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Tax Harmonization and Competition in the European Union

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Abstract
This paper presents a comprehensive review and analysis of tax harmonization and tax competition in the European Union. It is shown that while tax burdens in the European Union have increased substantially in the past 35 years, they did not converge. Also, there is no evidence of the 'race to the bottom' in taxing income from capital. However, small European Union country members tend to set lower effective tax rates than larger member countries. There is also a trend to abolish imputation systems in favour of a schedular tax on distributed profits.

I. INTRODUCTION

Economic integration in the European Union (EU) has progressed to a considerable extent culminating in the launch of Economic and Monetary Union (EMU) in 1999. Tax integration, however, has been relatively limited. Tax competition has attracted increasingly international attention, also within the EU. In itself, tax competition is

These criteria are consistent with the nature of the tax poaching schemes that are the object of the OECD's work: schemes that impede the ability of home countries to enforce their own tax laws.

Tax havens are often, but not always, somewhat peripherally located countries with extremely favorable tax regimes for certain groups of taxpayers. Examples are the Netherlands Antilles, the Bahamas, and the Cayman Islands. Examples in Europe are Andorra, Monaco, and the Channel Islands. Private investors who shelter their wealth in these tax havens do not pay income tax, wealth tax, or legacy duties provided that they are prepared to practice fraud by hiding their wealth and its returns for the tax man in their own country. The OECD does not confine itself to classic tax havens, but also targets harmful tax practices in industrialized countries. Virtually every industrialized country has certain favorable tax facilities to divert savings, financial activities, or investments from other countries. The OECD aims at phasing out a large number of these harmful facilities by 2006 by means of consultation and exerting pressure.

The EU also favors a coordinated approach to harmful tax competition. The EU (Euro

normally advocated because it reduces *economic* distortions and tax competition because it reduces *political* distortions. Politicians pur

TABLE 1 TOTAL TAX REVENUE AS PERCENTAGE OF GDP

	1965	1970	1975	1980	1985	1990	1995	2000
Austria	33.9	34.6	37.4	39.8	41.9	40.4	41.6	43.7
Belgium	31.1	34.5	40.1	42.4	45.6	43.2	44.6	45.6
Denmark	29.9	39.2	40.0	43.9	47.4	47.1	49.4	48.8
Finland	30.4	31.9	36.8	36.2	40.1	44.8	45.0	46.9
France	34.5	34.1	35.9	40.6	43.8	43.0	44.0	45.3
Germany	31.6	32.3	35.3	37.5	37.2	35.7	38.2	37.9
Greece	20.0	22.4	21.8	24.2	28.6	29.3	31.7	37.8
Ireland	24.9	28.8	29.1	31.4	35.0	33.5	32.7	31.1
Italy	25.5	26.1	26.1	30.4	34.4	38.9	41.2	42.0
Luxembourg	27.7	24.9	37.3	40.2	44.8	40.8	42.0	41.7
Netherlands	32.8	35.8	41.6	43.6	42.6	43.0	41.9	41.4
Portugal	Portugal 42.0Luxembbour Luxembbourg							

an international point of view. If the revenue losses in high-tax countries are not offset by revenue gains in low-tax countries, the overall tax revenue will decrease. Also, it may be unfair from the viewpoint of international equity because one country gains at the expense of other countries losing part of their tax bases. Fairness becomes a problem if some distribution of tax revenue resulting from the greater mobility of factors of production and tax bases is politically unacceptable to certain EU member states (Devereux and Pearson, 1989).

Sinn (1990) points out that though tax harmonization is needed to avoid distortions, it does not necessarily require centrally coordinated actions by European governments. Via a process of iterative adjustment tax competition might bring about the required harmonization. The losers of tax competition will be those unable to escape high taxation (including immobile workers and landowners) and those benefiting from a large government sector. The poor will also lose because governments will no longer be able to maintain their current scales of redistribution. Thus, unmitigated tax competition will be the death of Europe's welfare states.

