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FINANCING THE EU BUDGET: REPORT ON THE OPERATION OF THE OWN RESOURCES SYSTEM

ANNEX

Accompanying the document

Proposal for a Council Decision

on the system of own resources of the European Union

{COM(2011) 510 final}

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PART I: INTRODUCTION

1. Mandate of the working group and scope of the analysis

In the EU Budget Review adopted on 19 October 2010[1], the Commission decided to submit proposals regarding the future financing of the EU budget by the end of June 2011. This communication mentioned seven criteria to assess possible new own resources, as well as an explicit list of financing means, which could be possible candidates for new own resources to gradually displace part of the current GNI-based own resource.

This Annex identifies the particular characteristics and the advantages and disadvantages of potential new own resources using, primarily, the assessment criteria put forward in the Budget Review communication. It focuses on the potential candidates mentioned in the Budget Review, trying to envisage the main possible variants for any given option. Other candidates not identified in the Budget Review have also been briefly reviewed. However, no additional promising candidate was discovered.

2. Assumptions and limitations

The analysis presented in the report relies on important working assumptions. In particular, options for which the timeframe for implementation would extend beyond the next financial framework or for which a revision of the Treaty would be necessary have not been taken into consideration.

Furthermore, as indicated in the Budget Review, *"[i]t should be underlined that this is not an argument about the size of the budget – it is a debate about the right mix of resources. The progressive introduction of a new resource would open the door for other resources to be reduced, phased out or dropped*". Accordingly, it has been assumed that the introduction of a new resource to finance the EU budget would be done in a context of "constant budget" size. Consequently, revenues from new own resources would replace the current VAT-based own resource and to reduce the GNI-based own resource provided by the Member States. It would be up to the Member States to decide how best to take advantage of this reduction of their contributions.

Such an in-depth analysis performed over a limited period of time relies mainly on existing studies and material. It has not always been possible to provide robust information and assessment on some aspects of candidates as an own resource. The report indicates ongoing assessments undertaken by the Commission and potential avenues for future research or where an additional preparatory work could be envisaged in priority.

[1] COM(2010) 700 final

3. Structure of this report

This report proposes a systematic and structured presentation and assessment of potential new own resources.

It starts with a small methodological presentation in **Part II**, which clarifies a number of concepts used for the assessment. This section allows understanding how the final assessment table has been constructed and how to interpret results.

Each potential resource is analysed in details in **Part III** based on a common analytical framework.

- The first step in the analysis is to set the scene for each potential candidate with a view to understanding the specific political context surrounding an eventual proposal. This involves an examination of the main policy initiatives, political declarations, stakeholder positions and/or technical reports one needs to be aware of when assessing the options. This overview is presented in each section 1 "Political context".

- The second step consists in identifying the potential variants of a potential own resource. The objective is to define the scope of a proposal. It also helps assessing the potential resource in specific, rather than general terms. Where differences between several variants are substantial and can have an impact on the overall assessment of the potential resource, the variants are assessed separately. This scope definition is performed in each section 2 "Outline of the proposal".

- The third step in the analysis proposes a qualitative assessment of the potential own resource. This implies first examining potential issues or problems that are specific to the potential own resource and which require a particular attention. This covers, *inter alia*, legal issues or the link to existing instruments in the policy area under examination. This analysis also involves examining the potential resource with regard to the criteria defined in the Budget Review communication. This analysis can be found in each section 3 "Qualitative assessment".

- The fourth step is the quantitative assessment of the potential own resource. This involves examining the potential revenue and, where appropriate, distributional impacts. This quantification is made in each section 4 "Quantitative assessment".

An overview of the assessments is presented in the "Report on the operation of the own resources system". This overview provides a summary based on the ground work made in this Annex.

PART II: ASSESSMENT CRITERIA

This section presents the criteria that are used in this Annex to carry out an assessment of possible new EU own resources. Section 1 focuses on the criteria identified in the Budget Review. Section 2 presents essential additional criteria.

It should be noted that, although the list of criteria may appear already lengthy, many more criteria could have been added. Additional possibilities would include economic efficiency, budgetary sufficiency, potential difficulties regarding taxation in the Member States, the impact on- and acceptance by citizens, the administrative burden for Member States. In practice, most of these criteria are covered by the list of criteria set out in the Budget Review or by the supplementary criteria defined below. And criteria such as the acceptance by the citizens and the link with national tax systems are analysed in the part on political context in each technical chapter.

It is considered here that the technical analysis should not place emphasis on any specific criterion. At this stage, many uncertainties remain that call for a cautious and balanced approach to the matter.

It should also be noted that the analysis places little emphasis on the transition costs towards a new own resource. The decision not to deal with these costs in details was made owing to the difficulty of assessing both the economic and the political costs of such a transition.

1. Budget Review framework

1.1. Link to the acquis and the objectives of the EU

The Budget Review defines this criterion as follows: candidates as own resources "*should be more closely linked to the acquis and the objectives of the EU to increase the coherence and effectiveness of the entire budget in the achievement of EU policy priorities. In this respect it is important to keep in mind Article 2.2 of the Own Resources Decision*[2] *which states that 'revenue deriving from any new charges introduced within the framework of a common policy shall also constitute own resources entered in the general budget of the European Union*".

This criterion thus covers two dimensions: the link to the *acquis* and the relation to the EU objectives. The link to the *acquis* mainly refers to what already exists, whereas the link to EU policy objectives can also refer to a policy orientation for the future. Although the two aspects are usually strongly related, some discrepancies could be observed. It should be noted that the existence of a harmonized base and its implications for the development of a new resource are examined in section 1.3 below. The focus is placed here mainly on the policy dimension.

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[2] Council Decision of 7 June 2007 on the system of the European Communities' own resources (2007/436/EC, Euratom).

The analysis presented in Part III focuses first on whether a new own resource would derive directly from the implementation of an EU policy, in the spirit of the above-mentioned article 2.2 ORD. It also looks at whether the resource could serve EU policy objectives, for instance by creating a bridge between the revenue side and the expenditure side of the budget.

1.2. Cross-border aspect and internal market coverage

The Budget Review states that the candidate own resources "*should be cross-border in nature, based on a system covering the whole internal market*". This criterion relates to the subsidiarity principle. Levying the duty at the EU level should bring added value over and above what could be achieved by Member States acting alone. Resources for which the bases are highly mobile across boundaries would be particularly relevant.

The analysis in Part III examines whether a new own resource would have a clear cross-border nature and whether it would cover the whole EU. The focus of this criterion would be on the type of products, activities or processes involved.

A way to make the analysis of this criterion more operational is to test whether the own resource could be levied easily by a Member State independently of others: in cases of genuinely cross-border activities it is unlikely to be the case.

1.3. Base harmonisation and application throughout the Union

The Budget Review indicates that the candidate own resource "*should have a harmonised base to ensure an equal application of the resource throughout the Union*".

The analysis examines the legislative dimension of a policy. It looks at whether a common legislative framework already exists which could facilitate the development of the new own resource.

There is an important caveat, though. The absence, so far, of a harmonised base does not necessarily imply that having such a base in the future would be particularly problematic from a technical point of view. Building a completely new legal base in an area where nothing exists might in some cases be easier to achieve than obtaining a higher degree of harmonisation in an area where a complex set of legislations has been in place for many years.

1.4. Autonomous resource collection

The Budget Review states that "*[i]f feasible, the proceeds of a new resource should be collected directly by the EU outside national budgets*". An autonomous resource would not need to transit via Member States administration. The underlying motivation is to avoid Member States considering the resource as a form of spending to be minimized and reduce the "juste retour" considerations.

The issue of autonomy should not be misunderstood as meaning a change of sovereignty regarding taxation. The power to raise taxes independently at the European level is not permitted under the Lisbon Treaty. National tax sovereignty is not at stake. What is suggested is rather to return to financing mechanisms closer to those designed by the founding fathers such as the customs duties collected on the basis of the common custom tariff.

Part III thus looks at the potential mechanisms which could be used to collect revenues. In some cases, several collection models are envisaged.

1.5. Fair application and impact on correction mechanisms

The Budget Review indicates that the candidates as own resource "*should be applied in an equitable and fair way, and not exacerbate the question of corrections*". This criterion relates to a will that a new own resource would contribute positively to the debate on fairness in the budget and play a role in reducing the need for corrective mechanisms.

The communication also recalls the core principles behind the correction system as set out in the 1984 Fontainebleau European Council: "*expenditure policy is ultimately the essential means of resolving the question of budgetary imbalances*", and "*any member State sustaining a budgetary burden which is excessive in relation to its relative prosperity may benefit from a correction at the appropriate time*".

Conflicts could arise if it appeared that a resource falls disproportionally on some Member States and not on others, or would increase existing perceived budgetary imbalances in the budget.

It is generally considered that if the national origin of a resource is difficult to estimate and relates very closely to a EU policy, as is the case for the traditional own resources, tensions on net balances can be reduced.

1.6. Additional burden on specific sectors

The Budget Review indicates that "*[t]he cumulative impact on particular sectors should be taken into account*".

The focus is placed here on additional impacts, in particular the tax burden, compared to the existing situation.

- An own resource based on a revenue-sharing system would not generate an additional burden for taxpayers: the contribution from a sector would end up in a different account, but remain identical overall.

- An own resource coming in addition to existing resources could, on the other hand, lead to an additional burden for specific sectors.

Furthermore, a difference has to be made between those resources which have a very broad base and those which relate to specific sectors in the economy. An analysis is also necessary to identify what is the incidence of the resource and the market structure. In some cases, a sector in the economy could appear to be hit more heavily, but it could have the potential to pass on the burden of the resource to a large group of consumers. Another relevant element here is the financial capacity of the sectors involved, and in particular the yearly profits or cash flow which would allow contributing to the own resources system.

