Why Did the European Community Adopt the Common VAT System?[1]

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Introduction

Introduced first in France in 1954, the value-added tax (VAT) has quickly spread over the world; more than 160 countries have adopted the VAT system, and it brings important tax revenue to each government. However, there is very little information as to why so many countries have adopted VAT. Numerous studies have been conducted by international institutions such as the IMF and the World Bank to explain the VAT's global spread by emphasizing merits of the "good VAT." This approach, however, pays too much attention to the question of how best to design a VAT—but without explaining its spread throughout the world.

Kathryn James successfully explained VAT's spread by using case studies from Australia and the U.S. in which she employed a context-driven analysis inspired by historical institutionalism and fiscal sociology. Her works have showed the important role of political process analysis in seeking to understand the spread of the VAT[2].

This paper will focus on the process whereby the common VAT was introduced into the European Community (EC), having first been implemented in France. The common VAT was introduced by the adoption of the first and second directives of the Council in 1967. After its adoption, the six Member States—France, West Germany, Italy and Benelux—as well as other European countries willing to join the EC, were required to adopt the VAT as their sales tax system over other types of sales taxes such as production taxes, wholesale taxes, retail sales tax, or a cumulative transaction tax.

Why did the European Member States select the VAT from among these options? Through answering this question, we can, even partly, explain the reasons for the first

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[1] This is a short summary of my doctoral dissertation submitted at the University of Paris I Panthéon-Sorbonne in December 2018. The title is « Construire l'Europe par la fiscalité: l'harmonisation fiscale européenne 1950-1967 ».

[2] Kathryn James, *The Rise of Value Added Tax*, Cambridge: Cambridge University Press, 2015.

spread of the VAT system in the world.

Chapter 1: Why did Member States need to harmonize their sales tax system?

1-1 Different types of sales taxes in the Member States

Before the first and second directives for the Common VAT system, the Member States—except for France—had sales tax systems different from the VAT. West Germany, Luxembourg, and the Netherlands had a general cumulative tax system for all products, while Belgium and Italy had a mixed system, comprising both a cumulative tax system for one part of the products and a single flat-rate tax for the other. Only France had a non-cumulative sales tax, the VAT[3].

This diversity in the sales tax system among Member States was for the first time called into question with the creation of the European Coal and Steel Community (ECSC) which aimed at creating a common market for coal and steel. If the Member States were to have different types of sales taxes on these goods, their market price might be distorted, which would not be a favorable condition for a good common market.

However, there was no article allowing a fiscal harmonization among the Member States in the Treaty of Paris which created the ECSC; this meant that the Member States could not even imagine that they would be making efforts to coordinate their fiscal system for their economic community. In any event, the High Authority of the ECSC did not have any political power over the tax systems of the Member States[4].

None of this means, however, that fiscal questions did not matter to the ECSC. In fact, a decisive confrontation occurred between the French and West German governments concerning the border tax adjustments of the sales taxes[5].

The French government was, on the one hand, favorable to a "destination principle" that ensured that all products and services that share the same destination are taxed equally,

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3 Haute Autorité de la CECA, *Rapport sur les problèmes posés par les taxes sur le chiffre d'affaires dans le marché commun*, arrêté no° 1-53 du 5 mars 1953 ; Louis Reboud, *Systèmes fiscaux et marché commun*, Paris : Sirey, 1961, p. 326-340.

4 Article 4 a) of the Treaty of Paris simply excludes "entry or exit duties, or taxes of equivalent effect, and quantitative restrictions on the movement of products" of coal and steel.

5 Diebold, W., *The Schuman Plan. A study in Economic Cooperation 1950-1959*, New York: Frederick A. Praeger, 1959, p.223.

regardless of their place of production. According to this principle, exports are *not* taxed while the imports *are* taxed—and this demands border tax adjustments that provide for rebates to exporters and compensation taxes for importers. In order to calculate accurately the rebates and adjustment taxes, it would be necessary to adopt a non-cumulative tax in all Member States.

On the other side of the argument, the West German government was favorable to an "origin principle" that taxes goods and services in their original country. This principle no longer requires border tax adjustments and corresponds better to a common market; however, it requires much greater fiscal harmonization—such as harmonization tax rates or deduction systems—if they want to avoid a market distortion.

The conflicts between the two countries were so intense that the ECSC had to delay the opening of a steel common market for two months. After consulting the researchers' advisory committee (the "Tinbergen committee") that recommended a destination principle in its report, the High Authority of the ECSC adopted the French idea for its tax border principle[6].

1-2 The Treaty of Rome and fiscal harmonization

Although fiscal harmonization was not addressed within the ECSC, which only allowed for the creation of common markets in a limited domain, it did become an objective within the European Economic Community (EEC), created by the Treaty of Rome in 1957, which sought to create a common market for all products and services.

