

# Interim digital services tax on revenues from certain digital services

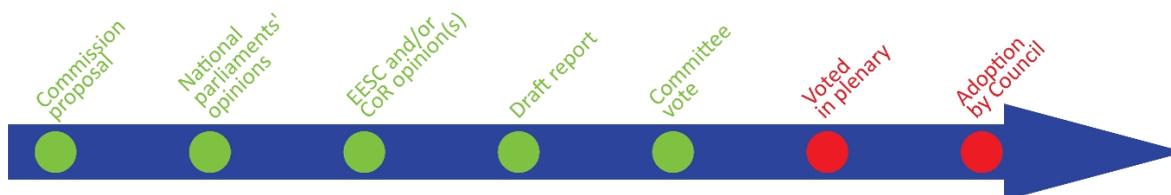
## OVERVIEW

According to the European Commission the digital economy is relatively under-taxed when compared with traditional businesses. Certain inherent characteristics such as reliance on cross-border provision of services without physical presence, easy transfers of intangible assets, and novel ways to create value make it particularly easy for enterprises to limit their tax liabilities.

In order to provide a solution to this problem, in March 2018 the Commission adopted the 'fair taxation of the digital economy' package, comprised of two proposals. One concerns a permanent reform of corporate tax regime while the second is a proposal for a directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services, which would apply as an interim measure until the permanent reform has been implemented. The tax is to cover businesses above two thresholds: total annual worldwide revenues exceeding €750 million and annual revenues in the EU exceeding €50 million. The proposed single rate is at 3 %, levied on gross revenues resulting from the provision of certain digital services where user value creation is essential.

Parliament's Committee on Economic and Monetary Affairs (ECON) adopted a report proposing to widen the scope and reach of the tax. The plenary vote is expected during the December session.

<b>Proposal for a Council directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services</b>		
<i>Committee responsible:</i>	Economic and Monetary Affairs (ECON)	COM(2018) 148 21.3.2018
<i>Rapporteur:</i>	Paul Tang (S&D, the Netherlands)	2018/0073(CNS)
<i>Shadow rapporteurs:</i>	Gabriel Mato (EPP, Spain) Ashley Fox (ECR, UK) Petr Ježek (ALDE, Czech Republic) Martin Schirdewan (GUE/NGL, Germany) Eva Joly (Greens/EFA, France) Marco Valli (EFDD, Italy) Barbara Kappel (ENF, Austria)	Consultation procedure - parliament adopts only a non-binding opinion
<i>Next steps expected:</i>	Vote in plenary	



## Introduction

Fair rules for the taxation of the digital economy are part of the Commission's broader taxation agenda, which aims to strengthen the single market by establishing an efficient, growth-friendly and transparent tax environment able to tackle tax avoidance<sup>1</sup> and secure sustainable public revenues. Action in this area with relevance to the digital economy has centred mainly on the [reform](#) of the corporate tax framework and the [VAT system](#). The latter has been updated to take into account the changes resulting from digitalisation, with a move in particular toward a [destination](#)-based system.

EU takes action in this area because, while the digital economy is an important driver of economic growth, it also presents challenges to a taxation system devised for traditional 'bricks and mortar' companies and cross-border sale of goods. It is indeed recognised internationally that, as a result of this, the digital companies pay lower effective taxes than their traditional counterparts. The digital economy through its inherent characteristics, such as reliance on cross-border provision of services without physical presence, easy transfers of intangible assets, and novel ways to create value, makes it particularly easy for enterprises to limit their tax liabilities.<sup>2</sup> It is worth noting that tax avoidance is not limited to the digital sector, however, as [multinational enterprises](#) from other sectors also utilise the fact that the tax jurisdiction is linked with geographical location while they operate globally.<sup>3</sup>

The Commission highlighted challenges related to taxing the digital economy in its 2017 [communication](#) 'A fair and efficient tax system in the European Union for the digital single market'. It outlined options for permanent reform of the corporate taxation rules to adapt them to the realities of the digital economy and for a short-term solution to protect the tax bases of the Member States. Also, President Juncker's [letter of intent](#) accompanying the 2017 address on the state of the Union announced that the Commission would be tabling a proposal for rules allowing taxation of profits generated by multinationals through the digital economy. This was followed by calls from the Council asking the Commission also to consider temporary measures when devising a taxation system fit for the digital economy.