Klaver and Timmermans (1999), however, question that tax competition will hurt the European welfare states. They argue that the rising tax burden on labor in a number of countries has more to do with their failure to make structural adjustments in the public sector and their traditionally low tax burden on capital than with excessive tax competition. Tax competition tends to keep tax/GDP ratios low, while low tax burdens encourage wage cost moderation and foster a more attractive business climate. In addition, if low labor mobility causes over-taxation of labor and high unemployment, the solution might be the implementation of policies increasing labor mobility.

Table 2 shows major changes in the share of personal income taxes in total tax revenues in individual EU member states.[6] For example, it almost doubled in Greece and Ireland, whereas it nearly halved in the Netherlands. In six EU countries (Finland, Germany, Luxembourg, the Netherlands, Sweden and the UK) the share of personal income taxes in total taxation was lower in 2000 than in 1965. In the other EU member states this share increased. On average, however, the EU's reliance on personal income taxes did not change very much. The development in Australia was more or less similar as in the EU though more pronounced. In the 1970s and 1980s, Australia increased its reliance on personal income taxes, but reduced it in the 1990s. In 2000 it was almost back at its 1965 level. The development in Japan was not fundamentally different. Initially, the share of personal income taxes rose somewhat, but in the 1990s it decreased again. In contrast, the USA's reliance on personal income taxes as a source of tax revenues was considerably higher in 2000 compared to 1965. This is the more remarkable since it is commonly assumed that labor is more mobile in the USA than in Europe and Japan.

Tax competition may force countries to adopt other tax structures than they would have preferred in the absence of tax competition. Competition for mobile tax bases may lead to a "race to the bottom", which could even result in the abolition of taxes on capital. As a result, the tax burden may shift to less mobile factors of production, which are easier to tax. Thus, tax competition may lead to inequality in tax treatment between mobile and less mobile factors. Also, the fairness and acceptability of EU

[6] Note that table 1 focuses on the tax *level* (relative to GDP), whereas tables 2-5 focus on the tax *structure* by showing the share of a particular tax in total taxation.

member states' tax laws could be jeopardized because their capacity to tax income from capital on the basis of recipients' ability to pay is undermined (Ruding Committee, 1992, p. 38). Table 2, however, does not show a strong trend towards a rising share of personal income taxes in total revenues with the exception of the USA.

TABLE 2 TAXES ON PERSONAL INCOME AS PERCENTAGE OF TOTAL TAXATION

	1965	1970	1975	1980	1985	1990	1995	2000
Austria	20.0	20.7	21.6	23.2	22.9	21.0	20.9	22.1
Belgium	20.5	24.9	32.6	36.3	35.6	32.1	32.0	31.0
Denmark	41.4	48.6	55.9	52.0	50.5	52.7	54.1	52.6
Finland	33.3	39.2	44.1	38.8	41.6	38.5	36.2	30.8
France	10.6	10.7	10.6	11.6	11.5	11.8	11.3	18.0
Germany	26.0	26.7	30.0	29.6	28.7	27.6	27.5	25.3
Greece	6.8	9.7	8.9	14.9	13.9	14.1	12.3	13.5
Ireland	16.7	18.3	25.2	32.0	31.3	31.9	30.7	30.8
Italy	10.9	10.9	15.2	23.1	26.7	26.3	26.0	25.7
Luxembourg	24.9	25.9	27.7	27.3	25.6	23.4	21.4	18.3
Netherlands	27.7	26.8	27.1	26.3	19.4	24.7	18.9	14.9
Portugal						15.9	18.0	17.5
Spain	14.3	11.5	14.5	20.4	19.7	21.7	23.6	18.7
Sweden	48.7	49.8	46.1	41.0	38.7	38.5	35.3	35.6
UK	33.1	31.5	40.0	29.4	26.0	27.1	27.1	29.2
EU-15	23.9	25.4	28.5	29.0	28.0	27.2	26.3	25.6
Australia	34.4	37.3	43.6	44.0	45.2	43.0	40.6	36.7
Japan	21.7	21.5	23.9	24.3	24.7	26.8	21.4	20.6
USA	31.7	36.6	34.6	39.1	37.8	37.7	36.3	42.4

Source: OECD (2002).

