during the mandate of former EU Commissioner Mario Monti in 1999.

The criteria for identifying potentially harmful tax measures are:[7]

- an effective level of taxation considerably lower than the general level of taxation in the country concerned[8];
- tax benefits reserved for nonresidents;
- tax incentives for activities that are isolated from the domestic economy and thus have no impact on the national tax base;
- the granting of tax advantages even if there is no real economic activity;
- the basis of profit determination for companies in a multinational group that departs from internationally accepted rules, particularly rules approved by the OECD; and
- lack of transparency.

In contrast, fair tax competition would be when a state decides to reduce the tax burden, either by reducing tax rates or by approving tax credits affordable for resident and nonresident companies. An exchange of information with other tax authorities and full transparency of the tax system are also required.[9]

It benefits the internal market that member states adopt a range of policy instruments to improve their competitive position, as this will also benefit enterprises and entrepreneurs. Nevertheless, it's obvious that some harmonization is required for combating harmful competition within the internal market.

Questions remain regarding the type of harmonization member states are willing to assume and whether they prefer to act in an open and competitive market, or if they prefer a regulated market controlled by the European institutions.

A possible solution could involve adopting a legally binding directive that regulates harmful tax competition, based on the premises already established by the code of conduct (not legally binding), and updating it

[4] *See* P. Lampreave Márquez, ''La propuesta de modificación de la Directiva sobre el ahorro,'' *Quincena Fiscal*, No. 11, 2009.

[5] Council Directive 2003/48/EC, OJ L157/38.

[6] Šemeta was answering a question by Philippe Lamberts (Greens-EFA, Belgium) on the impasse created by Austria and Luxembourg, which objects to the introduction of automatic sharing of bank account holders' tax information (under the revision of the savings tax directive). ''The issue of tax havens is a crucial one when member states are facing significant difficulties, and because of the crisis their level of debt is growing,'' Šemeta said, adding that he was prepared to try to convince the two countries to get on board with the new rules. The differences were still unresolved when EU finance ministers met in December.

[7] OECD, *Harmful Tax Competition: An Emerging Global Issue*, OECD, Paris, 1998.

[8] M. Mors, ''Tax Competition in Europe: An EU Perspective,'' in: W. Schoen (ed.), *Tax Competition in Europe*, IBFD, Amsterdam, 2003.

[9] P. Lampreave Márquez, ''Planificación fiscal internacional,'' *Jurisprudencia Tributaria*, No. 19, 2004, pp. 45-56; P. Lampreave Márquez, ''Planificación o fraude en el ámbito internacional,'' *Impuestos*, No. 8, 2005, pp. 11-23.

by accommodating new tax measures that have not yet been reviewed (such as hybrid instruments).[10]

Financial Transaction Tax

A new tax measure to help the financial crisis is the adoption of a worldwide financial transaction tax. In a speech at the Tax Forum in Brussels on March 1, Šemeta said:

> Experts and policymakers have directed increasing attention to potential options for taxing the financial sector. This would serve a twofold purpose of having financial intermediaries share the burden associated with government interventions in the banking system, as well as complementing additional regulation against excessive risk-taking.
>
> The debate has initially focused on some form of taxation of financial transactions, which could stabilize financial markets by reducing volatility due to speculative trading. More recently, following concrete policy initiatives, attention has shifted towards imposing a levy on risky assets of financial institutions. By increasing its cost, this approach would restrain risky behavior, and hence affect positively the stability of the financial sector.

The main promoters of the measure in the EU have been some member state leaders, such as French President Nicolas Sarkozy. However, Šemeta has said it will be necessary to assess the impact that the measure might have on the economy and trade before approving it. The commissioner insisted it is best tackled at a global level to prevent capital flight from the EU to other territories, or the measure would not achieve its proposed objective.

The new tax would contribute mainly to the stabilization of financial markets by controlling financial transactions rather than functioning as a new source of revenue for public budgets. It would be one more tool in the fight against tax evasion, but the challenge lies in being adopted globally, which is expected to cause misgivings.[11]

Green Taxation

Šemeta also seeks to prioritize the environmental taxation or ''green taxation'' agenda. Šemeta has emphasized that the ongoing work on the proposed amendments to the energy taxation directive must be finalized in order to redesign a framework adapted to current circumstances. ''Economic leaders of the future will be those who manage to combine high productivity with environmental efficiency. I am very aware of the positive impact that taxation can have on reaching our environmental objectives,'' Šemeta said at the Tax Forum.