## Context

The [mismatch](#) between tax rules and digitalisation, especially regarding large companies operating in [multiple jurisdictions](#), has been being discussed internationally for some time. The fundamental questions of how to address the issue and at which level – working out a global consensus or implementing interim measures sooner since this process is lengthy – are still being debated.

International efforts on digital taxation began in 2013 with the OECD's base erosion and profit shifting ([BEPS](#)) project. One of its actions deals specifically with the digital economy and one of its outcomes has been the March 2018 interim [report](#) on 'Tax challenges arising from digitalisation'. The document shows that there is no consensus among countries on how to adapt international tax framework permanently to the digital era, but that the intention is to arrive at a new global consensus by 2020.

The report also discusses the topic of interim measure turnover taxes, which has polarised countries depending on the expected benefits or losses to their tax jurisdictions. Those in favour consider that there is a sound imperative to act so that the tax paid by digital businesses corresponds to value generated in their jurisdictions. These countries consider that the current situation challenges the fairness, sustainability and public acceptability of the system. Taking into account the length of time it will take to achieve a global consensus on taxing the digital economy, they believe that more immediate action is needed. By contrast, countries that oppose the measure consider that there are a number of risks and adverse consequences such as negative impact on investment, innovation, growth and welfare, passing the tax on consumers and businesses, possibility of over-taxation, implementation difficulties and compliance and administration costs.

## Existing situation

There are currently no EU rules addressing the digital aspects of corporate taxation and there is no revenue-based EU tax on profits from digital activities. Under international law, the only business profits of a non-resident taxpayer that are liable for taxation are those that are [attributable](#) to permanent establishment in a tax jurisdiction. In order to avoid double taxation, the tax treaties (usually bilateral) strike a compromise between source and residence taxation. When the rights to tax are given to the source, the residence country [subsequently](#) either gives a credit for such taxes paid, or exempts the concerned income from its taxes. However, research shows that in an increasingly globalised world, there has been a [shift](#) towards residence taxation and [weakening](#) of the source taxation.

In case of large companies, the effective tax rate can be lowered by means of a combination of features of permanent establishment,<sup>4</sup> transfer pricing,<sup>5</sup> and the use of double taxation treaty provisions.<sup>6</sup> Furthermore, some inherent features of the digital economy can facilitate tax avoidance. For example, digital activities do not require a permanent establishment to carry out business in the source state and can generate significant profits there that as a result cannot be taxed. Conversely, the tax residence country can also be affected negatively. It may be the state where the services used via the internet are produced, but if the servers hosting the website through which these services are offered happen to be located in the low-tax jurisdiction, the permanent establishment may be determined there and the tax revenue of the residence country be reduced.

The OECD has identified other characteristics of digital businesses that are particularly pertinent to taxation challenges.<sup>7</sup> These features have also been [highlighted](#) by the Commission and are repeated in discussions on the topic. Digital enterprises rely heavily on intangible assets, particularly intellectual property, that are often hard to value. Furthermore, user participation, user generated content, network effects (for example, when users are the building blocks of networks) and data collection and mining are common for highly digitalised businesses. While they are precious assets in a digital economy and help to generate profits, it is difficult to value and tax these aspects. While valuing intangible assets is very difficult, they can be moved around the globe instantaneously in the digital world and this provides [opportunities](#) for aggressive tax planning. Although permanent establishment exists, by shifting intangible assets to low tax jurisdictions companies can [lower](#) their effective tax rates significantly. Despite recognition of the challenges at international level, the outcome of the work of bodies such as the OECD has been [limited](#) and there is not yet a common [understanding](#) of the concept of 'value creation' in relation to the digital economy.

The Commission considers that the current rules fail to recognise new business models and new ways in which value is created, and acknowledge the role of users in the process. It concludes in the accompanying [communication](#) to the proposal: 'all of this means that there is a disconnect between where the value is created, and where taxes are paid'. It also considers the current situation to be unsustainable and likely to get worse in an increasingly globalised and digitally connected world, with the digital economy on a path to growth. The Commission sees that if nothing is done tax avoidance opportunities are likely to grow and consequently tax revenues will further decrease, with a negative impact on social fairness and the level playing field for businesses. The [impact assessment](#) accompanying the proposal mentions that 10 Member States have planned or implemented unilateral indirect taxation measures.<sup>8</sup> As many as 15 of the 21 Member States that replied to the [consultation](#) stated that more unilateral measures were probable. For the Commission, this could endanger the integrity of digital single market as unilateral actions are a force for fragmentation. There is, therefore, a need to act before a more permanent solution to digital taxation can be put in place. In the absence of action there may be new tax barriers to start-ups and scale-ups and competitiveness may be affected negatively by an incoherent tax system and unstable environment. Furthermore, national rules forming partitions would make it more difficult to agree on common EU rules in the future.

