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**ACTIVITIES
OF THE EUROPEAN UNION (EU)
IN THE TAX FIELD IN 2003**

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ACTIVITIES OF THE EUROPEAN UNION (EU) IN THE TAX FIELD IN 2003

Note: Events and Commission initiatives which are not tax-specific but which contain an important tax dimension are included in the Annex to this Report. Activities etc. are listed in date order.

1 PERSONAL AND CORPORATE TAXATION

1.1 “Tax Package”

The Council of EU Finance Ministers on 20 January reached political agreement on a package of three measures to tackle harmful tax competition and on 3 June formally adopted the package. The Commission had proposed the package in October 1997 and the Council had continued discussions since then on the basis of an outline that it agreed in December 1997. The tax package consists of a Council Directive to ensure effective taxation of interest income from cross-border investment of savings that is paid to individuals within the EU¹; a Code of Conduct for business taxation²; and a Council Directive to eliminate withholding taxes on payments of interest and royalties made between associated companies of different Member States³. Member States agreed in 1997 that this package was necessary in order to help achieve certain objectives such as reducing the continuing distortions in the Internal Market, preventing excessive losses of tax revenue and re-structuring tax systems in a more employment-friendly direction.

Member States with dependent and associated territories agreed to ensure the adoption there of the same measures adopted in the Community concerning savings taxation and to ensure the standstill and rollback of harmful business taxation measures in accordance with the Code of Conduct. The Member States in question are the United Kingdom and the Netherlands and the relevant dependent and associated territories are the Channel Islands, the Isle of Man and the dependent and associated territories of the UK and the Netherlands in the Caribbean.

Savings Directive:

The Directive provides for the introduction of a system of automatic exchange of information on interest payments made by paying agents established in EU Member States to individuals resident in other EU Member States. During a transitional period, three EU Member States (Belgium, Luxembourg and Austria) will instead apply a withholding tax on such interest

¹ 2003/48

² 1.12.1997 – OJC 2 of 6.1.1998

³ 2003/49

payments at a rate which will progressively increase over time from 15% to 35%. These three countries will retain 25% of the revenue of the withholding tax and transfer 75% to the Member State of residence of the beneficial owner of the interest

EU Member States were required to transpose the Directive into national law before 1 January 2004.

They will apply the provisions of the Directive from 1 January 2005, provided that Switzerland, Liechtenstein, San Marino, Monaco and Andorra apply measures equivalent to those contained in the Directive from that same date and all relevant dependent or associated territories apply from that same date the same measures as Member States (i.e. automatic exchange of information or, during the transitional period, a withholding tax on the same terms as Belgium, Luxembourg and Austria). The Council will decide by 1 July 2004 whether the conditions for the application of the Directive have been met.

The Commission's immediate priority is therefore to finalise the agreements with the above European third countries. Negotiations are continuing in close conjunction with the Presidency of the Council. In accordance with the ECOFIN Council conclusions of 21 January and 3 June 2003, the negotiations with Liechtenstein, San Marino, Monaco and Andorra are based on the same four elements which also constitute the basis for the draft agreement with Switzerland, i.e.

- a withholding tax/retention with revenue sharing at the rates provided for in the Directive;
- voluntary disclosure;
- information exchange upon request in cases of "tax fraud or the like", and
- a review clause.

The Commission hopes to close these negotiations as soon as possible.

At the same time, the Netherlands and the UK have committed themselves to promoting the adoption of automatic exchange of information or, during the transitional period, a withholding tax (with revenue sharing) on the same terms as Belgium, Luxembourg and Austria, in all relevant dependent or associated territories. This work is also continuing.

Code of Conduct

The Code of Conduct requires Member States to refrain from introducing any new harmful tax measures ("standstill") and amend any laws or practices that are deemed to be harmful in respect of the principles of the Code ("rollback"). The code covers tax measures (legislative, regulatory and administrative) which have, or may have, a significant impact on the location of business in the Union. Member States and their dependent and associated territories have now introduced revised or replacement measures in substitution for the 66 business tax measures that the Council's Code of Conduct ("Primarolo") Group identified as harmful. For beneficiaries of those regimes on or before 31.12.2000, a "grand-fathering" clause has been provided under which benefits have to lapse no later than 31.12.2005, independently of whether or not they were granted for a fixed period. Some extensions of benefits for defined periods of time beyond 2005 have been agreed for measures in Member States and their dependent and associated territories. The Council on 25 November 2003 took note of a report from the Code of Conduct Group concerning implementation of rollback and standstill.

Interest and Royalties

The Directive on Interest and Royalties which came into force on 1 January 2004 eliminates taxes levied at source on payments of interest and royalties between associated companies of

different Member States. Transitional arrangements have been provided for Greece and Portugal for both interest and royalties and for Spain for royalties in order to alleviate the immediate budgetary impact of the Directive on those countries. Under these arrangements, Greece and Portugal will not apply the Directive until the Savings Directive takes effect on 1 January 2005 and Spain will not apply the Directive to royalty payments until that same date. Subsequently, Greece and Portugal will for a transitional period of eight years be allowed to apply a withholding tax on payments of interest or royalties that must not exceed 10% during the first four years and 5% during the final four years. Spain will, during a transitional period of six years starting on the same date of 1 January 2005, be authorised to apply a rate of tax on payments of royalties that must not exceed 10%. The Council agreed that the benefits of the Directive should not accrue to companies that are exempt from tax on income covered by that Directive and that the Commission should propose any necessary amendments to the Directive in due time.

For further details of the tax package see press release [IP/03/787](#) on the website of the Directorate-General for Taxation and the Customs Union⁴.

1.2 Proposed improvements to Mergers Directive

The European Commission on 17 October 2003 made a proposal⁵ to update, clarify and broaden the scope of the European Community's Directive that provides for tax deferral in the case of cross-border mergers and divisions of companies, transfers of assets and exchanges of shares⁶. In particular, the Commission proposes to broaden the Directive's scope to cover a larger range of companies including the European Company and the European Co-operative Society; to provide for a new tax neutral regime for the transfer of the registered office of a European Company or of a European Cooperative Society between Member States; to clarify that the Directive applies in the case of the conversion of branches into subsidiaries; and to introduce rules to prevent double taxation due to different valuations of shares and assets by different Member States.

