ACCADEMIA NAZIONALE DEI LINCEI

Attachment 1 - Tax sovereignty of Member States within the framework of European integration: overcoming of "Tax Havens" in the Union and transition to a European federal tax system *

Some European Union dossiers on taxation have remained open and unaccomplished for years. Despite the many agendas on harmonization or integration, the results have always been limited; every time a qualitative leap was called for, the political will failed.

Among the Union's strengthening measures required to overcome the crisis and establish the conditions for a wealthier development and increased stability, however, an essential one is that the distorting effects that determine tax disparities within the Union are eliminated. In fact, tax inequality affects the competitiveness of businesses, as well as the possibility for individual States to earn revenues on activities actually carried out in their country but taxed elsewhere.

The level of integration reached by the Union so far, regardless of the current crisis, has gone beyond being merely economic, while policies aimed at a rapprochement of the macroeconomic domestic policies have been implemented; the tax issue can thus no longer be circumvented. The time has finally come for a comprehensive, systemic approach to taxation that is complementary to debt policies, as well as to European investment policies.

In order to realize a system in which the fiscal sovereignty of individual Member States incorporates within the framework of European federal integration, the following guidelines are suggested.

Removal of the distorting effects causing tax inequalities within the Union

Competition between tax systems within the Union is apparent above all in corporate tax systems where profits are subject to low taxation. Individual countries can indiscriminately apply such rules to residents and non-residents, as well as lack of harmonization in determining the tax base for groups.

The more serious attempt of a global approach in Europe is possibly the Resolution of the Council of the Union of the 1st of December 1997 on a code of conduct on business taxation.[1] Within such context, it was recognized as compelling that a coordinated action at European

[1] Resolution of the Council and representatives of the governments of the Member States, approved at the Council assembly of 1 December 1997 on a code of conduct for the taxation of companies.

level be undertaken to reduce the distortions that exist within the single market, to prevent substantial losses in tax revenues, and to arrange tax structures more prone to encourage employment.

However, at that time the political deal did not go beyond adopting a *soft law* tool. Furthermore, the definition of 'harmful tax competition' included in the code is generic and restricted to the type of measures it encompasses. The ban was, in fact, limited to a few hypotheses of tax competition considered harmful and unfair because of their possible effects on the location of productive activities among States.

The proscriptions of the code have proved to be completely inadequate to guarantee national laws against abuse of tax competition. In fact, all the numerous and significant differences in corporate taxation have remained outside the code; in particular, those having an outcome in general schemes subjecting profit to low taxation, applicable without distinction to residents and non-residents.

In an area that should be economically integrated, with a single currency and with a view to a smoother political union, these differences cannot but represent a significant cost for the European production system, consisting of a partial exploitation of the integration potential. In fact, it is not easy to understand why, only because they are generalized, these schemes can be seen as harmless, consistent with a proper course of the market, far from producing serious distortions in the localization of business activities and even as a positive competitive factor.

As a political solution was not reached, in recent years the notion emerged that tax competition could be somehow reduced indirectly. This assumption relies on the resumption of the process of harmonization and coordination of corporate taxation based on the principle of consolidation and distribution of the bases taxable at Union and supranational level (the so-called *Common Consolidated Corporate Tax Base* - CCCTB) and *Base Erosion Profit Shifting* (BEPS).

These projects have been carefully studied by the appropriate bodies, which however did not yield significant results. It has appeared therefore very difficult, if not impossible, to implement them straightaway and with full agreement of the 28 EU member states. The option of enhanced cooperation remains, albeit it might not be an ideal solution, exactly because it cannot be generally spread out onto the whole Union. However, the problems posed by tax competition represent one of the greatest obstacles hampering the integration process under way and the application of the principle of solidarity that should permeate the application of the treaties.

Fiscal capacity of the Union: common taxes capable of changing certain conditions

The only alternative, should a further impasse occur, would be to provide the Union with a fiscal capacity separate from the budgetary policies of the individual States. A specific budget should be allocated and the fiscal capacity should be granted, to permit the Union to democratically establish its own taxes, to be used also with a countercyclical purpose to

support countries subject to asymmetric shocks. A satisfactory answer should also be given to the questions on what common taxes should contribute to fuelling the EU budget and how this new fiscal sovereignty should be exerted.