The focus of this analysis is economic and financial. However, there can also be highly relevant political concerns related to specific sectors. These are presented at the start of each chapter.

1.7. Administrative burden for the EU administration

The Budget Review states that new own resources "*should seek to avoid a heavy new administrative responsibility for the EU in terms of collection*". This criterion reflects the limited size of the EU administration and possible administrative constraints to undertake new tasks.

Levying a resource autonomously at EU level can be expected to entail administrative costs for the EU administration. Therefore, a trade-off between autonomous collection (see above) and the administrative burden can be expected. At the same time, due to economies of scale, substantial administrative cost-saving may be obtained overall, that is, taking into account also the administrative costs in 27 Member States.

2. Additional criteria

2.1. Revenue estimate

For each candidate own resource a revenue estimate is proposed. These estimates are usually based on simple and easily understandable assumptions. The amounts should be seen as indicative orders of magnitude rather than the produce of state of the art dynamic modelling.

Some caution is also necessary when comparing revenue estimates. Depending on data available, the estimate may relate to a recent year or, on the contrary, to future projections. Comparisons of absolute amounts should therefore take into account expected inflation, and comparisons in relative terms, the evolution of GNI.

Although there is no absolute level of revenue that would be considered as ideal for a new own resource, a working assumption used in the analysis is that a resource which would bring less than EUR 15 bn per year (when fully implemented) would probably not be suitable for the EU budget. This corresponds broadly to the revenue of the VAT-based own resource, which could be ended in parallel with the introduction of a new own resource.

2.2. Time needed for implementation

An indicative time needed for implementation has been provided in the tables. This timing reflects a conservative estimate of time needed for negotiating detailed provisions and having them effectively implemented, following a political agreement. Faster implementation could generally be envisaged if sufficient political support was found.

The working assumption was to exclude candidates which could probably not be made operational by the end of the forthcoming financial framework.

2.3. Legal issues

The technical analysis devoted particular attention to a number of legal matters, for which specific legal contributions were provided. In a number of cases, the existing legal framework could involve important complexities, which could delay or even exclude some variants or options.

BOX 1: TEN ASSESSMENT CRITERIA FOR AN EU OWN RESOURCE

Criterion n°1: Link to the *acquis* and the objectives of the EU
Would the own resource stem from – or directly relate to the *acquis* and would it contribute to EU policy objectives?

Criterion n°2: Cross-border aspect and internal market coverage
Would the own resource relate to primarily cross-border activities extending on the whole internal market?

Criterion n°3: Base harmonisation and application throughout the Union
Would the development of an own resource be facilitated by the existence of a harmonised base applicable on the entire EU?

Criterion n°4: Autonomous resource collection
Would the own resource be collected and managed outside the national budgets?

Criterion n°5: Fair application and impact on correction mechanisms
Would it be difficult for the Member States to estimate the origin of the own resource and/or would the resource relate closely to the level of economic prosperity of the Member States?

Criterion n°6: Additional burden on specific sectors
Would the resource constitute a revenue-sharing mechanism or would its impact be widely spread in the economy?

Criterion n°7: Administrative burden for the EU administration
Would the own resource have a very limited or no impact on the EU administration?

Criterion n°8: Revenue estimate
How much revenue would the own resource bring to the EU budget?

Criterion n°9: Time needed for implementation
How long would it take to implement the own resource following a political decision?

Criterion n°10: Legal issues
Would the own resource be faced with complex legal issues?

PART III: ANALYSIS OF THE CANDIDATE

1. FINANCIAL TRANSACTION TAXATION

1.1. Political context

1.1.1 Financial Transaction Taxation in the EU and beyond

As indicated in the Communication on the financial sector taxation[3], "*the recent financial crisis stressed the need for a more robust financial system, given the cost of financial instability for the real economy*".

The same communication recalled the state of EU and international discussions:

- "*The European Council concluded on 17 June 2010, in preparation for the G-20 Toronto Summit, that '[t]he EU should lead efforts to set a global approach for introducing systems for levies and taxes on financial institutions with a view to maintaining a world-wide level playing field and will strongly defend this position with its G-20 partners. The introduction of a global financial transaction tax should be explored and developed further in that context.*"

- The European Parliament has also been debating issues related to the financial sector and taxation. In particular its Resolution of 10 March 2010 asks the Commission and Council to look at how a financial transaction tax could be used to finance development cooperation, help developing countries to combat climate change and contribute to the EU budget.

- Such debates are not limited to the European Union. In addition to discussions in the G-20, the issue of taxing financial transactions has been prominently discussed during the UN High Level Plenary Meeting on the Millennium Development Goals. Moreover, the High Level Advisory Group on Climate Change Financing established by the UN Secretary General has also looked at the revenue-raising potential of key sectors active at the global scale, including the financial sector.

More recently, the conclusions of the Heads of State or Government of the Euro area of 11 March 2011 indicated that "*the Heads of State or Government agree that the introduction of a financial transaction tax should be explored and developed further at the Euro area, EU and international levels*".

The above-mentioned communication also indicated that, regardless of the tax instrument considered, the Commission sees several arguments for adapting the tax system to make the financial sector contribute in a fair and substantial way to public budgets:

- "*The financial sector is seen to bear an important responsibility for the occurrence and scale of the crisis and its negative effects on government debt levels worldwide. Additional taxes could also be justified by the fact that some governments provided*

[3] See Communication on the Financial Sector Taxation, COM(2010)549 of 7.10.2010.

substantial support to the sector during the crisis and it should hence make a fair contribution in return.

- *By contributing to fiscal consolidation and auxiliary resources as well as economic efficiency, new financial sector taxes could help to create the conditions for more sustainable growth, as envisaged in the Europe 2020 strategy.*

- *Most financial services are exempt from value added taxation in the EU. The reason is that the major part of financial services' income is margin based and therefore not easily taxable under current VAT.*

There are therefore arguments that the financial sector could make a fairer and more substantial contribution to government finances. This debate takes place in a general context of fiscal consolidation in the EU and elsewhere and when the world faces at least two urgent global policy challenges with significant budgetary implications. The EU has made substantial pledges to climate protection and development. To meet the commitments new revenue sources should be explored further."

1.1.2. FTT as an own resource

The FTT is perceived favourably by a number of MEPs, including in the own resources context. The European Parliament resolution of 29 March 2007 on the future of the EU's own resources *"notes that in the discussions in the European Parliament other possible avenues [for the creation of a new own resource] were also explored such as: taxes on currency transactions [and] taxes on financial transactions*"[4]. In a more recent resolution, the European Parliament "*calls on the Commission and the Council to assess the potential of different financial transaction tax options to contribute to the EU budget*"[5].

In absence of significant progress at G-20 level, an EU initiative on a broad-based FTT could be presented as a first step towards the longer-term development of a broad-based FTT at global level. Introducing such a FTT on a EU-wide scale would reduce the possibilities of tax avoidance currently found with existing Member States transaction taxes, ensure a more coherent tax framework, and eliminate one source of fragmentation of the Internal Market. Using elements like the tax residence principle could mitigate some of the relocation risks and ease administration of the tax.

To conclude, the FTT benefits from a large popular support and there is also a growing consensus on the introduction of some form of specific taxation of the financial sector. However, there is currently a proliferation of proposals and 10 Member States have already taken individual actions to tax one part of the financial sector, namely banks in different ways. The Commission also announced the creation of a framework for crisis management, which could require the creation of a Fund to finance resolution activities. Cumulative impacts of new taxation and regulation proposals should therefore not be underestimated. And the coherence and coordination of these parallel initiatives will be necessary to avoid creating confusion.

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4 See doc. 2006/2205(INI), §40.

5 European Parliament resolution of 10 March 2010 on "financial transaction taxes – making them work", P7_TA(2010)0056, adopted by 529 votes against 127 and 19 abstentions.

1.2. Outline of the proposal

1.2.1. Identifying variants

A number of financial transaction taxes have been discussed in recent months. It is important to distinguish these proposals as they are often mixed in the public debate.

- The narrow-based Financial Transaction Tax would be applied mainly to transactions on stocks and bonds traded on EU exchanges.

- The Currency Transactions Levy (CTL) would be applied mainly on currency transactions on EU currencies at the level of central banks. This would have the same principle as the FTT but would target currency conversions only;

- The broad-based Financial Transaction Tax would be applied to most financial transactions, such as the trade of stocks and bonds (like the narrow-based FTT), currencies (like the CTL), and derivatives.[6]

All proposals have in common that they would tax the turnover on some forms of financial transactions. They would be levied at a relatively low statutory rate and would apply each time the underlying asset was traded or transferred, which characterises them as cumulative taxes. The tax collection or the legal tax incidence should be – as far as possible – via the trading system which executes the transfer. However, the scope of these taxes is very different as are the types of products taxed and the implementation conditions.

Based on existing evidences and recent Commission analyses, the CTL could be faced with significant legal obstacles (see Box 2), which is why it is not the main subject of this analysis, despite its undeniable popularity.

BOX 2: LEGAL ISSUES FACING THE CURRENCY TRANSACTION LEVY (CTL)

A Currency Transaction Levy, i.e. a levy the taxable event of which is the exchange of currencies, indirectly restricts the underlying transactions of different currencies, both between Member States and between Member States and third countries, by rendering them more costly. This may affect payments for the supply of goods or services (current payments) and investments made, for example, by pension funds (capital movements). Although the levy would not apply to the cross-border flow of money as such, it could, absent similar effects on purely national flows, restrict free movement of capital within the meaning of Article 63 TFEU. This provision is applicable not only to Member States, but also to the Union.