Table 3 displays the development of the share of property taxes in total tax revenues. Since property is a typical immobile factor, tax competition may induce countries to rely more on this tax base. This assumption does not find strong support in empirical data. In only four EU countries (France, Luxembourg, the Netherlands, and Sweden) the 2000 share of property taxes in total tax revenues exceeded the 1965 share. In the EU as a whole and in Australia, however, the share of property taxes in total tax taxation was somewhat lower in 2000 than in 1965. Compared to 1975 the share of property taxes in total tax revenues in the EU and Australia was approximately the same in 2000. In Japan, the share of property taxes in total taxation slightly increased. It clearly declined in the USA, however, which occurred in particular in the late 1970s.[7] Another base that is relatively easy to tax is consumption. Empirical data shows, however, that the share of taxes on goods and services in total revenues declined rather than increased (table 4). This occurred in the EU-15, Australia, Japan

[7] Most likely, this reflects the impact of the so-called tax revolt in the USA. This started in 1978, when Californian voters adopted proposition 13 that was aimed at reducing the property tax. It seems that the high visibility of property taxes prevents governments from considerably increasing the burden on this immobile tax base, not only in the USA, but also in other countries.

and the USA. Luxembourg and the Netherlands are the only EU member states where the share of taxes on goods and services in creased somewhat in the period 1965-2000.

TABLE 3 TAXES ON PROPERTY AS PERCENTAGE OF TOTAL TAXATION

	1965	1970	1975	1980	1985	1990	1995	2000
Austria	4.0	3.7	3.1	2.9	2.4	2.7	1.5	1.3
Belgium	3.7	3.1	2.3	2.4	1.8	2.7	2.5	3.3
Denmark	8.0	6.0	5.9	5.5	4.2	4.2	3.5	3.3
Finland	4.0	2.2	1.9	1.9	2.7	2.4	2.3	2.5
France	4.3	4.8	5.1	4.8	5.8	5.1	7.4	6.8
Germany	5.8	4.9	3.9	3.3	3.0	3.4	2.8	2.3
Greece	9.7	9.3	9.7	4.6	2.7	4.6	3.4	5.1
Ireland	15.1	12.2	9.7	9.7	4.0	4.7	4.5	5.6
Italy	7.2	6.0	3.3	3.3	2.5	2.3	5.6	4.3
Luxembourg	6.2	7.1	5.1	5.1	5.5	8.4	7.2	10.6
Netherlands	4.4	3.3	2.4	2.4	3.5	3.7	4.1	5.4
Portugal	5.1	4.2	2.5	2.5	1.9	2.7	2.5	3.2
Spain	6.4	6.5	6.3	6.3	3.5	5.5	5.5	6.4
Sweden	1.8	1.5	1.1	1.1	2.3	3.5	2.9	3.4
UK	14.5	12.5	12.7	12.7	12.0	10.3	10.4	11.9
EU-15	6.7	5.8	5.0	5.0	3.9	4.4	4.4	5.0
Australia	11.4	11.0	8.8	7.8	7.8	9.0	8.8	8.9
Japan	8.1	7.6	9.1	8.2	9.7	9.1	11.7	10.3
USA	15.9	14.2	13.9	10.7	10.7	11.4	11.3	10.1

Source: OECD (2002).