Before elaborating the articles of the Treaty, the Member States' delegations assembled in Belgium to decide the basic framework for their new economic community and created a special committee—the Spaak Committee, whose chair was Henri Paul Spaak, foreign minister of Belgium. In 1956, the committee published the "Brussels Report on the General Common Market," known as the "Spaak Report."[7]

The principal authors of this report were French civil servant Pierre Uri and West German civil servant Hans von der Groeben, a future member of the European Commission of the EEC. He would play an important role in realizing the European

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[6] Haute Autorité de la CECA, *Rapport sur les problèmes posés par les taxes sur le chiffre d'affaires dans le marché commun*, arrêté no° 1-53 du 5 mars 1953 ; Jean Monnet, *Mémoires*, Paris : Fayard, 1976.

[7] Comité Intergouvernemental créé par la Conférence de Messine, *Rapport des chefs de délégations aux ministres des Affaires étrangères*, Bruxelles, le 21 avril 1956.

common VAT system as executive vice-president of the Directorate-General IV-Competition (DG IV) of the Commission in which fiscal problems were treated[8].

In this report, the committee proposed the framework for a greater degree of fiscal harmonization in the new community: uniformity of both direct taxes and indirect taxes and harmonization of the social security systems. However, as for the abolition of tax border adjustments, the report took an ambiguous position because the two principal authors, French Pierre Uri (in favor of keeping the tax border adjustment) and West German von der Groeben (in favor of abolishing the tax border), could not reach an agreement on this question.

The dispute between the two countries on tax border adjustment was not resolved even during the negotiations surrounding the Treaty of Rome. After a long discussion, the Member States' delegations excluded an option concerning its abolishment because the system without tax border adjustment would require advanced sales tax harmonization, including tax rates and exemption systems, if the Member States wanted to avoid a distortion of the market mechanism within the Community.

As for fiscal harmonization, the possibility of indirect tax system harmonization is clearly included in articles of the Treaty—unlike the Treaty of Paris that produced the ECSC. Nevertheless, the harmonization of direct taxes and the social security system, as proposed in the Spaak Report, were not included in the articles of the Treaty of Rome. For the authors of the treaty, harmonization of indirect taxes should come prior to that of direct taxes from the point of view of trade; but the most important point was that they tried to leave room to maneuver on fiscal policy for the Member States who were afraid of losing their fiscal authority by tax harmonization in the Community[9].

The Treaty of Rome established five articles regarding taxes in Articles 95–99. Article 95 prohibits tax discrimination between imported and national products. It aims to prevent the Member States setting improperly high rates of compensatory import taxes in order to protect domestic production. Article 96, on the other hand, prohibits fixing rebates for export products for the purpose of promoting a country's domestic industry. The next article, Article 97, was prepared so that Member States could respect the

8 *Ibid*., p. 60.
9 Georges Vedel, « Les aspects fiscaux du marché commun », Bulletin de Documentation Fiscale Internationale, Vol XII, 1958 ; Archives historiques de l'Union Européenne, l'entretien personnel de Pierre Uri en français enregistré le 22 avril 1988 à Paris, écouté par François Duchêne, dans le programme de Jean Monnet, Statesman of Interdependence, INT529, p. 49-50.

principle of non-discrimination, fixed in the previous two articles, even if they maintained the cumulative sales tax on goods and services. This article, therefore, allowed Member States with a cumulative tax system to set average rates per product or group of products for import compensatory taxes and export refunds. Article 98 sets out the principles for direct taxes. According to this article, there would be no tax readjustment for direct taxes, as opposed to indirect taxes. The next stipulation, Article 99, again deals with indirect taxes, explicitly setting out the rules for the harmonization of tax legislations in the Community.

These clauses provided the Community's fiscal rules in an ambiguous way so that Member States would still possess a large degree of control over their fiscal policy, thus keeping the Commission's political power over fiscal problems limited. Thus, the future of fiscal harmonization lay in the hands of Member States and the European Community[10].

The creation of these articles shows that the Member States could accept eliminating obstacles in the tax system in order to create a free trade zone which is the very foundation of the common market. However, an ideal "common market" that each country wanted to realize was not, in fact, *common*. West Germany wanted, on the one hand, a common market without tax border adjustment, which would have required an advanced sales tax harmonization; France and other countries, on the other hand, wanted to see a common market where the fiscal adjustments remain at frontiers, leaving more fiscal oversight to the Member States. Though these positions were opposed to one another, curiously both would end up promoting a common VAT after the Treaty of Rome, as we will see later.

Chapter 2: Initiative of the European Commission and conflicts among Member States

2-1 The fiscal directors' first meeting

After signing the treaty in Brussels, the European Commission's members established the administrative organization where the first initiative of sales tax harmonization was taken. They determined that fiscal matters would be treated in the Directorate-General IV—Competition (DG IV) which consisted of four different directorates: cartels and monopolies, dumping, discrimination by the industry;

[10] Georges Vedel, *op. cit*.

approximation of legislation; fiscal problems; aid and discrimination by the State. Hans von der Groeben, West German member of the Commission and one of the principal authors of the Spaak Report, was appointed as the chief of the DG IV[11].