## Comparative elements

In 2016, France<sup>9</sup> extended its tax on the distribution of audio visual content to include online video-on-demand services that are provided for free but monetised through advertisements shown to viewers. The tax is imposed at a flat rate of 2 %, unless the services contain pornography or incitement to violence in which case it is 10 %. Nexus is established based on destination of service, such as the location of the audience, and covers both resident and non-resident enterprises.

[Italy](#) has adopted a levy on digital transactions that is expected to become effective from 1 January 2019, aiming to ensure level playing field between digital and traditional businesses and capture activities presently uncaptured by corporate tax rules.<sup>10</sup> The rate of the levy will be at 3 % of the value of the taxable transactions concluded with customers resident in Italy. Suppliers with fewer than 3 000 taxable transactions annually will be exempted. It is estimated that the levy will raise approximately €190 million a year.

[Hungary](#) introduced tax on advertising (including through websites) in 2014. Initially designed with progressive rates ranging from 0 % to 50 %, it was amended after the [decision](#) of the Commission that found it to be in breach of EU rules. Present rules stipulate that only entities exceeding HUF100 million<sup>11</sup> in revenue must pay advertisement tax at the rate of 5.3 %. The nexus is established when the advertisement is shown in the Hungarian language, irrespective of the location of the publisher and of the advertiser. Tax authorities reported a low level of compliance by non-resident companies.<sup>12</sup>

[Australia](#) is moving towards taxing digital companies and is presently developing its own policy options owing to slow progress at international level. Some reports suggest that a measure similar to the interim tax proposed by the EU is being considered – a [levy](#) of 3 % on advertising revenue from 'globally significant enterprises' with annual [turnovers](#) of more than AUD1 billion.

In 2016 [India](#) introduced an [equalisation levy](#) on online advertising revenue earned by non-resident e-commerce companies. The tax base is the value of the transactions, not the profits. It works as a reduction of 6 % from amounts paid for the provision of online advertisement services to non-residents with no permanent establishment in India. The minimum revenue threshold for application is INR100 000 annually.<sup>13</sup> Only cross-border transactions are covered.

## Parliament's starting position

In its [resolution](#) of 16 December 2015, the European Parliament highlighted the challenges raised by digital business taxation, and in particular the need to adapt underlying concepts such as 'permanent establishment'. The resolution of the TAXE Committee approved by Parliament in [November 2015](#) underlined the risk that in the absence of a cooperative approach, unilateral measures taken by Member States might create new loopholes and opportunities for tax avoidance. It also called on the Commission to 'seek to ensure a fair tax system based on the principle of taxation in the Member State where profits are generated, thus avoiding internal market distortion and unfair competition.' The resolution of the TAXE 2 Committee approved by Parliament in [July 2016](#) called on the Commission to present a concrete legislative proposal on transfer pricing, which is a channel used predominantly for profit shifting. The resolution of the Committee of Inquiry into Money Laundering, Tax Avoidance and Tax Evasion (PANA), adopted in [December 2017](#), called on the Commission to include digital businesses in all European anti-tax avoidance and tax-related measures.

Furthermore, during the discussion on the common consolidated corporate tax base (CCCTB) [proposal](#) and the common corporate tax base proposal, the European Parliament voted in favour of taxing companies where their profits are made. It proposed a harmonised corporate tax system that uses certain benchmarks (such as the number of users or the volume of digital content collected) to establish whether an enterprise has a taxable digital presence in the EU.

