EU Own Resources

Background note for the BUDG public hearing on **"EU Own Resources and Fiscal Policy Harmonisation: Untapped potential for Synergies?"** European Parliament, Brussels, 23 January 2020

The EU revenue: a very specific structure

Article 311 of the Treaty on the Functioning of the European Union states that "*the Union shall provide itself with the means necessary to attain its objectives and carry through its policies. Without prejudice to other revenue, the budget shall be financed wholly from own resources*". In addition, Article 323 makes clear "*the European Parliament, the Council and the Commission shall ensure that the financial means are made available to allow the Union to fulfil its legal obligations in respect of third parties*".

Moreover, contrary to the Member States, the **European Union is not allowed to borrow**[1]to finance its policies or to cover any budget deficit[2], neither does it have the power to raises taxes. In practice, this balance principle implies that each year the **EU budget has to be in equilibrium** and revenue is determined according to the authorized level of expenditure (which is capped by multiannual ceilings). In addition, the overall volume of own resources that can be called on in any given year is restricted by a ceiling, which, for the 2014-2020 period, is set at 1.23% of the EU GNI.

Revenue for the EU budget comes from three types of own resources:

Traditional own resources (TOR) consist of custom duties, agricultural duties and sugar and isoglucose levies[3] which result directly from the existence of a unified customs area and are collected by Member States. Moreover, the Member States are authorized to retain a share of the collected amount as collection costs, for the 2014-2020 period this share amounted to 20% as opposed to 25% during the 2007-2013 period.

The VAT-based own resource results from a complex calculation based on a theoretical harmonised VAT base statistically computed for each Member State. Currently, the VAT base is not fully harmonised across Member States as derogations and different types of VAT rates continue to exist. Therefore, this VAT resource is **not levied directly on the final consumers** (who actually bear the VAT burden) but on the net VAT revenue collected, corrected and adjusted in order to obtain a harmonised VAT base. A uniform call-rate of 0.3% is then applied to each Member State's harmonised VAT base, with the exception of Germany, the Netherlands and Sweden, which benefit from the reduced call rate of 0.15%. In other words, this resource comes from national budgets.

[1] However, while borrowing to finance the EU budget is not allowed, for financial assistance by the Union to Member States or third countries the Commission can borrow the necessary funds on behalf of the Union on the capital markets or from financial institutions.

[2] Article 310 311 of the Treaty on the functioning of the European Union "*the revenue and expenditure shown in the budget shall be in balance*".

[3] As of 2018 the sugar sector levies no longer apply, Article 124 of Regulation (EU) N° 1308/2013(OJ L 20.12.2013, p 671)