In principle, nothing could justify this restriction, since the cross-border flows affected would not be objectively different from purely national flows (or flows within a single currency zone, i.e. the Euro zone), nor could any overriding reason relating to the public interest serve as a justification. Even if e.g. raising funds to benefit stability funding were to be considered as an overriding requirement of general interest, that requirement could

[6] Directive 2004/39/EC establishes clear definitions of regulatory market and multilateral trading systems.

not explain why transactions involving countries with different currencies would be treated less favourably than those involving only one currency. Furthermore, the tax could be considered disproportionate as funds could alternatively be raised by other means of budget attribution without affecting a basic freedom of the Treaty and, in any event, because the scope of the tax would be unrelated to the risks to be covered by the tax revenue raised. Even a very low tax rate could constitute an infringement, and it would not be possible to establish a threshold of insignificance.[7]

As regards Council Directive 2008/7/EC, its Article 5(2) provides that Member States shall not be subject to any form of indirect tax on the creation, issue, admission to quotation on a stock exchange, trading with stocks, shares or other securities of the same type, or of the certificates representing such securities. This concerns also loans, including government bonds, raised through the issuance of debentures or other negotiable securities, or any formalities relating thereto. Article 6(1)(a) of the Directive 2008/7/EC expressly states that "[n]otwithstanding Article 5, Member States may charge duties on the transfer of securities, whether charged at a flat rate or not".

As a result, a distinction needs to be drawn between the first issue of shares, bonds etc. and their subsequent trade. Only the former can be affected by Directive 2008/7/EC. In this regard, jurisprudence suggests that a Currency Transaction Levy would be considered a tax on the "issue" of the securities in question, prohibited by the Directive (cf. Case C-415/02, *Commission v Belgium*). Indeed, the issue of the securities would be meaningless without their acquisition by interested persons, and this acquisition in turn implies an exchange of currencies, in case it has a cross-border character and involves two different currency zones.

That said, any obstacle resulting from Directive 2008/7/EC would be relative in nature, because the CTL could be modified so as to contain an exception for the first issuance of instruments.

1.2.2. Tax basis

The FTT is a turnover tax on gross volumes of financial transactions.

As a general principle, all stocks, bonds and derivative transactions traded on European exchanges and OTC could be subject to the tax.

More specifically, the FTT could apply to:

- All stock and bond transactions on European exchanges;
- Spot transactions on stocks and bonds traded directly between financial operators (over the counter transactions);
- Derivative products traded on exchanges or over-the-counter;

[7] On free movement of capital and CTL, cf. also Opinion of the ECB on the 4 November 2004 at the request of the Belgian Ministry of Finance on a draft law introducing a tax on exchange operations involving foreign exchange, banknotes and currency (CON/2004/34). http://www.ecb.int/ecb/legal/pdf/en_con_2004_34_f_sign.pdf

- Derivatives that would be developed as close substitutes to the products subject to the FTT (in order to avoid the tax).

For spot transactions (like transactions on stocks and bonds) the value of the transaction would constitute the tax base. "*For example, if an investor buys 20 shares of a corporation worth EUR 100 per share the tax base would be EUR 2,000. In this sense, it is easy to define tax bases for transactions where the asset price is determined by the market at the time when the transaction is executed*"[8].

For derivative products, the notional value could be used as the basis for the value of the transaction.

For the definition of the scope of the tax, a challenge would be to define which types of investment funds would be covered by the tax. In addition, there are legal concerns which should be addressed on the link with the capital duty directive, which prohibits taxing primary issuance.

1.2.3. Tax rate

In order to reduce the risk of market disruptions, a very low tax rate would be imposed on these transactions.

It is assumed here that the rate would be set in a range of 0.01% to 0.5% maximum. This means a tax of EUR 1.0 for a transaction of EUR 10,000 or EUR 200 respectively. The lowest rate could be considered for the more volatile products.

Important principles should be respected when setting the rates:

- For a given transaction, the rate applicable in regulated exchanges or markets should always be more favourable than the rate applicable in other circumstances. The rate structure should promote virtuous behaviours;

- In order to reduce distortions and related welfare ("deadweight") losses, the rate should take into account, to the extent possible, the price elasticity of the products traded (this in turn would reflect underlying transaction costs);

- The rate should take into account the effective rates of taxation rather than the nominal rates. In particular, where the notional value of a transaction would be used to determine the value of a transaction using derivative products, it could be appropriate to use a lower tax rate to reflect the underlying value of the premium, etc.

Lastly, a lower rate should be used as the system is put in place, in order to avoid any shock in the markets. The rate could be cautiously increased subsequently.

1.2.4 Implementation

In order to reduce the operating costs of the system (administrative collection costs and compliance costs for taxpayers), the collection of the tax should to the extent possible be operated automatically through the trading platforms used on European exchanges and/or

8 SEC(2010)1166.

based on the trading books of financial institutions. This way the tax would focus on the trading activity of the financial sector and could reduce relocation risks since trading books may be more difficult to transfer than transaction if taxed under the source principle. Settlement systems used by financial operators or interbank financial telecommunication system could also play a role, notably as control mechanisms, in the tax collection.

To increase the effectiveness of the tax collection and reduce the risk of avoidance, a series of accompanying measures should also be envisaged as discussed in section 4.1.1 below.

- Similar to the UK approach, avoidance could be mitigated by imposing that the owner of a share or bond can only enforce his legal position where registration of his ownership has taken place (and, by and large taxation); such obligation could, however, be difficult to justify under the normal legal basis the Treaty offers.

- As indicated by the Commission in October 2010, to "*effectively reduce activities with a potential negative externality at global level and to avoid relocation of trading, the tax should be applied in all financial centres. These global centres are widely interconnected and companies face low costs when shifting trade between them. In addition, many financial companies operate with worldwide subsidiaries. Therefore, the fact that the FTT needs a broad base to reach its efficiency and revenue goals also implies that it would need a considerable amount of global coordination to reduce the risk of relocation and avoidance*"[9]. Cooperation should in priority be envisaged with non-EU countries, such as Switzerland and Iceland, which use exchange platforms with EU Member States.

Since the FTT could build in part on regulatory proposals which are not yet adopted, it could be made conditional on the adoption of such proposals.

1.3. Qualitative assessment of the own resource

1.3.1. Preliminary questions

(1) Experience in European countries

Annex A and B of the Staff working document accompanying the Communication on financial sector taxation provide an overview of experience with financial sector taxation in the Member States and other relevant countries[10]. They focus in particular on experience with transfer taxes and stamp duties in specific Member States, notably in the UK, Sweden and Switzerland.

- In the UK, stamp duties are collected on documents used to operate the sale and transfer of ownership in shares and other securities of UK-based companies. In order to collect duties on transactions carried out through electronic share dealing systems, the Stamp Duty Reserve Tax (SDRT) was introduced in 1986. The SDRT is a transaction tax, levied on agreements to transfer chargeable securities while the "standard" Stamp Duty is charged upon documents. Professional traders are excluded

9 See COM(2010)549, p. 6.
10 See SEC(2010)1166.

from the tax. Both SDRT and standard Stamp Duty are levied on share transactions in UK incorporated companies currently and in principle taxed at 0.5% of the purchase price of shares. It is charged whether the transaction takes place in the UK or overseas, and whether either party is resident of the UK or not. Securities issued by companies overseas are not taxed. This means that the tax is paid by foreign and UK-based investors who invest in UK incorporated companies. To put it differently, the tax is connected to the location of headquarters.

- Sweden introduced a 50 basis points tax on the purchase or sale of equity securities in January 1984. The tax applied to all equity security trades in Sweden using local brokerage services as well as to stock options. The fact that only local brokerage services were taxed is in the literature seen as the main design problem of the Swedish system. Avoiding the tax only required using foreign broker services. In July 1986, the tax rate was increased to 100 basis points. In 1987, the tax base was extended and half the normal rate was also applied to transactions between dealers. In January 1989, the tax base was widened again and a tax on fixed-income securities was introduced. The tax rate was considerably lower than on equities, as low as 0.2 basis points for a security with a maturity of 90 days or less. On a bond with a maturity of five years or more, the tax was three basis points. Only 15 months later, on 15 April 1990, the tax on fixed-income securities was abolished. In January 1991 the rates on the remaining taxes were cut by half and by the end of the year, they were also abolished completely.

- In Switzerland a transfer tax (*Umsatzabgabe*) is levied on the transfer of domestic or foreign securities where one of the parties is a Swiss security broker. Swiss brokers include banks and bank-linked financial institutions. A broker who acts as a party to the transaction must pay one half of the transfer tax for himself and another half on behalf of each party who is not a broker. The taxable base is equal to the consideration paid; if there is no consideration, the taxable base is the fair market value of the security. The duty is levied at a rate of 0.15% for domestic securities and 0.3% for foreign securities. Eurobonds, other bonds denominated in a foreign currency and the trading stock of professional security brokers are exempt. Certain types of transactions are also exempt.

The main lessons from these experiences are as follows:

- First, a number of Member States apply "financial transaction taxes" in the form of transfer taxes (BE, FI, FR, EL, HU, NL, PL) or stamp duties or other duties (BE, CY, FI, EL, EI, IT, MT, PT, UK). The exact provisions differ widely between the Member States. A number of these taxes relate to operations undertaken on exchanges.

- Second, the Swedish experience with transaction taxes shows that if evasion and relocation is easy and cheap, the market effects can be dramatic[11]. However, legal

[11] 60% of the trading volume of the eleven most actively traded Swedish share classes moved to the UK after the announcement in 1986 that the tax rate would double. 30% of all Swedish equity trading moved offshore. By 1990, more than 50% of all Swedish trading had moved to London. Even though the tax on fixed-income securities was much lower than that on equities, the impact on the traded volume was much more dramatic. During the first week after the introduction of the tax, the volume of bond trading fell by 85%, even though the tax rate on five-year bonds was only

security could be a means to decrease the potential for relocation. For example the UK stamp duty that covers only transaction in securities of UK-registered corporate companies seems to be rather resistant to relocation. The risk for relocation might be mitigated for exchanges trading domestic stocks and bonds; it is less clear whether this would also be possible for foreign stocks and bonds traded domestically. Attaching a system of licensing for brokers or trading platforms to the payment of the tax may also contribute to its effectiveness.