1.3 EU company taxation

The European Commission on 25 November presented an overview⁷ of its efforts to remove the tax obstacles affecting businesses operating across frontiers within the Internal Market. In it, the Commission confirms its commitment to its 2001 strategy⁸ for a series of legislative proposals and initiatives to address specific tax obstacles in the short term, as well as for work on a more wide-ranging long-term solution of allowing companies to use a single company tax base (taxable profits) for all their EU-wide activities. Good progress has been achieved on targeted initiatives with new legislative proposals under discussion in the EU's Council, more proposals and guidelines planned and a forum in place to tackle transfer pricing tax problems. With regard to the longer term, the Commission presents ideas for a pilot scheme that would allow small and medium-sized enterprises to use the tax rules of their home state for computing their EU-wide taxable profits. It also announces plans for work with Member States and businesses on using financial accounts as a starting point for a single tax base (taxable profits) and on possible arrangements for apportioning a single base between different Member States. The Commission's report was discussed at a Company Tax Conference in Rome on 5-6 December.

⁴ http://europa.eu.int/comm/taxation_customs/publications/official_doc/official_doc_en.htm

⁵ COM/2003/613

⁶ 90/434/EEC

⁷ COM(2003)726

⁸ COM (2001) 582

1.4 Dividend taxation

The European Commission adopted a Communication on 19 December 2003⁹ aimed at providing guidance for EU Member States and Accession States on how to render their systems for taxing dividends received by private individuals compatible with the EC Treaty. An analysis of the case law of the European Court of Justice makes it clear that EU Member States' tax systems should not hinder individuals from investing in foreign shares. Member States cannot levy higher taxes on dividends from companies in other Member States than on domestic dividends and, similarly, they cannot levy higher taxes on outbound dividends than on domestic dividends. The Commission calls on the Member States to co-operate in order to deal quickly with the issues examined in the Communication but this would not involve harmonisation of their systems. If Member States cannot agree on solutions, the Commission will be obliged to initiate legal action against those Member States whose dividend tax rules do not comply with the Treaty.

1.5 Adoption of amendment to EU Parent-Subsidiary Directive

The Council on 22 December adopted a Directive¹⁰ based on the European Commission's proposal of 29 July¹¹ to amend the European Community's Parent-Subsidiary Directive (90/435/EEC). The new Directive broadens the scope of the existing Directive to cover a larger range of companies, lowers from 25% to 10% the inter-company holding threshold required for the application of its tax benefits and improves the mechanisms the existing Directive provides for the prevention of double taxation. The Directive ensures that the European Company which can be created from 2004 comes within the scope of the Parent-Subsidiary Directive.

1.6 Proposal to amend Interest and Royalties Directive

The European Commission on 30 December made a proposal¹² to broaden the scope of the European Community's Directive that provides for the elimination of withholding tax in the case of payments of interest and royalties between associated companies of different EU Member States¹³ to cover a larger range of companies including the European Company and the European Co-operative Society. The proposal would also, at the request of the EU's Council of Ministers, eliminate a loophole by providing that the Directive would not apply to companies that are exempt from tax on interest and royalties received.

1.7 Joint Transfer Pricing Forum

The European Commission established an "EU Joint Transfer Pricing Forum" in 2002 to tackle transfer pricing problems notably the high compliance costs and potential double taxation that companies face when doing business across borders¹⁴. Double taxation results from tax disputes both between enterprises and tax administrations and between national tax administrations about the pricing of the transactions. In 2003 the "EU Joint Transfer Pricing Forum" examined pragmatic, non-legislative recommendations to solve the problems in the

⁹ COM (2003) 810

¹⁰ 2003/123/EC

¹¹ COM (2003) 462

¹² COM (2003) 841

¹³ 2003/49/EEC

¹⁴ For more info, see http://europa.eu.int/comm/taxation_customs/taxation/company_tax/transfer_pricing.htm

application of the EU Arbitration Convention¹⁵ and the mutual agreement procedures under Member States' double taxation treaties. It also addressed the procedural problems for companies resulting from the fact that the Arbitration Convention is formally no longer in force since 1 January 2000 because the prolongation Protocol has not yet been ratified by all Member States. The Forum started discussions on a common approach within the EU regarding transfer pricing documentation requirements with a view to reduce compliance burdens and the risk of double taxation for multinational enterprises.

2 VALUE ADDED TAX (VAT)

2.1 VAT on Travel Agencies

On 21 February, the Commission made a proposal¹⁶ to revise the EU regulation on administrative co-operation in the field of indirect taxes¹⁷ so as to include certain simplifications concerning the special margin taxation scheme for travel agencies. This was because when the European Parliament was considering the Commission proposal they suggested that travel agents established outside the EU should be allowed to deal with only one EU VAT administration rather than having to deal with a number of them. This principle has already been accepted in the context of the VAT on the supply of services on the internet. The Commission decided to amend its proposal accordingly.

2.2 Proposal concerning application of VAT to postal services

The European Commission on 5 May 2003 presented a proposal¹⁸ to apply VAT to all supplies of postal services. The proposal would eliminate competitive distortions that currently create difficulties both for traditional national suppliers of postal services that are currently exempt from VAT and for their competitors who have to charge VAT. The further liberalisation of the postal services markets is likely to increase these distortions. The proposed change is unlikely to have a significant impact on the cost of postal services for private consumers because it would mean that for the first time national operators would be able to deduct the VAT that they themselves incur on their costs and that they currently pass on to their customers as 'hidden VAT'. Moreover, in order to counter further any possible price increases for private consumers, Member States would have the option of applying a reduced VAT rate to the standard postal services concerning all addressed items up to 2 kg in weight. As far as business customers are concerned, the application of VAT to postal services provided by national suppliers would be advantageous since business customers would be able to deduct the VAT element of their postal charges.

2.3 Right to deduct and cross-border refund of VAT

The Council (Finance Ministers) on 13 May 2003 held an orientation debate on the rules concerning traders right to deduct VAT and cross-border refund of VAT on the basis of a report prepared by the Greek Presidency of the Council. It decided to suspend the discussions on the Commission proposal of 17 June 1998¹⁹ as regards new rules for VAT deductibility until after the Commission had published its communication on the new VAT strategy. The Commission 1998 proposal was for a simplification of existing rules in this area. The

¹⁵ 90/436/EEC of 11 July 1990. OJL 225 of 20.8.1990

¹⁶ COM/2003/78

¹⁷ 218/92 EEC

¹⁸ COM(2003) 234

¹⁹ COM(1998) 377

proposal was for a harmonisation of the rules governing the right to deduct VAT on expenses relating to passenger vehicles, accommodation, food and drink and for the establishment of the principle that a trader could deduct in his country of establishment VAT incurred in another Member State. The latter would replace the system whereby a trader has to claim VAT refunds where he incurs VAT expenses in Member States other than his Member State of establishment.

