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Reflections on EU Own Resources and Tax Harmonisation

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This paper is the result of a collective research work carried out within Astrid's subgroup on "The Union's own resources and fiscal harmonization", chaired by Vieri Ceriani and Loredana Carpentieri. This subgroup works within the research activity of Astrid's group on the "The European Union in a changing world", led by Giuliano Amato, Franco Bassanini, Marco Buti, Paolo Gentiloni, Marcello Messori and Gianluigi Tosato, research activity which is divided among nine subgroups.
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Foreword

The enlargement of the Own Resources (OR) is a long-standing issue, strictly connected with and preliminary to the enlargement of the competences of the EU[1].

In the last decade the issue of OR has been dealt with in depth by the High-Level Working Group on Own Resources chaired by Mario Monti, established in 2014 by the Parliament, the Council and the Commission[2].

The final report[3] delivered in 2016 explicitly mentioned the introduction of a fiscal competence of the Union, with the effective power of the European Parliament to impose European taxes, paid directly to the EU budget: a very ambitious, federalist solution, very different from the current OR system, that would require very relevant changes of the Treaties. The report also outlined possible reforms under the current institutional framework (see Box 1).

Box 1. Final recommendations of the High-Level Group on Own Resource

The Working Group's final report outlined recommendations for possible reforms of the EU budget, under the current institutional framework, in view of Brexit and the emergence of new political priorities and related expenditure needs. The guiding principles of the reform should be:

[1] In 1957 the Treaty establishing the European Economic Community stipulated that the revenue of the Community budget consisted of contributions paid by the Member States. But also provided that the Commission would study how to replace these contributions with OR of the Community. In 1970 the first OR decision established customs duties, contributions from the sugar sector (collected until 2018), and a share of harmonized VAT bases (1 percent). The 1988 decision added a fourth OR: a percentage of the gross national income (GNP) of each Member State. The GNP-based resource currently is the most significant, accounting for almost 70 percent of the EU budget. All OR do not flow directly to the Union budget, they are collected by Member States. The current system of own resources is ultimately a system of national contributions. The Union has no taxing power.

[2] It was composed of nine members: three from the European Parliament, three from the Commission, and three from the Council.

[3] High Level Group on Own Resources, *Future Financing of the EU. Final Report and Recommendations* (https://ec.europa.eu/info/sites/default/files/about_the_european_commission/eu_budget/future-financing-hlgor-final-report_2016_en.pdf) December 2016.

a) the European added value, i.e., the added value deriving from the intervention of the Union compared to the hypothesis of intervention by individual Member States. Union spending should focus on sectors where EU action is indispensable or where national funding possibilities are insufficient to achieve the aims pursued.
b) the introduction of a "subsidiarity test" to determine the level of government (European, national or sub-national) most effective and efficient to proceed with spending;
c) budget neutrality: the introduction of new OR, or other forms of revenue, should be matched by a reduction in GNP-based resources;
d) maintenance of the overall tax burden unchanged for the European taxpayer;
e) synergies between national budgets and the European budget in achieving the Union's objectives;
f) unity of the EU budget, limiting the use of "satellite budgets";
g) greater transparency and "readability" of the EU budget;
h) design of own resources deriving from and supporting EU policies in the most important areas of competence: strengthening the single market, environmental protection and climate action, energy union and reduction of tax heterogeneity.

The report recommended:

- safeguarding some elements of the current system: preserving the principle of the balance of the European budget; maintaining traditional own resources (custom duties and VAT); maintaining the GNP-based resource, as a residual and offsetting resource;
- introducing of a combination of new own resources, aimed at supporting European policies in the key areas of the Union's competence, like environment and energy policies and the strengthening of the internal market, particularly the capital market;
- considering as possible new OR: the carbon tax; the excises on fossil fuels; the taxes on electricity; the ETS proceedings; the common consolidated corporate tax base (CCCTB); the financial transaction tax (FTT); the financial activity tax (FAT), as a substitute of the FTT;
- aiming at more accurate notions of "costs", "benefits" and "net results", contrasting the current perception that looks at the European budget as a "zero-sum game", in which Member States evaluate their position by comparing their national contributions with the amounts they receive from the expenditure side of the budget, without considering the European added value of EU policies or the unmeasurable benefits such as the participation in the single market. The report suggests abandoning the arithmetical notion of "net results" and developing indicators that embody an assessment of the costs and benefits of European budgetary interventions;
- abolition of corrections and compensations on the national contributions;

- review of the consistency of the budgets of the Union and of the Member States within the European Semester process, so as to create synergies;
- possibility of leaving a certain degree of differentiation (variable geometry) to member states wishing to further develop the euro area or implement policies in enhanced cooperation.

In recent times, with the approval of the NGEU and the implementation of the Recovery and Resilience Facility (RRF), the OR have been increased, relying on the GNP-based resource, but with a mandate to the Commission to find new OR. The role of the European budget as an instrument of fiscal policy, complementary to the monetary policy, has gained renewed attention and has entered the public debate.

In the current institutional setting the issue of OR has been traditionally linked to the issue of tax harmonization. According to this approach, that was followed also by the Monti working group and could be defined as basically "federalist", the strengthening of the fiscal capacity of the Union, and the consequent strengthening of its own resources, pass through the harmonization of national taxes. Just as in the past, at the birth of the European Communities, the harmonized VAT was, together with custom duties, an own resource, so today other national taxes should be harmonized, and part of the revenues should be assigned to the budget of the Union.

On one hand, this traditional approach is the (appreciable) expression of a coherently federalist evolutionary vision. But, on the other hand, it has a very low probability of success. In fact, today political orientations and trends that go in other directions prevail.

