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UNICE COMMENTS ON THE COMMISSION COMMUNICATION ON THE CONTRIBUTION OF TAXATION AND CUSTOMS POLICIES TO THE LISBON STRATEGY

UNICE welcomes the opportunity to comment on the Commission Communication on the contribution of taxation and customs policies to the Lisbon Strategy. The "new" Lisbon Strategy, as decided by the Heads of State and Government in March 2005, has refocused the agenda on the competitiveness aspects. Sound and well-coordinated national tax policies are an essential instrument for reaching the Lisbon targets relating to growth and employment. In particular, economically unjustified obstacles to cross-border business transactions deriving from corporate as well as from indirect taxation must be eliminated.

National policies aimed at promoting growth and creating jobs, can produce important benefits which spill over to the economies of other member states. In these areas, coordination between policymakers is important in order to ensure the widest possible benefit to the EU economy overall. Two such areas are well defined in the Commission Communication: taxation and research and development. UNICE would like to put forward specific remarks on these policy fields.

1. Cross-border tax obstacles in corporate taxation hamper growth and competitiveness of the EU economy

The completion of the internal market for goods and services is impacted negatively by a number of tax obstacles. Such obstacles often discourage companies and traders from engaging in economically beneficial cross-border activities. This may entail significant cost to growth and employment in the EU economy.

Companies currently have to comply with the requirements of up to 25 diverse national corporate tax systems. In addition, cross-border business is severely affected by the limited possibilities provided by member states for offsetting losses incurred in another member state, as well as by the additional compliance costs and potential double taxation due to transfer pricing problems. The same applies with respect to exit taxes and charges levied for cross-border restructuring operations such as mergers and acquisitions.

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CCCTB

UNICE therefore supports the Commission's efforts to create a common consolidated corporate tax base (CCCTB) in the EU and its intention to propose a legislative measure by 2008.[1] In order to reach the desired objective, it is essential that the CCCTB remains **optional for companies** and is competitive. The competitive aspect does not solely translate into having a harmonised and consolidated tax system throughout the EU. It must also be reflected in the design of the tax base as such, providing for simple and competitive rules. UNICE is closely following the work of the Council Working Group on CCCBT and comments on a regular basis on the issues discussed in that group.

In UNICE's view, the establishment of a common tax base must not lead to a harmonisation of corporate tax rates or the introduction of minimum rates. With a common consolidated tax base, participating member states will loose some flexibility in structuring their tax systems, for example in setting investment and depreciation allowances.[2] It is thus all the more important that they keep the possibility to adjust their statutory rates to their specific economic and structural needs.

Tax rate competition is beneficial to achieving the Lisbon goals. Some policymakers view harmonised rates as a means of creating a level playing field, in the sense that companies should face the same tax burden in all countries. However, in UNICE's view, member states should set their own tax rates, in line with their competitiveness and need for tax revenues. For example, lower effective tax rates may be advisable for new member states in need of buoyant investments and growth. Locational decisions of companies are based on many factors. For a number of reasons - such as agglomeration advantages in the old member states - this does not imply that higher-tax countries lose investment to lower-tax countries.

A level playing field should rather be defined in terms of equal access to markets for domestic companies and those from other member states or third countries. This implies neutrality of tax treatment regardless of whether the addressee is a domestic or a foreign company. It also entails the reduction of regulatory, administrative and compliance obstacles for cross-border business activities.

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1 See UNICE's letter to then Commission Frits Bolkestein of 31 August 2004. CBI, the Confederation of British Industry, does not support this initiative at this time given the very significant issues raised in the Commission Non-paper concerning enhanced cooperation. IBEC, the Irish Business and Employers Confederation, is opposed to the development of a common consolidated corporate tax base in the EU because the members of IBEC are convinced that the existence of a consolidated tax base will inevitably lead, through political pressure, to full harmonisation of taxes and higher taxes generally on European business.

2 The use of the common tax base, which will exist alongside the different national tax bases, must remain optional for companies which may also choose to comply with the requirements of diverse different systems. Thus, while they would offer the use of the common tax base, countries would nevertheless keep the flexibility of setting their own national base and of making it competitive vis-à-vis the common base.

