



THE EUROPEAN  
UNION  
EXPLAINED

# Taxation

Promoting the  
internal  
market and  
economic  
growth

Towards simple, fair and efficient  
taxation in the European Union.



# THE EUROPEAN UNION EXPLAINED

*This publication is a part of a series that explains what the EU does in different policy areas, why the EU is involved and what the results are.*

*You can find the publications online:*

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### The European Union explained: Taxation

European Commission  
Directorate-General for Communication  
Citizens information  
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## Why do we need to address taxation matters at EU level?

Taxation is central to national sovereignty. Tax revenues provide governments with the money they need to exist and function effectively. In addition, tax laws reflect the fundamental choices of different EU countries in important areas of public expenditure, such as education, health and pensions. They influence private consumption and savings and set a financial framework for business activity and environmental issues. This is why the power to raise taxes and set tax rates lies with national governments.

So what role can the EU play in making taxation fairer, easier, and more efficient for governments, companies and citizens?

### Ensuring fairness

First of all, taxation needs to be fair. This is not always easy to ensure, even at national level. It becomes a real challenge, however, when it comes to cross-border activities. Tax laws should not give businesses in one country an unfair advantage over competitors in another one. And the tax laws of one country should not allow people to escape taxation in another. That's why the countries of the European Union have agreed on several rules to tackle these issues.

More and more companies and individuals are active in several countries, making it potentially easier to

use legal means to pay the least tax possible ('tax avoidance') or to not pay taxes due ('tax evasion'). A single country cannot solve these problems on its own. This is why in recent years the countries of the EU have cooperated more closely to tackle the problems of tax avoidance and tax evasion and to ensure the fairness of taxation systems.

### Making the internal market function better

The European internal market, also referred to as the single market, allows people and businesses to move and trade freely across the 28-nation group. However, the co-existence of different tax systems still makes life difficult for companies and individuals operating across borders. In some cases the tax laws may discriminate against foreign taxpayers or foreign income. But if they do there are EU laws in place to deal with the problem.

In other cases, the individuals and companies may face taxation and compliance burdens in each of the countries involved leading to a very high overall level of taxation. This problem cannot be tackled under current EU law. That's why EU countries need to cooperate closely. Agreement on simplifying certain tax rules, and eliminating inefficiencies, could contribute to ensuring the free flow of goods, services and capital around the EU.



*Whether football or business: clear rules ensure fair competition.*



*The internal market in practice: the Netherlands exports 630 million tulip bulbs per year to other European countries.*

## Promoting growth

Policy decisions made by one country may affect neighbouring countries either in a positive or in a negative way. That's why the countries of the EU have agreed to cooperate in the preparation of their national budgetary and economic plans. The overall objective is to put public finances on a surer footing, promote stronger economic governance and discipline, and make fundamental structural reforms to boost competitiveness. This work also includes assessing how tax policy can help in achieving these goals.

## In short

National governments are broadly free to design their tax laws according to their national priorities. However, in doing so, they must respect certain fundamental principles, such as non-discrimination and respect for free movement in the internal market. The EU supplements this with cooperation procedures and a legal framework to ensure the fair and efficient taxation of cross-border activities in the EU.

### Does the EU impose taxes?

*No, the EU does not impose taxes. This is done solely at the level of each country. The EU budget is funded almost entirely by 'own resources'. These include direct contributions from each country, customs duties and a very small share of national VAT revenues. The countries of the EU decide together on the types and maximum amounts of these 'own resources'.*

# How the European Union takes action in the tax area

## Legislation

Tax legislation is mainly decided by each country of the EU at national level. The European Commission can present proposals for tax legislation where it considers EU-wide action is needed for the internal market to work properly. It can also make recommendations and issue policy guidance in specific areas. The European Commission makes sure in all cases that:

- action at EU level would achieve a better result than if EU countries acted alone (the 'subsidiarity' principle); and
- the initiative proposed does not go beyond what is necessary to address the problem identified (the 'proportionality' principle).

Any European Union tax legislation must be unanimously agreed by all EU countries before entering into force. This makes sure that the interests of every single EU country are taken into account.

## Consulting the public

*Before proposing new legislation or other tax policy initiatives, the European Commission seeks input from people, businesses, trade associations, unions and others. This is generally achieved via public consultations. Consultations are also used to obtain information about specific tax problems. How often do these problems occur? What is their impact on taxpayers, EU countries' budgets and the EU's internal market? The Commission might also ask for suggestions about how to solve these issues.*

## **We distinguish between direct and indirect taxation.**

Direct taxes are imposed upon a person, a company or entity or a property. These include, for instance, income tax and company tax. Indirect taxes, by contrast, are imposed upon a transaction, such as value added tax (VAT) on sales of goods and services and excise duties on alcohol and tobacco.