In the tax field, recent years have seen the approval of European legislation aimed at strengthening administrative cooperation and revising anti-evasion and anti-avoidance regimes, to a large extent in coherence with larger projects promoted by the OECD and the G20. These are the issues on which it was possible to overcome the stumbling block of unanimity. On the other hand, no progress has been made on issues of genuine harmonization, such as the corporation tax: the directive on the CCCTB (Common Consolidated Corporate Tax Base) has been under discussion for a decade. Perhaps it is no coincidence that the political agreement on the establishment of new own resources, as will be seen in a moment, concerned the ETS and the CBAM, non-tax forms of levy, therefore not subject to unanimity.

In the context of the NGEU and the RRF, the new financial needs of the Union budget, also necessary to meet the financing of the new European debt, are in any case eventually ensured by the fourth resource (the one based on the GNP). However, this agreement was also reached on the basis of a consensus on the attempt to find new own resources, using new revenues raised mainly from foreign operators. In other words, the Commission has been given a mandate to seek solutions aimed to "export" the

levies, avoiding as far as possible transfers of revenues from the national budgets to the Union budget.

1. Background

In the interinstitutional agreement of 16 December 2020, the Commission committed to "put forward proposals on a **Carbon Border Adjustment Mechanism** (CBAM) and on a **digital levy** as well as an accompanying proposal to introduce new own resources on that basis by June 2021 with a view to their introduction at the latest by 1 January 2023.

In addition, the Commission committed to reviewing the EU **Emissions Trading System** (ETS) and to propose an own resource based on the ETS by June 2021. These new own resources should contribute to the repayment of the principal and the interest of the funds borrowed to be used for expenditure under NGEU.

In 2021 new important developments emerged on the co-ordination of the international taxation of MNEs' profits. The G20 (Venice 9-10 July 2021) endorsed an historical political agreement, to be defined at technical level by the OECD Inclusive Framework, on a new international tax system, based on the reallocation of taxing rights among jurisdictions (**Pillar 1**) and a global minimum level of effective corporate taxation (**Pillar 2**).

The Commission expressed the intention to translate into Directives (and thus enforce for all 27 member States) the provisions of the two Pillars, when defined and agreed at international level. Part of the expected additional revenues stemming from Pillars 1 and 2 could become new OR[4].

To avoid interferences with the finalisation of the work of the OECD Inclusive Framework, the Commission decided to put on hold its work on a proposal for a digital levy as a new own resource and to postpone the whole own resource package, also comprising revenues from the ETS reform and the CBAM to the second half of 2021, subsequently further postponed to 2022.

In the end, leaving aside deadlines and postponements, the new possible sources of OR on which the Commission is working are the CBAM, the ETS, the adoption of Pillar 1 and Pillar 2. All these measures imply levying revenues on non-EU residents, with

[4] The impact assessment presented by the OECD secretariat indicated that globally 150 billion dollars of profits could emerge because of the adoption of Pillar 1, and 125 billion of tax revenues could be raised following the implementation of Pillar 2. Part of these global effects would regard EU member states.

the exception of ETS. Also the digital levy, now in standstill pending the definition of Pillar 1 rules, would mainly impact foreign multinationals.

2. Recent progress and state of the art on Pillars 1 and 2[5]

The G20 in July 2021 agreed that there will be a minimum global rate of 15 percent on multinationals, applied country by country (Pillar 2). In addition, the countries where the sales take place (the market countries) will be entitled to tax at least 20 percent (now raised to 25 percent) of the profits exceeding 10 percent for the largest and most profitable global companies (Pillar 1) (for more detailed description see Box 2 and Box 3). Among them, are the large digital multinationals.

Appropriate cooperation will be ensured between the application of the new international rules and the removal of all taxes on digital services, or other similar measures, on all businesses. The importance of parallel progress in the agreement on both Pillars was reiterated.

Box 2. Main Features of Pillar 1

Pillar 1 is a binding regime, which should be enshrined in a multilateral agreement: its approval, initially scheduled for the end of 2022, has been postponed to 2023(*).

The political agreement on the basic principles has not yet resulted in defined technical proposals(**). The delay compared to the initial roadmap reflects the complexity of the project, both technical and political.

Pillar 1 includes multinationals with a global turnover of more than EUR 20 billion and a profitability (ratio of profit before tax to revenue) of more than 10 percent. Extractive industries and regulated financial intermediaries are excluded.

For multinationals falling within the scope, 25 percent of the "remaining" profit, i.e., the part that exceeds 10 percent profitability (called Amount A), will be allocated to market jurisdictions, using a revenue-based allocation key. The profit will be determined on the basis of the financial reporting, with a few adjustments.

[5] This section is based on the paper "*La tassazione delle imprese nella UE: Pillar One, Pillar Two e le proposte della Commissione Europea*", presented by Vieri Ceriani at the Conference "*La nuova politica economica e tributaria per l'Unione Europea*", Accademia dei Lincei, Rome 27 May 2022 (forthcoming).

The "ordinary" profit (called Amount B), up to 10 percent profitability, will remain subject to the traditional rules of coordination: it will therefore be allocated among the various jurisdictions on the basis of the presence of subsidiaries and permanent establishments and the usual transfer pricing rules.

Simplified rules for the application of transfer pricing to marketing and distribution activities will be introduced, with particular attention to the needs of jurisdictions with less administrative capacity.

A binding dispute prevention and settlement system will be established.

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(*) *Final communiqué of the G20 of finance ministers and central bank governors* held in Bali on 15-16 July 2022.