- Third, administrative costs of collecting a financial transactions tax could be relatively low. Data from the United Kingdom (UK), where a stamp duty is levied, show that the collection cost is only 0.21 pence per pound collected. The main reason is that the vast majority of UK company shares are held in the CREST settlement system which automatically debits the duty when shares are transferred. In contrast to that, for the income tax, the value is 1.24 pence and 0.76 pence for the corporation tax[12].

- Last, although observation of the current systems suggest that uncoordinated taxation of some transactions is possible, it is highly advisable, as a prerequisite for a unilateral introduction of a transaction tax at EU level, to achieve a high degree of co-ordination of tax bases and tax rates. The financial products covered by the tax as well as the applicable tax base, rates and possible exemptions should be the same in all Member States to reduce incentives for shifting to markets with lower tax rates and smaller product coverage. There might also be a need to find solutions with financial centres outside the EU in order to reduce the migration of transactions.

(2) Legal issues related to a FTT

The long-lasting implementation of stamp duties in the UK and other comparable taxes in other Member States, which do not seem to be questioned with regard to Treaty of GATS provisions, suggests that a FTT would not face the traditional legal arguments opposed to a CTL or a scheme with similar discriminatory features (see Box 2 above).

(3) Lessons from economic theory

As a general principle, "*the rationale for the FTT is based on two assertions about the tax. Firstly, it is seen to improve the functioning of financial markets through curbing harmful short-term speculation and reducing volatility by making it less profitable. Secondly, it is expected to raise significant amounts of revenue, even if the tax rate is very low (e.g. 0.1 %)*"[13].

- *Effects on the financial markets*

  First, as a general principle, the FTT is often promoted on efficiency grounds. "*This argument is based on the idea that short-term and high speed trading is particularly*

three basis points. The volume of futures trading fell by 98% and the options trading market disappeared. Trading in money market securities, which faced a tax as low as 0.2 basis points, fell by 20%. This reaction was due in large part to the existence of a wide variety of non-taxed substitutes. Once the taxes were eliminated, trading volumes returned and grew substantially in the 1990s. Source: SEC(2010)1166.

12 See the Departmental Autumn Performance Report 2009 of HM Revenue & Customs available at: http://www.official-documents.gov.uk/document/cm77/7774/7774.pdf

13 See SEC(2010)1166. Most of the analysis and quotes below are drawn from the same document.

harmful and speculative. Proponents of a financial transactions tax argue that the tax would reduce speculation, thereby linking trade more closely to the underlying fundamental economic market conditions and make financial markets less volatile. In reality, it turns out to be difficult to make a meaningful and operational distinction between speculative and non-speculative transactions[14]*. It is impossible to disentangle harmful from beneficial transactions simply based on their time-horizon. Besides, most of the short term ('harmful') speculation is done via derivatives – in particular under scrutiny in the aftermath of the financial crisis – and not with the underlying assets (bonds or stocks)*". In the case of a very low tax imposed on bonds and stocks only, the impact on volatility – and efficiency – would therefore likely be limited.

Second, "*the FTT is at variance with the requirement of "production neutrality", as it changes relative input prices for business*[15]*. It is comparable to a sales tax and since it is levied on transactions rather than value added it is cumulative. Products which are more frequently traded than others, e.g. the shares of large companies with many shareholders will face higher tax burdens*". In practice, if a specific stock is traded 10 times over one year, the cumulated impact could be up to 1% (10 times 0.1%) of the share value. This tax burden would be spread over all the traders and the other economic agents concerned (see below). As a consequence the tax could also marginally increase the cost of financing for companies and governments among other via higher interest rates. Furthermore, the FTT could have an impact on GDP, which could have an incidence on other tax revenues.

- *Tax Incidence – Would the Financial Sector carry the burden?*

There is no empirical evidence on the real incidence of a FTT. Transactions taxes are under the political and public spotlight because they are perceived as a contribution of the highly speculative financial institutions to the costs of the financial crisis. However, there is often a difference between the legal tax payer (legal incidence) and the economic agent who actually carries the economic burden of a tax (economic incidence). In the context of a FTT, the economic incidence of the tax could fall either on traders, on stock exchanges, on companies and governments (via higher capital costs) or on final consumers via higher prices for financial services.

To conclude, an FTT could be administratively feasible. However, the impact would depend to a large extent on the overall design of the proposal, and notably the room left to substitution effects like the use of credits and loans instead of bonds. In any event, an important motivation of the tax would be in the revenue brought to the EU budget. Given the distortions that would likely arise from the tax, this revenue could however have an economic cost.

[14] It must be said that there is no agreement among economists on which operations may be considered as "speculative" and which ones may not.

[15] This is the result of the production efficiency theorem. Since taxing production reduces total output, it is more efficient to tax output directly. (Diamond and Mirrlees (1971), Optimal Taxation and Public Production. The American Economic Review, Vol. 61)

1.3.2. *Criteria set out in the budget review*

(1) Link to the acquis and the objectives of the EU

First, as a new revenue stream, the FTT could play a role in budgetary consolidation efforts in the EU. Member States contributions to the EU budget could be reduced accordingly.

Second, the financial and economic crisis highlighted a number of misaligned incentives in the financial sector as well as weaknesses in the regulatory and supervisory framework for the financial system. As a result, significant regulatory reforms have been adopted or are in the pipeline.[16] There is a broad consensus that regulatory and supervisory reforms are essential in order to enhance the resilience and the stability of the financial system. The Commission has proposed new crisis management arrangements aimed at improving the capacity of public authorities to manage failures arising within the banking sector.[17] It is, however, unlikely that the FTT could play a significant role as a complement to these regulatory reforms. The design of the tax would need to be envisaged in that context.

Third, various new charges or taxes are imposed on- or envisaged in relation to the financial sector. This includes the implementation of a network of national resolution funds financed by a bank levy[18]. The coherence and coordination of these parallel initiatives will be necessary to avoid creating confusion.

(2) Cross-border aspect and internal market coverage

Past experiences, for instance in Sweden, show that risks of tax avoidance or market relocation are high in relation to financial transaction taxation. As indicated in the Communication on Financial Sector Taxation, the EU Member States are starting to put in place national tax instruments to respond to a number of challenges related to the financial sector. It is important that such developments take place in a coordinated framework. If not, different national systems levied on diverging tax bases could create incentives for tax arbitrage and result in allocation distortions between financial markets in the EU. The emergence of uncoordinated national solutions could also lead to double taxation and fragmentation of the financial sector, hampering the proper functioning of the Single Market. In other words, due to the very high mobility of tax bases, conceiving a FTT, even in its most conservative form – the narrow-based FTT, requires an action at global level or, as a second-best solution, at EU level[19].

(3) Base harmonisation and application throughout the Union

In order to reduce the extent of tax avoidance, the FTT should leave no room for tax arbitrages. It should ideally be fully harmonized across the EU.

16 The Commission set out initiatives in its Communication COM(2010)301.

17 COM(2009)561.

18 COM(2010)254.

19 In recognition of the cross-border nature of financial transaction taxation, the Commission of Finance and Budget in the Belgian Federal Parliament approved a bill implementing a Spahn tax on 15 June 2004. According to this legislation, Belgium will introduce the Tobin tax once all countries of the Eurozone introduce a similar law.

As shown in section 3.1.1, a number of transaction taxes can already be found in the EU. Based on the experience in the Member States, a system could be developed, which would ensure a level-playing field between the existing systems.

(4) Autonomous resource collection

Autonomous collection of the FTT by the Commission or an EU agency could be a key element of the proposal. It would critically depend on the design and implementation of the tax. A very preliminary analysis suggests that the tax could be levied directly by the 19 EU exchanges (see Table 1 below) on behalf of the EU or through centralised settlement or interbank telecommunication systems. Whether such an approach could be extended to other segments of the spot transactions or derivative markets, and what role the Member States could play in this context, would need to be examined as a matter of priority during the preparation of legislative proposals.

Table 1: Volumes on EU exchanges, trades executed and reported on the same day (World Federation of Exchanges, 2009)

billion US $ (2008)		
	share trading	**bond trading**
athens	113,67	0,04
BME spanish	2.410,72	6.839,48
borsa italiana	1.499,46	258,06
bratislava SE	0,02	33,90
bucharest SE	2,35	0,07
budapest SE	30,71	2,37
bulgarian SE	1,86	0,18
cyprus SE	2,06	0,02
deutsche borse	4.678,83	182,30
irish SE	81,92	36,69
ljubljana SE	2,34	0,37
london SE	6.271,52	6.567,40
Luxembourg SE	1,91	0,08
malta SE	0,07	0,64
nordic	1.338,18	2.929,51
nyse euronext	4.411,25	48,68
prague SE	43,95	33,36
warsaw SE	69,50	1,03
wiener borse	104,69	1,18
TOTAL	**21.064,99**	**16.935,38**
shares+bonds	**38.000,37**	

(5) Additional burden on specific sectors

The impact of a tax on transactions of stocks and bonds would be widely spread in the economy.

The FTT may have, in particular, some impact on the financial sector profitability, either directly, by taxing operations operated between financial institutions, or indirectly, by reducing the amount of transactions of their clients or by leading to market displacements to other financial institutions outside the EU. Exchanges themselves may suffer from reduced transactions.

