

Direct Taxation in the European Union Countries - Part I -

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Abstract

The importance of the topic lies in the role played by taxation and fiscal reforms in this field for the economic development of the states around the globe especially as this paper focuses on the Member States of the European Union, which record different levels of taxation and where there are still quite a few different approaches to taxation, despite sustained efforts towards convergence.

The involvement of our country in this process of European integration is based on removing the inconsistencies and failures of previous reforms, as well as reconciling the objectives of efficiency, effectiveness and equity that are the foundation of an optimal tax system.

Key terms: OECD, EU, tax system, Fiscal Code, convergence, fiscal policies, double tax treaties

JEL Classification: K34, H87

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➤ Introduction

Taken as a whole, the European Union is moving towards the convergence of tax systems even if a perfect harmonisation between them is not yet in sight.

The harmonization of taxes and fees in the Member States of the European Union implies the orientation of the different tax systems and an alignment in accordance with the European economic, social, financial and fiscal policy. According to the European Union definition, tax harmonization is the process of structuring the tax systems of the Member States; harmonization is multidimensional and influences the scope of fiscal systems.

We have chosen the direct taxation at the level of the European Union as a case study, because the European Union has the role of monitoring the national rules regarding taxation. In the case of income tax, the basic role of the European Union is to ensure concordance with the principle of non-discrimination and free movement in the single market.

It is well known that the economy mechanism is mainly influenced by the tax system, which represent a key factor when assessing the size or the power of a country. The taxation system determines the extent to which people save, invest, and work, influencing production growth and employment, which are essential elements of economic strategy, making fiscal reform an important component of economic reform.

Romania is going through a period in which the reform of the tax system is in full swing, so the management of each company's assets has become a very complex issue that requires the harmonization of Romanian tax legislation with existing international laws, a process in continuous development and adaptation.

➤ Aspects of fiscal policies

After World War II, in 1961 a body for intergovernmental economic cooperation and development was established at international level for all the countries around the globe in order to establish peace, to stimulate

economic progress and international trade. This supervisory organisation is entitled OECD, which stands for the Organisation for Economic Co-operation and Development, and originates from the year 1948, when the organization (referred to from now on as OECD) has been founded in order to play the role of the administrative power of the Marshall Plan. Among the objectives to which the forum is devoted to, there is the market economy, for which this organisation creates a platform in order to compare the policy experiences of the member countries and for which the taxation policy plays an important role in determining the international framework.

The European Union (referred to from now on as EU) has also started as an economic community after World War II and began to concern itself with many other policy areas such as climate, health, migration, etc. As part of the European Economic Community strategy, the creation of an internal market was one of the main objectives together with the customs union, where they will all charge the same amount of tax on goods moving freely without limits. Therefore, the OECD and EU go hand in hand in creating the economic framework regarding the taxation policies that should be applied in any interaction of the EU Member States and any other state which is not an EU member.

Even though the EU is not officially a member of the OECD, it has obtained the quasi-member status, so the OECD policies strongly influence European policies to such an extent that it could be argued that the OECD indirectly or at times directly shapes the EU trade policy. Out of the 27 EU Member States, 20 are also members of the OECD and are the main contributors to its budget. On the other hand, as far as the EU Member States and the European Commission are concerned, they take part in and contribute to discussions within OECD, so it can also be said the EU itself, including its Member States, has an influence on the OECD agenda and how the decisions and recommendations are formulated. (Mendonca, 2016)

These two institutions are the main actors of the policy guidance that have increased the level of taxation step by step in each state by enhancing principles to its members and have created a framework for the economic development. The OECD Model Tax Convention represents the publication concluding bilateral tax conventions that play the main role in eliminating tax barriers in the cross-border transactions and investments in order to support countries in the prevention of tax avoidance and evasion. At European level, the Double Tax Treaties (referred to from now on as DTT) represent the lever between two countries in order to facilitate the process of taxation of any taxpayer which operates in more than one country.

The state's fundamental concern is to collect budget revenues correctly and evenly, and one of the most important responsibilities of the tax administration is to protect its enforcement body, the public tax authority (James, 2009). In this sense, Professor Bistriceanu stated, in the magazine *Taxes and Fees*, that a government without taxes and fees cannot exist (Bistriceanu, 1995). He considers that progressive and high taxation is unfair and seriously affects the payment of work performed, explaining that the payroll tax is higher for the taxpayer who is more qualified and works harder, gets better results and has a more important contribution to the economic and social development of the country.