The "culture" of the DG IV was influenced by its Executive vice-president, von der Groeben, and the governmental policy of his country; consequently, the DG IV tried to realize a no-tax border adjustment zone within the EEC. For this objective, DG IV wanted the Member States to harmonize their sales tax system[12].

However, the competence of the Directorate of Fiscal Problems (DFP) attributed by the Treaty of Rome was quite limited. In fact, the articles on other questions relating to the DG IV were more developed so that the Commission could intervene more easily in these problems[13]. Furthermore, both Hans von der Groeben and the Dutch director-general of the DG IV, Pieter verLoren van Themaat, were specialists of the cartel and monopoly. It was natural, therefore, for the DG IV to put the questions related to cartel and monopoly ahead of fiscal problems.

This is why it took some time to start the discussion about sales tax harmonization. The real discussion on this question resumed only in June 1959—one and a half years after the beginning of the EEC. The DFP prepared a working paper and organized the first meeting with governmental fiscal experts on June 22, 1959, with von der Groeben as the chairman. The experts from the directorate of fiscal problems of the Commission and fiscal director-general of the Member States took part in this meeting. In the working paper, the DFP's experts explained that their worries related to problems due to different sales tax systems among the Member States and proposed a sales tax harmonization and the exclusion of a cumulative sales tax[14].

However, the governmental directors-general could not agree with the DFP's

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[11] For the creation process of the DG IV, see Entretien avec Hans von de Groeben, 16 décembre 2003, effectué par Éric Bussière. Cité dans Éric Bussière, « La concurrence », in M. Dumoulin, *La Commission européenne 1958-1972 histoire et mémoires d'une institution*, Union Européenne, 2014, p. 313.

[12] For the culture of the GD IV, see Katja Seidel, "DG IV and the origins of a supranational competition policy: Establishing an economic constitution for Europe", in W. Kaiser, B. Leucht, M. Rasmussen (ed.), *The history of the European Union: Origins of a trans- and supranational polity 1950-72*, New York: Routledge, 2009.

[13] AHCE, BAC 62 1980 39, Note pour monsieur le directeur Saclé, signé par Par Fernand Van Praet, datée du mois de janvier 1959.

[14] ANF, 19900580/53, Document de Travail pour la réunion avec les experts gouvernementaux, préparée au sein de la direction « Problèmes fiscaux » dans la DG IV, datée du 22 mai 1959.

propositions[15]. Fiscal harmonization would require them to transfer political power over fiscal policy to the European Community, and this made it difficult for Member States to accept the propositions. In particular, the Dutch and Italian representatives opposed the fiscal harmonization.

For Dutch experts, the idea of approximating tax legislation was completely out of the question as it could hamper their own fiscal policy. They considered the turnover tax rate as a tool of economic and social policy. As a matter of fact, the Netherlands used their taxes for economic and social policy more often than the Member States[16]. Since tax harmonization within the Community would require Member States to apply a more or less general and uniform tax system, the Commission's proposal risked, for the Netherlands, restricting the freedom of its usual tax policy.

For the Italian experts, the harmonization of turnover taxes was impossible because of technical problems in its tax administration. Italy's economy was highly dependent on the primary sector in which tax administration was weakly developed. In 1960, while the primary sector in Italy accounted for 17.1% of its GNP, it was only 7.2% for West Germany, 10.6% for the Netherlands, 6.8% for Belgium, and 8.6% for Luxembourg[17]. It is relatively difficult to apply ad valorem taxes to this sector, and all Member States apply the flat rate system or a special tax that does not require complex administration. Moreover, in Italian production, wholesale and retail units were very fragmented, which made the harmonization of sales taxes more difficult.

In order to advance the discussion on a sales tax harmonization, the Commission created three temporary working groups composed of government fiscal experts. Among the three working groups, it was the Working Group I (WG I) that treated problems on sales tax harmonization. Its first meeting was held on September 1959 in order to examine three different types of sales taxes: single sales tax (manufacturer's sales tax, wholesale

[15] ANF, 19900580/20, Harmonisation des régimes fiscaux dans le Marché Commun (taxes indirectes), une note qui résume le débat de la première réunion d'experts en matière fiscale du 22 juin 1959 à Bruxelles.
[16] Parlement Européen, « Rapport fait au nom de la commission du marché intérieur sur la proposition de la Commission de la C.E.E au Conseil (doc. 121, 1962-1963) concernant une directive en matière d'harmonisation des législations des États membres relatives aux taxes sur le chiffre d'affaires », Documents de séance 1963-1964, 20 août 1963, document 56, édition de la langue française, p. 6.
[17] Eurostat, Bulletin général de statistique, n° 12, Bruxelles : Office statistique des Communautés européennes, 1961.

tax, retail sales tax), manufacturer's sales tax and retail sales tax, and value added tax[18].