It should be recalled that "*in most if not all Member States, one element of the financial sector, the banking sector*[20]*, is both of high economic importance and relatively concentrated. For the EU-27, the assets of banks and the amount of private credit represent about 140% and 130% of GDP respectively, while the amount of bank deposits and the stock market capitalisation of the banking sector are about as high as GDP. The average combined share of assets of the three largest banks in each Member State is about 70%*[21]*. However, national shares range widely across Member States*[22]".

At the same time, it is probably useful to underline that the financial sector benefits from particular circumstances, as highlighted by the Staff working paper accompanying the Communication on the Financial Sector Taxation:

"*The debate on a fair contribution of the financial sector to (corporate) tax collection cannot be disconnected from the issue of profitability of the sector. There is evidence that the financial sector has been more profitable than the non-financial sector over the last two decades*[23]*. This is not problematic as such if higher profit is related to high productivity. However, the high profitability of the sector could result from certain sector specific characteristics. For example, the financial sector is different from other sectors in respect of the existence of an (implicit or explicit) safety net which, combined with banking regulation may enable some institutions to enjoy economic rents; and in the relative ability of certain financial institutions to use leverage to increase returns*". High profitability can possibly point to the existence of economic rents that are captured either by managers in the form of higher remuneration or by shareholders in the form of higher returns. Current available data is unfortunately scarce and patchy. Return on equity in the financial sector has broadly been at par with that of the non-financial sector. However, these median values hide large variations across institutions, years and countries. Turning to remuneration, there is some piecemeal evidence which would suggest that remuneration in the financial sector is or has been higher than in other sectors[24].

At the same time, any possible tax measures must also be seen put into a broader context of current efforts on regulatory reform of the financial sector, in particular with likely higher capital requirements, and discussions on a possible introduction of bank levies. The cumulative impact of such measures must be borne in mind (especially if they are not carefully coordinated and phased in), so that a viable financial sector, able to properly and efficiently finance the broader economy, is not put at risk.

An open issue is how to avoid product substitution. As in the case for the UK stamp duty there are a number of possibilities to avoid the tax, notably American Depository

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20 The banking sector is only a part of the whole financial sector which also includes credit card companies, insurance companies, consumer finance companies, stock brokerages, investment funds and some government sponsored enterprises.

21 Assets of three largest banks as a share of assets of all commercial banks.

22 2008 Data from Thorsten Beck and Asli Demirgüç-Kunt, Financial Institutions and Markets Across Countries and over Time: Data and Analysis, World Bank Policy Research Working Paper No. 4943, May 2009. Quote from SEC(2010)1166.

23 See Devereux, M.; Griffith, R; and A. Klemm (2004), Why has the UK Corporation Tax Raised so Much Revenue?, *Fiscal Studies*, 25(4): 367-388.

24 See for example Philippon, Thomas, and Ariell Reshef (2009), Wages and Human Capital in the US Financial Industry: 1909 – 2006. CEPR Discussion Paper No. 7282. They found for the US that starting in the 1990s 30% to 50% of the wage differential between the financial and non-financial sectors is due to rents.

Receipts and Exchange-Traded Funds. As was already mentioned, the easiest example to circumvent a tax on bonds is to use loans instead. Since bonds are usually used by large companies it is not entirely clear which effect a higher demand from large companies for loans would have on SMEs which in most cases rely more strongly on direct loans from banks.

(6) Administrative burden for the EU administration

The administrative burden for the EU administration would mainly depend on the exact design and implementation of the FTT. Further work is necessary to determine to what extent a centralised collection mechanism is feasible and whether one should rely on Member States administrations for the collection of part of the FTT.

Whereas a centralised collection system may lead to some economies of scale and reduced total collection costs, it would presumably entail higher costs for the EU administration. A system relying on national administrations may prove more costly overall, but would likely entail reduced costs at EU level.

In any event, experience in the UK suggests that administration costs related to a stamp duty could be relatively limited.

1.4. Quantitative assessment of the own resource

1.4.1. Revenue estimates

Revenue estimates vary widely depending on the rates, the tax base, and assumptions on the market reactions. The following estimates are therefore provided on an illustrative basis, using relatively conservative assumptions for 2010 data:

– A narrow-based FTT levied on all bonds and stock transactions executed in regulated markets could bring revenues of EUR 14.8 billion for a rate of 0.1%[25].

– Imposing a rate of 0.01% on Exchange Derivatives, notably Single Stock Futures, Stock Index Options, Stock Index Futures, Bond Options and Bond Futures, could bring an additional EUR 4.5 billion[26].

– The same rate applied to OTC interest rates derivatives, including Forward Rate Agreements, Swaps and Options, could bring EUR 3.1 billion[27].

– A Currency Transaction Tax, on spot transactions and currency derivatives levied at a tax rate of 0.1% could lead to revenues of around EUR 21.2 bn[28]. It should be noted, however, that a CTT could restrict the free movement of capital within the meaning of Article 63 TFEU. It therefore remains subject to considerable uncertainties.

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25 Assuming transaction costs of 0.6%, relocation and evasion of 10% and elasticity of -1.5.
26 Assuming transaction costs of 0.3%, relocation and evasion of 90% and elasticity of -1.5.
27 Assuming transaction costs of 0.7%, fiscal evasion of 90% and elasticity of -1.5.
28 Assuming an elasticity of -1.0 for spot transactions and -1.5 for derivatives.

– A broad-based FTT, consisting of all the above categories, including CTT, could bring EUR 43.6 billion (again subject to considerable legal uncertainties). Excluding the CTT, the broad-based FTT could bring an estimated EUR 22.4 billion.

Due to the large degree of uncertainty related to behavioural changes, tax avoidance, and the characteristics of individual markets, these revenue estimates have to be interpreted with caution[29].

1.4.2. Fair application and impact on correction mechanisms

Based on differences in the volumes of transactions on the various exchanges or OTC operated in the Member States, it could be argued that the potential tax revenues would be unevenly distributed from a geographical point of view.

However, whereas the bulk of transactions on regulated EU exchanges are operated on 5 or 6 exchanges, it would be incorrect to say that the corresponding tax revenues would be attributable to the country where the exchange is located. The financial institutions and their clients are located

It should also be recalled that a number of exchanges cover various countries (NASDAQ: DK, EE, FI, IS, LT, LV, SE; NYSE Euronext: BE, FR, NL, PT; Euronext Liffe: UK, FR, NL, BE, PT; EUREX: DE, SW; OMX Nordic Exchange: DK, SE, FI, IS), which would make it virtually impossible to identify the national origin of the tax.

29 For a critical review of revenue collection from transactions taxes see also Honohan and Yoder (2010): Financial Transactions Tax - Panacea, Threat, or Damp Squib? *World Bank Policy Research Working Paper* No. 5230, March 2010.

2. FINANCIAL ACTIVITIES TAX

2.1. Political context

2.1.1. FAT

The idea to develop a Financial Activities Tax (FAT) gained prominence following an IMF report on financial sector taxation to the G-20[30]. The IMF proposed two possible forms of contribution from the financial sector, serving distinct purposes: a "Financial Stability Contribution" (FSC) linked to a credible and effective resolution mechanism, and a "Financial Activities Tax" (FAT) levied on the sum of the profit and remunerations of financial institutions, which could also be designed to target economic rents or excessive risk taking.

The European Commission adopted a Communication on Financial Sector Taxation in October 2010. It examined in particular the Financial Transactions Tax (FTT – see chapter III.1) and the Financial Activities Tax (FAT)[31]. The Communication mentions three main arguments for adapting the tax system to make the financial sector contribute in a fair and substantial way to public budgets – as shown below, all three are directly relevant for a FAT:

- "*First, to complement the extensive financial sector reforms underway, taxes could contribute to enhancing the efficiency and stability of financial markets and reducing their volatility as well as the harmful effects of excessive risk-taking. In particular, the financial sector might take too much risk due to a range of factors, from actual or expected state support (resulting in moral hazard) and information asymmetries to remuneration structures which together with macroeconomic developments contributed to the recent crisis[32]. There is thus a case for a corrective tax to internalise such externalities.*

- *Second, the financial sector is seen to bear an important responsibility for the occurrence and scale of the crisis and its negative effects on government debt levels worldwide. Additional taxes could also be justified by the fact that some governments provided substantial support to the sector during the crisis and it should hence make a fair contribution in return. By contributing to fiscal consolidation and auxiliary resources as well as economic efficiency, new financial sector taxes could help to create the conditions for more sustainable growth, as envisaged in the Europe 2020 strategy.*

- *Third, most financial services are exempt from value added taxation in the EU. The reason is that the major part of financial services' income is margin based and therefore not easily taxable under current VAT*".

30 Claessens, S., Keen, M. and C. Pazarbasioglu (2010), "Financial Sector taxation. The IMF's Report to the G-20 and Background material", September 2010. http://www.imf.org/external/np/seminars/eng/2010/paris/pdf/090110.pdf

31 COM(2010)549 of 7.10.2010.

32 The occurrence of the crisis has also other important roots at macroeconomic level. (See for example surveys on this by Hemmelgarn and Nicodème, 2010; UK Financial Service Authority, 2009; and the High Level Group on Financial Supervision in the EU, 2009).

"*There are therefore arguments that the financial sector could make a fairer and more substantial contribution to government finances. This debate takes place in a general context of fiscal consolidation in the EU and elsewhere and when the world faces at least two urgent global policy challenges with significant budgetary implications. The EU has made substantial pledges to climate protection and development. To meet the commitments new revenue sources should be explored further.*

EU Member States are starting to put in place national tax instruments to respond to these challenges. It is important that such developments take place in a coordinated framework. If not, different national systems levied on diverging tax bases could create incentives for tax arbitrage and result in allocation distortions between financial markets in the EU. The emergence of uncoordinated national solutions could also lead to double taxation and fragmentation of the financial sector, hampering the proper functioning of the Single Market.