## Council starting position

On 22 May 2013, the European Council [underlined](#) that efforts are required to respond to the challenges of taxation in the digital economy. Following a political [statement](#) by several EU finance ministers, which supported a concept of launching a so-called 'equalisation tax' on the turnover generated in the EU by digital companies, the Council adopted its [conclusions](#) on 19 October 2017. It underlined the need for an 'effective and fair taxation system fit for the digital era'. Furthermore, the ECOFIN Council [conclusions](#) of 5 December 2017 noted 'the interest of many Member States for temporary measures, such as for example an equalisation levy based on revenues from digital activities in the EU'. The ECOFIN Council asked the Commission to consider these measures. The Bulgarian Presidency presented a digital taxation [roadmap](#) in May 2018, stressing that the issue merited the highest degree of priority in the Council.

## Preparation of the proposal

The Commission began to analyse the issue in the framework of the High Level Expert Group on Taxation of the Digital Economy [set up](#) in 2013. Its final [report](#) from 2014 concluded that there should be no special tax regime for digital companies, but rather one regime that also covers digital economy. It recommended setting up a well-coordinated and easy to comply tax system in which tax incentives and credits are administered with caution.

In September 2017, the Commission adopted a [communication](#) on a fair and efficient tax system in the EU for the digital single market. It suggested ways forward, namely developing a long-term solution preferably in the general international corporate tax framework. It also mentioned options for short-term measures in order to protect the direct and indirect tax bases of Member States. These could be in a form of: (i) an equalisation tax on turnover for all untaxed or insufficiently taxed internet-based activities, (ii) a withholding tax on digital transactions, specifically on certain payments made to non-resident providers of goods and services ordered online, or (iii) a levy on revenues generated from the provision of digital services or advertising activity applied to 'all transactions concluded remotely with in-country customers where a non-resident entity has a significant economic presence.' The communication announced that the relevant legislative proposals would be issued in spring 2018.

In a public [consultation](#) on fair taxation of the digital economy, respondents overwhelmingly agreed that the current rules allowed digital companies to limit their tax contributions and that something needed to be done about it. More than half of those responding (54 %) saw the need for interim measures (35 % were opposed) with the most preferable option being a tax on revenues from certain digital services 'concluded remotely with a non-resident entity that has a significant economic presence'.

The [impact assessment](#) recommended using a tax based on revenue, maintaining that other solutions, such as raising VAT or introducing a transaction tax or a tax on profits, were not applicable. Reasons included respectively no feasibility within an EU tax framework, excessive difficulties with implementation, and interference with double tax conventions.

## The changes the proposal would bring

The European Commission adopted its [proposals](#) for taxing the digital revenue of companies on 21 March 2018. The fair taxation of the digital economy [package](#) is comprised of two proposals. In the longer term, the Commission proposes a [reform](#) of the corporate tax rules in order to include a significant digital presence. The short-term solution is to be delivered by a proposal for a [directive](#) on the common system of a digital services tax on revenues resulting from the provision of certain digital services, which would apply as an interim measure until the permanent reform has been implemented.

The Commission describes this new temporary tax as 'a good and simple interim proxy to deal with the most extreme cases of mismatches between the location of taxation and value creation.' It would be levied on the gross revenues resulting from the provision of certain digital services where user value-creation is essential. Revenues from the following activities would be taxable: (i) targeted online advertising, (ii) intermediation services, such as online platforms and multi-sided digital interfaces that allow user interaction and may facilitate sales of goods and services among them, and (iii) the transmission of data collected about users and generated from users' activities on digital interfaces.

Businesses above two thresholds would be liable:

- those with total annual worldwide revenues exceeding €750 million, and those with
- EU annual revenues exceeding €50 million.

The proposed single rate across the EU would be set at 3 % and the tax would apply to both non-resident and domestic companies and to domestic and cross-border transactions. Member States would collect the tax revenues allocated to each country proportionally to the number of users of the taxed service. The Commission estimates that the resulting revenue would be around €5 billion annually.

## Advisory committees

The European Economic and Social Committee (EESC) adopted its [opinion](#) on 12 July 2018. The EESC is concerned that taxing not corporate profits but turnover may benefit larger economies with numerous consumers at the expense of smaller exporting countries. It also called for the introduction of a sunset clause ensuring that the tax is withdrawn when a permanent solution is implemented. The Committee of the Regions adopted its [opinion](#) on 5 December 2018.

## National parliaments

The deadline for the submission of reasoned opinions was 17 May 2018. The Danish, Irish, Maltese and Dutch parliaments have sent [reasoned opinions](#), saying that the proposal is not compatible with the subsidiarity principle. These countries argued that taxation is a national competence and that the proposal therefore has an unclear legal basis. They also question the need for an EU solution given the ongoing work of the OECD.