> **Šemeta seeks to prioritize the 'green taxation' agenda.**

Directive 2003/96/EC[12] restructured the EU framework for the taxation of energy products and electricity by setting minimum levels of taxation on those products (leaving the state the power to increase those rates under its environmental policy), to establish a clearer relationship between the taxation on energy and the directive's environmental objectives.

''Fighting climate change and rationalizing energy consumption'' are among the EU's highest priorities, Šemeta said. ''The revision of the energy tax directive would provide for an adapted and modernized framework of rules for the single market. 1) It would introduce framework rules for CO_2 taxation for emitters not included in the EU emission trading system, and 2) it would streamline remaining energy taxation to make it neutral and eliminate distortions.'' Any progress on the matter would be considered positive.

Common Corporate Tax Base

In relation to harmonization of direct taxation, another issue that should be solved soon is the final approval of the mechanism for calculating a common corporate tax base at EU level.

The commission realized long ago that each EU member state used different rules for calculating corporate income tax. This has several consequences, including that:

- companies must allocate profits to each jurisdiction on an arm's-length basis by separate accounting;
- member states are reluctant to allow relief for losses incurred by associated companies whose profits fall outside the scope of their taxing rights;
- double taxation may happen as a result of conflicting taxing rights; and

[10] P. Lampreave Márquez, *La Competencia Fiscal Desleal en los Estados Miembros de la Unión Europea*, Monografías Aranzadi, Cizur Menor, 2010.

[11] Z. Darvas and J. Von Weizsäcker, ''Financial Transaction Tax: Small Is Beautiful,'' Bruegel Policy Contribution, No. 2010/02.

[12] OJ L 283, Oct. 31, 2003.

- cross-border reorganizations involving a loss of taxing rights for a member state may give rise to capital gains taxation and other charges.[13]

Various committees and experts have put forward proposals for harmonizing crucial elements of the corporate tax regimes in member states.[14] Several methods have been considered to calculate a corporate income tax base at the EU level:[15]

- *Home state taxation*: This method involves all or a group of member states agreeing that certain enterprises with operations in a number of member states should compute their taxable base according to the tax code of a single member state.[16]
- *Common consolidated corporate tax base (CCCTB)*: This method has some of the traits of home state taxation, but instead of extending the application of each of the existing national tax codes across the EU, it suggests that an optional additional new code should be adopted throughout the EU.
- *EU company income tax*: This method would require the drafting of a new single corporate tax code to apply across the EU.[17]
- *A single compulsory ''harmonized tax base''*: This method would require a single corporate tax code to be applied by all member states, across the EU, and to all enterprises, replacing the existing domestic tax code.

All methods were received with relative indifference by the member states that have attempted to prevent the EU, through its institutions, from setting aside the tax sovereignty of its members.

The only method that the commission considers possible is the CCCTB, because of the optional method that allows each state to maintain its tax sovereignty.[18]

Šemeta is a strong supporter of the CCCTB. However, as it is well known, some states firmly oppose it, and a common agreement does not seem likely. Šemeta has announced that in any case the CCCTB could be implemented by means of the enhanced cooperation procedure (article 20 of the Treaty on the Functioning of the European Union (TFEU)), which requires that at least one-third of all EU member states agree to implement CCCTB in their territories. ''We need to take a fresh look at the option of a Common Consolidated Corporate Tax Base,'' Šemeta said at a January 12 European Parliament hearing. ''Harmonization and — I would like to stress — simplification of the rules for the calculation of this tax base could open broader opportunities for our companies to use the benefits of the internal market. It would reduce their costs and support business mobility and its competitiveness in the world.''

Double Taxation

Another initiative of previous commissioners, also mentioned by Šemeta, is related to the problems of double taxation and incompatibilities with EU law that are not being addressed by bilateral tax treaties.[19]

Šemeta is a strong supporter of the CCCTB.

The commission has been assessing the problem of double taxation, including the question of equal treatment of EU residents and the application of bilateral treaties when more than two countries are involved (triangular situations).[20]

One option is the development of an EU model treaty, based on the OECD model treaty, but taking into account the TFEU. Another less likely option is the conclusion of a multilateral tax treaty between all EU member states.[21]

An EU model treaty with articles drafted based on the TFEU could help member states in their future tax treaty negotiations with each other and with third

[13] European Commission, ''Company Taxation in the Internal Market,'' COM(2001) 582, pp. 7-27.

[14] C. Brokelind, *Towards a Homogeneous EC Direct Tax Law*, IBFD, Amsterdam, 2007.