The contribution required in order to ensure each state's public service is by its function the tax collected in the budget and the body responsible for the tax collection is the National Agency for Fiscal Administration. The taxation system is composed of a suite of methods, based on principles and processes to be used in practice with respect to fiscal elements such as quotas, taxable matter and tax subjects, between which there are interactions that results from the fiscal policies and laws in force.

In fact, internationally, the authors opt to reduce tax rates to a level that ensures coverage of public spending in real conditions. At the same time, fiscal policy also contributes to economic development through the fiscal facilities it promotes, insofar as they are properly targeted.

In order to make a comparison which reflects the reality and evaluates the fiscal obligations in the countries under observation fairly in this paper, it is necessary that we acknowledge the size of the main budgetary obligations from these countries stipulated in the double taxation treaties between them. In each state's treaty and fiscal legislation the principle of universal tax law is mentioned, which states that "if any provision of the

tax code of a country contravenes a provision of a treaty to which that country is a party, the provision of that treaty shall apply". For example, Article I Paragraph (3) of the Fiscal Code of Romania stipulates the following: "If any provision of this Code contradicts a provision of a treaty to which Romania is a party, the provision of that treaty shall apply."

➔ Literature review

Nowadays, the public and all the professionals focus their attention on the mechanisms of avoiding the taxes and the fiscal optimization techniques which tend to be less agreed upon by the governments and sought more by the economic actors from the private sector. Direct taxes and their volatility play an important role in tax avoidance.

It is of common sense that high incomes are hit harder by taxes than low incomes, because of direct proportionality and high incomes are generally equity incomes which would mean that the capital owners are disadvantaged. At the level of individual revenues, the degree of taxation being higher could have two effects: a negative one, where the person would stop their activity, and an incentivization role where the person would start a complementary activity in order to increase its level of revenue. For enterprises, high taxes would damage their activity, since applied to corporate income and excessive profits, they would remove the stimulus factor for a thoughtful and prudent business practice (Shultz and Harriss, 1954). The level of capital would be discouraged, as well as the investments, savings and the rate of debt facilities granted.

John Maynard Keynes was an advocate of the idea that if the state would decrease its taxes, it would determine an increase in the rate of consumerism of the individuals, an easing of the business processes and an increase in demand of ordinary goods. He believed in the idea that when the fiscal policy is used as an instrument to equally distribute income its effect would be the tendency for the consumption to increase and the direct taxes contribution must be correlated with the level of income and wealth, otherwise tax evasion would occur. (Keynes, 1970) At that time he proposed the introduction of a consistent tax, on transfers, which would have been applied for all transactions in order to combat speculation of the entrepreneurial spirit (Popescu *et al.*, 2019).

Fiscal resources are the main source of financing that allows the state to be present in the market through subsidies, investments and indirectly through the total value of allowances from the real economy. For an optimum functioning and growth of each state's economy, the forms of taxation should be adequately defined by their level and share in the budget revenues.

The maximization of the national revenues per resident must take into account the influence of the taxes on different realized incomes, on wealth and of the value added tax that influences the production per person. At the same time, the taxes on salary, profit and consumption reduce the income that can be saved and invested individually and globally. The main concern of the taxpayers is to manage the tax burden efficiently in order to protect their patrimony and still obtain a large profit, by finding different methods to diminish their tax liabilities, process referred to by the practitioners as fiscal optimization. Each country has some doors in its legislation available for the business actors to be exploited and to become creative, sometimes reaching the fine line between legal and illegal. Inconsistencies in the fiscal legislation are the key sources for the tax evasion and fiscal optimization, which could be referred to as "legal tax evasion".

A broader classification made by Boadway and Pestieau argued that consumption tax and income tax are the main forms of taxation. If we think about the OECD countries, personal income tax, corporate income tax (referred to from now on as CIT), taxes on goods and services and social security contributions are the essential sources of revenues from taxes. However, the percentage of personal income tax (referred to from now on as PIT) in the tax revenues is decreasing, while the trend for the social contributions and corporate income tax is to increase in percentages of the tax revenues. On the other hand, the share of indirect taxes as part of the tax revenues is significantly changing through the value added tax on goods and services. (Đurović *et al.*, 2019)

Many studies have been conducted in order to measure the impact of taxes on the economic growth and most of them concluded that lowering the number of taxes to be paid encourage the economic growth of the country, while a decrease in the level of tax contributes to and increases the level of economic activity. In terms of tax effects, the results of research are different as Pjesky (2006) confirmed that the impact of state taxes could be both positive and negative on the economy of that specific country.