The Member States, except for France, did not want to give up their cascade-type sales tax, but during the meeting of the WG I they reluctantly expressed their preference for wholesale taxes because it was technically not difficult to switch to this tax from their existing cascade-type sales tax. As France already adopted the VAT at the manufacturer level and wholesale level, French experts did not mind if the EEC adopted a common value-added tax system for the community; however, they also did not willingly advance a sales tax harmonization[19].

Although the first meeting for sales tax harmonization did not bring a definitive answer, it created working groups for this question and facilitated gatherings of fiscal experts both from governments and the Commission for a future fiscal harmonization.

2-2 "Stand-still" agreement

In the EEC, the problem of tax border adjustment once again became a pressing question. Under the pretext that it was difficult to know the exact amount of refunds for exportation at the border, French partners (who had a cascade-type sales tax) can tactically set the average rates of border adjustment taxes. Indeed, in parallel with the abolishing of customs duties within the EEC, some Member States had already increased compensatory taxes since the Treaty of Rome was implemented in the beginning of 1958. This increase could compensate an ongoing reduction in customs duties[20].

A working group of the Commission that dealt with the question of tax border adjustment, Working Group II, could not find a solution for this problem[21]. On January 1960, the president of the Commission, Walter Hallstein, sent a letter to all foreign

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18 ANF, 19900580/53, document de travail pour la première réunion du Groupe de Travail No.1, daté du 28 septembre 1959 ; ANF, 19900580/53, procès-verbal de la première réunion du Groupe de Travail N° 1 avec les experts gouvernementaux en matière fiscale (Harmonisation des taxes sur le chiffre d'affaires), préparé au sein de la direction « Problèmes fiscaux », daté du 17 novembre 1959.

19 ANF, 19900580/53, procès-verbal de la première réunion du Groupe de Travail N° 1, daté du 17 novembre 1959.

20 CAEF, B-59782/1, Note d'information, réponse de la Commission de la CEE en date du 27 avril 1959 à la question écrite n°12 posée par M. de SMET, membre de l'Assemblée parlementaire européenne, préparée au sein du secrétariat du Conseil des Communautés européennes, datée du 29 avril 1959.

21 ANF, 19930275-41, Procès-verbal de la première réunion du Groupe de Travail N°II avec les experts gouvernementaux en matière fiscale, direction des Problèmes fiscaux, daté du 16 novembre 1959, p. 4.

ministers and proposed a “stand-still” accord which would ask the Member States not to change their border adjustment taxes[22].

Similar to the issue of fiscal harmonization, the tax border adjustment controversy directly impacted the fiscal discretion of individual governments. The Member States did not want the European Commission to intervene in their fiscal policy; France, however, was an exception. Having a VAT for its sales tax system, only France could properly calculate its adjustment taxes at border and could not fix its tax rates arbitrarily. This was not a desirable situation for French industry; for this reason, the French industry group advocated for the “stand-still” accord at the Community level. Pushed by its industry group and fiscal administration, French representatives in Brussels asked the Commission to find a solution for this problem as soon as possible[23].

After long and difficult preparatory discussions, the six finance ministers reached an agreement on the “stand-still” question during the Council’s meeting on June 20 and 21 1960[24]. After this meeting, the Member States could not modify, in principle, the rates of compensatory taxes for imports and rebates for exports except for technical reasons. Furthermore, they needed to consult their partners in advance—at least two months before—when they were planning modifications to their tax border adjustments.

However, in reality, this accord was not effective. Just after the agreement, the Benelux countries announced the rise of their border adjustment taxes. The European Commission warned them not to do it, but the Benelux countries claimed that the modifications aimed to resolve their technical problems. Moreover, West Germany also sought a raise in its border adjustment taxes. As the West German modifications might have a large impact on the economies of Member States, the Commission’s DFP tried to prevent the modifications. Nevertheless, the West German government tried to justify the modification by emphasizing the “particular situation of industrial sectors” and did not

[22] ANF, 19900580/20, Lettre du Président de la Commission, Walter Hallstein auprès du ministre des Affaires étrangères, Maurice Couve de Murville, datée du 20 janvier 1960.

[23] ANF, 19900580/20, Note pour le ministre, écrite par le directeur général des Impôts, Robert Blot, au ministre des Finances, datée du 2 mars 1960 ; ANF, 19900580/20, lettre du Wilfrid Baumgartner auprès de Walter Hallstein, datée du 6 avril 1960 ; ANF, 19900580/20, lettre du Président de la Commission auprès du ministre français des Finances, Wilfrid Baumgartner, datée du 3 mai 1960.