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PE 647.459 - January 2020

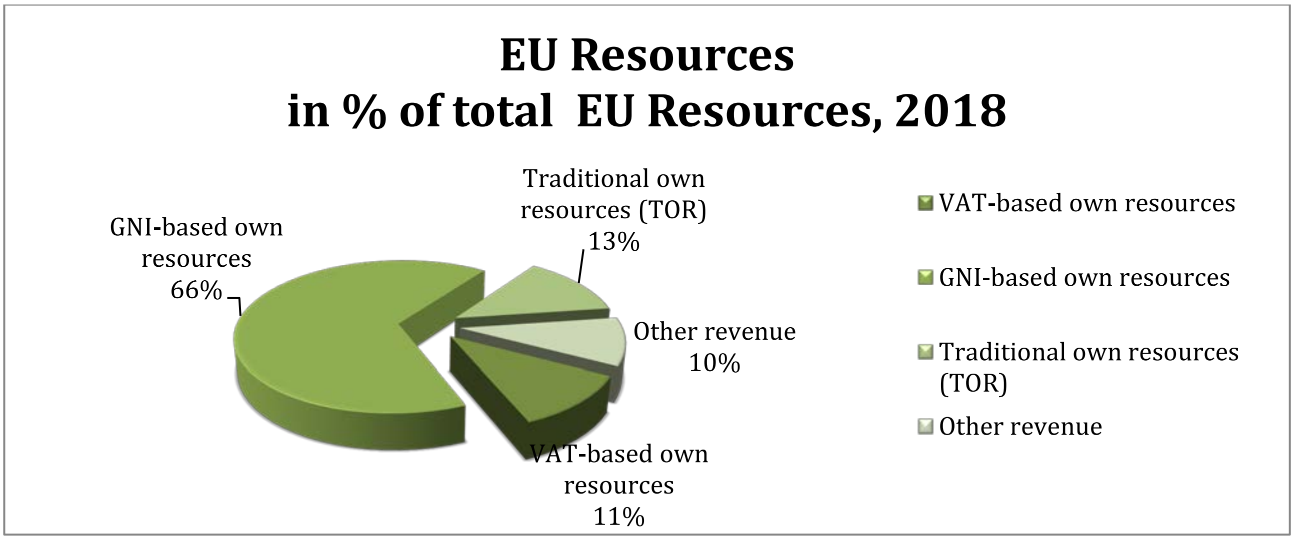
In cases where the taxable base of the VAT-based own resources is higher than 50% of a Member State's GNI, a 'capping mechanism' applies, whereby the call rate is applied to an amount equivalent to 50% of the Member States GNI. In such cases, this own resource is transformed even more clearly into a national contribution (e.g. in 2018: four Member States were concerned[4]).

It should also be stressed that any **frauds to VAT[5]** like "carrousel fraud" **directly impact the VAT-based own resources and therefore the composition of EU revenue**.

<u>GNI-based own resource</u> is a percentage of Member States' GNI calculated for each budget in function of other revenue and own resources. Initially created to **play the role of a residual balancing item in the EU budget**, this resource **has grown to represent around two thirds of the total revenue**, around 66% in 2018.

Finally, **<u>other revenue</u>**, which is anchored in legal bases other than the own resources decision, comes from fines to companies breaching EU competition law or other EU laws, contributions of non-EU countries to specific EU programmes, and taxes on EU staff salaries.

Graph 1 - EU resources in % of total EU resources 2018



Source: European Commission - EU Budget 2018 - Financial Report

[4] Croatia, Cyprus, Luxembourg and Malta.

[5] In 2013, the European Commission estimated the total losses, including fraud and evasion but also legal tax avoidance, bankruptcies and financial insolvencies to 1.5% of the EU GDP.

How to improve Own Resources: What has been done?

At the **request of the European Parliament** in the context of the difficult negotiations over the Multiannual Financial Framework 2014-2020 **a High Level Group on Own Resources**[6] was created in February 2014 to reflect on **finding more transparent, simple, fair and democratically accountable ways to finance the EU**. The group delivered its final recommendations[7] for a simpler, fairer, more transparent and democratically accountable system in December 2016. In particular, it advocated introducing **new categories of own resources** with a closer link to EU policies and the Single Market and **discontinuing correction mechanisms**. These recommendations were in line with the long standing position of the European Parliament to reform the revenue system.

The **Commission's legislative proposals for own resources**, which were published as part of the MFF package, in May 2018 put forward:

- to retain customs duties as one of the EU's own resources, but at a lower collection rate for Member States (10% instead of 20%).
- to retain the GNI-based resource as a significant source of revenue
- to simplify the calculation for contributions based on the VAT component.

Together, these three own resources would make up 87 % of EU revenue. In addition, **three new own resources** would be introduced, based on a new **tax scheme for EU companies (**CCCTB), the **EU Emissions Trading System** (ETS) and a **contribution levied on unrecycled plastic packaging waste**.

Moreover, **phasing out all correction mechanisms**[8] and **increasing the ceilings for own resources** are also proposed. However, the **phasing out would be gradual between 2021 and 2025**. The reference amounts of all the corrections for the five Member States concerned would be based on their calculation for the year 2020 under the current system. All corrections would be turned into lump sums and progressively reduced in equal steps (17 % per year).

