IN-DEPTH ANALYSIS

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Reform of the EU own resources

Policy Department for Budgetary Affairs
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Reform of the EU own resources

Abstract

This document was prepared by Policy Department for Budgetary Affairs for the Committee on Budgets as a background paper for the Public Hearing on 'Financing the EU budget: new own resources and possible other revenue'.

It provides a summary of the system of EU own resources in the light of the agreement on its revision reached during the negotiations of the 2021-27 MFF. It shows the rationale for the reform including the need to find sources to finance the repayment of the EU borrowing in the framework of the New Generation EU initiative. The paper gives a description of each new own resource listed in the Interinstitutional Agreement of 2020, and shows their probable policy and budgetary effects.

This document was requested by the European Parliament's Committee on Budgets.

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LIST OF ABBREVIATIONS

C(C)CTB	Common (Consolidated) Corporate Tax Base
CBAM	Carbon Border Adjustment Mechanism
DST	Digital Service Tax
EEA	European Economic Area
ETS	Emission Trading System
GHG	Greenhouse Gas
GNI	Gross National Income
HLGOR	High Level Group on Own Resources
IIA	Interinstitutional Agreement
MFF	Multiannual Financial Framework
NGEU	Next Generation EU
SMEs	Small and Medium Entreprises
VAT	Value Added Tax
WTO	World Trade Organisation

1. BACKGROUND

During the negotiations on the 2021-2027 Multiannual Financial Framework (MFF), the EU institutions reached an agreement on the review of the system of own resources and established a roadmap for introducing new own resources. This agreement was necessary in order for the EU to cover the repayment of the debt resulting from the borrowing connected to the European Union Recovery Instrument as part of the Next Generation EU initiative (NGEU) without jeopardising the budget of other EU programmes and instruments under the MFF. The agreement was codified in Council Decision (EU, Euratom) 2020/2053 of 14 December 2020 on the system of own resources of the European Union (Own Resources Decision). The details of the resources and the roadmap were fixed in Annex II of the Interinstitutional Agreement 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, Including a Roadmap Towards the Introduction of New Own Resources (IIA).

2. THE ESTABLISHED SYSTEM OF OWN RESOURCES

The system of own resources defines the basis of and the calculation methods for the revenue that finances the EU budget. It was established by the Own Resources Decision of 21 April 1970 revised by the Own Resources Decision of 24 June 1988. It consisted of three elements: Traditional own resources, VAT-based own resources and GNI-based own resources. Since the EU budget cannot run a deficit, the ceiling for own resources, including for the annual payment appropriations, was set at a maximum of 1.20% of EU gross national income (GNI) in the 2014-20 MFF. Due to the economic difficulties resulting from the COVID-19 pandemic, the 2021-27 MFF has increased this ceiling to 1.40%, while a temporary additional 0.6 percentage point increase was introduced "for the sole purpose of covering all liabilities of the Union resulting from the borrowing"[1] until all debt is repaid.

2.1. 'Traditional' own resources

'Traditional' own resources were created by the 1970 Own Resources Decision and include customs duties, agricultural duties and sugar levies. These duties and levies belong to the EU, while they are collected by the Member States, which in exchange receive a percentage to cover the cost of collection[2] (currently 25%). 'Traditional' own resources now account for between 10% and 15% of the revenue side of the EU budget[3].

2.2. The VAT-based own resource

The VAT-based own resource was initially provided for in 1970, and was introduced after the 1979 harmonisation of the VAT base. It is based on a complex statistical calculation[4] of the harmonised VAT base and applies a uniform call rate of 0.30%. The VAT resource now accounts for 10-15% of own resource revenue. As it is paid by the Member States from their tax income, and the amount has rather weak links to actual VAT revenues, the VAT-based own resource is often perceived as a second GNI based resource[5].

1 Own Resources Decision (Article 6)

2 The Union's revenue - Factsheet

3 Consolidated annual accounts of the European Union – Financial year 2019.

4 Council Regulation (EEC, Euratom) No 1553/89 of 29 May 1989 on the definitive uniform arrangements for the collection of own resources accruing from value added tax (OJ L 155, 7.6.1989, p. 9)

5 Own resources of the European Union Reforming the EU's financing system; Alessandro D'Alfonso; European Parliament; 2021

2.3. The GNI-based own resource

This own resource was introduced by the Own Resources Decision of 1988 as a balancing element, only to be collected if the other own resources did not fully cover expenditure, but has tripled since the late 1990s, and now usually accounts for around two thirds of own resource revenue[6]. It is a uniform percentage levy on Member States' Gross National Income (GNI) set in each year's budget procedure.[7]

2.4. Other revenue and the balance carried over from the previous year

Other revenue flowing into the EU budget consists of income tax levied on EU staff, contributions from third countries to EU programmes, such as Horizon Europe and Erasmus+, interest on late payments, and fines due to breaches of competition rules or other laws. These revenues, balances and technical adjustments usually make up less than a tenth of the total EU revenue.[8]

2.5. Correction mechanisms

The own resources system is designed to balance Member States' contributions according to their wealth, while the expenditure is partly intended to bring about economic cohesion. The resulting differences in net balances prompted the 1984 European Council conclusions that "any Member State sustaining a budgetary burden which is excessive in relation to its relative prosperity may benefit from a correction"[9]. The consequent 'UK rebate' was financed equally by all Member States, except for Germany, the Netherlands, Austria and Sweden, who were entitled to 'rebates on the rebate'.[10] In the current MFF period, Austria, Denmark, Germany, the Netherlands and Sweden benefit from lump-sum reductions to their GNI-based contributions[11].