Three proposals for directives that, if adopted, would strongly connotate the fiscal choices of the European Union and could align the tax system to the current economic reality. However, because an agreement was not reached, such proposals have all come to a standstill. These proposals involve the taxation of: i) financial transactions (the so-called *Tobin tax*), ii) the use of non-renewable raw materials (the so-called *carbon tax*), and iii) the annuities, such as that of the *digital economy*, deriving from the collection and the use of data and information gathered from individuals (the so-called *web* or *digital taxes*).

The first type of levy that could be taken into account as a European tax is therefore the financial transaction tax. Finance scholars and, in general, public economists agree that, in principle, this tax could play a very effective role in achieving a better regulation and rationalization of financial markets and, above all, in order to curtail excessive financial speculation. The opportunity is offered for a stricter regulation of financial instruments and, in particular, of derivatives. A form of para-patrimonial taxation should be designed in order to affect financial activities and reduce the ever-increasing amount of high-frequency exchanges automatically performed by computer algorithms. Obviously, this levy should be applied at extremely low rates (the Commission has suggested 0.1% for equities, bonds and exchange rates, and 0.01% for derivatives), in order to limit the risk that people do not make use of such instrument by this not being any longer a global tax. The revenues from this tax could fuel a European Fund for Development and Employment.

The Commission designed the second levy as a proper environmental tax, based mainly on the pollutants; that is to say that its very basis is the environmental damage actually produced. This moves away from the "environmental taxes in a functional sense", tailored on a traditional base (for example, on consumption, income, wealth), which legislator has only directed toward the safeguard of the environment, in terms of incentives or disincentives of certain activities or promoting or discouraging the use and production of certain goods. From a fiscal angle, the *European Green Deal* that the Commission has just launched has reaffirmed the crucial role of taxation in the transition towards a greener and more sustainable European growth. This new act is aimed at building a "pure" carbon tax, as an alternative to the *Carbon border tax*, which involves all goods, including those produced in the EU.

The third type of levy corresponds to the so-called *web tax*, whose implementation in Italy was met with little success so far. This tax could be devised following the indications of a first directive on the subject by the EU Commission. The Commission, in the wake of the OECD, proposed the taxation of all those operations performed by a digital service, intended as a "*service provided through the Internet or an electronic network, the nature of which renders the service essentially automated and requires minimal human intervention*" (Art. 7 of Implementing Regulation No 282/2011). Without terminological ambiguities, the taxation of the so-called e-income has to be tied onto a new concept, free from the physicality and corporeity of the traditional notion of permanent establishment and founded, instead, on

alternative markers such as the revenues deriving from the supply of digital services, as well as the number of users and contracts settled *on-line*.

The fiscal sovereignty of member states in the framework of European federal integration

European fiscal federalism, which could be achieved by combining the above-mentioned measures, would be competitive yet branded with a strong solidarity mark. This kind of federalism would combine the need for unity embodied by the federal state with the power of the domestic states to submit to the vote taxes on harmonized and freely chosen tax bases, although in accordance with the Union own system.

According to this model, the European Federal State would be given the power to establish its own fundamental and coordinating principles while respecting the different approach of the various Member States. At the same time, citizens residing in less developed areas would be granted, as for essential needs, the right to have minimum levels of services in education, health and other forms of assistance on a federal basis.

This would not diminish the role of domestic states. On the contrary, in addition to leaving them full freedom in the establishment and application of taxes on areas of their strict competence, it would strengthen their position in coordinating the sub-national territorial autonomies and their role in an active and essential participation in harmonizing the fundamental principles of the federal State's policies. This is in fact one of the many possible applications of the subsidiarity principle which is already at the basis of the Union Treaties.

9 may 2020

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* Attachment 1 to the Statement "The Covid crisis and a possible turning point for the European Union" by the Lincei Committee on Covid-19