(**) On 2 April 2022 measures to identify the market jurisdictions from which income derives and for the application of the distribution key were presented as a first draft for public consultation. These rules serve the purpose of allocating part of the revenue to the jurisdictions where goods and services are used or consumed. Subsequently, on 19 August 2022, the OECD Secretariat published the *Progress Report on Amount A of Pillar One, a public consultation document that will help to define the final solution that will be approved by the Inclusive Framework.*

Box 3. Main Features of Pillar 2

Pillar 2 is a form of political coordination, not legally binding: each jurisdiction is free to adopt the second Pillar in its legislation, but if it does it will abide by shared rules.

Multinational groups with more than EUR 750 million in revenues (in at least 2 years out of the last 4) are taxable persons. International shipping companies, public administrations, international institutions, pension funds, non-profit organizations, and investment funds are excluded. Groups are made up of Ultimate Parent Entities (UPEs) and Constituent Entities (CEs), i.e., subsidiaries and permanent establishments.

The intention is to guarantee a minimum level of taxation of 15 percent for each jurisdiction in which the multinational company operates. The first step will therefore be the calculation, in each jurisdiction, of the Effective Tax Rate (ETR). If it is less than 15 percent, the rules of Pillar 2 will apply. Since the approach is jurisdictional, it is envisaged that the equivalence of the US GILTI with the new system will be assessed, to ensure uniform global treatment.

Pillar 2 is based on two rules, connected to each other: the first is the Income Inclusion Rule (IIR). If the ETR calculated on a constituent entity (CE) is less than 15 percent, the parent company (UPE) will pay in the jurisdiction where it is resident a supplementary tax, the Top-up Tax (TUT), that will bring the effective CE taxation to the level of 15 percent. The IIR is the primary rule for imposing the minimum effective taxation, but not all jurisdictions will apply it, as Pillar 2 is not binding. If the jurisdiction where the parent company resides does not enforce the IIR (or inadequately applies it), the jurisdictions where the constituent entities reside may apply a second rule, the Under-Taxed Payment Rule (UTPR). UTPR operates as a 'backstop' in case the IIR is not applied, or insufficiently enforced, and also as an incentive to push the jurisdictions where the parent company resides to apply the IIR.

The calculation of the UTPR is quite laborious. First of all, the total UTPR is calculated for each multinational group, i.e., the sum of all the Top-up Taxes of the CE with an effective taxation of less than 15 percent. The total UTPR is then allocated among the jurisdictions that have adopted the UTPR and in which the multinational has the CE. The distribution is based on the share of the number of employees and the share of tangible fixed assets in the jurisdiction in the worldwide total: the two shares have equal weight (50 percent). Jurisdictions that have adopted the UTPR are free to choose how to apply and collect the Top-up Tax: they can deny some deductions, provide for a "fictitious" tax base, or impose a new tax.

The starting point, as mentioned, is the effective tax rate. The ETR in each jurisdiction is calculated as the ratio of the sum of the Adjusted Covered Taxes of the CEs to the Net Globe Income. Adjusted Covered Taxes are the taxes for the year, as resulting from the statutory financial statements, and include income taxes, substitute taxes (such as withholding taxes on foreign income), taxes on distributed profits and on accrued profits. They also include deferred taxation. They are subject to adjustments, in both directions, for exclusions from income, tax credits, and deferred taxes. In some cases, taxes need to be reallocated between jurisdictions. Refundable tax credits, paid in the form of compensation against other compulsory payments, are considered not as a tax rebate, but as public expenditure, and are excluded from the calculation of the ETR.

Net GloBE Income is the sum, if positive, of profits and losses of all CE resident in a jurisdiction, as reflected in their financial statements. A portion of income is subtracted from Net GloBE Income to consider the actual economic presence in the jurisdiction (Substance-based Income Exclusion, SBIE). The SBIE is calculated by applying figurative returns to labor and capital. The labor component considers the cost of labor (broadly defined, including collaborations), and applies a notional return of 10% (which will gradually reduce up to 5%). The capital component applies a notional yield of 8% (which will gradually decrease to 5%) to the balance sheet value of plant, machinery, real estate and leased property. In each jurisdiction SBIE is subtracted from

Net Globe Income and the Excess profit is determined.

For each jurisdiction, the Excess Profit is then multiplied by the rate of the Top-up Tax, i.e., by the difference between the minimum rate of 15 percent and the ETR: the result is the amount of the Top-up Tax, which will be taxed either with the IIR or with the UTPR.

Jurisdictions may also apply a Qualified Domestic Minimum Tax (QDMT) that allows Top-up Tax revenue to be retained in the jurisdiction itself and prevent it from going to another jurisdiction that applies the IIR or UTPR. It seems that this option will be used by many countries; some have already announced it (including Switzerland and the United Kingdom).

To meet the demands of less developed countries with less administrative capacity, Pillar 2 also provides for the STTR (Subject To Tax Rule), which allows jurisdictions to impose withholding taxes on outgoing payments (interest, royalties, and the like) directed to related parties that in their country of residence are subject to less than a minimum tax rate (9 percent). The STTR will be treaty-based: if required, countries of destination of payments that charge corporate tax at a nominal rate below the minimum will allow the application of the STTR by the jurisdictions of origin of the flows, disapplying more favorable conditions (for the taxpayer) provided for by the treaties in force. The withholding tax rate will have a limit: it cannot bring the total tax on payments to exceed the minimum rate. Unlike IIR and UTPR, STTR is independent of group size: it will therefore also apply to payments between related parties belonging to a group with revenues of less than EUR 750 million. The rate to be considered will be the nominal rate of the country of destination of the payments, not the actual rate. The withholding tax will apply payment by payment, not on the profit determined at the end of the financial year. The STTR will apply before the IIR and the UTPR and any withholding tax collected under it will have to be considered in the calculation of the overall minimum tax for the purposes of the IIR and UTPR.