3. REFORM OF OWN RESOURCES

3.1. History

The financing of the EU budget has remained unchanged since the late 1980s, while the need for reform has been apparent for decades. Parliament has called repeatedly for an in-depth reform of the system[12], a more autonomous budget financed by own resources which are linked to policy goals. After a failure to get unanimous support for the proposed reform at the Council in 2013, Parliament only gave its consent to the 2014-2020 MFF on the condition that an interinstitutional high level group was set up to review the reform options. It led to the establishment of the High Level Group on Own Resources (HLGOR, aka. Monti group) in 2014, which published its final report in 2017. In its conclusions, the 'Monti Report' suggested that all correction mechanisms be abolished, the principle of equilibrium and the traditional own resources be maintained, while the GNI-based own resource be transformed into a truly residual and balancing resource. It also recommended introducing new own resources linked to EU policies and European added value, contributing to broader EU policy objectives in policy areas such as the single market, tax coordination, energy, environment, climate change, and transport.

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6 Consolidated annual accounts of the European Union – Financial year 2019.

7 The Union's revenue - Factsheet

8 The Union's revenue - Factsheet

9 European Council Meeting at Fontainebleau, Conclusions of the Presidency; point 1./1.

10 For an overview of correction mechanisms see A. D'Alfonso, The UK 'rebate' on the EU budget: an explanation of the abatement and other correction mechanisms; EPRS; European Parliament; 2016. and also Zsolt Darvas and Bruegel; Who pays for the EU budget rebates and why?; Breugel; 2019

11 Own Resources Decision (Article 2/4)

12 OJ C 175, 21.6.1999, p.238; P6_TA(2007)0098; P7_TA(2011)0266; P8_TA(2018)0076.

Based on these recommendations, the Commission's 2018 MFF package proposed revising the existing own resources and introducing new ones, while phasing out corrections.

Although the Member States were reluctant at first, the COVID-19 crisis and the proposal for the Next Generation EU instrument financed by EU borrowing provided a new rationale for new own resources. The July 2020 European Council conclusions broadly supported the introduction of new own resources, starting with one based on non-recycled plastic waste. Parliament's legislative opinion in September 2020 also supported the proposal, while reiterating its call for a binding timetable.

The Own Resources Decision of 14 December 2020 took up some parts of the reform package. Annex II of the IIA provided more details, introducing the principles and criteria, confirming the link to NGEU repayments, and establishing an own resources roadmap.

3.2. Rationale for reform

Partly due to the increasing proportion of the national transfers in its financing, the EU budget is often viewed as a zero-sum game[13] based on the net budgetary position ("*juste retour*") of each Member State. Indirect benefits of EU membership, such as the single market, Schengen, the Euro, trade agreements and EU programmes are disregarded, while they can account for 3% to 25 % of the real income of different Member States[14]. Therefore, countries focus on maximising their net benefits or minimising their contributions, paying less regard to EU added value. This leads to lengthy and complicated budget negotiations, deadlocks, bargaining, which result in insufficient funding of EU initiatives supporting common goals.[15]

This issue was taken up in the conclusions of the 'Monti Report', but also in the academic literature, and several objectives and conditions for a new system were laid down. Some of their findings were reiterated in the 2020 IIA.

- New own resources need to create **sufficient resources** to be able to finance the debt resulting from the borrowing linked to the NGEU without increasing national GNI-based contributions or "undue reduction in programme expenditure or investment instruments under the MFF"[16]. This way they reinforce the **sustainability and credibility** on the financial markets of the NGEU repayment plan, to be able to borrow on the best possible terms.
- For the time being, the GNI and the VAT-based own resources are in fact considered transfers that the Member States 'provide', and not resources 'owned' by the EU. Replacing these with EU policy-based own resources would lead to increased independence of the EU budget.[17]
- "The new own resources should preferably be created in a way that allows generating »**fresh money**«"[18]. They need to be 'budget-neutral' for the Member States, meaning that no existing funds are redirected from national budgets to the EU budget. Rather, new taxes, levies or fees would be introduced that belong to the EU budget from the start.
- New own resources need to generate income from **European added value**, connected in particular to the single market and to sustainable growth. These own resources would, on the one hand, bring EU budget revenues more into line the *acquis communautaire*, while, on the other

[13] Future Financing of the EU; p.7

[14] Undoing Europe in a New Quantitative Trade Model by Gabriel Felbermayr, Jasmin Katrin Gröschl, Inga Heiland; ifo Working Paper Series; No 250; ifo Institute - Leibniz Institute for Economic Research at the University of Munich