TABLE 4 TAXES ON GOODS AND SERVICES AS PERCENTAGE OF TOTAL TAXATION

	1965	1970	1975	1980	1985	1990	1995	2000
Austria	37.4	37.4	34.5	31.5	32.6	31.5	27.7	28.4
Belgium	37.2	36.5	27.4	27.2	25.3	26.4	25.7	25.4
Denmark	40.6	38.8	33.6	37.4	34.2	33.5	32.2	32.5
Finland	42.5	39.6	32.4	35.7	33.9	32.6	29.6	29.1
France	38.4	38.1	33.3	30.4	29.7	28.4	27.4	25.8
Germany	33.0	31.8	26.9	27.1	25.7	26.7	28.0	28.1
Greece	48.8	48.2	46.8	41.2	42.7	44.5	42.1	36.1
Ireland	52.6	52.4	46.5	43.7	44.4	42.3	40.7	37.2
Italy	39.8	38.7	29.4	26.5	25.4	28.0	27.3	28.4
Luxembourg	24.7	14.3	21.1	20.9	24.1	24.8	26.7	27.3
Netherlands	28.6	27.8	24.2	25.2	25.6	26.4	27.2	29.0
Portugal	44.2	44.6	40.7	44.9	42.8	43.8	43.5	39.9
Spain	40.8	35.9	24.2	20.7	28.7	28.4	28.6	29.8
Sweden	31.2	28.2	24.3	24.0	26.6	25.0	24.2	20.7
UK	33.1	28.8	25.0	29.2	31.5	30.5	35.4	32.3
EU-15	38.2	36.1	31.4	31.0	31.5	31.5	31.1	30.0
Australia	34.7	32.0	29.3	31.1	32.8	27.8	29.0	27.5
Japan	26.2	22.4	17.3	16.3	14.0	13.2	15.2	18.9
USA	22.8	20.0	19.5	17.6	18.8	17.3	17.9	15.7

Source: OECD (2002).

Tax competition may lead to resource allocation on the basis of tax minimization rather than comparative economic advantages, which will lead to welfare losses. Tax differences between countries may cause allocative distortions in the capital market because capital will move to the country with the lowest effective tax rate rather than the most efficient use. In addition, differing tax rates may lead to trade diversion, which in turn also may result in welfare losses. However, this has been challenged by Bracewell-Milnes (1999, p. 87). He draws an analogy with a supermarket competing with its rivals on price or otherwise, trying to attract geographically mobile customers and to affect the location of their activities. The promotional activities of this store may also be accompanied by a dead-weight loss, which is considered normal part of its business.

Tax competition theory suggests that small countries set lower tax rates than large countries. The reason is that small countries attract more capital relative to their own size by reducing their tax rate (Kanbur and Keen, 1993). There is, indeed, some empirical evidence that small countries set relatively low effective tax rates compared to large countries. More specifically, the five largest EU members, Germany, France, Italy, UK and Spain, have an effective tax rate that is, on average in the period 1990-1999, 11.2% higher than in the smaller member states. The mean effective tax rate of small EU countries was 24.6%, whereas the mean effective tax rate of large member states was no less than 35.8%. The difference between small and large countries declined, however, from 10.8% in 1990 to 8.5% in 1999 (Gorter and de Mooij, 2001, p. 61).

Tax competition may serve as a disciplinary mechanism to prevent governments from growing bigger than the electorate prefers. Moreover, competition by other tax jurisdictions may put pressure on governments to increase their efficiency. A counter argument, however, is that tax competition will not lead to a lower tax level, but only to a shift of the tax burden from mobile factors to less mobile factors that are easier to tax (labor, consumption, real estate). If tax competition in the EU occurs, there is no evidence that it has led to lower overall tax burdens. Table 1 shows that the average tax burden in the EU-15 rose to 41.6% of GDP in 2000 from 27.9% in 1965, an increase of nearly 50%. This relative increase is comparable to that in Australia and Japan, though the overall tax levels in these countrie s are still considerably lower than in the EU. In the USA, the tax level has risen to 29.6% in 2000 from 24.7% in 1965, which is an increase of only 20%. Notably, though statutory corporate income tax rates in EU countries declined in the 1990s, effective tax rates on corporations did not decline irrespective of the measure of the effective tax rate (Gorter and de Mooij, 2001, p. 59). The share of corporate income taxes in total taxation increased by one third in the EU in the late 1990s.