The above describes the basic architecture of the Pillar 2. There are many more detailed rules, concerning the definition of Adjusted Covered Taxes, Net Globe Income, Substance-based Income Exclusion, special regimes for Joint Ventures, Investment Funds, Excluded Entities, Flow-through Entities, Special Purpose Vehicles, partially owned subsidiaries, hybrid instruments. There are also de-minimis rules and special rules for mergers and acquisitions. Special *safe harbor* rules, aimed at simplifying the system, are still being defined.

With respect to administrative aspects, a declaration (GloBE Information Return) must be completed by each constituent entity (or an entity designated by it) in each jurisdiction. Alternatively, the parent company (or a person designated by you) may deliver the declaration to a jurisdiction that holds the status of Qualified Competent Authority. The declaration must contain information on: the identification of the

constituent entity and its location; the overall structure of the multinational group; the information necessary for the calculation in each jurisdiction of the ETR and the Top-up Tax for each constituent entity; the allocation of the Top-up Tax to the IIR and UTPR.

The agreement was then elaborated by the OECD Inclusive Framework. On Pillar 1 there is still no agreement on a definitive technical proposal: work is continuing, with the expectation of an imminent solution. The approval of the multilateral convention that will enshrine the agreement on Pillar 1, initially expected by the end of 2022, has been postponed to mid-2023.

As for Pillar 2, on 20 December 2021 the OECD Inclusive Framework approved the model rules. Following this agreement at OECD level, two days later, on 22 December 2021, the European Commission proposed a directive to incorporate the second Pillar rules into EU law (EC, 2021). In March 2022, the Inclusive Framework approved the commentary on the model rules and some examples for their implementation. Therefore, the Pillar 2 project has entered an advanced stage of definition.

The French presidency (first semester 2022) gave priority to the proposed directive. Initially, all 27 MS had affirmed their support, in principle, to the second Pillar agreement. However, unanimity is always very difficult to achieve (see Box 4).

Box 4 - The progress on Pillar 2 directive

In response to the objections raised by several MS, a draft compromise text was published on 12 March 2022 with several amendments to the original version. One of the main concerns (expressed by Estonia, Malta, Poland and Sweden) was the tight deadline for implementation. The compromise text moved the deadline for transposition of the directive from 1 January to 31 December 2023 and introduced an option for MS to postpone the application until 31 December 2025, if there are no more than ten parent companies of multinational groups in their jurisdiction. A further revised compromise text was published on 28 March, extending the deferral period from two to six years and increasing the minimum number of parent companies in the MS to twelve (from ten). Furthermore, the principle of the political link between Pillar 1 and Pillar 2 was reaffirmed, as well as the commitment to the presentation of a solution on the taxation of the digital economy in the course of 2023.
The Polish government, which had initially declared its opposition to the directive, also for general political reasons related to its access to PNRR funds, declared itself satisfied with the revised compromise. However, the Hungarian government vetoed it,

denouncing delays in the work on Pillar 1, underlining that the international agreement foresaw the adoption of both Pillars, and deeming the approval of the directive premature in the current geo-political and economic context. The French presidency tried unsuccessfully to obtain unanimity, until the last Ecofin of its semester. The subsequent presidency (Czech Republic) resumed the negotiations, with the aim of achieving unanimity by the end of the year.
In the meantime, discussion started on the possibility, initially put forward by the French finance minister Le Maire, of starting an enhanced cooperation (*) on Pillar 2. Approval of the directive would obviously be preferable. It is feared that the number of MS that would join the enhanced cooperation could be well below the 26 that have supported the directive so far. The governments of Germany, France, Italy, Spain and the Netherlands have reaffirmed their commitment to the adoption of the second Pillar and announced their intention to proceed in any case, even on an individual (but coordinated) basis.

(*) Enhanced cooperation is a procedure provided for in the Treaties. It is designed to overcome the deadlock in case a particular proposal is blocked by one or more Member States. It allows a minimum of nine MS to establish advanced integration or cooperation in a specific area, if it is clear that the Union as a whole is unable to take the measures within a reasonable time. The procedure is authorized by the Council, on a proposal from the Commission and with the consent of the European Parliament.

Failure to approve the directive would have negative repercussions on the overall process. It was thought that the approval of the European directive could favor the adoption of Pillar 2 by other countries. In particular, that it could give some impetus to the legislative initiatives of the Biden administration. Although the announced tax reform did not seem to have the possibility of parliamentary approval (even more so, it was feared, after the mid-term elections), it was hoped that some aspects of the reform, connected to the transposition of the rules of the second Pillar, could find implementation with the next budget law.

Surprisingly, however, in August 2022 the Biden administration managed to pass the IRA (Inflation Reduction Act) which, in addition to measures aimed at containing inflation and in favor of green energy and environmental policies, also introduced a minimum tax on corporate income: the Corporate Alternative Minimum Tax (CAMT)[6].

CAMT is a purely domestic tax regime, which enters the determination of the US corporation tax. It differs in many relevant respects from Pillar 2 model rules.

[6] The CAMT applies to US resident companies with profits exceeding $ 1 billion and provides for a 15 percent tax rate on profit, as per the balance sheet results, with some adjustments. The company will be required to pay the greater of the corporate tax, as calculated on the normal tax base, and the CAMT.

Furthermore, the IRA does not provide for any other adaptation of the US tax system to the rules of the second Pillar. In substance, for the time being the adoption of Pillar 2 is not on the agenda of the US Congress.