[15] Reform Needs and Options in the EU System of Own Resources; Alexander Hudetz, Ann Mumford, Danuse Nerudová, Margit Schratzenstaller; Empirica; 2017-11; Vol. 44 (4); pp. 609-613

[16] Annex II of the Interinstitutional Agreement

[17] Strengthening added value and sustainability orientation in the EU budget; Margit Schratzenstaller; in: How to Finance Cohesion in Europe?; Ewald Nowotny, Doris Ritzberger-Grünwald, Helene Schuberth (eds.); Elgar; 2019

[18] Interinstitutional Agreement (Annex II, Preamble point I.)

hand, highlighting the EU added value for the citizens. An area where EU action could add value is fair taxation and the fight against tax fraud, tax evasion and tax avoidance, as tackling tax base erosion and profit shifting cannot be achieved at the national level. Correcting negative externalities, especially those connected to the environment and energy, also need to be addressed at the regional or even global level.[19]

- New fiscal instruments need to be devised to support **EU policy goals**[20], such as European Green Deal, a Europe fit for the Digital Age and medium and long-term investment[21]. The primary goal of these instruments would be to serve as economic incentives to achieve EU policy goals, besides serving as an own resource. A stronger focus on the policy goals and EU added value could promote further integration[22].
- New fiscal measures must not have a negative effect on **competitiveness and sustainable growth**.[23] Tax competition between the Member States and between the EU and third countries has to be taken into account in designing any new taxes or levies. For this reason, the most mobile tax bases and tax subjects need to be targeted, those that have significant international spillover effects, where taxes cannot be effectively enforced at the national level, due to fear of tax competition.[24]
- The financial burden must be **fairly distributed** among Member States.[25] This prompts a mix of own resources derived from different bases, as, due to the structural differences among Member States, any one tax or levy would affect them unevenly. Nevertheless, net contributors and net beneficiaries may interpret the concept of fairness in different ways.[26]
- Make the revenue side of the budget more **transparent**[27] by simplifying the calculation of national contributions, and also the decisionmaking process. "In parallel, they aim at **reducing red tape** and the burden for companies, especially for small and medium-sized enterprises (SMEs), and for citizens"[28]. "New own resources should fulfil the criteria of **simplicity, transparency, predictability and fairness.** The calculation, transfer and control of the new own resources should not lead to an excessive **administrative burden** for Union institutions and national administrations"[29]. The method of calculation needs to be simple, clear, transparent and uniform, and have a clear connection with the base of the resource, so that the payments are easy to plan, process, monitor and control.
- The system of own resources can only be modified by an 'Own Resources Decision', which is adopted by unanimity in the Council and requires ratification by all Member States. Therefore the "necessary reform of the own resources system should be achieved with a **limited number of revisions** of the Own Resources Decision"[30].

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19 EU budget for the future: Volume 2, Own resources; European Commission; 2018

20 Annex II of the Interinstitutional Agreement

21 Future Financing of the EU

22 Reform Needs and Options in the EU System of Own Resources; Alexander Hudetz, Ann Mumford, Danuse Nerudová, Margit Schratzenstaller; Empirica; 2017-11; Vol. 44 (4); pp. 609-613

23 Future Financing of the EU

24 Tax-based Own Resources as a Core Element of a Future-Oriented Design of the EU System of Own Resources; Margit Schratzenstaller; Intereconomics; 2018; Vol. 53; pp. 301-306

25 Future Financing of the EU

26 The next EU budget and the financing of cohesion policy; Sándor Richter in: How to Finance Cohesion in Europe?; Ewald Nowotny, Doris Ritzberger-Grünwald, Helene Schuberth (eds.); Elgar; 2019

27 Annex II of the Interinstitutional Agreement

28 Interinstitutional Agreement (Annex II, Preamble point I.)

29 Interinstitutional Agreement (Annex II, Preamble point J.)

30 Interinstitutional Agreement (Annex II, Preamble point K.)

3.3. Legal framework for new own resources

According to the treaties, the EU has no right to levy taxes, and needs to respect national fiscal sovereignty when introducing new own resources. The Council can, however, establish or abolish categories of own resources in the Own Resources Decision.[31] New own resources may be introduced if an approximation or harmonisation of existing national indirect taxation is necessary for the good functioning of the Single Market or in order to achieve environmental or energy-related objectives.[32]

The processing and payment of taxes needs to be organised by national or regional tax administrations and then the due share can be transferred to the EU budget. This way national tax sovereignty would not be restricted, nor would there be a need for changes to the treaties. This can be best achieved by new own resources based on taxes that do not exist at the national level, thus are budget-neutral for the Member States. In case some of the Member States already levy a tax that forms the basis of a new own resource, they would need to agree to give up their rights to (part of) this revenue.[33]