[15] European Commission, *supra* note 13, at 461-467.

[16] S. Lodin and M. Gammie, *Home State Taxation*, IBFD, Amsterdam, 2001.

[17] S. Plasschaert, ''An EU Tax on Consolidated Profits of Multinationals Enterprises,'' *European Taxation*, IBFD, Amsterdam, 1997.

[18] *See* ''An Internal Market Without Company Tax Obstacles Achievements, Ongoing Initiatives and Remaining Challenges,'' COM(2003) 726 final, Nov. 24, 2003. *See also* ''Implementing the Community Programme for Improved Growth and Employment and the Enhanced Competitiveness of EU Business: Further Progress During 2006 and Next Steps Towards a Proposal on the Common Consolidated Corporate Tax Base (CCCTB),'' COM(2007) 223, May 2, 2007; and *CCCTB Working Group: Possible Elements of a Technical Outline*, July 26, 2007.

[19] L. De Broe, *International Tax Planning and Prevention of Abuse: A Study Under Domestic Tax Law, Tax Treaties and EC Law in Relation to Conduit and Base Companies*, IBFD, Amsterdam, 2008.

[20] ''Co-ordinating Member States' Direct Tax Systems in the Internal Market,'' COM(2006) 823 final, Dec. 19, 2006; ''Tax Treatment of Losses in Cross-Border Situations,'' COM(2006) 824 final, Dec. 19, 2006.

[21] *See* M. Lang, *Multilateral Tax Treaties: New Developments in the International Tax Law*, Kluwer, Vienna, 1998; and M. Lang et al., *Tax Treaties and EC Law*, Kluwer Law International, Amsterdam, 2007.

countries, and should eliminate treaty shopping and differences between treaties signed within the internal market.

Good Governance

The promotion of good governance has been another priority of the commission in recent years, and it also has become a highlight for Šemeta's agenda. The commission identified actions last year that EU member states should consider in order to promote good governance within the EU and at an international level (such as increasing transparency, exchange of information, and fair tax competition).

The commission proposed to identify ways to ensure better coherence between EU policies in general, so that EU members would commit to good governance principles. This includes enhancing good governance principles in relevant EU-level agreements with third countries, offering development cooperation incentives, and coordinating action against jurisdictions that refuse to apply good governance principles.

VAT

It has long been one of the main goals of the tax commissioner to conquer tax fraud, particularly VAT carousel fraud, where the same goods are repeatedly sold across EU borders.[22] (For a European Commission memo describing carousel fraud, see *Doc 2009-21514* or *2009 WTD 187-18*.)

To avoid carousel fraud, a ''definitive VAT system'' must be implemented based on the taxation of goods and services in the member state of origin.

A definitive VAT system would have many advantages, and would be simple for businesses and less vulnerable to fraud. Under such a system, goods would not circulate tax free within the community. A definitive VAT system would certainly offer a solution to carousel fraud, although it would not be able to eliminate all types of fraud (such as the black economy).

A system of taxation at origin requires a much higher degree of harmonization of the taxation system and of VAT rates compared with the current destination-based VAT system in order to avoid delocalization of businesses.

Šemeta stressed that a new VAT strategy must be started to simplify and modernize the VAT system and to reduce the administrative burden for companies.

Conclusion

Šemeta may not have submitted major new proposals to the EU tax policy, however, because of the continuous opposition by some states to any progress in tax coordination and the unanimity requirement. But if Šemeta achieves a common agreement related to the most relevant ongoing tax proposals, his mandate could be considered successful.

Regarding possible progress in EU cooperation, it seems difficult to ignore that the EU, through the actions of its institutions, has not always had the cooperation of all member states and their citizens, as evidenced by the failed attempt to adopt a European Constitution and the difficulties in ratifying the Lisbon Treaty. All this indicates the serious distortion between member states (through their political representatives) and the European institutions.

However, an understanding between member states and European institutions (more than a simple tax coordination and less than full tax harmonization) is necessary to turn the balance into a clear benefit for everyone, not just for each member state, but also for enterprises and entrepreneurs acting within the EU.

It could be argued that the European institutions (mainly the commission) have failed in communication with member states. At this point, I consider the work of the European Commission valid, but it could be in danger of excessive dogmatism. At this stage, the new commissioner has much to contribute in the next four years. ◆

[22]The European Parliament approved with 391 votes a resolution based on the report presented by Economic and Monetary Affairs Committee member Sharon Bowles to implement a definitive origin-based VAT system.