As mentioned before, the work on Pillar 1 in the OECD Inclusive framework continues, albeit with a delay compared to the initial (ambitious) roadmap. Looking at both Pillars, the prospects for their full implementation do not appear as brilliant as they did a year ago.

The growing uncertainty over the capacity and willingness of the Biden administration to have the international agreements on both Pillars adopted by the US parliament has a negative influence on the whole process. Furthermore, the climate of international cooperation within the G20 has recently deteriorated. These uncertainties might also have some return effect on the implementation of the second Pillar: as mentioned, the historic agreement reached in 2021 was based on the implementation of both pillars.

2. The "narrow path"

The preceding ample digression on the G20 agreement on the two Pillars and its adoption in the EU and the USA highlights some important issues.

- In the first place, tax harmonization within the EU cannot ignore the international context. Quite the opposite, the international context prompts and sets the conditions for progress at the EU level. In a more general context, in a globalized world tax policy is part of a global framework of economic and political relationships. National tax decisions impact on other countries' decisions.

- Secondly, it is extremely difficult to reach unanimity in the EU, even when a wider international agreement has been achieved, with the consent of all MS, and the issue at stake regards enforcing tax collection and fighting base erosion and profit shifting, certainly not harmonizing direct taxation per se, under a "federalist" approach. The unanimity rule is a formidable obstacle on any progress on tax issues.

- In the third place, at technical level, there are perplexities on the high complexity of the proposals, strong suggestions to introduce simplifications, preoccupation on the tightness of the timetable for the implementation, that emerge also from the discussion at EU level.

- In the fourth place, the expectation of a rapid entry into force of the two Pillars is weakening, particularly so in respect of Pillar 1. Consequently, the prospects of raising substantial revenues from the Pillars, as a potential source of OR, is waning.

- Last but not least, if Pillar 1 does not fly, the issue of the tax treatment of the digital economy will come again to the front. The EU is still committed to introduce a digital levy, consistent with the international agreements and compliant with the WTO rules. If Pillar 1 is not implemented, the introduction of a European digital levy would inevitably lead to a confrontation with the US government.

As mentioned, the strategy of the UE and the mandate to the Commission for strengthening the OR has been based on CBAM, ETS, the two Pillars and (possibly) the digital levy. In substance, the burden of financing the borrowing for NGEU would have been "exported" on digital multinationals and on foreign producers consuming high quantities of carbon, thus not impinging on the national tax bases and the tax revenues of the MSs.

The reformed ETS was also considered appropriate as a source of OR, although the burden will fall on EU companies. However, both the CBAM and the ETS cannot be viewed as permanent sources of finance, because their revenues will tend to decline over time. The CBAM is intended to induce third countries to implement forms of ETS at home: as they will do so, CBAM revenues will shrink. Also ETS is a behavioral levy, intended to induce reductions of carbon emissions produced in the EU: its very success implies a decrease of its revenues.

The weakening of the prospects for the implementation of the two Pillars has been highlighted. In any case, not much additional revenue of permanent nature can be expected from Pillar 1 and revenues from Pillar 2 might vanish over time as the low-tax jurisdictions bring their level of effective taxation in line with the agreed international minimum.

The CBAM and ETS proposals, part of the whole package of "green" measures which has been proposed by the Commission in mid-July 2021, so far have not received a very favourable endorsement. On the contrary, the recent sharp increase in energy prices and the shortfalls in the supply of energy, exacerbated by the war in Ukraine, make it unfeasible to push forward in the immediate future, at a time when many national governments are implementing new interventions aimed at countering the spike of energy prices and a common approach to cap energy prices and reform the EU mechanisms of price formation is under development. Although their implementation is not feasible in the short term, CBAM and ETS remain viable in the medium-to-long

term. But it must be kept in mind that in the framework of Fit-for-55 it has been decided to earmark the bulk of the revenues from ETS to compensatory schemes and the promotion of research and innovation, leaving little room for OR. Furthermore, as mentioned, CBAM and ETS are behavioral levies whose revenues tend to shrink over time.

As for the digital levy, the decision to postpone a proposal, as well as proposals on business taxation at large (BEFIT), for not interfering with the developments at OECD-G20 level, is still valid. Until an agreement is consolidated on Pillar 1 (or the failure of the project is recognized) a proposal by the Commission would be considered as disruptive of the current international effort to reach a new and sound way of taxing digital MNEs' profits. Taxation of the digital economy, the very definition of digital economy for tax purposes, constitute one of the most contentious points of discussion and negotiation. It must be remembered that the US Secretary of State for Trade, the same day (10 July 2021) of the G20 agreement on international taxation, has suspended retaliatory tariffs against some countries (Austria, India, Italy, Spain, Turkey, United Kingdom) that have introduced digital levies, in the hope that in the meantime an overall agreement will be reached, which will imply the abolition of those national digital levies. At the meeting of the OECD Inclusive Forum of 8 October 2021 an agreement has been reached on a standstill and a removal of national digital levies, conditional upon further progress on Pillar 1. The Commission is still committed to propose a digital levy that will be consistent with the international agreement on Pillars 1 and 2, and consistent with the WTO rules. If the OECD work reaches a conclusion on globally agreed technical rules on Pillar 1, there will be virtually no political room for proposing a European digital levy. If the OECD project on Pillar 1 fails, the issue of the digital levy will raise again, but at the cost of a possible stiff confrontation with the US government. However, a recognized failure of Pillar 1 is not very likely: more probably, the project will be "frozen", and the digital levy alike.