2.4 Evaluation report on the experimental application of reduced rates for labour-intensive services

The Commission on 2 June 2003 adopted a report²⁰ to the Council and the European Parliament on the application of the 1999 Directive²¹ which allowed those Member States which so chose to apply a reduced VAT rate to certain specified labour-intensive services, but only for an experimental period of three years so as to test its impact, in terms of job creation and in combating the 'black' economy. The Commission concluded that it was impossible to identify with any certainty any beneficial impact on employment or a reduction in the black economy as a result of reducing VAT rates. Compared with measures that directly target labour costs, the budgetary cost per job created by VAT cuts is always higher (euro for euro, reducing labour charges creates 52% more jobs than reducing VAT rates). It is therefore necessary to examine whether reducing taxes and charges other than VAT would not be a better way of boosting employment.

2.5 Directive relating to VAT on certain electronic services

The Directive²² and Regulation²³ modifying the rules for applying VAT to certain services supplied by electronic means as well as subscription-based and pay-per-view radio and television broadcasting entered into force in the EU on 1 July 2003. The new rules, based on Commission proposals of 7 June 2000, establish a level playing field for the taxation of digital e-commerce in accordance with the principles on the taxation of e-commerce agreed at a 1998 OECD Ministerial Conference held in Ottawa.

2.6 Proposal to rationalise and simplify reduced rates of VAT

The European Commission on 23 July presented a proposal²⁴ for simplifying the rules on reduced rates of VAT in order to ensure its more uniform application. The purpose of the proposal is to afford Member States equal opportunity to apply reduced rates in certain fields (e.g. restaurants, housing and the supply of gas and electricity) and to rationalise the numerous derogations currently applying in some Member States. The aim is to improve the functioning of the internal market and avoid potential distortions of competition, which have given rise to numerous complaints from traders. Following the experimental application of a reduced VAT rate to certain labour-intensive services, the Commission is convinced that the reduced rate had very little, if any, impact on prices or job creation. A reduction in VAT rates would therefore seem to be a waste of budget resources which could be deployed more usefully.

²⁰ COM(2003) 309 plus SEC(2003) 622

²¹ 1999/85/EC

²² Council Directive 2002/38/EC

²³ Council Regulation No 792/2002

²⁴ COM (2003) 397

2.7 Council adoption of VAT rules for gas and electricity supplies

The Council on 7 October 2003 adopted a Directive²⁵ that modifies the rules for applying VAT to the supplies of gas and electricity so as to facilitate the Internal Market for energy. The new rules, based on a Commission proposal of 5 December 2002²⁶, eliminate current problems of double taxation and non-taxation and distortions of competition between traders. They will do so by changing the place of taxation of natural gas in pipelines and of electricity from the place of supply to the place of consumption. The current rules worked adequately in a national context but are not appropriate now with market liberalisation and increasing cross-border supplies of gas and electricity. Member States must implement the new measures by 1 January 2005.

2.8 Strategy for improving the operation of the EU VAT system

The European Commission on 20 October presented a follow-up report²⁷ on its strategic programme that it adopted in 2000²⁸ for the improvement of the VAT system. The Commission reviews progress with proposals already made, lists forthcoming VAT proposals and presents its ideas for a VAT system that would be suitable for an Internal Market consisting of 25 Member States. In particular, the Commission announces its intention of promoting the idea of a one-stop shop system, whereby a trader could fulfil all his obligations for his EU-wide activities solely in the Member State in which he is established. The Commission suggests that taxation at the place of destination may become increasingly necessary, particularly for services, in order to prevent distortions of competition and in order to ensure that VAT continues to accrue to the Member State where consumption takes place. Finally, the Communication emphasises the need for continuing work on ways of eliminating the growing problem of carousel fraud.

2.9 VAT implementing powers

On 25 November the Council (of Economics and Finance Ministers) gave its political agreement to a draft Directive, based on a Commission proposal of 10 June 2003²⁹ proposal for a Directive which amends the common VAT system in two respects:

- First, it ensures more simplification and transparency in the procedure for authorising derogations.
- Second, it confers on the Council the power to adopt common technical measures to implement the general rules laid down in the Sixth VAT Directive.

The Council's formal adoption of the proposal was not possible at that Council meeting because the Parliament had not yet provided its opinion on the proposal. The Parliament did so in December³⁰.

2.10 Proposal to extend reduced rates on labour-intensive services

On 10 December the European Commission decided to propose³¹ to allow nine Member States to continue to apply for an additional two years (i.e. until 31 December 2005) the

²⁵ 2003/92/EC

²⁶ COM/2002/688

²⁷ COM/2003/614

²⁸ COM (2000)348

²⁹ COM(2003)335

³⁰ The Council's formal adoption of the proposal took place on 20 January 2004

³¹ COM(2003)825

reduced rates of Value Added Tax (VAT) they currently apply to specified labour-intensive services such as renovation of private dwellings, hairdressing, window-cleaning and small repairs. Directive 1999/85/EC allowed those Member States that so chose to apply a reduction of VAT on these services for an experimental period from 1 January 2000 to 31 December 2002 (later extended to end 2003), in order to test the impact of such a reduction in terms of job creation and of combating the black economy. In response to requests from the EU's Council of Ministers and the European Parliament, the Commission decided to propose a further extension for two years because Member States have not so far agreed on the Commission's July 2003 proposal to rationalise and simplify the overall rules for reduced rates of VAT.