Any possible tax measures must also be seen put into a broader context of current efforts on regulatory reform of the financial sector, in particular with likely higher capital requirements, and discussions on a possible introduction of bank levies. The cumulative impact of such measures must be borne in mind (especially if they are not carefully coordinated and phased in), so that a viable financial sector, able to properly and efficiently finance the broader economy, is not put at risk."

In conclusion, the Communication indicated that there is potential for a Financial Activities Tax at EU-level. The Commission has more closely analysed the possibility and the effects of introducing a FAT at EU level as part of the ongoing preparatory work for a comprehensive Impact Assessment on financial sector taxation.

This option could deal with the current VAT exemption of the financial sector and raise substantial revenues. The debate following the green paper on the future of VAT, to take place later this year, will be a most appropriate opportunity to discuss FAT as a compensation scheme for VAT exemption on financial services.

2.1.2. FAT as an own resource

The idea of a FAT is new in the public debate and it has never been discussed in the context of own resources.

This analysis therefore constitutes a first assessment of FAT as a potential own resource.

2.2. Outline of the proposal

2.2.1. Identifying variants

As explained in the Staff Working Document (hereafter "the Staff Working Document") accompanying the Communication on Financial Sector Taxation (hereafter "the Communication")[33], several taxes on the financial sector have been discussed, such as bonus taxes, a surcharge to the corporate income tax for the financial sector or a Currency Transaction Levy (CTL). Together with regulatory and other tax initiatives, this raises a concern of policy coherence and the necessity to examine closely at the

[33] Respectively SEC(2010)1166 and COM(2010)549 of 7.10.2010.

combined effect of EU initiatives. Box 3 below presents a brief overview of short term issues related to financial levies (based on a recent report to the ECOFIN)[34].

Technically, there are different ways of defining profit and remuneration for FAT purposes. The choice of the method depends on the ultimate objective sought with the introduction of the FAT.

- The addition method FAT (FAT1)

The addition-method FAT intends to tax value added of financial institutions on an aggregated basis. In order to be effectively levied on economic rents, the profit and remuneration of the financial institutions could be calculated on a cash-flow basis for FAT1 purposes, defined as (i) the sum of cash-in from sales, borrowed funds, interest received and loan repayments, minus (ii) the sum of cash-out from purchases and investments, interest paid, debt repaid and lent funds. There are different technical methods for calculating the FAT taxable base in cash-flow terms, using the data of accrual accounting.

- The rent-taxing FAT (FAT2)

The rent-taxing FAT aims at taxing the rents accruing to the financial sector while leaving untaxed the normal return to capital and labour factors. The profit item would be calculated by adjusting the result of the profit and loss account (P&L result) with an Allowance for Corporate Equity (ACE). This would allow a deduction for a notional return to equity, which would be calculated by reference to the interest rate payable on low-risk debt (government bonds, for instance). The normal return to labour would be exempted by providing an allowance for ‘normal’ remuneration.

- The risk-taxing FAT (FAT3)

A third version of the FAT would tax excess return due to unduly risky activities. The risk-taxing FAT would determine the 'normal profit' by adjusting the P&L result with a higher ACE (i.e. higher ‘normal’ return for corporate equity), so that only the excessive return to (average) equity is taxed. The reason is that this excessive return is arguably the result of high risk-taking activities. Therefore, parts of the rents could theoretically be untaxed as long as the return to equity does not exceed this threshold. Similarly to the FAT2, only expenses for remuneration for labour over a certain threshold would also be added-back to the P&L result and be, consequently, taxed.

Most recent analysis conducted as part of the ongoing preparatory work for the Impact Assessment on financial sector taxation shows that the FAT would be most convincing in the form of the addition-method FAT applied at source.

[34] "Report on financial levies - short term issues", as drawn up by the Economic and Financial Committee. Ref. 17009/10, FISC 148, 30 November 2010.

BOX 3: FINANCIAL LEVIES – SHORT TERM ISSUES

The June 2010 European Council agreed that "*Member States should introduce systems of levies and taxes on financial institutions to ensure fair burden-sharing and to set incentives to contain systemic risk. Such levies or taxes should be part of a credible resolution framework.*" Although the working assumption is that all Member States[35], should introduce systems of levies or taxes, in the very short term this is rather unlikely to be achieved by all Member States as ten Member States have indicated they consider introducing a levy at a late stage.

Member States have so far introduced country specific systems of levies for which the parameters (base, rate and scope) differ considerably. This raised concerns of double charging and competitive distortions arising in the short term within the single market.

The national systems, with different parameters, are likely to co-exist in the short term. This will result in some double charging of financial institutions, in particular in those cases where a country introduces a levy that also covers i) subsidiaries of its own financial institutions in other EU countries or, ii) on its own territory, foreign branches of EU banks. However, based on a preliminary analysis, the risk of double charging is limited under current circumstances to some member states. The potential problem of double charging may nevertheless become more significant if other Member States were to introduce a levy. The Central and Eastern European countries may be particularly affected due to the significant share of foreign ownership of their banking sector.

Other level playing field issues may also be at stake: spill-over effects, distortion of competition and relocation of businesses. Considering that levies should ensure a fair contribution of the financial sector to the cost of financial crises and mitigate systemic risk, their impact on the level playing field can be considered relevant. The sheer fact that some Member States will introduce a levy with different features, and some will not introduce them at all, in the short term may create further distortions in EU level playing field. It seems unlikely that financial institutions would geographically relocate their business in the short term, in particular if there is an expectation of European solution for bank levies in the medium term. There is, however, a potential risk that these levies may influence the flow of business, favouring those instruments that enjoy less tax burden. Continuous monitoring is essential to address timely potential negative effects.

Going forward, in view of minimising the risk of further double charging or disruptions in the level playing field and enhancing harmonization and coordination in the short term, a number of practical recommendations in respect of scope, base and rate for the levy could guide Member States. Finally, an absence of coordination of the introduction of levies in the short term will complicate agreement in the medium term on an EU-wide solution in the context of a crisis resolution framework. In light of this, and in view of the cumulative effects of such a levy with other regulatory changes, including on the credit supply to the economy, these recommendations and structures of the national systems of levies and taxes could be revisited in the course of 2011.

35 "The Czech Republic reserves its rights not to introduce these measures".

2.2.2. Tax basis

The potential tax basis is briefly described in the previous section for the three variants.

A FAT is in theory a relatively simple tax in the sense that it draws on existing information in company accounts. It would tax the profits and remuneration in the financial sector, which could help increasing efficiency and stability of financial markets.

Besides, from a pure economic point of view, the tax base should be as wide as possible. Otherwise there is the danger that activities might move to untaxed parts of the financial sector, in particular to areas often referred to as the shadow banking sector. Since the FAT requires a clear definition of what the financial sector is, this could induce a large amount of lobbying of some parts of the financial sector to convince policy makers that they should not be part of the tax base.

The exact delineation of the tax basis will also require defining concepts such as remunerations, (normal) profits (cash-flow or based on profit and loss accounts), for tax purposes. This may be a complex task.

2.2.3. Tax rate(s)

The tax rate would depend on the revenue and other objectives of the tax, as well as the definition retained for the tax basis.

As an illustration, the rate considered so far has been 5%.

2.2.4 Implementation

Considering the variety and the number of financial institutions that would be concerned by a FAT, the tax should be levied by Member States administrations.

In this respect it would be important to see whether the tax should be defined by elements used for determining the usual corporate tax base (so that the FAT declaration could be linked to the corporation tax) or if a cash flow definition of profits should be used (thus requiring data that tax authorities do not currently use). In the first case, issues about the definition of the tax base across the EU would arise, while in the latter case the increasing administrative burden for tax authorities would need to be examined.

An important concern would be to ensure effective tax compliance and limit possibilities for tax avoidance, for instance through profit-shifting or displacements of highly profitable parts of the banking and insurance industry (e.g. investment banking) towards jurisdictions that would not be subject to the FAT.

2.3. Qualitative assessment of the own resource

2.3.1. Preliminary questions

(1) International experience

The forthcoming Commission Impact Assessment on financial sector taxation will provide an overview of the taxes on the financial sector which are currently being applied by the Member States.

Some Member States have experience with FAT-type taxes – Denmark with the labour tax on banks, Italy with the IRAP and France with the "taxe professionelle". It seems that FAT provokes less relocation risks than taxes on transactions.

The Commission launched three studies in the context of the above-mentioned Impact Assessment. A study contracted to PricewaterhouseCoopers (PwC) analyses four areas of the tax system in order to identify potential legal provisions which might lead to tax advantages or disadvantages for the financial sector. The taxes considered are the Corporate Income Tax, the Personal Income Tax, the Value-added Tax (VAT) and the tax treatment of financial products. Broadly speaking, the study does not find any significant differences in the tax treatment of the financial sector compared to other sectors, with the main exception of VAT for which the financial sector is granted an exemption.

(2) Lessons from economic theory

The rationale for the FAT is to target specifically financial sector activities, without intervening into the direct operation of financial markets. It can, however, be designed (rent- taxing FAT and risk-taxing FAT) in such a way as to improve market efficiency and discourage high risk taking.

Although alternative designs exist, a FAT essentially targets the sum of profit and remuneration of a financial institution. The FAT is therefore not based on sales or turnover, but relies instead on items of the financial statements of financial institutions (i.e. profit and remunerations). The FAT should not be confused with the concept of a bank levy. Whereas the tax base of a bank levy is the balance sheet, the tax base for a FAT would be profit and remuneration and come from the profit and loss statement or in the cash-flow case company accounts. The idea here is to tax the outcome of a company's activity in terms of profit and wages rather than levy a duty based on a structural indicator like leverage.