In conclusion, the general context on the three new and most promising sources of OR, the CBAM, the ETS and the digital levy, is currently affected by uncertainty and indetermination (and political impracticability for the digital levy) that make it unfeasible to advance well-defined proposals in the short run. Today the scope for enlarging OR is shrinking, due to the recent developments on the two Pillars, the repercussions of the current energy crisis on the ETS and the CBAM, the difficulty in proceeding with the digital levy.

It is necessary to enlarge the basket of possible candidates for new OR. Inevitably, because of the declining feasibility of "exporting" the burden of the new OR, the new candidates will rely more on European tax bases and revenues.

4. Exploring other proposals

Other proposals have been put forward. Some, besides providing new OR, have also the structural aim of harmonizing important aspects of the EU taxation, like the BEFIT project on business taxation, thus improving the functioning of the internal market. Others are temporary bridge solutions. Others, that regard the taxation of the financial sector, are not as general as BEFIT, but also aim at creating a level playing field in taxation that is instrumental for some important projects (*e.g.*, the Capital Market Union).

4.1. BEFIT

The BEFIT[7] (Business in Europe: Framework for Business Taxation) is the successor of the CCCTB (Common Consolidated Corporate Tax Base) and is the key proposal for the harmonization of the tax base of the business sector, for common booking rules and the apportionment of the consolidated tax base among MSs. Thus is a milestone in improving the functioning of the internal market. The common tax base is also a natural candidate for OR. It joins the achievement of new OR with the traditional "federalist" approach.

The revenues for OR will derive from domestic European business and from national corporation taxes. The Commission links the definition of BEFIT to the definition of Pillars 1 and 2: the directive on BEFIT should comprehend the directives on Pillars 1 and 2. Therefore its presentation will not be immediate, although the Commission intends to do it in 2023. The effective implementation will obviously take time, due to the lengthy negotiations of such an important directive, subject to the unanimity rule.

4.2. Temporary solutions

Other proposals have been put forward for OR, based on contributions from the business sector, but there are no strong candidates. Basically, they aim at building temporary “bridges”, before a more comprehensive reform of OR is proposed and implemented. All these temporary solutions foresee charges on the EU business sector (Simplified Corporate Contribution, Solidarity Tax, CIT top-up). Hence, these new OR would raise revenues from the national tax bases of MSs.

[7] BEFIT was presented by the Commission on 18 May 2021 with the *Communication on Taxation of Business for the XXI century* (COM (2021) 215).

4.3. FTT

The FTT (Financial Transaction Tax) has been identified as a possible alternative candidate for OR. It is now a project of enhanced cooperation among ten MSs (nine is the minimum number required), but negotiations have come to a standstill. Some participants now feel that the scope of the (almost) agreed FTT is too narrow and should embrace a larger tax base, in terms of type of transactions and type of financial instruments. In fact the (tentative) agreement that had been reached considered only transactions of equities listed on regulated markets at the moment of settlement (like the French, Italian and Spanish national FTTs). Negotiations under the enhanced cooperation have been suspended with COVID-SARS pandemic and have not resumed.

As for the OR, the tentative "final" agreement on the FTT foresaw a sharing of the revenues among all the participants, in accordance with the share of each participating MS in the OR based on GNP. In other words, the revenues from the FTT would be redistributed among the participating MSs in order to reduce each MS's net contribution to the OR. But the total OR would be unchanged and the total financing of the EU budget would not increase. In any case, the limited scope of the current FTT and the fact that it does not involve all MSs make it an improbable candidate for OR.

4.4. Excises on energy products

The proposal for a new directive on energy products has been approved by the Commission in July 2021 (COM(2021) 563 final) as part of the package of measures on the green transition. It had been decided to exclude the new excises from the OR package and instead include the ETS. But the ETS is now destined mainly to finance the innovation fund and the climate social facility. This in principle opens the door to a further discussion on the possible role of energy excises as OR. When approved, the reviewed excises could be a good candidate for OR under the same logic of the ETS, i.e. to share additional revenues raised to foster the green transition through price signals. Like the ETS, its revenues will tend to shrink over time. The burden will also fall on imports from third countries, not only on the domestic economy, differently from the ETS.

4.5. Harmonizing the CIT on the financial sector

At the meeting of the OECD Inclusive Forum of October 8, mainly under pressures of the UK, a carve-out for regulated financial services has been agreed for Pillar 1.

The Banking Union (BU) and the more general capital markets union (CMU) are

fundamental steps forward in strengthening the internal market and the institutional setting of the Union. The banking sector is already subject to harmonized rules in the fields of supervision and regulation and the same holds for insurance companies and other financial intermediaries. The creation and deepening of the BU and the CMU imply more harmonization also on profit taxation. In a nutshell, the proposal is to harmonize the CIT for the financial sector, as a first step toward the BEFIT.

As noted above, this proposal would not interfere with the current OECD project, that excludes the financial sector from Pillar 1. Also, it would not violate the inter-sectoral uniformity of taxation: all national CITs have special rules for banks (as well as insurance companies) and the general BEFIT should in any case do so: also the CCCTB project had special rules for the financial sector.

A fast track for BEFIT in the financial sector is justified by the objective of strengthening the functioning of the internal market and the CMU. It would create a level playing field in taxation, an important source of distortions and inequalities. Heterogeneous tax rules weaken the internal capital market and the effectiveness of supervision: with equal gross profits differing tax rules produce different net profits and different effects on banks' regulatory capital. Tax rules also influence the decisions on the composition of assets and liabilities, leading to differences in the level of leverage and in investment decisions.