## Stakeholders' views<sup>14</sup>

The [larger European countries](#) (Germany, Spain, France, Italy and the United Kingdom) welcomed the proposal and agreed that, in the absence of a global consensus under the G20/OECD, it was necessary to move forward at the EU level. However, there are significant [differences](#) in opinion among the Member States and proposals on digital taxation are a [difficult issue](#) in some Member States.

The [Tax Justice Network](#) (TJN) welcomed the proposal, underlining that the EU has set the course toward a profound shift in international tax rules, which needs to be followed globally, with a view to protecting the tax bases of lower income countries in particular. The TJN sees the tax as an effective way to end the tax abuses of large digital services companies.

While [Oxfam](#) acknowledged that the proposal was updating EU rules in order to deal with the challenges of the digital economy, it considered that the new tax targeted only a limited number of large companies, and would not prevent businesses from systematically avoiding paying of billions of euros in tax liabilities.

Trade unions represented by [Public Services International](#) welcomed the proposal as a 'good first step to address public outrage over the dodgy tax practices of some of the world's biggest corporations'. It reiterated that tech companies needed to pay their fair share of taxes and noted that the EU proposal highlighted the fact that the OECD BEPS process had not fixed the problem.

The [OECD](#) considers<sup>15</sup> that the development of an EU-level solution, in form of an equalisation tax based on revenues, before a global one, while likely to increase taxation of the digital economy, comes with the risk of 'economic distortions, double taxation, increased uncertainty and complexity, and associated compliance costs for businesses operating cross-border', in some cases potentially conflicting with pre-existing bilateral tax treaties.

The [KPMG](#) consultancy firm considers that the proposal is not contrary to third countries' interests or World Trade Organization rules or any double taxation agreement.

[Lobby groups](#) for large technology companies have reportedly criticised the proposal, arguing that the EU should focus on OECD efforts to find an international solution.

## Academic views

Researchers from the [Oxford University Centre for Business Taxation](#), in response to the Commission consultation, considered that interim turnover tax is likely to have distortive effect and will be politically difficult to reverse.

Academics from [University of Muenster](#) argue that the interim tax will increase complexity and create legal uncertainty and administrative burdens for the affected businesses.

Legal researchers from the [International Bureau of Fiscal Documentation](#) deliberate on taxing the digital companies and propose a new permanent establishment nexus, which contains four main elements or requirements: (i) limited to digital services; (ii) user threshold; (iii) a certain time threshold, and (iv) a *de minimis* revenue threshold.

## Legislative process

To adopt the directive, the Council needs unanimity, after consulting the European Parliament. The proposal is being examined within the 'Working party on tax questions (direct taxation)'. The Commission gave a presentation to the Council in April 2018 and to Parliament in May 2018. On 29 November 2018 the Austrian Presidency published a compromise text setting out those positions that enjoy the broadest support from Member States. However, the text did not gather the necessary [support](#) of delegations and was therefore not discussed in detail during the public ministerial policy debate held on 4 December 2018. However, ministers examined a joint declaration by the French and German delegation which proposes to limit the tax base to revenues from sales of advertisements. The Presidency recommended that the working group continues working on the basis of this joint declaration and the Presidency compromise text.

In the European Parliament, the draft report was published on 21 September 2018 and the Committee on Economic and Monetary Affairs (ECON) held its vote on 3 December 2018. The committee's report proposes to lower the threshold above which companies would need to pay the tax from €50 million to €40 million. It also proposes to broaden the tax base by including the supply of digital content such as video, audio, games and text, and the processing and sale of data collected from users and generated from their activities on digital interfaces. In principle, the tax should cover revenues generated from the supply of digital services where users or intangible assets contributed significantly to the process of value creation. The tax would also cover services consisting of the supply of digital content by an entity through a digital interface, regardless of whether the digital content is owned by that entity, or that entity has acquired the rights to distribute it. Finally, the level of revenues generated by the tax should be evaluated by the Commission within two years of the entry into force of the directive.