2.11 Proposal for change to place of supply of services

The European Commission on 23 December presented a proposal³² to change the place of supply of services for VAT purposes where the customer is a trader. The proposal would shift taxation in most cases from the place where the supplier is established or has a fixed place of business to the place where the customer is located. However, there would be exceptions to this general rule for certain services for which special arrangements currently exist (e.g. services related to immovable property and transport services), so as to avoid imposing disproportionate administrative burdens upon certain traders. The rule of taxation in the place where the supplier is located worked adequately when the VAT system was first introduced but, with increased supplies of services across borders, this rule can now lead to administrative complexities, distortions of competition and double or non-taxation of international supplies of services. The Commission intends to put mechanisms in place to ensure that the proposal would not lead to increased tax evasion. The Commission plans a follow-up proposal concerning the place of supply of services to individuals and entities not subject to VAT in 2005.

2.12 Council decisions concerning individual Member States

Individual Member States are entitled to request authorisation of the Council to apply special rules that depart from normal VAT rules for reasons such as to prevent fraud and tax evasion or to introduce simplification. Such a request must be submitted to the Commission which, if it considers the request justified, will make a proposal on this basis for consideration by the Council.

For VAT derogations authorised for individual Member States in 2003 see http://europa.eu.int/eur-lex/en/lif/reg/en_register_093010.html

3 EXCISE DUTIES AND OTHER TAXES

3.1 Computerisation of the movement and control of goods subject to excise duties

The Council on 16 June adopted a decision³³, based on a Commission proposal of November 2001³⁴, to computerise the system under which excise goods - alcohol, tobacco and mineral oils - are moved between traders in the Community under duty-suspension arrangements. The

³² COM(2003)822

³³ Decision No 1152/2003/EC

³⁴ COM/2001/466

new system is intended to improve the functioning of the internal market by simplifying the intra-community movement of excise products under the suspension system and by affording Member States the possibility of monitoring the flows in real time and of carrying out the requisite checks where necessary. The paper-based system is unable to cope with increasing levels of tax evasion - fraud involving alcohol and tobacco is particularly prevalent - and is unpopular with traders, who find it cumbersome. Around 80,000 individuals or firms will need to be connected to the system. Running costs are expected to be high, both for the Commission and the Member States. However, the cost to their respective budgets will probably amount to no more than 5% of the revenue lost to tax evasion in a given year. In 1996 alone tobacco and alcohol fraud was responsible for an estimated €4.8 billion in lost revenue. The European Parliament and the Council have estimated that it will take six years to implement the Decision from the date of its adoption.

3.2 Energy tax

The Council of Ministers, following a political agreement on 20 March, adopted on 27 October a Directive³⁵ which widens the scope of the EU's minimum rate system, previously limited to mineral oils, to all energy products including coal, natural gas and electricity. In particular, the Directive will reduce distortions of competition that currently exist between Member States as a result of divergent rates of tax; reduce distortions of competition between mineral oils and the other energy products that have not been subject to Community tax legislation up to now; increase the incentive to use energy more efficiently (so as to reduce dependency on imported energy and cut carbon dioxide emissions); and allow Member States to offer companies tax incentives in return for specific undertakings to reduce emissions. The Commission undertook to propose appropriate transitional arrangements for acceding Member States shortly afterwards. The Directive entered into force on 1st January 2004.

3.3 Council decisions concerning individual Member States

Under the Community harmonised rules providing minimum rates of excise duty for mineral oils, the Council may authorise a Member State to apply an exemption or a reduction in excise duty on fuel for specific policy considerations.

No Council decisions for derogations for individual Member States were adopted in 2003.

4 TAX MEASURES DESIGNED TO TAKE ACCOUNT OF THE STRUCTURAL, SOCIAL AND ECONOMIC SITUATION OF THE OUTERMOST REGIONS OF THE EU

4.1 Excise duties on tobacco products in Corsica

On 5 December, the Council adopted a Directive³⁶ authorising France to prolong the application of lower rates of excise duty to tobacco products released for consumption in Corsica. In order to prevent damage to the island's economic and social equilibrium, the Council agreed that it is both essential and justifiable to grant a transitional period with effect from 1 January 2003 to 31 December 2009, by which France may apply a rate of excise duty

³⁵ 2003/96/EC

³⁶ 2003/117/EC

that is lower than the national rate to cigarettes and other manufactured tobaccos released for consumption in Corsica.

4.2 Dock dues in the French overseas departments

The Commission on 17 December proposed³⁷ to authorise the continuation, until 31 December 2013, the dock dues payable in the French overseas departments to a list of products but from which partial or total exemptions are allowed for local products. In accordance with the requirements of the EC Treaty, the measures favouring local produce adopted are only those strictly necessary and proportionate and are justified in the light of the handicap of the remoteness of these departments.

5 TAX AVOIDANCE AND EVASION MEASURES

5.1 Commission proposal to strengthen co-operation to combat fraud in the direct tax area

The European Commission on 31 July 2003 presented a proposal³⁸ that aims to speed up the flow of information between the tax authorities of Member States by permitting them to coordinate their investigative action against cross-border tax fraud and allowing them to carry out more procedures on behalf of each other. The proposal which relates to direct taxation (income tax, company tax and capital gains tax) would update and rectify weaknesses in the existing Directive on Mutual Assistance³⁹. Modern technology and increased cross-border activity have made it more important than ever for information exchange and co-operation between tax administrations to be improved. A Council ad-hoc report on tax fraud of June 2000 noted that the existing EU directives and regulations were inadequate for the combat of fraud, which in the direct tax area involves, in particular, problems of under-invoicing and over-invoicing (transfer pricing). This proposal was designed to complement other EU legislation in the field of information exchange such as the adopted agreement on savings income and the Regulation on strengthening administrative co-operation in the VAT area that the Commission proposed in 2001 and that the Council adopted on 7 October 2003 (see. 5.2 below).

5.2 Council adopts new rules to strengthen VAT cooperation between tax authorities

The EU's Council of Finance Ministers on 7 October 2003 adopted a Regulation⁴⁰ to strengthen co-operation between Member States' tax authorities to combat fraud relating to VAT. The Regulation has three main objectives: to lay down clearer and more binding rules governing the exchange of information, to provide for more direct contact between national anti-fraud agencies, and to facilitate more extensive exchange of information. The aim is to remedy weaknesses in information exchange and administrative co-operation between tax authorities that had been identified in a Commission report of February 2000 on VAT fraud and the report of the Council's adhoc group on tax fraud of June 2000. The Council at the same time adopted a Directive to extend the scope of the Mutual Assistance Directive⁴¹ so as to allow Member States to exchange information concerning taxes levied on insurance

³⁷ COM(2003)792

³⁸ COM (2003) 446

³⁹ 77/799/EEC

⁴⁰ Council Regulation (EC) No 1798/2003

⁴¹ 77/799/EEC

premiums. The two legal texts are based on a Commission proposal of 19 June 2001⁴². The Commission (in Case C-533/03) and the Parliament (Cases C-548 & 549/03) have challenged the two measures in the Court of Justice. They consider that the Treaty legal bases of the measures should be Article 95 (Council-Parliament co-decision procedure with qualified majority voting in the Council) rather than Article 93 (providing for unanimity in the Council after simple consultation of the Parliament).