[24] CAEF, B-59782, Propositions de la Commission au Conseil relatives à l’application des articles 95 à 97 du Traité concernant les ristournes à l’exportation et les taxes compensatoires à l’importation, (projet du procès-verbal de la 33ème réunion du Conseil de la CEE tenu à Pau les 20 et 21 juin 1960), pas de date.

heed the Commission's warning. This shows that the Member States could easily ignore the "stand-still" accord for their own economic profits[25].

As the "stand-still" accord did not work, the only solution for the tax border adjustment problem was that the all Member States should abandon cascade-type sales tax systems so that they could not set their border adjustment tax arbitrarily. In the end, the failure of the "stand-still" accord accelerated the discussions on harmonization of sales tax systems within the Community.

2-3 The original bill of the first Directive bill for a common VAT: ABC subgroups and Neumark Committee

The European Commission held a second meeting on sales tax harmonization with fiscal general directors of Member States in February 1960. During the meeting, the Commission's members emphasized the importance of the sales tax system harmonization for creating a common market in the EEC. Nevertheless, the Member States' positions had not changed since the first meeting, and they remained unwilling to harmonize their fiscal system.

In the face of strong opposition by the Member States, the Commission created two new working groups in order to advance a sales tax harmonization: ABC subgroups and the Fiscal and Financial Committee. The nature of these working groups was quite different.

The ABC subgroups were comprised of fiscal experts from individual governments and those of the European Commission. They were subgroups of Working Group I, which was created during the first directors-general's meeting on June 1959. The ABC subgroups were asked to examine the different aspects of sales tax harmonization from a technical perspective.

The Fiscal and Financial Committee, called the Neumark Committee, was

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[25] AHCE, BAC 5/1966 12, Mesures dans le domaine des taxes compensatoires et des ristournes, envisagées par les gouvernements belge et néerlandais, préparées par la direction générale de la Concurrence, datées du 26 octobre 1960 ; AHCE, BAC 375/1999 303, le projet de la lettre de la Commission auprès du gouvernement allemand, daté du 30 mai 1963 ;AHCE, BAC 5/1966 12, Avis du gouvernement fédéral concernant l'interprétation de l'accord conclu le 21 juin 1960 par les représentants des gouvernements des États membres réunis au sein du Conseil au sujet des mesures dans le domaine des taxes compensatoires sur le chiffre d'affaires et des ristournes, daté du 21 septembre 1963.

comprised of ten university researchers on economics, public finance, and law. The president of the committee was Fritz Neumark, a German researcher on public finance. The commission analyzed fiscal harmonization from a theoretical perspective.

It was Hans von der Groeben's idea to create the advisory committee comprised of researchers. In his original country, West Germany, it was a common practice for the government to collaborate with university experts when the government determined its policies[26]. However, this approach was not welcomed by the French government, which was not accustomed to bringing academic opinion into public debate. The French government, especially the fiscal general direction, feared that the Neumark Committee would force the abolishing of fiscal border adjustment through the use of scientific studies[27].

In spring 1962, the two different working groups completed their reports in which they proposed the creation of a common VAT in the Community[28]. However, in both working groups, the VAT was not the only candidate for a common sales tax system. For example, in the ABC subcommittees, the Member States (except for France) preferred a wholesale tax system to a VAT because the wholesale tax was closer to their current sales tax system. As for the French representatives, they emphasized the merits of VAT such as neutrality and the encouragement of investment through its deduction system.

As for the fiscal border adjustment, the Neumark Committee proposed its abolition; the ABC subcommittees, however, did not give their final opinion. The Neumark Committee was in favor of abolishing it because it was a requirement for the creation of a veritable common market, but also because the president, Fritz Neumark, strongly supported it. Although some members disagreed with Neumark in the committee meetings, the members finally adopted the abolition of tax border adjustment as the committee's official opinion.

After the two reports were published, the DFP prepared an original bill of the first directive for sales tax harmonization in the EEC on September 1962, in which they

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[26] Seidel Katja, "DG IV and the origins of a supranational competition policy…" *op. cit.*

[27] ANF, 19900580/20, Note pour le ministre, écrite par le directeur général des Impôts, Robert Blot, au ministre des Finances, datée du 2 mars 1960.

[28] ANF, 19900580/53, Rapport général des sous-groupes, A, B et C, créés pour examiner différentes possibilités en vue d'une harmonisation des taxes sur le chiffre d'affaires, Commission de la CEE, daté du mois de janvier 1962, p. 2 ; ANF, 19900580/21, « Rapport du Comité fiscal et financier », 1962

proposed the introduction of a common VAT and the future abolition of fiscal border adjustments[29].

A favorable context for promoting tax harmonization had been created: the European integration went from the first step to the second; the fiscal bureaucrats in the Member States shared information on the VAT system through meetings in Brussels; bringing France and Germany were brought closer together on a diplomatic level.