Effects on financial markets:

- First, in terms of its effects on market structures and risk-taking, the addition method FAT would not directly alter the markets structures within the EU where financial institutions are active since it would tax profits independently from how they are earned. In this sense, it would not discriminate between different products nor depend on the level of turnover, and hence bring no corrective mechanism per se. For all versions of the FAT, however, by making financial services more expensive, the tax would decrease the size of the financial sector. The rent-taxing FAT that tax rents only would not distort marginal investment decisions. If the financial sector earns economic rents and experiences a higher profitability due to its unique role in the economy, economic rents translate into higher before-tax company profits. If the policy goal is to reduce these rents in order to correct for the potentially distorted size and behaviour of the financial sector, a tax that falls directly on this profit is a solution. The risk-taxing FAT attempts to tax excess return due to unduly risky activities. Such a tax would directly target the harmful effects of excessive risk-taking. This would be done via applying a relatively high tax rate (as to discourage risk) on returns above a defined level. This FAT therefore introduces some elements of progressivity. For capital, the interest rate on risk-free investments could be taken and increased by a rate of return for the risk component. The latter is of course difficult to estimate. For wages, the average wages in other sectors could serve as a proxy. This would however not account for structural differences in sectors which might lead to different wage structures in addition to potentially untaxed rents. In addition, this FAT cannot distinguish between high returns due to unduly risky behaviour or due to skills and efforts. This makes the threshold somewhat arbitrary.

- Second, all versions of the FAT could be designed to be neutral vis-à-vis financing and investment decisions, and hence not distort the activities of the financial sector while still reducing its size. This can be achieved by the application of either an Allowance for Corporate Equity (ACE) or a definition of profit which would include both real transactions and financial transactions in cash-flow terms.

- Third, any version of the FAT could lead to differences in treatment between financial institutions subject to such a tax and quasi-financial institutions outside its scope. The implementation of a FAT should therefore cover as large as possible range of financial institutions. The whole financial sector indeed includes banks, credit card companies, insurance companies, consumer finance companies, stock brokerages, investment funds, management funds companies and some government sponsored enterprises. In this context, it should also be mentioned that quite a number of MNEs have very large financial activities without qualifying them as financial institutions. In order to catch also intra-group financing and shadow-banking activities, all the enterprises conducting more than a certain threshold of financial activities would become subject to the FAT too.

- Fourth, all versions of the FAT can be seen as tax on the profits from net transactions and other financial sector business. This is an important difference compared to the FTT which would tax gross transactions and have a cumulative effect.

- Fifth, in the technical design of the risk- and rent-taxing FAT important parameters deriving from "normal" profit rates or wage levels would need to be determined, which illustrates the potential practical complexity of such taxes.

- Finally, given the ongoing regulatory work, the assessment of the possible introduction of a FAT would have to take into account the cumulative impact of the regulatory plus the tax changes.

Tax Incidence:

There is no empirical evidence on the real incidence of a FAT. However, the incidence of the addition method FAT when all remuneration and (cash-flow) profit is taxed could possibly fall on the consumers of financial services via higher interest rates spreads. Indeed, in case the tax is shifted to the customer and since there is no deduction for business consumers the tax burden could also partly fall on all users of financial services.

Both the rent-taxing and the risk-taxing FAT provide less incentive to shift the tax to customers since the profit maximization condition would be unaffected and therefore marginal investments would remain undistorted.

(3) Legal issues

FAT could raise issues of inequality of treatment across sectors. This is mainly an issue in Germany. A tax on one sector only might conflict with equal treatment article in the Constitution.

In addition depending on the definition and harmonisation of the tax base it could raise concerns about equal treatment across Member States.

2.3.2. Criteria set out in the budget review

(1) Link to the *acquis* and the objectives of the EU

As indicated in section 1, to complement the extensive financial sector reforms underway, a FAT could contribute to enhancing the efficiency and stability of financial markets and reducing their volatility as well as the harmful effects of excessive risk-taking.

A FAT could also be justified by the fact that some governments provided substantial support to the sector during the crisis and it should hence make a fair contribution in return. By contributing to fiscal consolidation and auxiliary resources as well as economic efficiency, new financial sector taxes could help to create the conditions for more sustainable growth, as envisaged in the Europe 2020 strategy.

In addition, a theoretical arguments supporting the introduction of new taxes on the financial sector, particularly FAT, is that most financial services are exempt from value added taxation in the EU. The reason is that the major part of financial services' income is margin based and therefore not easily taxable under current VAT. The extent to which applying VAT to the financial sector would raise additional tax revenues and – consequently – the extent to which the exemption constitutes an under-taxation case for the financial sector is, however, an unsettled empirical question. Whereas the exemption means that the financial sector does not charge VAT on most of its output, it cannot deduct the VAT charged on its inputs. This is known as the 'irrecoverable VAT problem'. Based on case studies, PricewaterhouseCoopers (2006) found that VAT recovery rates in the financial sector varied from 0% to 74%[36]. The variations in recovery rates could be explained by differences in the way in which the Member States interpret the scope of the exemption and the option to tax. Further work on the matter is expected as part of the impact assessment on financial sector taxation to be carried out by the Commission by summer 2011.

(2) Cross-border aspect and internal market coverage

Although an important part of financial activities are cross-border in nature, the tax in itself would not be specifically targeted at this cross-border dimension. (Excessive) risk-taking by financial institutions, revenue-raising and a level playing field with other sectors of the economy (which are subject to VAT) would be central considerations in the design of a FAT.

[36] PricewaterhouseCoopers (2006), Economic effects of the VAT exemption for financial and insurance services, Report to the European Commission.

However, considering the high mobility of financial activities and institutions, conceiving a FAT at EU level could reduce the risks and the extent of tax avoidance. In that sense, the cross-border, EU, dimension of the project would be a highly relevant issue.

(3) Base harmonisation and application throughout the Union

The FAT would need to cover the entire Internal Market. Not doing so would entail the risk of significant distortions of competition and fragmenting the Internal Market in the area of financial services.

A concern relates to the fact that some financial institutions may not be covered by the FAT whereas others would. This may lead to distortions of competition.

(4) Autonomous resource collection

As indicated above, a FAT would not lend itself to autonomous revenue collection at EU level. Considering the scope of the tax, the number of operators potentially involved, the complexity of tax accounting and the potential for tax avoidance, national administrations will play the central role in the tax collection and recovery process. It would be almost impossible to have the FAT collected at EU level autonomously.

(5) Additional burden on specific sectors

The impact will be examined in the impact assessment to be prepared by the Commission by summer 2011.

It can be expected that the impact of the FAT would be widely spread on the economy because the financial institutions would pass on the tax burden onto their customers. Furthermore, the FAT could have an impact on the cost of capital, investment, employment and, ultimately, GDP.

At the sectoral level, the FAT could nevertheless have an impact on business relocation (physical, profit-shifting, payroll-shifting), on market stability and on risk. It is particularly important to keep the cumulative effects of regulatory evolutions and the tax proposals into account.

In so far as important negative externalities in the financial sector could be addressed by the FAT and the revenue could be recycled into welfare enhancing projects, global economic efficiency and macroeconomic variables could be positively impacted by the measure.

(6) Administrative burden for the EU administration

Although the national administrations would deal with the bulk of administrative issues, the EU administration would need to control work done at national level (in the same way that traditional own resources are controlled today).

An important concern, in the case the FAT would be envisaged as an EU own resource, is that the (national) administrations collecting the FAT would not have strong incentives to collect the tax effectively, since it would finance another level of government. This may in turn require specific measures, such as a sharing of the FAT revenue (as 'collection costs'), and reinforced control procedures from the EU administration.

Lastly, depending on the definition of the tax base for FAT purposes (whether or not it would rely on national accounting rules), a high degree of technical knowledge of the different Member States accounting and corporate income tax rules would be necessary at EU level to monitor the correct application and collection of the FAT at national level.

2.4. Quantitative assessment of the own resource

2.4.1. Revenue estimates

The revenue potential of the FAT depends on the type of FAT that is chosen and on the assumptions. An appropriate estimation of revenues would require comprehensive firm-level data as with aggregate data profits of some companies are compensated by losses of others[37].

The addition-method FAT could provide revenue of about 0.26% of GDP (EUR 30 billion) if levied at a rate of 5% and, based on one model, would lead to a small decrease in GDP of 0.04% in the long-run. The FAT is not immune from relocation effects. If it was assumed that 40% of foreign non-EU subsidiaries could relocate and that the taxable profit part of the remaining companies could decrease by 35% – a rather conservative scenario – the revenues estimate for the FAT1 is EUR 24.6 billion for 2009.

It should be stressed, in this context, that a link between a FAT and an own resource to finance the EU budget was not made in previous Commission work. Considering the considerable administrative capacities necessary throughout the Union to levy the tax and check tax declarations based on companies' accounts, Member State administrations would therefore need to collect and manage the tax.

Furthermore, a FAT would face similar obstacles towards harmonization as any form of corporate tax, as further described in the chapter on EU CIT. As an own resource, a FAT could thus only be conceived as a system of revenue-sharing, whereby Member States would transfer a limited share of the FAT levied by their administration to the EU budget. The revenue estimates above should therefore be seen as a global amount, of which only a small proportion would accrue to the EU budget should an own resource be based on FAT.

The FAT would probably be very cyclical in the amounts collected. Given that it would use a tax base which is not necessarily based on accrual accounting, the influence of losses in a downturn would be immediately felt in the tax revenue. However, in the EU budget context, where the GNI-based resource is automatically adjusted to ensure a balanced budget, the revenue stability of a specific own resources does not constitute a problem to the same extent than in the Member States.

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37 Profits are defined as gross operating surplus and mixed income in the financial intermediation sector.

