STUDY GROUP ON THE EUROPEAN CONSTITUTIONAL PROCESS

Working Group 11
FEDERAL TAXATION

Chair: Prof. Ana I. GONZÁLEZ
Coordinator: Samuele NANNONI

I. INTRODUCTION

1 The EU represents a "sui generis" integration process. Although it is an advanced model of political integration, it is designed as an international organization between different states.

2 The integration process has increasingly involved the transfer of powers by the member States. However, fiscal powers remain in the states, as an example of their sovereignty. In addition, this is a matter in which unanimity is required for decision-making.

3 Having a budget is inherent to any organization. This is necessary to achieve your aims. For this reason, it is also necessary that it has sufficient resources. These are one of the instruments to guarantee the achievement of the planned objectives.

4 Usually, international organizations feed their budgets with contributions from their members. The peculiarity of the European Union is that it has its own resources. Moreover, due to this and to the use of credit the financial autonomy of the EU has been recognized.

5 However, while EU spending is visible to the citizen, its resources do not have the same visibility.

6 The establishment of a system of own resources, which granted financial autonomy to the European Communities, was an important step in the integration process.

7 In any case, progress in fiscal capacity or in the own resources model will be conditioned by the direction taken by the EU. It will be decisive if intergovernmental relations predominate or if it deepens in a federal model.

II. BACKGROUND

8 The EEC Treaty of 1957 provided a single budget, including all income and expenses (article 199 EEC). At first, this budget was financed under a system of national contributions (article 200 EEC) but the possibility of replacing this model with a system of own resources was already established, in particular by revenue accruing from the common customs tariff (article 201 EEC).

9 The system of national contributions was intended as a transitory model. This system would be replaced by another model, in accordance with the EEC dimension, granting autonomy to the member states. These resources, once they were established would not require further approval by the member states, since they would be obliged to make them available to the Community in accordance with European regulation.

10 The Own Resources Decision of 21 April 1970 (70/243/CECA/CEE/CEEA) involved the substitution of the financial contributions of the Member States by own resources of the Communities. It was an "independent" financing model based on “traditional” own resources, linked to policies or activities of the European Union. Since 1970, different Decisions have specified the own resources system, revised by the Own Resources Decision of 24 June 1988 that introduced the GNI-based own resource.

11 The financing of the EU budget has remained unchanged since the 1988 Decision as its structure regards. However, the progressive decrease of the VAT-based own resource in the total budget has implied the increase of the GNI-based own resource, which currently represents more than 70% of the budget. This resource is similar to national contributions, which contradicts the financial independence of the European Union and approaches the model prior to the 1970 Decision.

12 The reform of this system has been demanded from different sectors, including the EP. The necessary unanimity for its approval may explain why there has not been an in-depth reform until now. Although there have been different reports about it.

III. CURRENT STATUS

13 The Treaty of Lisbon establishes that the EU will be financed with its own resources linked to common policies. However, of the current own resources,

only customs duties are directly related to these policies. The other own resources rather involve transfers from the Member States, which reduces the autonomy of the European Union.

14 There are several problems with the system of own resources, among them we have that it is not transparent and simple. This is recognized by the European Parliament in the Resolution of 14 March 2018 on reform of the European Union's system of own resources (2017/2053(INI)). The EP stresses that "the current system of own resources is highly complex, unfair, non-transparent and totally incomprehensible to the EU's citizens; (…) in particular to the opacity of the calculations relating to the national rebates and correction mechanisms which apply to the system of own resources or the statistical VAT-based resource". It can also be recognized by the current Council Decision (UE, Euratom) 2020/2053 of 14 December 2020 on the system of own resources of the European Union and repealing Decision 014/335/EU, Euratom.

15 Another problem may have its origin in the absence of a direct relationship between most of the own resources and the taxes paid by the citizens. What is worse, in general, they are considered by the member states rather than the EU's own resources as transfers that they provide. For this reason, they tend to value financial relations with the EU in terms of their particular net budgetary position (difference between their contributions to the European budget and the return obtained). This reduces transparency for European citizens who do not know their actual participation in European financing and it does not allow giving visibility to the budgetary consequences of the Union's policies. Different reports confirm it.[1]

16 The Decision 2020/2053 of 14 December 2020 on the system of own resources of the European Union and repealing Decision 2014/335/EU, Euratom proposed linking own resources more visibly to Union policies.

