4
Objectives of Corporate Income Tax Coordination in the European Union

4.1 Introduction

Corporate income tax coordination is a necessary step to achieve the objectives stipulated in the European Union (EU) Treaty. The specific objectives of corporate income tax coordination were defined by the European Commission’s strategy documents and were based on studies, research and analysis. This chapter presents the specific objectives of corporate income tax coordination in the EU. It also argues for the idea that corporate income tax coordination can contribute to creating a level playing field for all Single Market participants, to limit and prevent non-taxation and abuse, and to avoid harmful tax competition.

4.2 The prevention of distortion of competition within the Single Market by fiscal policy that stimulates corporate location decisions

Foreign direct investment (FDI) flows between member states have a particular importance for the EU economy. These flows generate new jobs, representing a factor that stimulates productivity and European economic integration. Intra-EU direct investments reported by EU member states show a considerable variation in the FDI flows from year to year, depending on the economic opportunities offered by each state (Annex 3).

During 2007–2009, there was a trend of disinvestment (affecting in particular the new member states), because during recessions corporate groups focus more on activities in the markets they already serve.

Statutory rates on corporate income tax diverge significantly across EU countries (Table 4.1), and these differences are susceptible to encourage corporate decisions to locate in low tax states.
During 2005–2010, some member states with lower corporate income tax rates were able to attract an important volume of FDI (such as Ireland or Cyprus). But some member states with higher corporate income tax rates registered similar performances (Belgium, the Netherlands and Sweden). It is obvious that the statutory tax rates cannot provide complete information on the tax burden faced by companies.

This deficiency can be removed by determining the effective tax rate. In the literature, one can find the effective marginal tax rate (EMTR) as well as the effective average tax rate (EATR). The methodology used in order to determine the two rates was created by Michael P. Devereux and Rachel Griffith (1999). The approach proposed by these two economists consists in considering a hypothetical investment in the home country of residence or in another country.

Investment decisions are affected by both rates, but in different ways. According to Michael P. Devereux, the EATR orientates the decision on the selected investment emplacement, and the volume of investment is more influenced by the EMTR (Devereux, 2006, p. 5).

The EATR allows the measurement of the effect of taxation on the impulse to invest. It represents the rate that applies to the marginal investment, showing the effect of taxes on an investment with a minimum after-tax rate of profit. Assessing the impact of corporate income tax on the capital investment level is done through the cost of capital, defined as the benefit rate (before taxes) required by companies owners.