Legislation in the direct tax area is limited to bringing the different laws in each EU country more in line with each other (approximation of laws). This can only be done to the extent necessary to improve the functioning of the European Union's internal market and address common cross-border challenges such as tax evasion.



*What you see: four friends having a good time in a beer garden in Munich. What you don't see: the EU fosters fair trade by harmonising excise duties on beer.*

Legislation in the indirect tax area may involve harmonising national laws. Tax rules for goods and services that differ too much can distort competition between businesses and make it difficult to buy and sell products across borders.

## Policy statements and recommendations

The Commission can issue policy statements and recommendations. They are not legally binding, but rather suggest actions that EU countries could take in the tax area. They can also highlight best practices in tax matters that EU countries might consider adopting.

## European semester — Country-specific recommendations

The economic crisis highlighted how intertwined our economies are, and how important it is to work together if we want to promote sustainable growth in Europe. As a result, the EU countries agreed to coordinate their economic policies closely, through a process known as the 'European semester'. In the context of this stronger economic coordination between EU countries, the European Commission issues country-specific recommendations each year. In tax policy, these recommendations focus on how national tax systems could be made fairer, more efficient and more growth-friendly.

Why not have a look at the **recommendations addressed at your country?**



## State aid

The European Commission is responsible for examining whether or not state aid granted by EU countries gives any company, sector or person an unfair advantage over their competitors. This also covers state aid given by way of tax reductions. An example of an illegal tax state aid could be offering lower tax rates to domestic companies compared to foreign ones. The Commission can insist that any illegal aid be abolished and that the benefits from it be repaid.

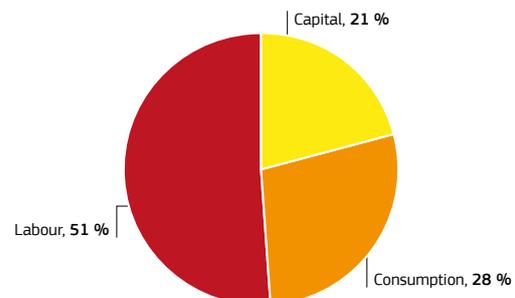
## Decisions of the Court of Justice of the EU

The Court of Justice of the EU interprets European Union law to make sure it is applied correctly. In doing so, it often requires EU countries to make changes to their tax laws. There are two ways in which the Court can be asked to examine tax laws.

**National courts** may refer a national tax provision to the Court for a 'preliminary ruling'. This means they are asking if a national law is compatible with EU law.

**The European Commission** may refer a case to the Court if it believes that an EU country is breaching EU rules. The Commission will only do this if that country has failed to amend its law when requested to do so.

SOURCES OF TAX REVENUE IN THE EUROPEAN UNION (2012)



*Labour taxation is still high in most EU countries. The EU recommends shifting the focus to growth-friendly bases, such as environmental taxes.*

## What the EU is doing



*Riding a Danube liner from Germany to its mouth in Romania will bring you in touch with many different national VAT systems.*

### Value added tax (VAT)

Until the 1970s, each EU country had their own individual system for taxing the production and consumption of goods and services. This made it very difficult to do business across borders and created competitive distortions between suppliers. In 1977, things changed for the better. EU countries agreed on a common set of tax rules for goods and services and a general framework of rates. That was the start of the EU VAT system.

VAT is a consumption tax, charged on most goods and services sold in the EU. Under the European VAT system, only the end consumer is ultimately taxed on the goods or services. Businesses involved in the supply chain are, in most cases, required to apply VAT when selling on to the next customer in the chain. But they can also deduct the VAT on the cost of the materials and other goods or services that they themselves have used.

VAT is a major source of revenue for national budgets, and this common system of taxing goods and services is crucial for the internal market.

The existing VAT rules for determining the **place of taxation** are quite complex.

With EU countries, the European Commission is working towards a destination-based EU VAT system for all goods and services which would ensure that tax revenues are received by the EU country where the customer is located. There are many ways in which this can be designed and implemented. The Commission is now assessing the impact of several options for businesses and for EU countries. Based on its findings, it will present the possible way forward in 2015.

The European Commission is also working on adapting the VAT system better to the needs of the internal market, and on simplification methods such as allowing companies to use common VAT declarations and to fulfil all their compliance obligations in one country.