In December 1962, the bill was the subject of debate at the European Council in which the bureaucrats of the DFP and the finance ministers of Member States took part[30]. The meeting was chaired by Hans von der Groeben. The members of the Commission recalled the advantages of the common VAT system and the removal of fiscal borders. Although Italian Finance Minister Giuseppe Trabucchi outlined the Italian government's fundamental objections to the Commission's proposal, the Council nevertheless decided to send the bill to the European Parliament and the Economic and Social Committee for advisory purposes. Although the Commission could not reach unanimous agreement among the Member States for the creation of the common VAT system, it nonetheless succeeded in transmitting the bill to the advisory bodies, which was necessary to carry the fiscal harmonization forward.

Chapter 3: Political consensus on the common VAT system

3-1 Sales tax reforms favorable to common VAT in France and West Germany

The European Parliament and the Economic and Social Committee discussed the bill between 1963 and 1964 and proposed some modifications such as (1) an introduction of the VAT system all at once (not by two steps as proposed in the original bill) and (2) a delay of the deadline for the VAT introduction at the national level until the end of 1969 and not 1967[31]. The Commission's DFP then prepared a new bill of the first directive for

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29 ANF, 19900580/59, Télex par courrier du conseiller Financier du représentant permanent, R.Mermoux, intitulé « harmonisation des taxes sur le chiffre d'affaires », daté du 18 septembre 1962.

30 ANF, 19900580/59, Télex du SGCI, session des conseils des 17 et 18 décembre, propositions de directive de la commission relative à l'harmonisation des législations des États membres en matière de taxe sur le chiffre d'affaires, daté du 18 décembre 1962.

31 ANF, 19900580/59, Note d'information sur les travaux de l'Assemblée, résolution portant avis de l'Assemblée sur la proposition de la Commission au Conseil d'une directive en matière

the fiscal harmonization in which it proposed a common VAT system and the fiscal frontier abolishment. It also proposed implementing the VAT system at the retail stage, which was not recommended by the ABC subcommittees or the Neumark Committee[32].

At the same time, the DFP proposed an outline of the European common VAT system, modeled on the French example. The characteristics of the common VAT can be summarized by three points: the general consumption tax, payment at each stage of production or distribution, and front-end tax credit method[33].

In the Community, some Member States started to think that the fate of the introduction of the common VAT had been left to the political choice of France and West Germany, who were the two most important countries for European integration. For example, according to its finance minister, the Belgian government was examining the introduction of the single-stage sales tax in the country, but the government was ready to switch to the VAT if France and Germany were willing to accept the introduction of the common VAT in the Community[34]. In fact, both countries were already prepared to do so.

In France, a significant VAT reform was adopted in January 1966. Introduced in 1954 for the first time anywhere in the world, the French VAT had been only applied to production and wholesale stages—but not to the retail stage. As there was strong opposition by the retail industry group against the application of the VAT, retail sales were exempted from the VAT and were paid as an independent sales tax. However, the reform in 1966 successfully extended the application of the VAT to the retail sales stage, too. This reform was possible because a new generation of fiscal experts, more daring than the previous generation, had emerged in the French fiscal administration during the early years of the 1960s—and this created an environment for more innovative tax reform than ever before[35].

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d'harmonisation des législations des États membres relatives aux taxes sur le chiffre d'affaires, datée du 7 novembre 1963.

[32] ANF, 19900580/59, Directive en matière d'harmonisation des législations des États membres relatives aux taxes sur le chiffre d'affaires (proposition modifiée de la Commission au Conseil), la Commission, datée du 9 juin 1964, p. 2-3.

[33] ANF, 19900580/59, Avant-projet sur les grandes lignes du système commun de TVA, direction C « Problèmes fiscaux », non daté.

[34] ANF, 19900580/59, Note d'information « harmonisation des législations des États membres relatives aux taxes sur le chiffre d'affaires », le conseiller financier du représentation permanente de la France auprès des Communautés européennes, datée du 19 juin 1964.

[35] Frédéric Tristram, *Une fiscalité pour la croissance, la direction générale des impôts et la politique fiscale en France de 1948 à la fin des années 1960*, Paris : CHEFF, 2005, p. 561-562.

The extension of the VAT to retail sales had an important impact on the discussions in Brussels. The French tax administration, which had been reluctant to cooperate in tax harmonization before, became actively involved in the matter. Two tax officials who had contributed to the extension of the VAT to the retail stage in France regularly attended tax officials' meetings in Brussels and shared French experiences with the VAT[36]. The introduction of the common VAT system in the EEC was also supported by French managers. They wanted to modernize the French tax system by leveraging the Community's pressure, so that they intervened in the discussion on sales tax harmonization at both the national and European levels[37].

During the same period, the West German government was also reforming its sales tax. It tried to transform their cumulative-type general sales tax into the VAT, and their new VAT became more neutral than the French VAT. As a result of this reform, the French and German sales tax systems came close together. These fiscal reforms of the two countries helped to persuade the other Member States to accept a common VAT and promoted discussion for the creation of a common VAT in the Community[38].