TABLE 5 TAXES ON CORPORATE INCOME AS PERCENTAGE OF TOTAL TAXATION

	1965	1970	1975	1980	1985	1990	1995	2000
Austria	5.4	4.4	4.3	3.5	3.5	3.6	3.7	4.7
Belgium	6.2	6.9	7.4	5.1	5.6	5.5	6.7	8.1
Denmark	4.5	2.6	3.1	3.2	4.8		2.6eo812Tc 0 T.78 Tw ( ) Tj	

allocation between the private and the public sectors since it does not respect cross-country differences in the preference for income redistribution (Hagen et al., 1998).

A less ambitious strategy is to fix some minimum rates leaving more latitude for member states.[8] Nonetheless, low-tax countries would suffer welfare losses because they are forced to raise their tax rates to the minimum. The European Commission abandoned its original plan for harmonization of indirect taxes. Instead, the EU agreed on low minimum tax rates representing a binding constraint only for very few member states. This is not surprising given the extent of diversity among EU member states. Diversity does not only result from different national preferences with regard to income redistribution, but also from differences in factor productivities, population size and composition, capital composition, and mobility of various types of capital. The extent of diversity between EU member states will further increase as a result of the eastern enlargement of the EU in 2004.

It can be expected that the welfare effects of tax harmonization will be unequally distributed, both over countries and over interest groups within countries. Large countries tend to benefit more from tax harmonization than small countries. Since large countries have certain advantages over small countries, they can impose higher taxes and yet remain competitive. Enterprises in small countries more often need to cross borders if they want to expand their activities than companies in large countries. Moreover, companies in a small country have fewer opportunities for loss compensation and depreciation relief than enterprises in a large country.

EU decision-making on taxation requires unanimity reflecting that taxation is in the heart of national sovereignty. Given the differences between and different interests of large and small countries it seems very difficult to agree on a tax level that is in the best interest of all EU member states. This seems a prisoner's dilemma. Harmonization can lead to a sub-optimal allocation of resources and welfare losses, if it is accomplished at too high a level. Therefore, tax harmonization can most likely only be achieved if the winners from harmonization compensate the losers. This not only requires that the efficiency gains exceed the efficiency losses, but also that winners are willing to compensate losers. Tax harmonization in the EU might thus lead to higher tax levels, may protect inefficient governments, and may lead to reduced competitiveness relative to other trading blocks.

IV. THE LEGAL FRAMEWORK OF HARMONIZATION

The general harmonization provisions (articles 94 and 95 of the EC Treaty) form the main legal basis for harmonizing taxes. Article 94 pertains to "directives for the approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the common market." So far, however, only three directives have been issued,[9] though the European Commission has proposed several corporate tax directives. The Single European Act amending the EC Treaty introduced article 95 stipulating that the Council will adopt

[8] Janeba and Smart (2003) show that under specific conditions a minimum tax rate is superior to a restriction of tax preferences.

[9] The first aims at mutual assistance by tax administrations of member states and was issued in 1977. The second directive (Parent-Subsidiary Directive) aims at elimination of double taxation of dividends of parent companies and subsidiaries of different member states and was issued in 1990. The third directive (Merger Directive) was also issued in 1990 and stipulates that capital gains arising from a merger or a similar operation will only be taxed upon realization.