Empirical evidence shows that industrial countries have witnessed a substantial reduction in statutory corporate tax rates over the last twenty years, while tax revenue and public expenditure remained high. More investment projects became viable at the lower tax rates, resulting in additional corporate tax revenues as well as other tax revenues.

It is important, in UNICE's view, to establish an optional common EU-wide tax base in order to allow for growth stimulation in the EU economy. By making the system optional to businesses, the risk of a non-competitive common system is reduced. The CCCTB should be optional to all businesses, domestic as well as those engaging in cross-border activities.

Until a competitive CCCTB is successfully introduced, it is crucial that some intermediate solutions to current tax obstacles are adopted. UNICE would therefore like to urge the Commission to make quick progress on some shorter-term measures. This especially regards the introduction of a regime for cross-border loss relief and the removal of CFC-rules within the EU. UNICE would also like to stress the importance of providing for simpler and more transparent Transfer Pricing rules, including better arbitration mechanisms.

HST

The European Commission has recently adopted a Home-State-Taxation pilot scheme[3] that presents "a possible solution to the compliance costs and other company tax difficulties that small and medium enterprises (SMEs) face when doing business across borders". The pilot scheme proposed is voluntary for Member States and companies. It makes it possible for SMEs to calculate the taxable revenue of the parent company and of all the branches and subsidiaries established in other Member States participating in the project by applying the tax rules in force in their home state.

SMEs are not reaping the benefits of the internal market and are not realising their potential for growth, in terms of markets, cross-border activities not least due to obstacles arising from administrative complexity and the high costs of compliance with the different national tax systems, which have proportionately a far greater impact on SMEs than on large companies.[4]

While in the long run the optimal solution to cross-border tax problems is an optional common consolidated tax base that is open to companies of all sizes and legal forms, the voluntary Home-State-Taxation pilot scheme can make an important difference for

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[3] See Communication from the Commission to the Council, the European Parliament and the Economic and Social committee, "Tackling the corporation tax obstacles of small and medium-sized enterprises in the Internal Market – outline of a possible Home State Taxation pilot scheme" COM(2005) 702 final, 23.12.2005

[4] See "Let SMEs Grow!", UNICE, April 2005 (available at www.unice.org)

SMEs in the medium-term and prove to be a worthwhile, reproducible experience.[5] However, for the sake of certainty of those companies opting for HST, UNICE urges Member States to make provisions for exit options if a country decides not to extend the scheme after the pilot phase is over.

2. VAT

As the European Tax Survey has shown, and as is pointed out in the Communication, VAT compliance requirements are a real obstacle to cross-border trade. This is especially true for SMEs. A large proportion of them do not take part in cross-border trade at all solely because of VAT problems, and the rest are having problems. Most Member States rely at present on SMEs to boost employment, and that makes this unnecessary problem even more important to rectify.

The Commission has since more than a decade realised this and is doing its best to alleviate the problem. However, in the Council process the Commission proposals, already being compromises, are generally eroded and are filled with derogations and exemptions in order to satisfy the needs of single Member States.

The Invoicing directive is a typical example of this. There we now have over twenty options for Member States to derogate from a directive that was supposed to harmonize invoicing rules for traders all over the Community. Since the number of invoices exceeds 100 billion it is easily imagined the extra cost this has put on business. Administrative cooperation should be on top of the agenda. A uniform application with only one VAT-system would give a significant boost to Europe's competitiveness and thereby expand the tax base and increase both employment and revenues.

If we are to achieve an Internal Market we need to do away with all these country-by-country rules and get to the point where we have one single VAT system, not 25.

The Commission legislative process in the VAT area is fairly open. Important proposals are sent out for consultation before being adopted as formal proposals. UNICE would like to express its appreciation of this way of working. However, one major stakeholder is lacking in this process and that is the Council. UNICE urges governments to take part in this early legislative process, in order to make it possible to have an open debate. At present, the Commission proposals are discussed in the Council working groups behind closed doors and are sometimes changed in a way that is clearly detrimental to the concept of an Internal Market.