### Excise duties

Excise duties are indirect taxes on the manufacture, sale or use of certain products such as:

- alcoholic beverages;
- tobacco products;
- energy products (for instance, motor and heating fuels, such as petrol and gasoline, electricity, natural gas, coal and coke).



*Positive side effects: excise duties on tobacco products may encourage people to stop smoking.*

When the internal market was established in 1993, tax controls at the borders between EU countries were abolished. EU countries, therefore, agreed on some common rules to facilitate cross-border trade of these products while reducing the scope for distortions.

The excise legislation concerns, for instance:

- the minimum rates that EU countries have to apply;
- the scope for possible exemptions;
- general rules for producing, storing and moving these goods around the EU.

EU excise duty rules may also support other policies, such as discouraging smoking. Special provisions, such as reduced rates, are also included for disadvantaged industries and areas in the EU.

## Taxes on the financial sector

EU countries and their citizens want to ensure that the financial sector makes a fair contribution to public finances. Moreover, it is generally agreed that the sector should pay back at least part of what European tax payers pre-financed in the context of recent bank rescue operations.

Many EU countries introduced, or considered introducing, their own financial transaction tax. However, there are drawbacks to isolated national initiatives in this area. They may lead to a fragmentation of the internal market for financial services. And they may have undesired side effects such as double taxation or double non-taxation. For those reasons, the Commission proposed a common system of financial transaction tax for the EU. Through a special procedure known as ‘enhanced cooperation’, 11 EU countries are now negotiating the details of the common financial transaction tax, with a view to reaching a compromise agreement on the application of the tax in those countries.

## Car taxation

At present, there are no EU-wide rules on car registration and circulation taxes. Countries may levy these taxes or not, but if they do so they must apply them in a non-discriminatory way. The European Commission has published documents to clarify how general EU law impacts on EU countries’ rules on the taxation of cars moved from one country to another. The European Commission has also made recommendations to improve the functioning of the internal market, in particular to avoid double taxation of cars moved from one EU country to another and to remove obstacles to cross-border car rentals.



*Tallinn business district: Estonia is one of the 11 countries ready to adopt a European financial transaction tax.*



*Live where it's beautiful: in Crete (Greece) or anywhere else you like. Double taxation should not get in your way.*

## Personal taxation

Personal taxes (for instance, taxes on the income of individuals) are mainly the responsibility of the individual EU countries. However, they may constitute barriers to mobility in Europe. Individuals who move from one EU country to another or who invest or inherit across borders can face taxation in two or more EU countries as well as other difficulties such as complicated compliance obligations. There are treaties in place between most EU countries that are supposed to eliminate double taxation but they may not cover all taxes or all cross-border situations and may not be applied effectively in practice. The Commission is working in several ways to resolve these problems. In particular it is trying to get more information on the precise tax problems that arise in cross-border situations and the extent of these problems, in order to propose solutions.

In recent years, the Commission started investigating national tax provisions, applicable to cross-border and mobile workers and inheritance tax laws. If discrimination or other breaches of European law are found, legal proceedings may follow. The Court of Justice of the EU has ruled several times that EU countries must eliminate tax discrimination in their national laws.

*The Court of Justice has ruled that an EU country cannot discriminate when applying inheritance tax like, for example, allowing a tax deduction from the value of an estate if the deceased lived in that country but denying the deduction if the deceased resided in another EU country prior to death.*

## Company taxation

Company taxation is another area where EU countries decide on their own tax rules. However, there are certain areas in company taxation which require an EU approach in order to remove obstacles to the internal market, to ensure fair tax competition and to tackle common challenges, such as corporate tax avoidance.

An important focus of EU legislation on company tax is to eliminate double taxation i.e. where a company is taxed twice (or more) on the same income by different EU countries. Here are some examples.

- The interest and royalties directive eliminates withholding taxes on cross-border interest and royalty payments between associated companies that are resident in two different EU countries.
- The parent and subsidiary directive prevents double taxation of the parent company on the profits of its subsidiary located in another EU country.
- The merger directive simplifies taxation of activities aimed at restructuring companies situated in two or more EU countries.
- The EU Arbitration Convention establishes a procedure to resolve disputes where double taxation occurs between enterprises of different EU countries.

An equally important focus of EU company taxation work is tightening EU tax law and EU countries' legislation so as to curb tax planning, profit shifting and abuse of law; this includes, for example, improving transparency on cross-border tax rulings.