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the measures for the approximation of the provisions aiming at the establishment and functioning of the internal market. By way of derogation from article 94 it allows for qualified majority decision-making, but according to paragraph 2 this does not apply to fiscal provisions. In addition, some non-binding instruments have been applied.[10]

Obviously, EU member states have retained their national fiscal competence, although they will have to observe the limits imposed by EU legislation and policies. In particular the common objective of an internal market without borders restricts national governments' autonomy to design their own tax policies. The most significant progress in harmonizing member states' tax systems, however, has been achieved by decisions taken by the European Court of Justice (ECJ). These decisions are not based on provisions on taxation in the EC Treaty, but rather on the provisions on non-discrimination and the four freedoms of the internal market. The four freedoms imply the right of cross-border movements (market access and exit) and the prohibition of discrimination by reason of nationality of persons or origin of goods. The ECJ has ruled that national legislation must avoid any overt or covert discrimination by reason of nationality to be consistent with EU legislation.

Generally, EU legislation only affects European citizens and companies engaged in intra-community cross-border economic activities. They can claim protection under the EC Treaty if they encounter discriminatory or restrictive measures while making use of one of the four freedoms. The ECJ interprets the free movement provisions broadly by prohibiting not only distinctions based on nationality or origin (direct or overt discrimination), but also distinctions based on other criteria if they result in disadvantages for foreign products or factors (indirect or covert discrimination). Obviously, this concept of discrimination goes beyond that of international tax law. The OECD Model Tax Convention, for example, assumes that non-residents are in a different position and may be subject to different tax treatment. Therefore, it only

- are justified by pressing reasons of public interest;
- are of such a nature as to ensure achievement of the aim in question; or
- are proportional.

A measure restricting free movement may be justified on the basis of two categories of grounds:

- The measure falls within the scope of one of the derogations the EC Treaty explicitly provides for.
- The measure can be justified on grounds the EC Treaty does not provide for, but which the ECJ has recognized and accepted as overriding requirements in the general interest.

With regard to income taxation the ECJ has developed both a non-discrimination and a non-restriction approach. The *non-discrimination* principle prohibits treating non-residents from other member states less favorably for the income tax than residents. However, there is no violation of the EC Treaty if residents and non-residents are treated equally, but non-residents face a barrier while operating in another member state. The *non-restriction* principle is based on the free movement of goods and is more radical. It forbids national rules leading to a disadvantageous treatment of people, goods or investments from other member states.

In most EU member states tax treatment is distinct on the basis of residence. If a particular tax rule is discriminatory or restricts the free movement of factors in the internal market member states may try to justify this rule. The only justification the ECJ has accepted so far is the cohesion argument: the need to protect the integrity of national tax systems. However, member states can only refer to the need to preserve fiscal coherence if there is a direct link between any fiscal advantage and a corresponding disadvantage. The cohesion argument must be viewed in the light of European regulations, bilateral tax treaties, and the possibilities of mutual assistance in tax matters. Arguments that the ECJ has refused to accept include:

- the lack of harmonization of income tax legislation;
- the need to prevent a reduction of tax revenues;
- the presence of an offsetting advantage;
- the problem of obtaining necessary information from other member states;
- the fact that the disadvantageous effect of a tax measure can easily be avoided; and
- the need to protect consumers.

V. ACHIEVEMENTS

The achievements with regard to tax harmonization in the EU have been most pronounced in the field of indirect taxes. In particular the adoption of a common Value Added Tax (VAT) system has brought about uniformity, since it is the only system that member states are allowed to use. Notably, the current VAT system is still a transitional one. The move to a definitive system requires an agreement on approximation of VAT rates and rules as well as a compensation mechanism to ensure that revenues continue to accrue to the countries in which consumption occurs. However, the member states are unwilling to accept the changes that would be needed for a definitive system to be implemented (Bolkestein, 2000). Nonetheless, the rules

determining the tax base have been harmonized to a large extent. The same holds true

However, progress on harmonization of excise taxes has been very slow. Often, excise harmonization has been spontaneous. As borders were abolished and mobility grew, excises were reduced to their lowest common rate. Total excise revenues for the EU as a whole amounted to 3.8% of GDP, down from 4.4% in 1970, whereas in the same period the total tax/GDP ratio increased (see table 1). As a result, excise revenues decreased relative to total tax revenues. Table 7 shows that excise revenues still widely vary across EU member states. In 2001, the share of excises in total taxation ranged from 14.9% in Greece to 5.3% in Belgium, while the share in GDP ranged from 5.7% in Denmark to 2.4% in Belgium.