5 See the European Parliament’s support for the Home-State-Taxation pilot scheme in “European Parliament Resolution on taxation of undertakings in the European Union: a common consolidated corporate tax base” (2005/2120(INI)), 13.12.2005

3. A shift from labour to consumption taxes may yield uncertain results

Economies with lower tax burdens tend to achieve stronger rates of economic growth. The structure of taxation systems is also a crucial determinant of a country's economic performance and welfare. Taxation is necessary to finance public services and to cover the social cost of certain economic activities. However, taxes distort economic behaviours in ways that can have a significant negative impact on the economy's capacity for growth and job creation. It is therefore essential, in line with the new Lisbon strategy, that the overall tax burden is restrained to minimise the associated negative economic impact and that its structure minimises economic disincentives.

In this regard, an excessive tax burden on labour, combining high personal income tax, social security contributions and payroll taxes, is clearly a factor hampering the level of employment in the economy. High levels of taxation reduce the incentives for firms to hire and individuals to work

Hence, given the unacceptably high levels of unemployment in Europe, UNICE recommends a further reduction in the tax burden on labour to stimulate employment growth. These reductions should be accompanied primarily by measures aimed at consolidating public spending and reforming social security systems, in particular those government and social security expenditures, that distort labour markets.

A shift from labour to consumption taxation, as proposed by the Commission can yield benefits for aggregate employment since consumption taxation is less likely to distort the functioning of labour markets. First, it reduces disincentives to work as it provides equal treatment for income from labour and capital. Second, as it avoids the double taxation of savings, it might create incentives for companies to invest, to the extent that reinvested financial income is free of tax. However, it also has a significant knock-on effect on domestic demand and creates disincentives to invest and hire in particular in high value added sectors. Moreover, it is likely that an increase in indirect taxes will lead to higher real wage demands, in particular in lower income groups, which spend proportionately more of their income on consumption. These negative effects could offset the benefits of lower labour taxes. UNICE therefore believes that there would be larger gains in terms of economic growth and employment from reducing the burden of taxation on labour as part of a strategy of reducing the overall tax burden.

In UNICE's view, lowering labour taxation while at the same time increasing indirect taxation will only yield long-term employment gains, if labour markets are flexible enough to prevent potential higher real wage claims. Moreover, with regard to VAT, before general statutory rates are raised, it needs to be considered whether a broadening of the tax base via a reduction in economically inefficient reduced rate regimes might not yield the same revenue. A reduction in non-wage social security contributions, financed by higher indirect taxation can then be a suitable solution for the medium-term. In the longer term, however, a comprehensive solution, such as the decoupling of social security contributions from wages, has to be found in order to make social security systems sustainable.

4. Environmental taxes

Environmental taxes belong to the economic instruments that can be considered for improving the environment and promoting a more sustainable use of resources. UNICE supports well-designed economic instruments capable of delivering progress at lower cost than traditional "Command-and-control" regulation. The design of such economic instruments must successfully meet environmental effectiveness criteria, economic efficiency criteria and policy coherence criteria (in particular, compatibility with the principle of balance inherent in sustainable development). Environmental taxes are only one instrument among many others - like voluntary agreements, emissions trading, norms, labelling and tax incentives - to promote a more sustainable use of resources. In UNICE's view, environmental taxes are not the most efficient instrument. If environmental taxation is meant to internalise the external costs of energy consumption in production processes, the revenue thus generated should be redistributed to offset cost pressures or be used on repairing environmental damages.

In any case, an increase of energy taxation or any other business taxation to raise revenue is not a way forward and would bring Europe a step away from the Lisbon Strategy. A further increase of the excise rates on energy products and electricity or the introduction of an automatic indexation of these rates would have a negative economic impact as this would increase final consumer prices, lower disposable income and affect consumer confidence.

It would be completely inefficient to aim to reduce industry CO2 emissions *both* by emissions trading *and* CO2 taxation. A double taxation (both emission trading and CO2 taxation) will hamper European competitiveness compared to other countries. As long as excise duties or specific environmental charges are on resource or energy consumption in Europe only, such a unilateral burden would generate competitive distortions in a global context. Europe needs to be competitive to facilitate growth and employment.