3-2 French government leads the common VAT creation

Since 1964, the European Commission has accelerated the creation of a Common Market. Through the "convergence clause" and the "Initiative 1964," the Commission attempted to promote a coordination of national policies among the Member States. In this context, the Commission's members tried to promote the abolishing of fiscal borders, which would require the Member States to uniform their sales tax rates and the deduction systems[39]. This, in turn, could affect their budget and the price of goods and services. The

[36] Philippe Rouvillois, « Michel Debré, la mise en œuvre de la loi du 6 janvier 1966 et l'adoption des premières directives 1966-1968 », in Le rôle des ministères des Finances et de l'Économie dans la construction européenne (1957-1978), Actes du colloque tenu à Bercy le 14 novembre 1997 et le 29 janvier 1998, Paris : CHEFF, Tome II, 2002, p. 34.
[37] George Égret, « Le patronat français », *op. cit.*, p.44 ; Pierre Guieu, « La Commission européenne et l'harmonisation fiscale », in *Le rôle des ministères des Finances et de l'Économie dans la construction européenne (1957-1978), Actes du colloque tenu à Bercy le 14 novembre 1997 et le 29 janvier 1998*, Paris, CHEFF, Tome II, 2002, p. 55.
[38] CAEF, B-1467, Comparaison des principales dispositions du projet de réforme des taxes sur le chiffre d'affaires préparé en Allemagne fédérale et en France. Idem, L'institution de la TVA en République Fédérale d'Allemagne, préparée par la direction générale des Impôts (France), datée du 31 janvier 1968, p. 2.
[39] ANF, 19900580/21, Note pour Dromer, Clause de convergence, écrite par H. Zeller (SGCI), datée

Member States also feared losing fiscal sovereignty. During the meetings in Brussels, the national representatives expressed opposing views.

In order to persuade them, Hans von der Groeben asked the DFP to examine the impact of abolishing the fiscal border on governments' budgets. Table 1 shows the possible impact on the budgets of the Member States if they adopted a common VAT tax rate. The country that might have experienced the most significant impact on the budget was France. It could theoretically suffer from a tax revenue shortfall at any hypothetical tax rates. The French representatives were thus unable to accept this trial calculation, and it was difficult to reach political consensus for the tax border abolishment.

du 29 octobre 1964. Idem, Clause de convergence, préparée par la direction C « Problèmes fiscaux », datée du 16 novembre 1963. Initiative 1964, Community Topics 15, December 1964, EU Commission - Brochure, p. 6. Disponible sur < http://aei.pitt.edu/34497/1/A667.pdf > (October 26, 2021)

Table 1
Impacts on the budgets of the Member States when they adopt a common VAT tax rate

	10 %	11.2 %	12 %	14 %
West Germany	0 %	+ 2.7 %	+ 4.6 %	+ 9.2 %
France	- 13.2 %	- 10.3 %	- 8.2 %	- 3.3 %
Italy	+ 5 %	+ 7.7 %	+ 10 %	+ 15 %
Netherlands	+ 5.5 %	+ 8.4 %	+ 10.3 %	+ 15.1 %
Belgium	- 2.3 %	+ 1.2 %	+ 3.5%	+ 9.4%
Luxembourg	+ 7.7 %	+ 10.4 %	+ 12.4%	+ 17.0%

BAC 375/1999 180, Problèmes soulevés par l'article 4 du projet de directive sur l'harmonisation des taxes sur le chiffre d'affaires, dans la Note pour MM. les membres de la Commission, préparée par le Secrétariat Exécutif, la Commission, datée du 20 mai 1964, p. 2.

However, this does not mean that the French government was reluctant to agree to a sales tax harmonization in the Community. On the contrary, during the final step of the common VAT creation, it was the French governments' members who played a pivotal role in adopting the first and second directives for sales tax harmonization. For this to happen, the idea of the fiscal border abolishment had to be eliminated.

The "Empty Chair Crisis" helped eliminate the possibilities. The French government firmly opposed a common budget management of the Common Agricultural Policy (CAP) and a "democratization" of the EEC. In June 1965, in order to avoid the discussion with its partners, French withdrew all its administrators from Brussels. The French Government believed that national sovereignty should be protected even after the creation of the Common Market. This view was strongly supported by the French president, Charles de Gaulle[40].

After six months of the crisis, the "Luxembourg Compromise" was concluded in January 1966[41]. Thereafter, under pressure by the French government, the Member States attempted to create a common market within the framework of national sovereignty. When it comes to the fiscal harmonization, the abolishment of fiscal border was no longer a central issue. The most important discussion point was how to make a common VAT more neutral. The French administrators then took the initiative for the creation of the common VAT.

Finally, in the articles of the first Council directive of the Council for a sales tax harmonization, the removal of the tax border has become only one of the possibilities. The Member States, except for West Germany, supported the opinion of the French government. It was subsequently decided that the tax border adjustments would remain in the EEC[42].