5.3 Adoption of report on implementation of "Fiscalis" programme to combat fraud

The Commission on 21 November 2003 adopted a report on the implementation of the 1998-2002 Fiscalis programme to help Member States work more closely together with a view to preventing tax fraud. The areas covered by the programme are improved electronic information exchange systems between national administrations, joint investigation exercises (multilateral controls), training seminars for tax officials and experts, exchanges of officials between national administrations and working groups and project groups.

The report concludes that, overall, the programme's joint activities are helping to ensure that tax systems operate more effectively in the internal market. However, there must be greater complementarity between the programme's activities (e.g. the results of a control exercise could be discussed at a seminar or exchanges could be organised on the basis of one area discussed at a seminar if they are to have greater impact). A number of the report's recommendations have already been included in the revised Fiscalis 2003 to 2007 programme that the European Parliament and the Council adopted on 3 December 2002⁴³.

5.4 Strengthening of co-operation to combat fraud in the field of excise duties

The European Commission on 18 December proposed a Regulation⁴⁴ to strengthen cooperation between Member States' tax authorities in the field of excise duties on alcohol, tobacco and energy products, in order to ensure the proper functioning of the Internal Market, facilitate collection of taxes by Member States, ensure equal treatment of traders and combat fraud. In 1996 alone tobacco and alcohol fraud was responsible for an estimated €4.8 billion in lost revenue. The proposed Regulation would in particular ensure more direct contacts between local tax offices of Member States, so as to speed up information flows; establish clearer and more binding rules on cooperation between Member States; require more automatic and spontaneous information exchange (as opposed to information exchange on request); and improve the systems in place for the transmission of information. The proposal would complement the initiative to computerise the movement of excisable goods in the Community adopted in June 2003 and is the counterpart to the strengthened rules concerning administrative co-operation in the VAT field adopted by the EU's Council of Ministers in October.

6 ENLARGEMENT OF THE EU

6.1 Enlargement negotiations

After successfully growing from 6 to 15 members, the European Union is now preparing for its biggest enlargement ever in terms of scope and diversity. 14 countries have applied to

⁴² COM(2001) 294

⁴³ Council Decision 2002/2235/EC

⁴⁴ COM(2003)797

become new members: 10 of these countries - Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, the Slovak Republic, and Slovenia are set to join on 1st May 2004. They are currently known by the term "accession Countries". Of the remaining 4 countries, Bulgaria and Romania could join the EU by 2007, while for Turkey the decision to start the accession negotiations will only be addressed by the European Council in December 2004, and Croatia's application for membership of the EU is currently being assessed and it is expected that the Commission will adopt its Opinion by 30 March 2004.

The accession negotiations with the ten countries set to join on 1 May 2004 were in principle completed during the Copenhagen European Council in 12 and 13 December 2002 and the Treaty of Accession was signed on 16 April 2003. The accession negotiations focused on the terms, under which the applicants will adopt, implement and enforce the *acquis*, and, notably, the granting of possible transitional arrangements which must be limited in scope and duration. Under similar arrangements in previous accession negotiations, new Member States have been able to phase in their compliance with certain laws and rules by a date agreed during the negotiations.

All accession countries requested transitional measures and a limited number of derogations, mainly in the field of VAT and excises. One country put forward a request for a transitional arrangement in the field of direct taxation. The level of rates was certainly the most sensitive issue for candidate countries during negotiations. The application of VAT zero-rating and/or the scope of the application of the reduced VAT rate did to some extent differ from the *acquis*, and in most cases excise duty rates were considerably lower than the minimums required under the *acquis*. Governments feared the economic and social implications of significantly raising rates -and hence prices- of socially sensitive goods by accession. Therefore, all candidate countries requested transitional periods on specific goods or services, aiming at stretching over a longer period of time the rate adjustment and at reducing its economic and social impact.

In considering whether transitional measures could be accepted, the EU took into consideration the need to safeguard the proper functioning of the internal market in the field of taxation, as well as the political, economic and social implications for the candidate countries. As a result, some transitional arrangements, limited in time, or derogations from the *acquis* could be accepted, insofar as the impact on competition or on the internal market was considered to be limited, and a social need for candidate countries was clearly demonstrated.

For details of the transitional measures and derogations agreed for the different accession countries see:

<http://europa.eu.int/comm/enlargement/negotiations/chapters/chap10/index.htm>

In parallel with the accession negotiations, in which the acceding Countries committed themselves to comply with the principles of the Code of Conduct for Business Taxation and, notably, to introduce only new tax measures which are in conformity with these principles, the Commission undertook to assess an established list of tax measures in the acceding Countries as to whether these could be considered as being harmful under the Code of Conduct. Following a report from the Commission of 6 June 2003, the Council concluded on 9 October 2003, which tax measures were harmful and which must be eliminated or amended in order to bring the corporate tax systems of the acceding Countries in line with the principle of the Code of Conduct by the date of accession. 52 potentially harmful tax measures were considered of which 30 were assessed as being harmful. With regard to 27 of these 30 harmful tax measures, the proposed changes were considered adequate.

Following the signature of the Accession Treaty on 16 April 2003, new tax *acquis* has been adopted, which has prompted the acceding Countries to request additional transitional arrangements. Following a comprehensive assessment of these requests, the Commission will shortly presents its position on these requests for transitional measures.

In line with the Copenhagen European Council of December 2002, the Commission has continued monitoring the preparations of the acceding Countries for EU membership, and will continue to do so until accession. As part of the monitoring, the Commission adopted on 5 November 2003 Comprehensive Monitoring Reports on each of the acceding Countries (and Regular Reports on Bulgaria, Romania and Turkey)⁴⁵. The Comprehensive Monitoring Reports identified for each country the state of preparedness for membership. Overall the Commission found that the preparedness for membership was very advanced and that the acceding Countries should be able to fulfil their obligations and commitments from accession without foreseeable problems in most areas.

