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Comment on "The Future of Corporate Income Taxation in the European Union"

Ewald Nowotny

Vienna University of Economics and Business Administration

I. Starting with the end of this very interesting paper: There one finds six tables about the structures of European taxation that are a unique source of information about the huge variety to be found in European Corporation and Individual Income Taxation. It is a remarkable achievement by Professor Cnossen not only to compile these tables, but also to find some structures and common features in them.

It clearly emerges that the concept of comprehensive income taxation has no practical relevance in Europe any longer. Labour income is taxed at much higher nominal and effective rates than capital income. The more mobile factor gets the more favourable tax treatment. No time series are given in Cnossen's paper, but there are many indications, that the differences in the taxation of labour and capital are widening. The proposal in the "Ruding Report" of a unified minimum corporate tax rate of 30% appears widely unrealistic nowadays.

Cnossen also demonstrates that in spite of many discussions and projects on harmonizing tax bases, rules for calculating taxable profits still differ widely among Member States. It is also quite obvious, that there still exist numerous specific tax incentives. This indicates that – contrary to academic "conventional wisdom" – policies of reducing tax rates have not been fully combined with a corresponding expansion of the tax base.

This relates to two interesting aspects:

- EU-competition policy is much more active against direct subsidies than against tax transfers – in spite of a policy against "unfair tax competition".
- This results in a clear incentive for Member States to substitute direct subsidies by tax incentives. This has the special effect of promoting investments in the home country. In contrast, general rate reductions in an enlarged Europe may have the effect to use higher profits for higher investments not at home but in low-wage countries. This effect will increase with greater tax possibilities for loss compensation, following recent decision by the European Court of Justice.

II. A point that has not reached enough public attention is the fact that in most EU Member States pension funds and investment funds are tax-exempt. This offers a

number of opportunities for legal tax evasion, as is shown in this paper. Given the growing importance of these funds this may create substantial effects in further reducing the progressivity of the total income tax system, even if eventually taxation takes place at the level of the individual income earner.

III. Concerning policy proposals Cnossen gives an interesting presentation of the Nordic dual income tax system. This kind of tax system is discussed also in many other countries of Europe and is very similar to the tax system which evolved in Austria.

It is however important, to analyse a dual income tax system in connection with the system of corporate taxation, the existence of a wealth tax and the personal taxation of high income earners. Thus, it is important for the ongoing discussion to point out, that in Norway, Finland and Sweden there exists a net wealth tax – something that does not exist for instance in Austria.

Giving a little "political economy background" as a former chairman of the Finance Committee of the Austrian Parliament, I may add that the introduction of the dual income tax system in Austria was mainly motivated by the fact, that in a system of strict bank secrecy, as we (still) have in Austria, the only way for effective taxation of capital income is via withholding taxes and thus via a dual income tax system with proportional taxation of capital income. In the specific case of Austria, were large parts of capital income had not been reported to tax authorities, this new system also had positive distributional aspects. As the share of capital income in total income rises with rising income, an effective proportional taxation of capital income has a stronger distributional effect as compared to a non-effective progressive taxation of capital income.

Although the new system of taxation of capital incomes resulted in a substantial increase in tax revenues, it is generally accepted and undisputed. This seems to indicate, that withholding taxes are not only technically efficient, but they are obviously seen as "soft-taxes", given their smaller visibility and the absence of any bureaucratic reporting needs. Especially for countries that have no "puritan tradition" of tax "morale", proportional, but technically efficient withholding taxes may be superior compared to progressive, but difficult to administer systems of income, especially capital income taxation.

IV. Concerning tax-competition, one often sees (fortunately not in Cnossen's paper) a strange divergence between theoretical discussions and real-world experiences. We clearly do not live in the idyllic "Tiebout World", that is assumed in the previous paper of Feld, but in a world where multinational companies, helped by armies of highly paid tax consultants and lobbyist exploit (and create) every possibility for "tax arbitrage". As a great number of studies (recently e.g. by Financial Times) have demonstrated, this already now has the effect, that big

multinational companies in many cases avoid all or most of corporate taxation. All this will increase with increasing opportunities for tax competition in the EU.

The real issue thus is not about welfare – driven locational choices a la Tiebout and not even about "voting by feet", but about creating massive new inefficiencies. The distributional inefficiency is obvious, as capital is more mobile, i.e. has "longer feet" to use tax-competition as compared to labour. But there exist also massive allocative inefficiencies. "Legal" tax evasion by big multinational companies in fact means a free-rider strategy, as these companies will continue to use the better physical and institutional infrastructure of the (relatively) high-tax countries, but do not contribute in (tax-) financing this infrastructure. It also has to be noted that the strategies of "tax planning" of big multinational companies are not open to small and medium sized companies, which thus have to bear a higher effective tax burden. This may create huge distortions – which strangely up to now did not attract the attention of the European Commission. On the contrary, EU proposals like Home State Taxation would increase the inefficiencies shown above.

One only can agree with Cnossen's statement that the arguments for coordinating the capital income taxes are overwhelming. Limiting tax competition to me seems to be of utmost importance for a credible, socially accepted system of income, especially capital income taxation in Europe. In his paper Cnossen demonstrates, that there are indeed ways to stop and reverse the present tendency of an ever decreasing role of capital income taxation, especially with regard to high income groups and multinational companies. As Cnossen, however, rightly shows, these alternatives are confronted with a number of administrative and especially political problems. But it is of absolute importance to continue to work on this. Josef Schumpeter, the great Austrian economist and short-term minister of finance once wrote in his essay "Die Krise des Steuerstaates[1]" that the structure of taxation is the best indicator for the political structure of a society. This also holds true for the European Union.

[1] J. Schumpeter (1976) Die Krise des Steuerstaates, in: R. Hickel (ed.) R. Goldscheid and J. Schumpeter, Beiträge zur politischen Ökonomie der Staatsfinanzen, Frankfurt am Main.