A tax on energy consumption or on CO2 emissions would not yield sufficient revenue to finance a reduction in labour taxation to increase employment. This is true even if the environmental tax was meant to compensate only for a reduction in labour taxation of specific problem groups in the labour market. In short, UNICE is sceptical of the so called "double dividend" of a shift from labour to energy taxation.

In UNICE's view, an increase in environmental taxation would be detrimental to growth, in particular in an environment of high energy prices. Before taking any action, UNICE asks for an in-depth impact analysis including quantitative projections regarding the expected behavioural changes, the impact of such changes on industries (and their competitiveness) as well as the expected tax revenue.

5. A new strategy for car taxation

From industry's point of view, any initiative to change how cars are taxed must be conducted on an equivalency basis. That is, changes in the way cars are taxed should under no circumstances lead to an increase in the already high taxes levied on motor transportation. In regard to this it should be noted that 16 out of the 25 Member States does not impose any car registration taxes at present.

6. Coordination of member states' R&D tax incentives

Investment in R&D is essential for economic development in the EU and the Community framework for state aid for R&D is therefore of great importance to improving European competitiveness, as emphasised in the Lisbon Strategy and Barcelona Objective. A large number of R&D activities produce positive externalities across borders. In a market economy, R&D activities will be undertaken by private businesses provided they face proper market prices and are not hindered by regulations, undefined property rights or by unfair competition from public entities. However, public policy may have a role to play where market imperfections exist, for example in terms of spill over effects that cannot be internalised by the market alone.

UNICE has made several concrete recommendations to review the rules which are set out in its comments on the State Aid Action Plan and the recent Communication on State Aid for Innovation.[6] Given that a great number of R&D projects involve companies from different member states and in view of the principles of EC law, it should be stressed that tax credits for R&D must be granted in a non-discriminatory manner, i.e. they must not be restricted to domestic taxpayers but should also apply to taxpayers based in one jurisdiction who conduct research in another.

In this context it should also be noted that the introduction of an optional common consolidated tax base will contribute to the transparency and consistency of tax incentives for R&D as it will establish common rules for such incentives.

UNICE would like to take this opportunity to stress that there is an urgent need to clarify and simplify rules on state aid for R&D, either directly by the Commission or indirectly through member state authorities. The new rules need to be made transparent and easy to comply with by companies involved in such R&D activities. Current rules are often complex and unclear, resulting in Member States adopting different interpretations, legal uncertainty for companies and procedural delays. R&D aid is too narrow hampering the effectiveness of Member States' measures to encourage R&D.

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6 "State Aid Action Plan - Less and Better Targeted State Aid: A Roadmap for State Aid Reform 2005-2009", 15 September 2005; "Review of the Community Framework for State Aid for Research and Development", 14 September 2004.

UNICE thus welcomes the intention of the Commission, as set out in paragraph 3 of the Communication, to offer guidance to Member States on R&D tax incentives and on how to design and implement relevant measures. This should lead to a more coherent system of national tax incentives for R&D. Member States should redeploy state aid so that the share allocated to research and innovation will be doubled. The EU must flank Member States efforts by quickly implementing changes to the state aid rules which would encourage firms to innovate without harming transparent and effective state aid control.

UNICE has made several concrete recommendations to review the rules which are set out in its comments on the State Aid Action Plan and the recent Communication on State Aid for Innovation. UNICE urges the Commission to abolish the distinction between industrial research and pre-competitive development activity and create a single category “industrial RTD”. As set out in UNICE’s comments to the State Aid Action Plan, the current framework for assessing R&D projects on the basis of the separate sequential R&D stages from the outdated linear innovation model is incompatible with strict time-to-market requirements and should be updated to reflect today’s concurrent, iterative and interactive industrial innovation process with constant market feedback.

Finally, it would be of great value to establish a clear definition of the concept of R&D. Business conducts much research but it also conducts a lot of development and innovation. A clear definition of what constitutes R&D is vital to fully exploiting the contribution which tax and customs policies can make to the Lisbon Strategy.

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