6.2 Technical assistance

Technical assistance (TA) activities to third countries in the field of taxation have primarily been focussed on supporting the Candidate Countries in their preparations for EU membership. The core strategic objectives in the Taxation pre-accession strategy are to provide support to policy makers responsible for taxation and in creating:

- an overall modernisation strategy for the administrations concerned,
- a legal framework in accordance with the EU's pre-accession strategy,
- administrations that have the operational capacity to apply and enforce the Community taxation *acquis*.

Increasingly, the focus has been on administrative capacity.

In 2003, the major part of the activities consisted of ensuring proper tax expertise in the definition and implementation of the TA projects financed via the Phare National Programmes (managed by the Enlargement Directorate General in the European Commission). Twinning, which is an agreement between one or several Member State(s) and a candidate country to implement a specific programme, has remained the most common tool for providing TA. Other forms of TA, such as 'twinning light', with reduced administrative requirements, have also been used, especially for remaining specific needs which have to be addressed swiftly before accession.

A specific issue, to which particular attention has been paid, is the situation concerning IT interconnectivity and inter-operability. In order for the Internal Market to function properly without fiscal frontiers, candidate countries must have several IT systems in place before accession which are compatible with the EU systems. The most important system in the field of taxation is the VIES system (Value Added Tax Information Exchange System) whereby information for VAT purposes on intra-Community trade is exchanged via a secured network (CCN/CSI), which ensures the transfer of the data between Member States.

Monitoring (and assistance) missions to assess the situation concerning interconnectivity and IT operational capacity have been carried out in all the 13 candidate countries (except Turkey) during 2003. Progress has been made, but for a couple of countries continued, determined

⁴⁵ http://europa.eu.int/comm/enlargement/report_2003/index.htm#comprehensive

efforts are required in order to meet the deadline. Close monitoring of these countries will be continued.

7 FISCAL STATE AID DECISIONS

The State aid provisions of the EC Treaty provisions apply when a tax measure is discriminatory and provides an advantage only to certain enterprises, or certain activities. The Commission has been given the exclusive power under the Treaty to take decisions on whether or not aid granted by Member States is compatible with the Treaty. The Commission may require that illegally granted aid be repaid by recipients to the public authorities which granted it. The Member State must recover the aid immediately in accordance with domestic procedures. Commission decisions can be challenged before the European Court of Justice. On application by a Member State, the Council may, acting unanimously, decide that aid which that State is granting or intends to grant shall be considered compatible with the common market, if such a decision is justified by exceptional circumstances.

For decisions on fiscal state aid cases see the state aid register on the website of the Directorate General for Competition of the European Commission at:

http://europa.eu.int/comm/competition/state_aid/register/ii/#by_instrument

8 INFRINGEMENT PROCEEDINGS LAUNCHED BY THE COMMISSION

The Commission is the ‘guardian of the Community Treaties’. It monitors the Member States’ application and implementation of primary and secondary Community legislation, institutes infringement proceedings in the event of any violation of Community law (Article 226 EC) and, if necessary, refers the matter to the Court of Justice. The Commission also intervenes if Community law is infringed by any natural or legal person and imposes heavy penalties. Over the last few years, efforts to prevent abuse of Community rules have become a major part of the Commission’s work.

The Twentieth Annual Report on monitoring the application of Community law (2002) was published in November 2003⁴⁶.

See also the following press releases on infringements on the website of the Directorate General for Taxation and the Customs Union at:

http://europa.eu.int/comm/taxation_customs/publications/official_doc/press_releases_2002_en.htm#IP2002

January 2003

- VAT - infringement procedures against Belgium, France and Spain
- Capital gains tax on shares: Commission decides to refer Spain to Court over discrimination
- Car tax: infringement procedures against Greece and Denmark

http://europa.eu.int/comm/secretariat_general/sgb/droit_com/pdf/rapport_annuel/20_rapport_annuel_en.htm

February 2003

- Tax on company capital: Commission to take Italy to Court of Justice
- Pension taxation: Commission tackles discrimination against foreign pension funds in six Member States

April 2003

- Recovery of tax claims infringement procedures against Portugal and Italy

July 2003

- Taxation: recovery of tax claims - infringement proceedings against Belgium and Portugal
- VAT : infringement proceedings against Germany and Austria for restrictions on the right of taxable persons to deduct VAT
- Corporate taxation: infringement proceedings against Italy for misapplying the Directive on exchanges of shares
- Taxation: Germany and Austria must end discrimination against foreign investment funds; Commission seeks information from France
- Vehicle taxation: Commission takes Denmark to court and asks Greece to stop discrimination
- Pensions taxation: Commission decides to refer Denmark to Court over discrimination and to open infringement procedures against the UK and Ireland

December 2003

- Excise duties: Commission refers Germany to Court over taxation of "hand made" cigarettes
- VAT: Commission asks France to end double taxation of second-hand vehicles from other Member States
- Pension taxation: Commission requests Belgium, Portugal, Spain and France to end discrimination against foreign pension funds

9 EUROPEAN COURT OF JUSTICE JUDGEMENTS

For judgements of the European Court in 2003 in the tax field see the website of the ECJ at <http://curia.eu.int/en/index.htm>.

See also website of the Directorate General for Taxation and the Customs Union at http://europa.eu.int/comm/taxation_customs/law_en.htm#judgements

10 ACTIVITIES OF THE EUROPEAN PARLIAMENT

The European Parliament always provides its opinion on Commission proposals in the tax field. In most other fields, there has been a movement from unanimity voting in the EU Council to co-decision between the EU Council and the European Parliament and this is to become the general rule under the draft Constitution. The Commission's 2001 proposal for a Decision for the Member States to commit themselves to computerising the documents that accompany products subject to excise duty was made on the basis of co-decision by the Council and the European Parliament and the Council adopted its common position on this basis at the ECOFIN Council on 21 January 2003.