Without a doubt, the performance indicator of a state's economy is represented by the gross domestic product. At the European Union level, Mutașcu *et al.* (2007) researched the impact on the gross domestic product of the direct and indirect taxes for the period between 1995 and 2005 and reached the conclusion that tax policy enhances gross domestic product (referred to from now on as GDP) per capita with 1.61% at a 1% increase of direct taxes. Regarding the indirect taxes, these are decreasing the GDP per capita with 0.83% at 1% increase in direct taxes, suggesting the idea that the tax harmonization process would be more appropriate instead of the tax competition (Mutașcu *et al.*, 2007).

In contrast with the previous studies, in the long run, a negative correlation has been found by Dackehag and Hansson (2012) between the rates of taxation on personal and corporate income and the economic growth of the country, by using data from the richest 25 countries of the OECD from the period between 1975 and 2010.

The Guardian released in 2013 an article on profit shifting and the ethical dimension of this method of decreasing tax duties. The article detailed how corporations were moving money through different countries with low tax rates where their subsidiaries were resident. (Foster, 2013) The governments should look closely on how the corporate profit tax is returned in order for the process to be as fair as possible since it is affecting its economy and power of negotiating with other countries. In case of an economic crisis, as the one that is about to start now, people are realizing that the revenues from taxes are not enough to cover governmental expenditures, so this begs the question of who is to blame? We think that efficient planning from a tax perspective as a company should be fair, as long as the transparency of the company is maintained, but the government's inability to pay attention to its legislation in order to make it work in its favour should be a subject to reflect on.

There is no such thing as the perfect fiscal system, since each country has its particularities and the optimum design of it is different and specific to each country. The impact of direct taxes is proved to be strongly positive on the economic growth of a state, as long as a balanced is kept between the tax collection and tax burdens. Obviously, factors such as the political regime and social redistribution are of importance as well when discussing a country's ability to develop a strong economy.

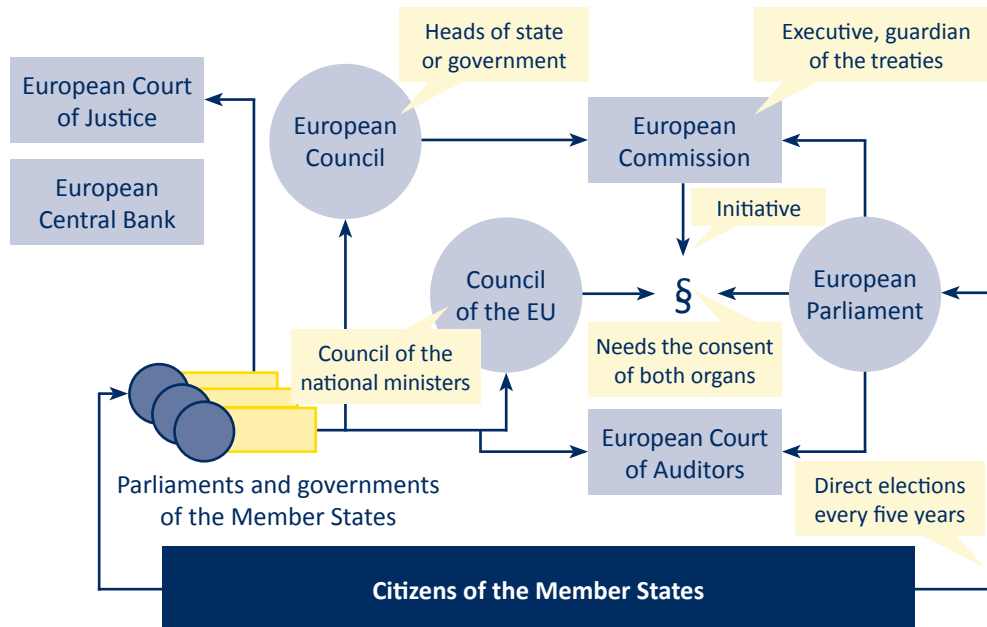
➔ Regulatory bodies at EU level

In the general policy context of EU, the fiscal policy is an essential part for every state of the European Union. The fiscal independence of each state is constrained by the obligation of non-distortion of the competition inside the single market, as well as by the convergence criteria established in the Maastricht Treaty in 1993. These principles were also incorporated into subsequent treaties to coordinate the national fiscal policies so the community climate could be stable and the budgetary prudence to be present.