Under the Commission proposal, the three new own resources (based on the CCCTB, the EU ETS and plastic packaging waste contribution), would cover approximately 12 % of the budgetary needs, thereby mitigating the predominance of the GNI-based contributions. The other sources (TOR and other revenue) would, overall, remain stable.

In its resolution adopted in May 2018 on the 2021-2027 MFF and own resources, **the European Parliament** welcomed the Commission proposal as an important step and encouraged even **more ambition** in this direction, notably by further **extending the list of new own resources** (FTT, carbon border adjustment mechanism) and other revenues. It also reiterated that "*the expenditure and revenue side of the next MFF should be treated as a single package in the upcoming negotiation*".

In its Opinion No 5/2018 on own resources, published on 1 October 2018, the **European Court of Auditors** concluded that the **proposed EU financing system remains complex**. They pinpointed several issues which are likely to undermine the effectiveness of the proposed new own resources.

The Commission proposes calculating the resource based on the EU ETS as a percentage of receipts from the auctioning of emissions allowances, the overall volume of which is fixed. While this would certainly

6 The group was chaired by former Italian Prime Minister and EU Commissioner Mario Monti and was composed of members designated by the European Parliament, the European Commission and the Council.

7 Future Financing of the EU: Final report and recommendations of the High Level Group on Own Resources December 2016 https://ec.europa.eu/budget/mff/hlgor/library/reports-communication/hlgor-report_20170104.pdf

8 The existing correction mechanisms are: the UK rebate, the 'rebates on the UK rebate' for Germany, the Netherlands, Austria and Sweden, the lump-sum reductions to the GNI-based own resource for Denmark, the Netherlands, Austria and Sweden, and the reduced VAT call rates for Germany, the Netherlands and Sweden.

generate revenue, it would not create an additional incentive for Member States to reduce greenhouse gas emissions.

The common consolidated corporate tax base (CCCTB) would, realistically, not be phased in until several years after the start of the new MFF.

Finally, Member States would need to harmonise how they collect and calculate plastic recycling data, which would then have to be verified by the Commission.

The **European Court of Auditors** also believe that the Commission should reconsider its proposal to simplify the VAT-based resource, the calculation of the Weighted Average Rate (WAR) remains complex. In addition, the proposal still does not provide any direct link to the tax base. Such a link could, however, be obtained by applying a call rate directly to the VAT receipts.

The Commission proposes phasing out the correction mechanisms that currently apply to certain Member States. However, the Commission does not propose to complete the process until 2026.

On 14 November 2018 the **European Parliament** put forward its views and invited the Commission to **take into account the opinion of the European Court of Auditors**. It recalled that the introduction of new Own Resources should firstly, bring about a **substantial reduction in the proportion of GNI-based contributions**[9] and secondly, guarantee the **adequate financing of EU spending** under the post-2020 MFF.

Moreover, the **European Parliament** demanded an **extension of the list of potential new Own Resources**, which should include:

- an Own Resource based on a **Financial Transaction Tax** (FTT), while calling on all Member States to reach an agreement on an efficient scheme;
- the introduction of a **carbon border adjustment mechanism** as a new Own Resource for the EU budget, which should ensure a level playing field in international trade and reduce the off-shoring of production, while internalising the costs of climate change in the prices of imported goods;
- the introduction of **other revenue** that should constitute extra revenue for the EU budget without entailing a corresponding reduction in GNI contributions, i.e. fines paid by companies for breaching the Union's rules, or fines for late payments of contributions and fines generated by rulings of the Court of Justice of the European Union, including lump sum or penalty payments imposed on Member States, stemming from infringement actions;
- the introduction of **other forms of revenue**, in line with the Commission proposals, in the case of fees linked to the implementation of mechanisms in direct relation with the EU, such as the European Travel Information and Authorisation System (ETIAS) and seigniorage, in the form of assigned revenue, for the purpose of financing a new Investment Stabilisation Function;

Finally, the European Parliament expressed strong approval of the **abolition of all rebates and other correction mechanisms**, accompanied by a **limited phasing out period**;

The **European Parliament** resolution of 10 October 2019 on *the 2021-2027 multiannual financial framework and own resources: time to meet citizens' expectations* welcomed the new Commission President's commitments to relaunch or extend a number of initiatives that should be part of the future basket of new own resources, in particular, to seize the opportunity of **introducing a carbon border adjustment mechanism,** which would be a fair way to respond to popular demands for decisive leadership in the fight against climate change, while ensuring a level playing field in international trade.