If new tax based own resources were introduced, the total of contribution of each Member State would not necessarily change, since their contribution is limited by the own resources ceiling. The amount collected by the Member State for the EU budget could, therefore be counted against the GNI-based contribution. This way the latter would continue to play a balancing role, so even if a new tax-based own resource were to affect the Member States to a differing extent, fairness in terms of overall contributions could be achieved.[34]

3.4. The package

In November 2020, with the aim of mitigating the economic effects of the pandemic, EU institutions agreed on a revised 2021-27 MFF and in addition, the NGEU, borrowing up to €750 billion by issuing bonds on the international markets with maturities of 3 to 30 years. To strengthen the EU's financial market position, the own resources ceiling was exceptionally and temporarily raised by 0.6% of the EU's GNI, in addition to the permanent increase from 1.2% to 1.4% of GNI taking account of the new economic context, including Brexit.[35] A new own resource based on non-recycled plastic packaging waste was introduced and options for additional new own resources to be applied in the future were included in the Own Resources Decision: a revised Emissions Trading System-based own resources (possibly to include the maritime and aviation sectors), a carbon border adjustment mechanism, a financial transaction tax and a digital levy. The IIA added to this, as a possible future own resource, a corporate contribution based on a common (consolidated) corporate tax base.

31 EU budget for the future: Volume 2, Own resources; European Commission; 2018

32 Articles 113, 115, 192 (2) and 194 (3) TFEU

33 Tax-based Own Resources to Finance the EU Budget; Margit Schratzenstaller, Alexander Krenek; Intereconomics; 2019; Vol. 54; pp. 171-177

34 Tax-based Own Resources as a Core Element of a Future-Oriented Design of the EU System of Own Resources; Margit Schratzenstaller; Intereconomics; 2018; Vol. 53; pp. 301-306

35 The Union's revenue - Factsheet

3.5. Roadmap

The political agreement reached on 10 November 2020 included a new Annex to the IIA on budgetary matters, establishing a binding roadmap for the introduction of new own resources over the period of the 2021-27 MFF.

1 January 2021	"Plastic tax" applies from this date, although the Own Resources Decision is yet to be approved by Member States.
Spring 2021	Commission undertakes a review of the EU Emissions Trading System, including its possible extension to the aviation and maritime sectors.
June 2021	Commission publishes proposals on an own resource based on the EU Emissions Trading System, a carbon border adjustment mechanism and a digital levy.
1 July 2022	Deadline for Council decision on the proposed new own resources.
1 January 2023	The new own resources are introduced, after the Member States' approval.
June 2024	Commission to propose additional new own resources, possibly including a financial transaction tax, a contribution by the corporate sector, possibly based on a new common consolidated corporate tax base (CCCTB).
1 July 2025	Deadline for Council decision on the proposed new own resources.
1 January 2026	These new own resources are introduced.[36]

4. PLANNED NEW EU OWN RESOURCES

In the package on the table, one group of new own resources is related to the single market and fiscal coordination. These could contribute to the better functioning of the single market, and have positive effects on fair taxation and combatting tax fraud, tax evasion and tax avoidance. This category includes a corporate income tax and a financial transaction tax. Another group is related to the Energy Union, environment, climate or transport policies, and includes proceeds from the revised EU Emission Trading System, a carbon border adjustment mechanism and the plastic levy. The primary objective of these would be to combat climate change. However, their EU level introduction would also contribute to the better functioning of the single market by limiting the uncoordinated proliferation of environmental taxes.[37]

4.1. Plastic own resource

4.1.1. Description

The first new category of own resources was introduced by the Own Resources Decision as of 1 January 2021, although its ratification is still pending. The plastic levy is a national contribution on the basis of the quantity of non-recycled plastic packaging waste (calculated as the difference between the weight of the total plastic packaging waste generated and that recycled) in the Member State with a uniform

[36] Interinstitutional Agreement (Annex II)

[37] Future Financing of the EU; p.8

call rate of €0,80 per kilogram. It is accompanied by an adjustment mechanism, which reduces the contributions of Member States with a GNI per capita below the EU average by an annual lump sum corresponding to 3.8 kilograms of plastic waste per capita.[38]

4.1.2. Policy effects

The European strategy for plastics in a circular economy[39] calls for the application of taxation in order to incentivise the recycling of plastic waste. This plastic levy will urge Member States to introduce fiscal measures of their own to reduce the consumption of single-use plastics, foster recycling and boost the circular economy. However, respecting subsidiarity, the Own Resources Decision leaves it to the Member States to take the most suitable measures to achieve these goals. Besides a growth in the proportion of recycling of plastic packaging, another desired effect is a reduction in the production and use of plastic packaging.

The advantage of introducing such a levy at the EU rather than national level is that it could prevent the displacement among Member States of plastic waste for treatment.

4.1.3. Revenue

The estimated revenue, taking into account the current call rate and the quantities of non-recycled plastic waste produced in the EU, is around €7 billion annually, which corresponds to approximately 4% of the budget.[40] However, as a result of this levy, the revenues generated should decrease in time, as non-recycled plastic packaging waste gradually disappears.