In recent years some aspects of the national tax rules on banks have been challenged by DG COMP on the basis that they are state aids and create competitive advantages, specifically in the fields of deferred taxes and of hybrid instruments. In general the existing differences in national CITs interact with regulatory and prudential measures and lead to distortions in competition, damaging the functioning of the internal capital market, particularly of the BU. Many such differences in taxation refer to the specific rules for banks (and insurance companies and other regulated intermediaries). The recognition of the current shortcomings should lead to conclude that CIT harmonization is needed in the financial sector. On some specific aspects and under some conditions the application of Art. 116 of the TFEU[8] (that allows to approve directives with qualified majority) could be investigated, and used as a tool of pressure, alike state aid rules, that have been used on several occasions for this purpose.

It may be argued that attempting a fast track on BEFIT, if unsuccessful, would jeopardize the whole BEFIT project, that needs careful and cautious preparation. But also the contrary might be the case: a fast track on the financial sector is fully justified, is consistent and necessary to create level-playing-field and fulfill the requirements of

[8] See: Englisch, Joachim, *"Article 116 TFEU – The Nuclear Option for Qualified Majority Tax Harmonization?*", EC Tax Review, 2020, n. 2, pp. 58-61. Nouven, Martijn, "*The Market Distorsion Provisions of Articles 116-117 TFEU. An Alternative Route to Qualified Majority Voting in Tax Matters?",* Intertax, 2021, vol. 49, 1, pp.14-28.

the BU and the CMU. Hence, is very well motivated, very well targeted, it appears as "necessary" for attaining some strategic specific goals of the Union, is much less intrusive of national taxing rights of MSs; may be it has more chances of success marching alone on a fast track than staying within the general BEFIT. And might be a very useful experiment in view of the preparation and negotiation of the general BEFIT. And if it fails, given its limited sectorial scope, not necessarily will imperil the general BEFIT project.

A fast track for BEFIT in the financial sector could consider not only common rules for the tax base, for consolidation and profit allocation, but could also fix a minimum level of taxation, that could eventually be adapted to fulfill Pillar 2 rules if and when it will be needed, to comply with the OECD agreement.

This fast track for BEFIT in the financial sector would be a natural candidate for OR, as the general BEFIT. It should be decided if this new OR will decrease the revenues of MSs (leaving the total burden on financial intermediaries unchanged), or if it will supplement national revenues (increasing the total burden on taxpayers); these two options could also be combined.

4.6. A FAT as a substitute for the FTT

As mentioned, today the project of an FTT under enhanced cooperation is blocked. If the situation remains as it is, there could be room for the Commission to advance a new proposal resuming a FAT (Financial Activities Tax). Initially proposed by the IMF after the 2008 financial crisis, FAT taxes the gross margin of financial intermediaries, i.e., all remunerations (profits and wages). In the opinion of the IMF, FAT could be a valid and preferable alternative to the FTT. It can discourage high level of leverage and risk, not only for the banking sector but also for other intermediaries; therefore, in respect of the FTT is more tailored to contrast the true causes of a systemic financial crisis.

However, the FAT falls upon the gross margin of EU intermediaries. Although it is very likely that to a large extent it would be passed on to the customers, probably some burden will remain on the intermediaries; instead FTT is directly paid by business and individuals who enter the transactions and the intermediary is entirely unaffected. Not by chance in 2008 the very preliminary plans of the Commission to introduce a FAT were substituted by a proposal for an FTT. The proposed directive on FTT was blocked by a wide and strong opposition of MSs and an enhanced cooperation was launched. After roughly a decade of attempts, the current FTT stalemate induces to rethink the issue and explore new/old ways forward. A FAT would be a natural candidate for OR and could strengthen the design of EU harmonized business taxation.

The BEFIT and the FAT could well be integrated and form a pack. The Fat tax base

could be determined by summing wages and other remunerations to the profits calculated and apportioned under the BEFIT (either total profits or the profits above a "normal" rate, in order to improve the disincentive to assume risks). The rates of both taxes should be coordinated. The FAT could also help streamlining the VAT in the financial sector (see section 4.7).

The possible increase in the tax burden of EU intermediaries stemming from FAT should be carefully balanced and coordinated with the proposed harmonization of the CIT, also taking into consideration the system of levies that has been set up to finance the Resolution Fund and the current works on a proposal to review the VAT on financial services. The latter review and the introduction of new special tax allowances based on ESG indicators (see section 4.8) could partly compensate the possible increase in the tax burden stemming from FAT and BEFIT.

4.7. Reforming the VAT on the financial services

Currently financial services are exempt for the customers, and the burden of the input VAT is borne by the suppliers who cannot deduct it. The current plans to apply VAT to the financial services and to allow for its deduction may ease the tax burden on the sector, balancing the possible introduction of a FAT. Eliminating the burden of the un-deducted VAT from the financial services sector would eliminate some well-known distortive tax effects, namely cascading and obstacles to out-sourcing. As a further improvement of the neutrality of the European tax system and further relief of the burden on financial intermediaries, the proposal could include the abolition of national specific taxes/levies on wages and insurance premiums.

4.8. An allowance correlated to the ESG rating

A further way to mitigate the burden on the financial sector could be considered: the introduction of a special relief from the BEFIT (or from the FAT), i.e. an allowance correlated to the ESG rating of the company.

A strong international effort is currently under way to establish and implement ESG indicators based on solid and internationally agreed methodologies. International regulatory authorities (including the European ones) are engaged in this effort, recommended by the G20. The ESG indicators will counter "green washing" phenomena and will orientate the financial sector to promote the green transition and the sustainable growth. Central banks are also considering ESG use in implementing monetary policy. Also tax policy could consider using the ESG to introduce allowances

aimed at the green transition and the sustainable growth, alike the other tax allowances already in place aimed at fostering R&D.