At the final step in adopting the directives, the discussion was difficult because of the strong opposition of the Netherlands, whose politics were then in turmoil[43]. However, the Commission was in hurry because the West German government sought to increase its compensatory taxes for imports which could exert a significant impact on the economy of the EEC's countries[44].

The bill of the first Council directive for sales tax harmonization was discussed in the Committee of Permanent Representatives (COREPER) in January 1967, adopted in February, and officially approved in April in the Council of the Finance Ministers. At the

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[40] Philip Robert Bajon, "The empty chair crisis of 1965-1966" in Ramussen Morten and L. KNUDSEN Ann-Christina, *The road to a United Europe. Interpretations of the Process of European Integration*, 2ème colloque RICHIE, Réseau international de jeunes chercheurs en histoire de l'intégration européenne, Copenhague, décembre 2006, Bruxelles : P.I.E. - P. Lang, 2009, p. 205-222.
[41] CVCE, « Le compromis de Luxembourg (janvier 1966) », dans les dossiers de Pierre Werner et la construction européenne : du plan Schuman au sommet de Fontainebleau. Disponible sur : https://www.cvce.eu/education/unit-content/-/unit/d1cfaf4d-8b5c-4334-ac1d-0438f4a0d617/a9aaa0cd-4401-45ba-867f-50e4e04cf272
[42] Philippe Rouvillois, « Michel Debré, la mise en œuvre … », *op. cit.*, p. 40-41. ANF, 19900580/60, Note : proposition modifiée de la Commission d'une première directive du Conseil en matière d'harmonisation des législations des États membres relatives aux taxes sur le chiffre d'affaires, le Conseil, datée du 22 juin 1966.
[43] ANF, 19900580/60, Télégramme à l'arrivée signé Jean-Marc Boegner, le 14 octobre 1966.
[44] AHCE, BAC 375/1999 303, Note écrite par le ministre des Finances à la Commission sur la modification des taux des taxes compensatoires sur le chiffre d'affaires en République fédérale d'Allemagne, datée du 25 novembre 1966.

same time, the bill of the second Council directive which decided some details of the common VAT, was also adopted[45]. As a result, the EEC's common VAT with a tax border adjustment was created, as the French government had expected. The Member States were then required to switch their sales tax system to a VAT by January 1, 1970.

Although Italy and Belgium could not change their sales tax system to the VAT before the deadline—due to political and economic reasons—the Council directives were nevertheless successful in showing a general framework of the European common VAT, which has become a condition for joining the European Community.

Conclusion

We will return to our first question: Why did the EEC's Member States choose a VAT for a common sales tax system?

First, a sales tax harmonization was deemed necessary in order to create a common market within the EEC. If the Member States aimed to only create a simple free trade zone, it would be enough to eliminate cumulative-type sales taxes, and it would not be necessary to harmonize tax systems among the Member States. However, their objective was to establish a *common market*, not simple a free-trade zone, where the Member States could strive to harmonize their politics, including their fiscal systems. This is why they opted for the creation of a common sales tax system, which allows the Member States to eliminate problems due to cumulative tax. Politically, we cannot ignore an important role played by the European Commission and their fiscal administration, the DFP, for the creation of the common sales tax system.

The second reason why the VAT was adopted is that the two most important countries in terms of European Integration—France and West Germany—engaged actively in the creation of the common VAT. However, their objectives were never the same. On the one hand, the West German government wanted to create a common sales tax system in order to abolish fiscal borders, which is necessary for a common market;

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[45] ANF, 19900580/60, Note, première et deuxième directives du Conseil en matière d'harmonisation des législations des États membres relatives aux taxes sur le chiffre d'affaires, datée du 14 février 1967. ANF, 19900580/50, Informations rapides sur les problèmes européens, préparé par le SGCI, datées du 2 décembre 1966.

on the other hand, France hoped to realize a common VAT in order to make a common sales tax system more neutral and investment-promoting. Thus, the separate national interests were an important driving force for the creation of the common VAT.

The French government, furthermore, had an ulterior motive: It tried to take the political initiative for European integration by leading the discussion on the creation of the VAT after the "Empty Chair Crisis." The Member States attempted to realize its political objectives and to maximize economic profits through the fiscal harmonization.

After 1970, the Member States and the European Commission started examining the possibility to harmonize the VAT's tax bases, deduction systems, and tax rates within the Community in order to create a true VAT system in the EC, successfully creating it with the adoption of the Sixth Council directive in 1977.

As France feared during "Empty Chair Crisis," the common VAT contributed to the democratization of the European Community. In December 1977, after the creation of the EC's VAT system, a portion of the VAT revenue of the Member States became the common resource of the EC. In the next year, the members of the European Parliament were first elected through direct vote. The common VAT, therefore, had contributed to the development of the European Community.

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