4.2. EU ETS-based own resource

4.2.1. Background

The EU Emission Trading System (ETS) is a 'cap and trade' system: a gradually reducing cap is set on the total amount of greenhouse gas emissions, while emission allowances can be traded among emitting companies. The cap and its reduction ensures the reduction of the total greenhouse gas (GHG) emission. The trading system incentivises emissions reduction in sectors or production methods where it is most economically viable, therefore reducing the cost of greening by creating a market and putting a price on the externalities.

The EU ETS was launched in 2005, and during its phase 3 (which ended in 2020) it introduced a single, EU-wide cap (instead of national ones) and made auctioning the default method for allocating allowances (instead of free allocation). The increased GHG emission reduction target put forward as part of the European Green Deal prompted a revision of the EU ETS: phase 4 (starting on 1 January 2021) increased the pace of cap reduction. Currently, the EU ETS covers carbon dioxide (CO_2), nitrous oxide (N_2O) and perfluorocarbons (PFCs) from specific industrial production. Commercial aviation is included, but until the end of 2023 the EU ETS will apply only to flights between airports located in the European Economic Area (EEA). The Own Resources Decision envisages the inclusion of the maritime sector in the system. However, the recent amendment[41] to the EU ETS entrusts the International Maritime Organisation (IMO) with curbing maritime emissions.

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38 Own Resources Decision; Article 2

39 A European Strategy for Plastics in a Circular Economy; Commission Communication; COM/2018/028 final

40 EU budget for the future: Volume 2, Own resources; European Commission; 2018; pp. 8-9. and Plastic Tax in Europe; Kaushik Mitra; IHS Markit; 24 September 2020

41 Directive (EU) 2018/410 to enhance cost-effective emission reductions and low-carbon investments

Revenues from the ETS are generated by auctioning off allowances allocated to Member States and the proceeds go to the national coffers, although at least 50% of auctioning revenues has to be spent for climate- and energy-related purposes.

4.2.2. Policy effects

The EU ETS is an essential tool, created at a European level (besides EU Member States also Iceland, Lichtenstein and Norway take part) with the aim of reducing greenhouse gas emissions. Its current objective is to help achieve a climate-neutral EU by 2050 and a reduction in greenhouse gas emissions of at least 55% (compared to 1990) by 2030, in a market-driven, cost-effective way.

An EU own resource based on EU ETS revenues would fit the criteria as it is derived from EU added value, besides contributing to climate goals and strengthening the internal market. The possibility of transferring a part of ETS revenue to the EU budget was already proposed and abandoned once in 2010 as the economic impact of the ETS varies significantly from one Member State to the other due to structural differences.[42]

4.2.3. Revenue

The income resulting from auctioning off allowances is far from stable, as the price of these allowances is determined by the market. The auction price of CO_2 varied between €2.65 and €30.92 per ton in the period 2013-2020[43], although the Market stability reserve, introduced by the Commission in 2019, should make the system more resilient to economic shocks.

The revenues raised from selling ETS allowances amounted to €3.5 billion per year on average in the 2013-2020 period, but in both 2018 and 2019 over €14 billion income was generated. In 2018, the Commission proposed 20% of the revenues from auctioning to be allocated to the EU budget, generating €1.2 to 3 billion, which is less than 2% of the budget on average.

4.3. Carbon border adjustment mechanism

4.3.1. Background

In the IIA, the "Institutions agree that the carbon border adjustment mechanism and the EU Emissions Trading System are thematically interlinked and that it would therefore be warranted to discuss them in the same spirit"[44].

Although the EU ETS regulates reduction of GHG emissions within the EU (and participating EEA countries), it also can cause carbon leakage if international partners do not introduce similar pricing of environmental externalities. Carbon leakage occurs when production is moved to a location where emission rules are more relaxed, or when EU production is replaced by imported products from countries with lower carbon prices.[45] This may neutralise the positive environmental effects of EU regulation, counteract global climate efforts[46], and at the same time reduce revenue from the ETS. Stricter emissions targets, such as those of the European Green Deal, result in higher carbon prices, which in turn raise the cost of domestic production and therefore increase the risk of carbon leakage[47].

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42 Future Financing of the EU; p.44

43 Emission Spot Primary Market Auction Reports; EEX

44 Interinstitutional Agreement (Annex II, Part B, 7.)

45 Draft Report on Towards a WTO-compatible EU carbon border adjustment mechanism (2020/2043(INI))

46 Carbon border adjustment mechanism, Inception impact assessment

47 A WTO-compatible Border Tax Adjustment for the ETS to Finance the EU Budget; Alexander Krenek, Mark Sommer, Margit Schratzenstaller; WIFO Working Papers; No. 596; Österreichisches Institut für Wirtschaftsforschung; March 2020

For the time being, carbon emissions embedded in EU imports correspond to over 20% of EU emissions[48].

A carbon border adjustment mechanism (CBAM) would counter such carbon leakage by putting a price on the GHG content of imports, thus cancelling out the price advantage of offshoring or outsourcing carbon-intensive production to third countries and, at the same time, reducing the competitive disadvantage of EU companies paying for their emissions.