The principal decision-making bodies of the European Union are: the European Parliament, the European Council, the Council of the European Union, the European Commission, the Court of Justice of the European Union, the European Central Bank, and the European Court of Auditors.

The legislative power is shared between the Council of the European Union and the European Parliament, while the executive power is exercised by the European Commission and in a limited capacity by the European Council, which sets the directions and the priorities for the time being. The judiciary power lays in the Court of Justice of the European Union responsibilities, which has to apply and interpret the treaties and the EU laws.

The institutions of the European Union are presented below:



Source: www.wikipedia.org

The process of establishing legislations begins with the European Commission, which has the right to initiate legislation and in addition has the power of decision and could formulate opinions and deliver recommendations on different matters included in the Treaties. On the other hand, the Commission has the supervisory role in order to ensure that the rules are properly and uniformly applied within the Member States and must implement the rules laid down by the Council of the European Union together with the European Parliament. The procedure of adopting legislation is a co-decision procedure, where the European Parliament and the Council of the European Union are exercising substantial powers of legislative, supervisory and budgetary nature. The application of the EU law is ensured by the Court of Justice of the European Union, which headquarters in Luxembourg and is composed of two separate courts: the Court of Justice and the General Court.

In conclusion, the EU laws are generally promulgated by EU Directives, which are to be implemented in the domestic legislation of the Member States and by EU Regulations which are enforceable in all Member States. EU taxation has two components: direct taxations, which falls in the responsibilities of the Member States, and indirect taxation, which interferes with the free movement of goods and the freedom of providing services in the single market. However, the direct taxation in the EU has gone through the harmonization process, which is a continuous process given the developing standards regarding personal and company obligations, double taxation and tax avoidance measures.

➔ European fiscal policies applied in Romania

Romania is part of the 27 states of the European Union since 2007 and as each Member State has the obligation to implement the directives of the EU as well as to ensure that the EU Regulations are enforced according to the deadline given by the Union. The Romanian tax system is composed of the legislation which establishes the taxes and duties which represents part of the state's revenues, the fiscal mechanism represented by the technical procedures and methods of collecting the duties and the fiscal units represented by specialised bodies that ensures the fiscal mechanism is set in motion in order to achieve its objectives.

The main regulations of the European Union centre around:

- eliminating customs duties between member countries and any other measures with similar effect;

- ensuring free competition within the common market;
- ensuring that the budget deficit should not exceed 3% of GDP.

In terms of EU law, while the EU has some power to produce laws and harmonize the system of indirect taxation, in terms of direct taxation, the right to organize the tax system, the choice of rates and the application of exemptions is generally offered to exclusive national sovereignty and the laws of EU Member States. The most important law at EU level on direct taxation has been drafted through various significant decisions in the case law of the European Court of Justice concerning the interpretation of the “four freedoms” of the European Community Treaty.

However, harmonized standards for corporate and private taxation are set on the basis of the European directives and rulings of the European Court of Justice. Direct taxation is not considered to affect trade between Member States and therefore requires only coordination and good communication at EU level in the field of tax evasion and double taxation, in order to prevent distortions of competition and capital movements in the internal market. Romania had to reform its fiscal system in order to align the fiscal legislation with the EU laws and to satisfy the membership conditions. In order to support Romania’s accession program to the European Union and to correlate the provisions of the Romanian tax legislation with the European one, it was necessary for an emergency ordinance to be issued by the Government, which was published on the Finance Ministry’s website on October 13th 2009, which brings a series of amendments to the Fiscal Code approved by Law No. 571/2003, with the subsequent amendments, part of which are taken over in Law No. 76/2010.