The Parliament adopted positions in Plenary in 2003 on the following Commission tax proposals and Communications mentioned earlier in the report – for further information see website of the Parliament at http://www.europarl.eu.int/home/default_en.htm

- report Kauppi: 2nd reading on the proposal for the computerisation of movements of excisable goods
- report Rapkay – proposal concerning VAT on gas and electricity
- report Torres Marques – proposal concerning VAT on travel agents
- report Kauppi - change of legal basis of the proposal concerning administrative cooperation in the field of VAT
- report Jonckheer – re-consultation of the Parliament concerning the proposal on energy taxation
- report Purvis – proposal concerning excise duties on tobacco in Corsica
- report Honeyball – Communication concerning passenger car taxation
- report Kauppi (rejection of) proposal concerning excise duties on diesel used for commercial purposes
- report Randzio-Plath – proposal concerning reduced VAT rates
- report Blokland – proposal concerning VAT implementing powers
- report Karas – proposal for an amendment to the "parent/subsidiaries" directive
- report Schmidt (1st rejection of proposal concerning VAT on postal services, but still pending in EP)

Parliamentary Questions on tax subjects are found on the Parliament's database at http://www.europarl.eu.int/questions/default_en.htm

The Commissioner for Taxation and the Internal Market, Frits Bolkestein, briefed the Parliament regularly on tax developments.

11 ACTIVITIES OF THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE (ECOSOC)

This Committee is also required to provide its opinion on Commission proposals in the tax field. It can also provide opinions in the taxation field at its own initiative. See website at: <http://www.esc.eu.int/pages/en/home.htm>

12 ACTIVITIES OF THE COMMITTEE OF THE REGIONS

The Committee of the Regions adopts opinions on tax proposals that have regional implications. See website at <http://www.cor.eu.int/home.htm>

13 TAX PUBLICATIONS OF THE EUROPEAN COMMISSION IN 2002

13.1 Speeches

- *Frits Bolkestein, Commissioner for Taxation and the Internal Market*⁴⁷

"EU Corporate Tax Reform: Progress and New Challenges" - Opening address at European Commission Conference on Company Taxation, Ostia (Rome), 5th December 2003

- *Robert Verrue - Director General, to the Conference on "Multinational enterprise taxation in the European Union"; Sienna, Italy, 25 January 2003*

« International tax competition and co-operation between tax administrations⁴⁸ »

13.2 Publications produced by the Directorate General for Taxation & the Customs Union

- Study carried out on behalf of the European Commission by PriceWaterhouse&Coopers finalised on 17 January 2003 on the simplification and modernisation of VAT obligations. The Commission has launched a consultation of European companies on the basis of the study, requesting comments by 31 December⁴⁹.
- Survey⁵⁰ on economic and environmental impacts of energy taxation, February 2003
- Survey on the taxation of the European Company (SE) in the EU Member States (April 2003, in English only)⁵¹
- VAT rates in existing and accession Member States⁵² (May and October 2003)
- Report of outcome of the Commission's public consultation on the rules on the place of supply of services for VAT purposes⁵³
- « The Structures of the Taxation Systems in the European Union from 1995 to 2001⁵⁴ », 13 June 2003, published by the Commission's Taxation and Customs Union

⁴⁷ All tax speeches by Commissioner Bolkestein are available on the website of the Directorate General for Taxation and the Customs Union at http://europa.eu.int/comm/taxation_customs/speeches_en.htm

⁴⁸ http://europa.eu.int/comm/taxation_customs/speeches/speech_siena.pdf

⁴⁹ http://europa.eu.int/comm/taxation_customs/taxation/consultations_en.htm

⁵⁰ http://europa.eu.int/comm/taxation_customs/taxation/economictaxation_final_report.pdf

⁵¹ http://europa.eu.int/comm/taxation_customs/taxation/company_tax/developments.htm

⁵² http://europa.eu.int/comm/taxation_customs/publications/info_doc/info_doc.htm#vat_rates

⁵³ http://europa.eu.int/comm/taxation_customs/taxation/consultations/supply/supply_en.htm

⁵⁴ http://europa.eu.int/comm/taxation_customs/publications/other/varia.htm#structures

Directorate-General and Eurostat, the EU's statistical office. This Study presents a unified statistical framework that makes it possible to monitor the evolution of national taxation systems and the levels of the tax burdens in the different Member States and in the Union as a whole. It also presents statistical indicators of the average effective tax burden on labour, consumption and capital.

- Consultation paper⁵⁵ and summary report⁵⁶ on the results of the open consultation on « The application of International Accounting Standards (IAS) in 2005 and the implications for the introduction of a consolidated tax base for companies' EU-wide activities ».
- Consultation paper⁵⁷ and summary report⁵⁸ on the outcome of the Commission's Taxation and Customs Union Directorate-General consultation on "The experimental application of *Home State Taxation* to small and medium-sized enterprises in the EU".
- Provisional Draft Recast of the Sixth VAT Directive, July 2003. This document does not necessarily reflect the views of the European Commission, nor does it signify that the Commission is committed to any official initiative in this area. The Commission launched a public consultation to invite comments on the text. The deadline established was 26 September 2003⁵⁹. The Commission will have regard to these comments in drawing up the proposal that it will present in 2004.
- The excise duty rates applicable in Accession States and Candidate countries⁶⁰ - situation in July 2003
- VAT in the European Union and the Accession Countries - basic information on the application of VAT for the use by administrations, business, information networks, etc. Application in the Member States (updated July 2002; UK information updated December 2003; country tables updated October 2003)⁶¹
- Environmental taxes in the European Union 1998-2001. Joint paper with Eurostat. Series "Statistics in Focus", Eurostat, Theme 8, No. 9/2003⁶².
- The excise duty rates applicable in the EU Member States – situation in December 2003⁶³
- "Inventory of taxes in the Member States of the European Union – updates for Austria, Belgium, Denmark, France, Greece, Italy and Luxembourg⁶⁴
- Guidance (December 2003) on application of new VAT Invoicing Rules in force from 1 January 2004⁶⁵

⁵⁵ http://europa.eu.int/comm/taxation_customs/taxation/consultations/iaspaper06feb2.pdf

⁵⁶ http://europa.eu.int/comm/taxation_customs/taxation/consultations/ias.htm

⁵⁷ http://europa.eu.int/comm/taxation_customs/taxation/consultations/pilotproject_sme_0203_en.pdf

⁵⁸ http://europa.eu.int/comm/taxation_customs/taxation/consultations/home_state_sme.htm