However, such a measure must not breach either World Trade Organization (WTO) rules or other EU international obligations.[49] Such a fee will need to equal the price EU producers pay, and exemptions would need to be applied to producers proving that they already paid for their emissions (under an ETS or otherwise).

4.3.2. Policy effects

As part of the European Green Deal, a CBAM could contribute to the decarbonisation of the economy while ensuring that competitiveness is not jeopardised by carbon leakage. The introduction of a CBAM would not only affect the EU itself, but also its trading partners.

As currently carbon leakage is countered by free allowances to keep some high-emission sectors competitive, a CBAM would decrease emissions in the EU by eliminating (or significantly reducing) the need for such free allocations[50]. A carbon adjustment mechanism will make carbon-intensive imports more expensive, which can incentivise changes towards more sustainable goods and improve the competitiveness of EU products, thus reducing offshoring of production and creating jobs. In parallel, it can lead to consumer price increases.

It may also have positive effects outside the EU, contributing to global climate goals. By incentivising low carbon production, it may indirectly promote the adoption of stricter emissions standards and investment in climate-friendly technologies by the EU's trading partners.[51]

Even if the CBAM is fully WTO-compliant, respecting the principle of non-discrimination and the most-favoured nation clause, it may be conceived as unfriendly by some trading partners and lead to trade disputes and might even damage the WTO.[52]

4.3.3. Revenue

In order to avoid discrimination, the CBAM needs to put a price on the CO_2 content of the imported product that is equal to the price an EU producer would pay for its CO_2 allowance in the EU ETS[53]. Therefore, the revenue resulting from this source could be just as volatile as that from the EU ETS.

4.4. Digital levy

4.4.1. Background

Digital services can generate income from online advertising, the online sale of goods and content, digital intermediary activities, the sale of user-generated information etc. These services are not (fully)

48 Draft Report on Towards a WTO-compatible EU carbon border adjustment mechanism (2020/2043(INI))

49 Carbon Border Adjustment Mechanism: Greening the EU trade? Assessing CBAM from a trade perspective. Round-table discussion; Breughel; 4 February 2021

50 Draft Report on Towards a WTO-compatible EU carbon border adjustment mechanism (2020/2043(INI))

51 Carbon border adjustment mechanism; Inception impact assessment

52 Carbon Border Adjustment Mechanism: Greening the EU trade? Assessing CBAM from a trade perspective. Round-table discussion; contribution of Suman Bery; Breughel; 4 February 2021

53 Draft Report on Towards a WTO-compatible EU carbon border adjustment mechanism (2020/2043(INI))

covered by existing tax regulations, and therefore remain (partly) untaxed: the average effective tax rate of digital companies is half that of the traditional economy. Another issue is taxing digital services at a national level, as profits can be generated in a country without the provider being physically present there, while corporate taxation rights are based on the physical location of the firm. Companies providing digital service can therefore relocate their seats to optimise taxes.[54] Cases of global tech companies such as Amazon, Google or Facebook following aggressive tax planning practices have caused public uproar[55]. An "EU digital levy will counter tax base erosion, ensure a level playing field and improve tax fairness by capturing mobile bases."[56]

The Commission submitted a pack of two proposals in 2018: one to reform corporate tax rules for significant digital presence, and one for an interim digital services tax (DST). Although the Council has not been able to reach an agreement on them, discussions continue.[57]

Some Member States have already introduced taxes on digital services and several other countries have announced plans to implement a DST. However, the activities covered, the revenue thresholds and the tax rates vary significantly across these Member States. Austria and Hungary are only taxing revenues from digital advertising; France, Italy, Poland, and Spain have implemented a DST on a much broader basis. Tax rates range from 1.5% to 7.5%, while thresholds vary from €285,000 to €7,500,000.[58]

There are also initiatives at the international level; the OECD/G20 Inclusive Framework on base erosion and profit shifting (BEPS) aims at "reaching a consensus-based long-term solution to the tax challenges arising from the digitalisation of the economy". The goal is to agree on a fair and equitable international tax system that ensures additional tax revenues by making profitable multinationals pay their fair share and establishes clear taxing rights rules for both governments and businesses. For the time being, negotiations point toward taxation rights based on the concept of economic participation and the establishment of minimum tax rates[59]. All EU Member States (except Cyprus) are participating in these discussions, together with 113 other countries and territories.[60]

4.4.2. Description

The Commission's proposed Directive on corporate taxation of a significant digital presence introduces new rules to tax profits generated on the territory of a Member State by foreign firms based on their 'digital presence'. This would be defined as having €7 million in annual revenues, more than 100,000 users or over 3,000 business contracts in a Member State in a tax year. Rules are also laid down on how profits, and consequently taxing rights are distributed among Member States, linked to the users' location at the time of consumption of the digital service. This directive is intended as a long-term solution, which could eventually be integrated into the Common Consolidated Corporate Tax Base (CCCTB) legislation.