[9] with the objective of moving progressively towards 40 % its share in the financing of the EU budget, while preserving its balancing function.

The **European Parliament** will not give its consent to the MFF without an agreement on the reform of the EU own resources system, including the introduction of a basket of new own resources that are better aligned with and incentivise progress in major EU policy priorities. It recalled that the purpose of introducing new own resources is not only to mitigate the predominance of GNI-based contributions, but also to guarantee the appropriate level of financing of EU spending in the next MFF.

It reaffirmed its position regarding the list of potential candidates for new own resources (**a common consolidated corporate tax base, digital services taxation, a financial transaction tax, income from the emissions trading scheme, a plastics contribution and a carbon border adjustment mechanism**), as well as the **abolition of all rebates and corrections**, the **simplification of the VAT-based own resource**, the reduction of national 'collection costs' withheld on customs duties, and the **inclusion of other revenue in the form of fines and fees in the EU budget**.

Fiscal policy harmonisation initiatives

Directives in force

VAT,

Council Directive 2018/1910 of 4 December 2018 amending Directive 2006/112/EC as regards the harmonisation and simplification of certain rules in the value added tax system for the taxation of trade between Member States

The objective of this latest Directive amending the main piece of legislation on VAT (Directive 2006/112/EC) is to build improved operation of VAT arrangements in the context of cross- border business to business trade.

Energy taxation Directive,

Council Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity (Text with EEA relevance)

This Directive lays down harmonised rules for excise duties, sets minimum levels of taxation and lays down the conditions for applying tax exemptions and reduction for the taxation of energy products used as motor or heating fuels and for electricity. All revenues from excise duties entirely go to the budget of the Member States.

The primary objective of the Directive was to support the proper functioning of the internal market by avoiding double taxation and other distortions of trade and competition between energy sources and energy consumers and suppliers. In addition, the Directive also intended to contribute to the achievement of a wide range of EU policies, in fields such as environment, energy and climate change while maintaining the competitiveness of EU companies.

In its evaluation assessing the performance of the Energy Taxation Directive published on 12 September 2019, the Commission concluded that while the Energy Taxation Directive initially made a positive contribution to the internal market, current rules do not contribute to the new EU regulatory framework and policy objectives in the area of climate and energy, where technology, national tax rates and energy markets have all evolved considerably over the past 15 years[10].

The evaluation also points out that the high divergence in national energy tax rates is **not in line** with other policy instruments and can **lead to fragmentation of the internal market**, a problem **exacerbated by the widespread use of optional tax exemptions.** At a time when the EU has considerably raised its ambition by setting new climate targets for 2030 the EU’s energy taxation framework has not kept pace[11].

Directives proposed: Common Consolidated Corporate Tax Base, Digital Business Activities and Financial Transaction Tax

The **Common Consolidated Corporate Tax Base** (CCCTB) is a single set of rules to calculate companies' taxable profits in the EU. Therefore, cross-border companies will only have to comply with one, single EU system for computing their taxable income, rather than many different national rulebooks. Companies can

[10] For example, no link exists between the minimum tax rates of fuels and their energy content and CO2 emissions.
[11] For instance, the Energy Taxation Directive does not reflect the current mix of energy products on the market in the EU.

file one tax return for all of their EU activities, and offset losses in one Member State against profits in another.

The consolidated taxable profits will be shared between the Member States in which the group is active, using an apportionment formula. Each Member State will then tax its share of the profits at its own national tax rate.