*The Commission's proposal for a common consolidated corporate tax base (CCCTB) would allow companies operating within the EU to use a single set of rules to calculate their taxable profits. It would therefore greatly simplify life for businesses working in more than one EU country. Moreover, the CCCTB could also serve as a powerful anti-tax avoidance tool, as it would shut down many of the current opportunities companies have to shift profits and minimise the taxes they pay.*

## Digital economy

The European Commission is examining the best ways of taxing the digital economy in the EU. This means fostering a business-friendly environment and removing tax obstacles that might discourage investment and growth while ensuring that the digital sector contributes fairly to public finances.

## Combating tax avoidance and evasion

Collecting taxes is the competence of each individual EU country. And it is also for national authorities to deal with those who do not pay the taxes they owe. However, tax avoidance and evasion are complex problems which extend beyond borders. EU countries

need to work closely together to tackle these problems at home and abroad.

European legislation and bilateral tax treaties provide for cooperation and information exchange between EU countries. To further strengthen the fight against tax fraud and tax evasion, the European Commission presented an action plan in 2012, with over 30 planned actions in this area. There are now several EU initiatives in place or under development, such as:

- a platform for tax good governance to monitor EU countries' progress in tackling aggressive tax planning and in clamping down on tax havens;
- EU rules whereby each EU country automatically passes to other EU countries information it has on the income or financial accounts of individuals resident in those other EU countries;
- a quick reaction mechanism to combat VAT fraud;
- rules for assistance between EU countries in recovering claims for taxes, customs duties and certain fees as well as taxes on income, capital and insurance premiums;
- cooperation to combat VAT fraud through the use of information exchange systems to alert other EU countries of fraudulent activities.



*The digital economy is growing fast. Tax legislation needs to keep pace.*



©Fotolia/moodboard

*Racing for better taxation in Europe: cooperation is key.*

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*EU countries have signed up to a code of conduct for business taxation. This is an important tool for ensuring fair tax competition in the EU. The code is not a legally binding instrument, but it clearly does have political force. Under the code, EU countries commit to amending or eliminating any harmful tax measures, and to refraining from introducing such measures in the future.*

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## Cooperation programme between EU countries

Through the **Fiscalis 2020** programme, the Commission provides support to EU countries in the administration of their tax systems. This includes providing forums for the exchange of best practices and cooperation between EU countries in several areas, including financial income, employment income, capital income, VAT and excises.

## International cooperation against tax evasion

EU countries and the European Commission also work at international level to push for stronger global standards against tax evasion and avoidance.

The EU contributes actively to the work at the Organisation for Economic Cooperation and Development (OECD) to define international tax policy. Major advances have been made at this level, notably a new global standard for automatic exchange of financial account information and a project to reshape international corporate tax rules against avoidance.

The EU has arrangements with five neighbouring non-EU countries (Andorra, Liechtenstein, Monaco, San Marino, and Switzerland), which provide for the exchange of information for tax purposes. EU countries also have similar agreements with the dependent and associated territories of the United Kingdom and the Netherlands outside the EU.

Finally, the EU's international agreements with non-European countries include clauses which commit those countries to 'good governance' standards in tax matters. This essentially means agreeing to exchange tax information with EU countries and eliminating harmful tax measures.

## The way ahead

People, goods, capital, services and companies in Europe are on the move. It follows that EU countries cannot operate their tax systems in isolation from each other or from the rest of the world.

In the wake of the economic crisis, European and international efforts to combat tax avoidance and evasion have increased and are likely to be stepped up further. As a result, tax dodgers will have a tougher time, no matter where they are resident or where their assets are located.

At the same time, European tax policy aims at facilitating free movement of people, goods, services and capital. The European Commission will continue to work on eliminating tax obstacles to free trade in Europe and internationally. It will continue to help EU countries grow and prosper.



*Rotterdam harbour: Europe's largest door to world trade.*

## Find out more

- ▶ **Detailed information on EU tax and customs policies (in English, French and German):**  
[http://ec.europa.eu/taxation\\_customs/index\\_en.htm](http://ec.europa.eu/taxation_customs/index_en.htm)
- ▶ **Help and advice for EU nationals, including tax issues:** [http://europa.eu/youreurope/citizens/index\\_en.htm](http://europa.eu/youreurope/citizens/index_en.htm)
- ▶ **Solutions to your problems with EU rights:** <http://www.solvit.eu>
- ▶ **Country-specific recommendations:**  
[http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/index\\_en.htm](http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/index_en.htm)
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