The second element of the package, the proposal for a Directive on a digital services tax, is intended as a temporary measure to counter the loss of tax revenue until the above-mentioned system is implemented and to avoid potentially contradicting national measures that could damage the single market. It proposes a consumption tax on revenues derived from specific digital services: online

[54] Fair Taxation of the Digital Economy; European Commission

[55] Tax Challenges in the Digital Economy; Eli Hadzhieva; European Parliament; April 2016

[56] Draft opinion of the Committee on Budgets for the Committee on Economic and Monetary Affairs on digital taxation: OECD negotiations, tax residency of digital companies and a possible European Digital Tax (2021/0000(INI))

[57] Proposal for a Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services; Legislative Train Schedule; European Parliament

[58] What European OECD Countries Are Doing about Digital Services Taxes; Elke Asen; Tax Foundation; 14 October; 2020

[59] Cover Statement by the OECD/G20 Inclusive Framework on BEPS on the Reports on the Blueprints of Pillar One and Pillar Two

[60] Action 1 Tax Challenges Arising from Digitalisation; OECD Inclusive Framework on BEPS

advertising, intermediary services between users for selling goods and services, sale of user-provided data. Companies with annual revenues above €750 million worldwide and €50 million in the EU would be subject to this tax, in order to exempt start-ups and scale-ups.[61]

4.4.3. Policy effects

The main benefit of taxing digital services could be creating a level playing field between digital services and traditional providers, between EU-based and third country multinationals, between multinationals and SMEs and between Member States with different corporate and consumption tax schemes. This would contribute to the EU objectives of fighting tax evasion and avoidance, strengthening the internal market and achieving fair taxation.

One of the adverse effects may present itself in global trade relations, as major players on the digital services market may persuade their home countries, like China and USA, to retaliate, as happened when France introduced its DST.

There are also two important concerns about a digital levy introduced in the form of a consumption tax. The first is double taxation, as providers could be liable for a consumption tax on their digital services, while also having to pay a corporate income tax on the profits gained from the same services. The other potential issue is that consumption taxes may need to be paid even if the company is not profitable[62].

4.4.4. Revenue

If a digital services tax is introduced as an intermediary measure, applying a 3% rate according to the Commission proposal, the annual revenue is estimated at around €5 billion[63].

4.5. Own resources based on Common Consolidated Corporate Tax Base (CCCTB)

4.5.1. Description

The idea to establish a common (consolidated) corporate tax base in the EU has been on the agenda for decades. Currently, corporations are not only taxed at different rates in the Member States, but also the methods of calculation for profits and losses that form the basis of the tax are different. In the case of cross-border operations, this may lead to an additional administrative burden for compliance. It may also lead to over-taxation and double taxation, thereby discouraging companies from going international and growing. Thus, it that may act as a barrier to the operation of the Single Market. Besides the **common** rules, cross-border operations, tax declarations and taxation could be made fairer and simpler by the **consolidation** of corporate accounts, i.e. offsetting losses occurring in one country against profits achieved in another.[64]

However, the CCCTB would not mean the harmonisation or unification of corporate tax rates; this will remain at the discretion of the Member States.

Having a common consolidated tax base would also be a precondition for a corporate tax-based EU own resource, as, for a fair contribution, a uniform method of calculation is necessary.

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61 Fair Taxation of the Digital Economy; European Commission

62 Taxation of the Digital Economy; FISC workshop; 12 February 2021

63 Fair Taxation of the Digital Economy; European Commission

64 Strengthening added value and sustainability orientation in the EU budget; Margit Schratzenstaller; in: How to Finance Cohesion in Europe?; Ewald Nowotny, Doris Ritzberger-Grünwald, Helene Schuberth (eds.); Elgar; 2019

4.5.2. Policy effects

Having common rules on calculating taxable profits for corporations in the EU is highly relevant for the better functioning of the Single Market, as multinational companies would be subject to a single set of rules all across the EU. This would simplify tax administration, reduce obstacles for companies operating across borders, and improve legal certainty. The harmonisation of rules would make tax systems more transparent and provide symmetrical information to all players on the effective tax rate[65]. A CCCTB would help counter tax avoidance by eliminating preferential regimes, making transfer pricing redundant and thus reducing the room for aggressive tax planning and profit shifting. Using the uniform rules, companies would be able to consolidate their losses against their profits across borders. It could even make it possible for them to file a single tax return, and the different countries of operation could levy their different corporate taxes on their proportional share of the tax base. By simplifying administration and providing predictable rules, a CCCTB could encourage investment and promote growth.[66]

According to the Commission's proposals for digital taxation and the Parliament's report, in the long run, digital services should be incorporated in a C(C)CTB, and the Digital levy should be abandoned.