17 This Decision simplifies the calculation of the own resources and introduces a new category based on national contributions calculated on the basis of non-

1 For example, Report from the Commission - Financing the European Union - Commission report on the operation of the own resources system /* COM/2004/0505 final */ or Reform of the EU own resources, European Parliament's Committee on Budgets, March 2021.

recycled plastic. This resource is linked to the European strategy for plastics, helping to promote recycling and boost the circular economy.

18 In addition, for the first time the Commission is empowered to borrow funds on capital markets on behalf of the Union.

19 Finally, the Gross National Income (GNI)-based own resource remains a keystone of the system to ensure that the EU budget is initially balanced.

IV. FUTURE PERSPECTIVES

20 The efficient functioning of the EU requires an adequate financing capacity. Policy areas have been enlarged in recent years in reaction to emerging new challenges such as the environmental issues, public health emergency, digitalisation and related industrial policy aspects. Assuming that this shift in activity will continue, it calls for the widening of the own resources. Given the global and complex nature of the economic, security and environmental challenges we are facing, more and more common and concerted European efforts are likely to be needed to manage them, thus more EU-wide funding will be required.

21 The financing of the EU budget has remained unchanged since the late 1980s until the 2020 Decision. But, the need for an in-depth reform has also been repeated for years. The EP has called repeatedly for a reform of the system. In fact, in the Multiannual Financial Frameworks (MFF) agreement in 2013, the EP requested the appointment of a group to investigate new sources of finance for the EU's budget.

22 The final report of the High Level Group on Own Resources (December, 2016) suggested some changes in the system and the introduction of new own resources, conclusions also requested from academic literature.

23 The inter-institutional agreement of December 13, 2022 between the European Parliament, the Council of the European Union and the European Commission on budgetary discipline, on cooperation in budgetary matters and on sound financial management, as well as on new own resources, includes a roadmap towards the introduction of new own resources.

24 In order to enhance the credibility and sustainability of the European Union Recovery Instrument repayment plan, "*the Institutions acknowledge that the introduction of a basket of new own resources should support the adequate*

financing of Union expenditure in the MFF, while reducing the share of national GNI-based contributions in the financing of the Union's annual budget".[2]

25 This roadmap contains three phases, between 2021 and 2026.Only the first step has been accomplished with the establishment of a new own resource composed of a share of revenues from national contributions calculated on the weight of non-recycled plastic packaging waste.

26 As regards the rest of the proposals, the Council and EP reached an agreement on the Carbon Border Adjustment Mechanism (December, 2022). According to the provisional agreement, this mechanism will operate from October 2023.

27 A provisional deal on EU emissions trading system was also reached. However, this has not been the case with the digital tax. It has been preferred to collaborate for a consensus-based global solution on international digital taxation within the framework of the OECD that has not yet been reached.

28 The Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions. The next generation of own resources for the EU Budge*t* (December, 2021) proposes an own resource equivalent to 15% of the share of the residual profits of the largest and most profitable multinational enterprises (Pillar 1). At the moment, Council has reached agreement on a minimum level of taxation for largest corporations (Pillar 2).

29 According to this Communication, the Commission will present a proposal for new own resources by the end of this year 2023. These new resources could include a Financial Transaction Tax.

30 As the Commission considers, it would be important to reach a quick agreement on the proposals to amend the Own Resources Decision and the Regulation establishing the multiannual financial framework for the years 2021-2027, as well as a quick subsequent approval by the Member States.

31 However, the roadmap towards the introduction of new own resources as provided for in Annex II of the 2020 Interinstitutional Agreement set **three types of criteria to be met**, for all possible new own resources' options.

2 Interinstitutional Agreement, Anexe II.

32 The **first type entails the substantive criteria** i.e. the new own resources should be aligned with EU policy objectives and should support EU priorities such as the European Green Deal, or the Digital Europe Programme, and should contribute to fair taxation and the strengthening of the fight against tax fraud and tax evasion. Such criteria should be taken into account when deciding the contents of tax to be imposed and the policy field in which the tax will be introduced. The substance of the above-described political agreements on new taxes seem to abide with these criteria, in terms of policy fields but their impact on reducing tax evasion and fraud needs to be further researched.