Cnossen (2001, p. 37) argues that harmonization of excises is more urgent than harmonization of VAT for four reasons. First, excises, particularly on drinking and smoking interfere less with production efficiency than VAT, let alone taxes on labor and capital. Harmonization would enable the member states to use the revenue to reduce more distortionary taxes on labor and capital. Second, harmonization would reduce the incentive for tax-base snatch

any relief of double taxation, whereas imputation systems provide full or partial relief by granting shareholders a tax credit against their personal income tax for the corporation tax that can be imputed to the dividends they received. Subjecting dividend income to a separate or schedular personal income tax rate lower than the top rate can also mitigate double taxation.

Six member states (Austria, Belgium, Denmark, Germany, Luxembourg and Sweden) apply a schedular treatment system that provides dividend relief to shareholders by taxing distributed profits at a schedular personal income tax rate separate from other personal income. Six member states (Finland, France, Italy, Portugal, Spain and the UK) employ an imputation system providing full or partial relief by permitting shareholders a tax credit against their personal income tax for the corporation tax that can be imputed to the dividends (grossed up by the tax credit) they received. Usually, the gross-up and tax credit are expressed as a fraction of the net dividend. Finland and Italy are the only member states that permit a full tax credit against the personal income tax for the corporation tax attributable to the shareholder's dividend income. Two member states (Greece and the Netherlands) apply a dividend exemption system for shareholders. However, the Netherlands levies a net wealth tax, which is called a presumptive capital income tax. One member state (Ireland) employs the classical system and subjects dividend income fully to both the corporation tax and the personal income tax. There is a trend to abolish imputation systems in favor of schedular taxes on distributed profits as well as other capital income. Notably, member states providing shareholders relief for the corporation tax generally confine this to dividends received from domestic firms implying double taxation of foreign dividends.

VI. CONCLUSIONS

EU member states participating in EMU have given up the possibility of an independent monetary policy. Therefore, they have fewer policy options, so they might have incentives to use taxes to achieve competitive advantages, which may intensify tax competition. However, tax burdens in the EU increased on average by almost 50% in the past 35 years, while they did not converge. Since capital is much more mobile than labor it can be expected that the tax burden has partly shifted from capital to labor. Yet, there is no evidence for a "race to the bottom". In the 1990s, effective tax rates on corporations did not decline in the EU. Unlike the USA there is no strong trend towards a rising share of personal income taxes in total taxation in the EU. Moreover, there is no evidence of a rising share of property taxes in total tax revenues [illegible]

rates. As a result, VAT rates differ across EU member states. Moreover, VAT tax bases differ between member states because of derogations and exemptions. Less progress has been achieved with regard to harmonization of excise taxes. Harmonization in this field has been very slow and often spontaneous.

Insofar the EU has been involved in direct taxation, it mainly pertains to corporate taxes. The most significant progress in this field has been achieved by decisions taken by the ECJ. These decisions are not based on provisions on taxation in the EC Treaty, but rather on the provisions on non-discrimination and the four freedoms of the internal market. The ECJ has ruled that national legislation must avoid any overt or covert discrimination by reason of nationality to be consistent with EU legislation. However, major differences still exist between corporate tax systems in EU member states. Six member states apply a schedular treatment system providing dividend relief to shareholders by taxing distributed profits at a schedular personal income tax rate separate from other personal income. Six member states employ an imputation system providing full or partial relief by permitting shareholders a tax credit against their personal income tax for the corporation tax that can be imputed to the dividends they received. Two member states apply a dividend exemption system for shareholders. One member state employs the classical system and subjects dividend income fully to both the corporation tax and the personal income tax. However, there is a trend to a-pr mdty t

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