As of the 1st of January, 2010 the amendments to the Fiscal Code entered into force. These amendments took into account the modification of the essential elements of the Romanian fiscal system, mainly on the basis of the single quota of 10% applied to revenues and of a value added tax of 24%. It is also worth noting that it was not decided to standardize the two taxes. The amendments to the tax law aimed at adapting the Romanian legislation in the matter to the new status of Romania as a Member State of the European Union, so that both rules on the taxation of dividends for companies located in the Member States and new provisions on value added tax have been introduced as well as excise duties under the conditions of intra-community trade in goods and services. Another category of changes concerned local taxes and duties, in particular real estate taxes.

With regards to corporate income tax, changes were made to the determination of corporate income tax, but the marginal profit tax rate of 16% was not affected. The dividend tax is established by applying a tax rate of 5% to the gross dividend distributed/paid to a Romanian legal person. These provisions do not apply in the case of dividends paid by a Romanian legal entity to another Romanian legal entity, if the dividend beneficiary holds, at the date of dividend payment, at least 10% of the participation titles of the legal entity, for a period of one year, including the date of their payment, in accordance with the Article 43 Paragraph (4) of the Fiscal Code.

Within the medium-term strategy of the National Agency for Fiscal Administration in Romania in the period 2012-2016, there were three important premises, respectively:

- fighting tax evasion;
- increasing the efficiency and dynamics of tax revenue collection;
- encouraging voluntary compliance.

They rely on the idea that budget revenues are the decisive conditions for the sustainable development of Romanian society. The existence of the state and the functioning of public authorities both depend directly on taxation, which influences the economy as a whole and also the members of society. The National Agency for Fiscal Administration has achieved a great part of their objectives, however more actions are being considered for the next period.

As part of their strategy for the period of 2017-2020, their strategic objectives were the following:

- increasing voluntary compliance;
- reducing tax evasion and the underground economy;

- improving the institution-taxpayer relationship;
- increasing the efficiency of tax collection;
- implementation of the Revenue Administration Modernization Project.

Today, even the modernization process has been a struggle and even if some insufficient actions have been taken in order to implement technological and online systems to improve the relationship with the tax payers and efficiently manage their resources, the pandemic is pressuring the state's administration to fasten this process.

The authors of the book *Metode și tehnici fiscale (Tax Methods and Techniques)* (Juravle and Vintilă, 2000) considered that to ensure maximizing the efficiency of the tax system, without tax pressure becoming unbearable, it is necessary to reject tax facilities that destroy neutrality and stimulate legal tax evasion.

Discouraging and eliminating tax fraud requires, in addition to increasing tax sanctions, for the legislation on tax evasion be amended, by introducing more drastic and diversified administrative and criminal sanctions.

An important initiative in the fight against the unethical fiscal optimization techniques comes from the OECD, that has started a project called BEPS which stands for Base Erosion and Profit Shifting with the aim of eliminating all fiscal avoidance practices of companies shifting their profits. Even though Romania is not a member of the OECD, it has embraced this initiative in order to increase the transparency and the fairness of the transfer pricing outcomes.

The consequences did not take long to show up and now we have the Anti-Tax Avoidance Directive 2016/1164 (ATAD I) setting out rules against tax avoidance practices which have a direct impact on the functioning of the internal market, the Anti-Tax Avoidance Directive II 2017/952 (ATAD II) on the non-uniform treatment of hybrid elements involving third countries and also Directive 2018/822 (DAC6) with regard to the mandatory automatic exchange of information on cross-border arrangements in the field of taxation.

In our opinion, aligning legislation between countries is something unrealizable, and even difficult to attempt, but if the countries are open to tax harmonization instead of tax competition, they cannot be blamed for this attempt. It is obvious that emerging economies are the most affected by tax evasion, as in the case of Romania, since our main necessity is for the public budget to sustain and contribute to development.

The level of taxation proves to be essential for the economic revolution of the states of the Union, the European Union's 27 countries being characterized by different levels of development, especially if we consider the last states that joined the EU. The analysis of the current level of taxation, but especially in perspective, is important, because the fiscal conditions are among the first considered by investors, majorly influencing the decision to invest and the business environment.

Tax authorities all around the world have concerns about the efficiency of their tax systems, since the resident status is something so volatile, and here is where the main difficulty arises, when companies have multiple tax jurisdiction and they have to identify the place where the company needs to pay taxes (Stoica, 2018).

To be continued...

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