33 The **second type entails the budgetary/financial criteria** i.e. the capacity of the new own resources to generate “new money”. The ratio behind these criteria seeks to achieve a balance between covering the need to increase the Union’s revenue and avoiding the excessive increase of bureaucratic and financial burdens on taxpayers (both legal entities and citizens). Also, the reduction of the Member States’ current contribution through the GNI own resource should be taken into account. The suggestions put forward so far cannot replace the total amount of revenue generated by the GNI-based own resource but their structure (tax rate, tax basis, etc.) may be extended to meet that requirement, in conjunction with corresponding amendments to existing similar national tax obligations.

34 The **third type of criteria entails the procedural criteria**, i.e. the new own resources should fulfil the criteria of simplicity, transparency, predictability and fairness. Simple and monodimensional provisions and procedures that will not confuse the persons involved (tax authorities and tax payers), transparent reasoning of the calculation of the resulting tax burden, predictable tax burden that will enhance mutual trust between tax authorities and tax payers thus reducing incentives for tax evasion, and fair treatment, i.e. proportional tax burden according to taxable capacity of each person (legal entity or individual).

35 Of course, all these criteria should be considered in tandem with possible adjustments to the national taxation framework in all EU Member States, in order to coordinate the relevant administrative procedures and – more importantly - avoid overburdening the taxpayers with additional tax obligations.

36 Beyond this reform, the evolution of the integration process could affect the financing system. According to the treaties, the EU has no right to levy taxes

and must respect national fiscal sovereignty when introducing new own resources. However, a deepening towards a federal model should also consider a tax capacity of the EU. In this sense, fiscal federalism could serve as a guide in relation to the choice of new own resources.

37 Some policies may be linked to particular dedicated new resources, as is the case with the policy of green transition and national contribution on the basis of the use of non-recycled plastic; but, as a principle, financing of a strategic policy area, boosting the circular economy in this case, should not be necessarily tied to a particular taxable product or activity. Where negative externalities emerge in the market, the correcting efforts may include EU-wide user fees, pricing or regulatory measures but key policy areas should be financed in a sustainable way, from a stable pool of own resources.

38 While member states mostly tend to rely on taxing labour and consumption (VAT, excise) predominantly, and to a lesser degree on taxing corporate income and property, EU-level own revenues have a different pattern due to earlier developments of the integration process, and the principle of national sovereignty of taxation in member states. A move to a more federal structure may open up new allocation of tax revenues within the EU, but the EU-level tax revenue mix should not copy the pattern of the member states even in a longer term. Given that the Union functions as a single market for goods, services and capital with products and services produced and sold on a vast single market, a strong case can be made that not only tax on consumption (VAT) but corporate income as well should be shared between the member states and the EU level. The ongoing international efforts to collect a fair share of multinationals' profit is an important step toward a global order but also toward a potential future structure of the EU-level tax system, on the condition that member states reach agreement on the principles and system of a new and enlarged own resource of the EU.

39 As not only doing business and earning corporate incomes may have a cross-border nature in present day Europe but paying (and sometime avoiding) taxes as well, there is also a strong case for a federal corporate tax framework, including supervision. This aspect is highly political but a future design of the EU-level tax policy framework must deal with the control and enforcement aspect of taxation (particularly concerning business actors). Such a tax policy

design may include the universal, EU-wide mandate of the EPPO as an agency to strengthen the functioning of the single internal market.

40 There is no fiscal union in the EU, but fiscal integration is necessary to meet the objectives of a public finance, especially in the context of an economic and monetary union.

41 Despite the difficulties, steps have been taken to transfer fiscal sovereignty. Although there are still handicaps for further progress, such as the unanimity rule.

42 Overall, this perspective sets a **challenge of "constitutional" or "fundamental" proportions for the EU**, as it calls for a major shift of the status quo of the conferred competences upon the EU by the Member States, by tipping the balance established so far. More specifically granting the EU the authority of imposing taxation at EU level, would call for a strategic re-examination of the overall procedure of establishing the own resources system at EU level.

43 Such a re-examination should focus on the **involvement of other actors in the decision-making process on EU taxation**. Based on the axiom "no taxation without representation" which is one of the foundations of modern western democratic regimes, the participation of the European Parliament in the relevant procedures should be reinforced and increased from the level of "consent" (as provided for in the current provisions of the Treaties) to the level of "co-decision" as an equal actor, along with the Council, the democratic legitimisation of which is strong at national level (for its individual members) but much weaker at EU level. Furthermore, the rule of unanimity regarding the decision-making process about the own resources system should be revisited and the adoption of a qualified majority rule may be considered as a means of facilitating progress and avoiding the use of veto for imposing "political" agendas other than the own resources system.

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