⁵⁹ http://europa.eu.int/comm/taxation_customs/taxation/consultations/recast_6th/recast_6th_en.htm#Recast

⁶⁰ http://europa.eu.int/comm/taxation_customs/publications/info_doc/taxation/c4_excise_table_acce.pdf

⁶¹ http://europa.eu.int/comm/taxation_customs/publications/info_doc/info_doc.htm#VAT plus

http://europa.eu.int/comm/taxation_customs/taxation/economictaxation_summary.pdf

⁶² http://europa.eu.int/comm/taxation_customs/publications/other/varia.htm#environment

⁶³ http://europa.eu.int/comm/taxation_customs/publications/info_doc/taxation/c4_excise_tables.pdf

⁶⁴ http://europa.eu.int/comm/taxation_customs/publications/info_doc/info_doc.htm#TAXATION

⁶⁵ http://europa.eu.int/comm/taxation_customs/taxation/e_invoicing/e_invoicing_rules_en.htm

13.3 Publications produced in other areas of the Commission

- How much has labour taxation contributed to European structural unemployment? European Economy Economic Papers No. 183. April 2003. European Commission. Brussels.⁶⁶
- Foreign ownership and corporate income taxation : an empirical evaluation⁶⁷. European Economy Economic Papers No. 185, European Commission, June 2003.

14 CONFERENCES AND SEMINARS ORGANISED BY THE EUROPEAN COMMISSION

14.1 Conference on company taxation: Rome, 5-6 December

The Commission hosted a conference on "EU Corporate Tax Reform Progress and New Challenges" together with the Italian Presidency of the EU's Council of Ministers on 5 and 6 December in Rome. The objective of the Conference was to assess the progress that has been made in EU corporate tax co-ordination since October 2001 when the Commission proposed a two-track strategy for removing the tax obstacles in the Internal Market including a single consolidated tax base for the EU-wide activities of companies. The Commission presented its follow-up Communication of 25 November on this subject (see 1.2 above) at the Conference.

14.2 Fiscalis Seminars (Co-operation between tax administrations under the Fiscalis programme):

- Excises – calculation of guarantees and rules on treatment of losses, 2-4 June, France
- New VAT invoicing legislation, 2-4 July, Sweden
- The transitional VAT regime and intra-community transport of goods and related services, 28 September – 3 October, Ireland
- E-services, 14-16 October, Denmark
- Risk Analysis Training, 3-7 November, United Kingdom
- Heads of CLO (National Heads of VAT mutual assistance), 12-14 November, Greece
- Transfer Pricing and EU Arbitration Convention, 17-20 November, Lithuania
- Special VAT Schemes, 24-28 November, Belgium
- VAT treatment of services in the general interest, 4-5 December, Portugal
- Use of the Common Communications Network and Common Systems Interface ("CCN/CSI") for direct taxation information exchange, 10-12 December, Spain
- VAT Car Fraud, 17-19 December, France

⁶⁶ http://europa.eu.int/comm/economy_finance/publications/economic_papers/economicpapers183_en.htm

⁶⁷ http://europa.eu.int/comm/economy_finance/publications/economic_papers/economicpapers185_en.htm

ANNEX

GENERAL COMMISSION INITIATIVES WITH A SIGNIFICANT TAX DIMENSION

Future of Europe

Based on the draft Constitution adopted by the European Convention under Valéry Giscard d'Estaing, the Intergovernmental Conference (IGC) on a Constitutional Treaty for the EU began on 4 October 2003. One topic of discussion is the question of introducing qualified majority voting in the area of taxation. At present, the general rule is that EU Member States must agree tax proposals unanimously before they can be adopted.

The European Commission has proposed that there should be a move from unanimity to qualified majority voting for proposals in a limited number of tax fields, essentially proposals necessary for the proper operation of the Internal Market, proposals to combat tax fraud and evasion and proposals related to the protection of the environment.

The website "Taxation and the Intergovernmental Conference"⁶⁸ presents:

- the European Commission's position to the IGC and
- the positions taken by the Commission and other participants to the debate on taxation that took place in the Convention on the Future of Europe that provided a basis for the IGC discussions.

Internal Market Scoreboard

The Internal Market Scoreboard⁶⁹ published on 5 May 2003 illustrated, inter alia, how differing rates, bases, and systems of taxation in the areas of corporate taxation, Value Added Tax (VAT), motor vehicles, and occupational pensions prevent the Internal Market from delivering its full potential.

Internal Market Strategy

The Commission on 7 May 2003⁷⁰ presented its Internal Market Strategy 2003-2006, a ten-point plan to make the Internal Market work better, building on the 2.5 million jobs and €877 billion of wealth it has already created since Europe's frontiers were dismantled at the end of 1992. The Strategy aims to respond to the challenges of enlargement and an ageing population and to keep Europe on course to become the world's most competitive economy by 2010. Particular priorities include improving the implementation and enforcement of Internal Market law, making the free movement of services into a practical reality, removing remaining obstacles to trade in goods and building genuinely European public procurement markets. In the tax area, the Commission announced that it would propose revisions of the Parent/Subsidiary Directive and of the Mergers Directive (now done), to eliminate double taxation within the EU and reduce certain tax charges. It would also explore different options for introducing a common consolidated corporate tax base at EU level and to simplify VAT rules so that businesses established in one Member State but supplying products and services in several others could pay VAT in their home country only. On vehicle taxation, the Strategy argued for registration tax to be replaced by increased road and fuel taxes.

⁶⁸ http://europa.eu.int/comm/taxation_customs/taxation/igc_taxation/igc_taxation_en.htm

⁶⁹ http://europa.eu.int/comm/internal_market/en/update/score/index.htm

⁷⁰ http://www.europa.eu.int/comm/internal_market/en/update/strategy/index.htm

Tax state aid: Commission takes stock

The Commission on 26 November 2003⁷¹ adopted a report on the action taken by it in the field of tax aid. The report deals first with the supporting role played by the 1998 notice on tax aid in the Commission's monitoring of state aid and concludes that the notice proved to be a suitable tool. It also looks at the relationship between the monitoring of state aid and the measures taken to tackle harmful tax competition. Lastly, it considers the question of indirect taxation, which, in principle, is not covered by the 1998 notice.

⁷¹ http://europa.eu.int/comm/competition/state_aid/legislation/aid3.html#fiscal_aid