5. Conclusion: the way forward

The discussion on the best way forward for OR must be placed in the general context of the development of EU finance. Two scenarios may be taken as reference.

The first scenario foresees new exceptional and urgent tasks, that imply strong financial commitment at Union level. They may be linked to environmental emergency, energy transition, common defense, waves of migration, reconstruction of Ukraine, and the like. In this scenario the Union will be faced in the next future with "emergencies" that foster strong political determination and unity and need strong financial commitment from the EU budget. A sort of repetition of the experience of the NGEU. In this context, a solution like the one adopted for financing the RRF may be envisaged. If the political commitment is strong, the fourth OR (based on GNP) may be a viable solution, as it has been for the RRF. It has been pointed out that, in case of a substantial increase of OR, any solution based on sharing the revenues of one (or more than one) national tax may be very lengthy and possibly inconclusive, because of structural differences among MS that will lead to perceived imbalances in the sharing of the financial burden and to sharp and extensive negotiations to reach a "fair" distribution. The OR based on GNP would probably be easier to accept as a "fair" solution. If this scenario is accepted as the "best" way forward, the Commission should propose the OR based on GNP and leave aside any other proposal. If the political commitment on engaging in the new tasks is strong, it could be counterproductive to engage in an ancillary burdensome discussion on new OR.

The second scenario envisages a gradual evolution of the Union toward a federalist outcome. The strengthening of the federal budget would proceed along the traditional path, seeking proper OR based on revenue sharing of harmonized taxes (or levies). The Commission should continue, as it is doing now, to use the need for more OR as a "troy horse" to foster tax harmonization among MS. In the very long run, the (unspoken and implicit) outcome might be the establishment of autonomous taxing rights of the EU, separate from the taxing rights of the MS.

In summary, the first scenario envisages a development of the EU fiscal capacity that is somehow emergency driven, with no fundamental changes at institutional level. The second scenario envisages a strengthening of the fiscal capacity of the EU that is accompanied by an institutional strengthening, through tax harmonization (but not only), towards a more federalist setting.

As for the concrete strategy on OR, both approaches have pros and cons. Going straight to the OR based on GNP and ignoring all the other proposals put forward insofar may

be rational under the considerations mentioned before but has the drawback of ignoring the will of MS to explore the possibility of new OR that "export" the burden to the rest of the world. As a matter of fact, the legal agreement on funding the NGEU with the fourth resource was reached on the basis of a political agreement to find new OR, raised from foreign operators. In other words, the fourth resource acted as a temporary legal solution, easy and simple to implement, while building the new OR. After almost two years of political commitment and work on a package of new OR, it would be difficult to abandon the effort and declare that everything was already fixed from the beginning: the legal provision has been approved, the fourth resource is the solution for reinforcing the fiscal capacity of the Union. This a U-turn would be politically very demanding and quite controversial.

On the other side, as indicated, the prospects of raising revenues from foreign operators are not brilliant and most of the new OR are in any case transient. Only the BEFIT (the new version of the old CCCTB) will raise consistent and durable revenues, but its approval will be lengthy and difficult, pending the unanimity rule and the scarce willingness of many MS to proceed towards a true harmonization, that would go well beyond the fight against tax evasion and avoidance.

Nevertheless, it is also necessary to pursue the long-term objective of building a European tax system that is less fragmented, more cohesive, more growth friendly, consistent with the full exploitation of the potentialities of the internal market, that are hampered by the obstacles stemming from the current state of business taxation in Europe.

This applies to BEFIT for the taxation of business in general. As for the financial sector, the aim to harmonize both direct and indirect taxation is strictly functional to create a level-playing field for the capital market union. This long-term objective is of strategic nature and cannot be abandoned. Joining it with the objective of reinforcing the fiscal capacity of the EU seems a rational and quite natural way forward. The BEFIT and the more limited proposals to proceed on a fast track for the financial sector on both direct and indirect taxation (see para 4.1, 4.5, 4.6, and 4.7) are consistent with this long-term goal.

Finally, one important issue must be outlined.

There is a difference between strengthening the fiscal capacity of the Union with new resources deemed to finance new expenditures, on one hand, and finding new OR for the service (and possibly the reimbursement) of European borrowing, on the other hand. In the latter case, investors in the EU bonds will pay attention to the long-term sustainability of the European debt.

Relying on new OR based on sharing tax revenues will probably be considered more reliable than using the GNP-based OR. After all, traditionally the valuation of the

sustainability of the debt is based on the capacity of raising compulsory levies by the constituency that issues the debt. Revenue sharing may be a reasonable alternative for the Union, as far as it implements a certain and durable source of inflows to the EU budget. The GNP resource is more linked to the political agreement on the size of the EU budget, which is negotiated every seven years. A reduction in the size of the GNP resource and the related increase in the share of other levy-based OR may improve the perception of sustainability of the EU debt. Some financial operators might raise perplexities about the certainty of funding the EU debt in the long run, if an agreement on new OR is not met.

What matters, after all, and what markets want to appreciate, are not the legal provisions, but the political capacity of the Union to take decisions and move forward to strengthen the common fiscal capacity. What matters is the political cohesion and the capacity to take initiatives and consistent decisions: the legal prescriptions are the mere outcome of the political process. And the reverse does not always hold: a legal prescription is not immutable and might be reviewed or corrected if the political mood wants so. The decision on GNP resource is subject to renegotiation every seven years.

As a final note, the two approaches may not be incompatible. The first scenario may be placed in a short-term perspective; the second one may be consistent with a more long-term view. In this context, the first scenario could be a pass-through to the second scenario.