4.5.3. Revenue

An academic study calculates a CCCTB of around €480 billion in the EU27[67]. The Commission proposal of 2018 contains a calculation using a call rate of 3% for the EU budget, which would result in an annual revenue of around €12 billion, equivalent to around 7% of the budget.[68]

4.6. Financial Transaction Tax (FFT)

4.6.1. Background

Following the rejection of the Commission's FTT proposal by the Council in 2011, it was revived in the form of 'enhanced cooperation' in 2013, with the participation of 11 Member States. This attempt also fell through after Estonia's withdrawal in 2016, but negotiations are continuing in the Council[69]. The latest proposal was submitted by Germany for discussion in the relevant working groups in 2019.[70]

Meanwhile, nine current Member States, most recently Spain, have introduced their own domestic FTTs, taxing different transactions and using different rates.[71] The European Court of Justice upheld the compatibility of Italy's FTT with the principle of free movement of capital and services.[72]

65 New proposal for financing the EU budget after 2020; Agnieszka Klos; Studia Europejskie - Studies in European Affairs; 4/2018; pp. 149-166

66 Common Consolidated Corporate Tax Base (CCCTB); European Commission

67 The Impact of the Introduction of a CCCTB in the EU; Danuše Nerudová and Veronika Solilová; Intereconomics; Volume 54 / Number 3; May/June 2019

68 EU budget for the future: Volume 2, Own resources; European Commission; 2018

69 Deeper and fairer internal market with a strengthened industrial base; Legislative train schedule; European Parliament

70 Financial Transaction Tax: The latest information on the EU's FTT proposal and various country FTTs; KPMG

71 The Financial Transactions Tax as Tax-based Own Resource for the EU Budget; Danuše Nerudová, Margit Schratzenstaller, Veronika Solilová; Fair Tax Policy Brief no. 2; September 2017

72 A Financial Transaction Tax deal worth fighting for; Euractiv; 17 July 2020

4.6.2. Description

An FTT is a very low rate tax applied to the exchange of securities, bonds, shares and derivatives between financial institutions. It does not cover everyday retail bank transactions of private individuals, households or businesses.[73]

The Commission's 2011 proposal suggested a 0.1% minimum tax rate for financial transactions in general, and a 0.01% rate for derivatives. The main open questions in the negotiations were: taxation of derivatives transactions, the taxation principles, and the method of tax collection.[74]

Parliament' 2013 resolution called for, inter alia, an extension of the scope, clarification of the exceptions, the application of uniform (0.01 %) rates instead of minimum rates, the creation of uniform methods of collection, and the partial allocation of the revenues to the Union budget as genuine own resources.

4.6.3. Policy effects

The objective of the FTT is to ensure the financial sector makes a fair contribution, to prevent further fragmentation of the Single Market, and to discourage risky trading activities.[75] If all financial transactions are taxed, avoidance is no longer possible by using untaxed financial instruments instead of other, taxed methods. As several types of short-term speculative transactions have a very low margin, even a very low tax rate could render them unprofitable, without seriously affecting long-term oriented transactions, such as investments and finance. This could contribute to the stabilisation of the financial markets.

For the time being, nine Member State operate different FTTs, which may, on the one hand, cause divergence in the internal market, and on the other, create a competitive disadvantage for the countries applying them. These effects could be countered by unifying the rules and introducing the FTT at a European level, while also strengthening of the internal market.[76]

A very low tax rate would not have a significant negative effect on the profitability of financial institutions, while the revenue generated could still be significant to the national and EU budgets, given the size of the sector.[77]

4.6.4. Revenue

According to a Commission calculation from 2011, the tax could raise approximately €57 billion per year if implemented in all Member States[78], while their later calculation based on 11 participating countries suggested €30-35 billion[79]. Other estimates, counting on the 'enhanced cooperation' of 10 Member States, range from €4 billion to €33 billion.[80] The level of EU budget revenue would depend on the specific rules and the share of the tax proceeds to be earmarked as EU own resource.

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73 Common Rules for a Financial Transaction Tax – Frequently Asked Questions; European Commission

74 Deeper and fairer internal market with a strengthened industrial base; Legislative train schedule; European Parliament

75 Common Rules for a Financial Transaction Tax – Frequently Asked Questions; European Commission

76 The Financial Transactions Tax as Tax-based Own Resource for the EU Budget; Danuše Nerudová, Margit Schratzenstaller, Veronika Solilová; Fair Tax Policy Brief no. 2; September 2017

77 Common Rules for a Financial Transaction Tax – Frequently Asked Questions; European Commission

78 Common Rules for a Financial Transaction Tax – Frequently Asked Questions; European Commission

79 Taxation of the financial sector; European Commission

80 The Financial Transactions Tax as Tax-based Own Resource for the EU Budget; Danuše Nerudová, Margit Schratzenstaller, Veronika Solilová; Fair Tax Policy Brief no. 2; September 2017

4.7. Other revenues

The Commission's 2018 package for the 2021-27 MFF included a proposal to allocate automatically to the EU budget revenues generated by new common EU policies. The example mentioned is the European Travel and Information Authorisation System (ETIAS). The re-routing of such revenue could be included directly in the legal act establishing the policy and may not require modification of the Own Resources Decision.[81] These revenues differ from own resources, as they are not collected by national authorities and then transferred to the EU, neither are they included in the calculation of national contributions. These revenues are administered by the EU and could thus flow directly into the budget.[82]

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