In October 2016, the Commission re-launched the **common consolidated corporate tax base** (CCCTB) to make corporate taxation in the EU fairer, more competitive and more growth-friendly. The Commission had originally proposed the CCCTB in 2011, but that proposal proved too ambitious for Member States to agree in one go. However, there was still strong demand for the benefits that the CCCTB could offer to Member States and businesses in the EU.

The 2016 CCCTB proposal is divided in two steps. In the first step, the **common base** should be implemented. **Consolidation** should be put in place swiftly afterwards.

The Economic and Monetary Affairs Committee is in charge.

On 21 March 2018, the European Commission proposed a package to ensure that **digital business activities** are taxed in a fair and growth-friendly way in the EU.

The first initiative[12] aimed to reform corporate tax rules so that profits are registered and taxed where businesses have significant interaction with users through digital channels. This forms the Commission's preferred long-term solution.

The second proposal[13] responded to calls from several Member States for an interim tax which covers the main digital activities that currently escape tax altogether in the EU.

This package should set out a coherent EU approach to a digital taxation system which supports the Digital Single Market and which will feed into international discussions aiming to fix the issue at the global level.

The Economic and Monetary Affairs Committee is in charge.

On 14 February 2013, the European Commission made a proposal for a Council Directive on enhanced cooperation in the area of **financial transaction tax**[14]. As requested by the eleven Member States involved[15], this proposal mirrors the scope and objectives of the original Commission FTT proposal from 2011, while also strengthening the anti-relocation and anti-abuse rules.

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12 Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence.

13 Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services

14 Proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax

15 In autumn 2012, 11 Member States wrote to the Commission, officially requesting enhanced cooperation on the financial transaction tax to be authorised, on the basis of the Commission's 2011 proposal. They are Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia and Slovakia.

Follow-up

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EU budget financing: discrepancies between Member States

The following table shows the specific arrangements applicable to some Member States.

12 Member States out of 28 (i.e. around **43% of all Member States**) enjoy specific arrangements in one or several ways.

Table 1 - Specific revenue arrangements to some Member States

Member State	*Capping VAT base (50% GNI)*	*Reduced VAT call rate in % (Normal call rate 0.3%)*		*Reduced GNI contribution Lump sum reduction In million EUR*		*Op-out adjustment Deduction for not taking part in Union action or policy*	*UK Rebate*	*Reduced participation in bearing cost of UK rebate Reduction of 75% of the amount due*
		2007-2013	2014-2020	2007-2013	2014-2020			
Denmark					130 *per year*	✓		
Germany		0.15	0.15					✓
Ireland						✓		
Croatia	✓							
Cyprus	✓							
Luxembourg	✓							
Malta	✓							
Netherlands		0.10	0.15	✓	695 per year			✓
Austria		0.225			30 *in 2014* 20 *in 2015* 10 *in 2016*			✓
Slovenia	✓							
Sweden		0.10	0.15	✓	185 *per year*			✓
United Kingdom						✓	✓	

Source: Council Regulation 608/2014 26 May 2014 (Official Journal of the European Union L 168 7.6.2014)

Outside the capping of the VAT base to 50% of the GNI which, currently, is theoretically granted to all Member States, a quarter of the Member States enjoy specific resource arrangements. Moreover, the 2014-2020 period does not see any reduction in the number of specific resource arrangements.

It should be also mentioned that the high percentage[i][16] that Member States are authorised to retain as costs for the collection of the traditional own resources can be seen as another form of rebate for Member States with high customs duty collection. Currently, more than half of the traditional own resources is collected by just a handful of Member States[17][ii]

[16] 25% then 20% for the new Multiannual Financial Framework for 2014-2020. A Commission Staff Working Paper - SEC (2011) 876 shows that these percentages of collection costs do not correspond to the actual costs incurred.

[17] DE, UK, NL.

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Print ISBN 978-92-846-6130-5 | doi:10.2861/902134| QA-04-20-028-EN-C
PDF ISBN 978-92-846-6129-9 | doi:10.2861/018600| QA-04-20-028-EN-N