Taxing rights would be given to the Member State where the goods or services are delivered to the buyer. When a taxable person is liable for taxation in more than one Member State, the Commission would audit, every three years, the tax return filed with the Member State of identification. Furthermore, the report requests the Commission to examine the possible establishment of a dispute-resolution mechanism for cases of disagreement on the allocation of taxable revenues

among Member States. The total digital service tax paid in the different Member States by a taxable person should be part of the system of country-by-country reporting. The report also introduces a sunset clause specifying that the tax would expire: (i) with the adoption of a proposal for a significant digital presence, or (ii) with the introduction of both a common corporate tax base (CCTB) and a common consolidated corporate tax base (CCCTB), should they include the concept of the [digital permanent establishment](#) as requested by the European Parliament, or (iii) with the implementation of an international solution reached in a forum such as the OECD or the United Nations. In case no comprehensive solution were to be agreed by 31 December 2020, the committee asks the Commission to consider presenting a proposal based on Article 116 TFEU, which provides for the ordinary legislative procedure to be used.

Two years after the date of entry into force of the directive, the Commission should assess its application and present a report to the European Parliament and the Council. The Commission should then focus on the possibility of increasing the tax rate from 3 % to 5 %, on the scope and the amount of tax collected, and on the methods used by companies to avoid the tax. Member States would report relevant figures to the Commission annually, as well as inform it on the payment of the tax, and on their cooperation with other national tax authorities.

## EP SUPPORTING ANALYSIS

Delivorias A., [Common consolidated corporate tax base \(CCCTB\)](#), EPRS, European Parliament, June 2018.

Remeur C., [Understanding the OECD tax plan to address 'base erosion and profit shifting' – BEPS](#), EPRS, European Parliament, June 2017.

[Tax challenges in the digital economy](#), Policy Department for Economic and Scientific Policy, European Parliament, June 2016.

## OTHER SOURCES

[Common system of a digital services tax on revenues resulting from the provision of certain digital services](#), European Parliament, Legislative Observatory (OEIL).

[Tax challenges arising from digitalisation – Interim report 2018](#), OECD.

## ENDNOTES

- <sup>1</sup> Tax avoidance continues to be a significant problem. A [study](#) for the EPRS estimates that revenue losses for the EU owing to corporate tax avoidance could amount to €160-190 billion per year.
- <sup>2</sup> A [study](#) for the European Parliament's second special Committee on Tax Rulings (TAXE 2) identified the issues that arise from taxing the digital economy: 'difficulty to define tax jurisdiction, the problem of attributing value to data created by users free of charge and the dilemma on whether or not e-commerce transactions fall under the category of royalties (...) Thin capitalisation, transfer pricing, hybrid mismatches, circumvention of controlled foreign capital (CFC) rules, preferential tax regimes and artificial contractual agreements are commonly used methods to eliminate tax base by multinational enterprises (MNEs) in the digital sector'. It is worth noting that these abuses are not exclusive to the digital economy but are also deployed by 'traditional' companies.
- <sup>3</sup> A June 2018 research [paper](#) estimates that close to 40 % of multinational profits are shifted to low-tax countries every year, and that the tax revenue losses are largest for the European Union and developing countries.
- <sup>4</sup> A growing body of academic [literature](#) underlines the problem with the definition of permanent establishment, seeing it as unfit and [obsolete](#) in the context of digital economy.
- <sup>5</sup> Academic [research](#) points to [transfer pricing](#) as an important channel of profit shifting and an area that [merits](#) the immediate attention of [policy makers](#). Transfer pricing rules have also been developed in the area of the traditional 'bricks and mortar' economy.
- <sup>6</sup> These provisions may lead to double non-taxation, as explained in the [study](#) for the European Parliament's second special Committee on Tax Rulings (TAXE 2) (p. 46).
- <sup>7</sup> They are discussed extensively in Chapter 2 of the Tax challenges arising from digitalisation [report](#), OECD 2018, pp. 23-60.
- <sup>8</sup> For more details, see page 54 of the [impact assessment](#).

<sup>9</sup> OECD (2018), p. 146.

<sup>10</sup> *Idem*, p.143.

<sup>11</sup> Approximately €320 000.

<sup>12</sup> For more details, see OECD [report](#), p.145.

<sup>13</sup> Approximately €1 400.

<sup>14</sup> This section aims to provide a flavour of the debate and is not intended to be an exhaustive account of all different views on the proposal. Additional information can be found in related publications listed under 'EP supporting analysis'.

<sup>15</sup> See the 2018 report on [Tax Challenges Arising from Digitalisation](#), p.159.

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