2.4.2. *Fair application and impact on correction mechanisms*

The FAT would be collected by national administrations. They would know the origin of the revenue and would see the EU FAT as a form of national contribution to the EU budget.

The geographical distribution of revenues would by large reflect the actual distribution of the financial sector in the EU. The base of the FAT is not trading activity, which takes place mainly in a few financial centres, but rather remuneration and profit, which is more evenly spread. In this sense the FAT would be well suited to raising revenue for national budget consolidation either via direct tax collection of Member States or through reduced national contributions for the EU budget.

In the context of an own resource based on national legislations that would be approximated at EU level, differences in national FATs would be likely to exist. Due to these differences a revenue-sharing mechanism applying the same share of transfer to the EU budget in all the Member States would likely raise opposition from a number of them on fairness grounds.

Besides, FAT could pose issues of inequality of treatment across sectors. This issue may conflict with legislation or general tax practices in some countries. On the other hand, a FAT could arguably also be seen as a tax surcharge that aims at correcting inequalities of treatment across sectors (e.g. VAT exemption) as well as excessive risk taxing.

Table 5. Estimates for FAT with tax rate of 5% in EU-27 in 2009

Member State	Number of banks in sample	Coverage in assets	FAT1 (EUR m)	FAT2 (EUR m)	FAT3 (EUR m)
AT	181	30.4%	604.8	378.0	262.7
BE	24	82.3%	1,000.5	700.9	406.1
BG	15	38.2%	48.9	42.0	29.9
CY	6	41.7%	410.6	359.4	282.2
CZ	13	20.7%	119.4	92.5	40.9
DE	1,495	43.2%	6,315.4	3,821.0	2,828.9
DK	99	70.8%	513.2	257.0	53.3
EE	1	4.7%	13.7	0.0	2.2
EL	15	65.2%	78.2	6.3	36.2
ES	126	73.0%	1,582.8	799.0	460.7
FI	9	78.4%	298.3	225.9	101.9
FR	200	87.5%	5,873.8	2,903.9	1,789.2
HU	11	10.1%	163.8	141.8	105.7
IE	18	39.9%	80.4	66.9	46.2
IT	468	81.4%	2,186.7	490.7	332.4
LT	2	9.2%	9.1	8.3	8.7
LU	55	65.3%	229.2	186.7	143.4
LV	4	7.2%	4.5	1.1	1.1
MT	10	43.8%	43.1	30.4	12.6
NL	23	79.0%	3,141.8	2,524.3	2,295.3
PL	24	12.1%	549.2	396.4	280.6
PT	17	66.5%	95.2	4.4	26.2
RO	11	21.4%	247.1	231.5	222.0
SE	73	52.4%	85.3	40.7	45.8
SI	8	21.6%	69.9	53.7	32.8
SK	8	29.5%	6.6	3.3	3.7
UK	92	58.1%	6,538.2	5,135.8	3,719.1
EU27	**3,008**		**30,309.7**	**18,901.7**	**13,569.8**

Source: Orbis and DG Taxation and Customs Union calculations

3. EU REVENUES FROM AUCTIONING UNDER THE EU EMISSION TRADING SYSTEM

3.1. Political context

The EU Emissions Trading System (EU ETS) is the cornerstone of the European Union's policy to combat climate change and its key tool for reducing industrial greenhouse gas emissions cost-effectively. The EU Emission Trading System (ETS) has been in operation since 2005 (1^{st} trading period). Since 1 January 2008 (2^{nd} trading period) it applies to 30 countries (EU-27, Norway, Iceland and Liechtenstein).

Being the first and biggest international scheme for the trading of greenhouse gas emission allowances, the EU ETS covers some 11,000 power stations and industrial plants, which are collectively responsible for close to 50% of the EU CO_2 emissions and 40% of its total greenhouse gas emissions. An amendment to the EU ETS Directive agreed in July 2008 will bring the aviation sector into the system from 2012.

Important design changes agreed in the December 2008 European Council will apply from 2013 to 2020 (3^{rd} trading period) and beyond. In particular, the significantly increased share of auctioning as a method to allocate allowances will further increase the effectiveness of the EU ETS. In the context of a discussion on the possible development of an EU own resource based on the revenues from auctioning under the ETS, the following key elements of the discussion on the climate and energy package need to be recalled:

- The Commission did not propose any share of the allowances to be auctioned by the Commission, or any share of revenues to be allocated to the EU budget.

- Political earmarking of revenues was a sensitive issue. The Commission proposal included a provision stipulating that 20% of the auction revenues should (not shall) be used for several climate related purposes (for aviation 100% was already agreed). Under the pressure of the European Parliament, this share was increased to 50%.

- The distribution of auction rights was one of the key issues that remained open until the very end of the negotiations. 88% of the allowances are distributed on the basis of historic emissions, 12% is distributed on the basis of GDP/capita and "achievement of the Kyoto-Protocol targets", see Annex 1 to this chapter for the shares of individual Member States both for the 88% and the 100% distribution.[38] This distribution balances the estimated costs not only from the EU ETS revision, but also the other elements in the package, notably the Effort Sharing Decision and Renewable Energy Directive.

- Pursuant to the revised ETS Directive (2009/29/EC), the Commission adopted an Auctioning Regulation. Member States have been keen to preserve control over their revenues. Nevertheless, a large majority of Member States is expected to make use of a common auction platform procured jointly by the Commission and the Member States. The timely and solid conduct of this procurement is of major importance for

[38] This redistribution does not apply to the auctioning of allowances issues in respect of aviation activities. Member States shares in the auctioning of these allowances will be based on their share in the total historical emissions from aviation.

the smooth functioning of the carbon market. Failure to deliver could undermine not only the Commission's reputation, but also the EU ETS itself.[39]

- The volume to be auctioned equals the total cap on emissions minus the allocation free of charge. For the latter, comitology procedure is ongoing to determine the rules ("Benchmarking Decision"). 'For the third trading period (2013-2020), sectors exposed to significant risk of carbon leakage receive 100% of the benchmark based calculations and most industrial sectors covered by the EU ETS have been identified to be exposed to such risk. For other sectors the free allocation is gradually phased out. For the outcome of the current exercise, but also any later review, the perspective of receiving auctioning revenues is an important factor for Member States.

- For the third trading period (2013-2020), ten new Member States may on a transitional basis allocate a significant but decreasing volume of allowances free of charge to electricity producers. Poland is determined to do so[40], while a number of other eligible new Member States have not decided so far to make use of this provision.

Other issues are relevant for this analysis. In case the EU would decide to step up its reduction effort to 30% below 1990 emission levels, the EU ETS can be expected to be tightened. The reduction of the cap is more likely to affect the auctioned volume rather than the allocations free of charge. The carbon price increase that would result from the move to 30% is expected to outweigh the decrease of the auctioned volume, so auction revenues would increase. This is one of the arguments to find agreement on such a decision in Council. It is sometimes argued that transforming the auctioning revenues into an own resource would limit the possibilities for agreeing a step up in emission mitigation efforts, as it would not be possible to redistribute auctioning revenues, if these would be already allocated to the EU budget. However, it should be recalled that any increase in auctioning revenue attributed to the EU budget would automatically result in a corresponding decrease of the GNI-based residual resource, that is, a decrease of Member States contributions to the budget.

Furthermore, in the medium- or long-term, the scope of the EU ETS may be further expanded (see below). Given the need to avoid double regulation, the larger the scope of the EU ETS, the smaller the potential scope for energy taxation.

Finally, auction revenues could be a source for the financial means that are to be made available in the context of the outcome of international negotiations on climate change. Such financing could go through the Commission's budget; it could also be a direct transfer to the relevant funding mechanism.

In the current context, a re-opening of the ETS Directive for the sake of making auction revenue an own resource could trigger pressure to revise provisions beyond those that would directly concern the development of a new own resource. This could create a lot of regulatory uncertainty at a time when stability is needed, as both authorities and market participants prepare for the substantial changes to the EU ETS that were agreed in 2008 and will be implemented as of 2013.

[39] DE, PL and UK notified their intention to opt-out from the common auction platform.

[40] For Poland, a very rough estimate is that this could concern some 100 million allowances in 2013.

3.2. Outline of the proposal

3.2.1. Identifying variants

Three main variants can be envisaged for a new own resources based on ETS auctioning revenue:

- Simple revenue-sharing. An obligation would be imposed on Member States to transfer a specified share of the auction revenues to the EU budget. This would be straightforward and it would best preserve regulatory stability for the EU ETS. With this variant, no change to the ETS Directive would be necessary.

- Auction-based revenue-sharing. Instead of organising the revenue-sharing system at the level of the ministries of finance, the revenue-sharing system could be organised as part of the auctioning mechanism itself. An obligation would be imposed on the auctioneer appointed by each Member State pursuant to Article 22 of the Auctioning Regulation to transfer a specified share of the auction revenues it receives from the settlement or clearing system(s) to the EU budget, or agree with the settlement or clearing system a corresponding direct transfer.

- Centralised revenue collection. The Staff Working Document accompanying the Budget Review Communication suggests that fully centralised auctioning could be organized by the Commission[41]. The proceeds from allowances auctioning would accrue to the EU budget instead of the Member States budgets. Part of the revenue collected could be removed from EU revenues and transferred to Member States to maintain the redistribution agreed in the legislation. This would however impose revising a number of provisions from the ETS Directive, which makes it more problematic to envisage as a short-term option.

All three mechanisms are conceptually simple. The first two options could relatively easily be set up from a practical point of view, while the third option does not appear suitable in the short-term. However, they would have increasing implications for the degree of regulatory stability of the European carbon market.

3.2.2. Scope of the resource

In all variants, the revenue collected would arise from the auctioning of emission allowances under the ETS. The basis for an own resource is already defined in EU legislation.

As indicated in section 1, the cap could be adjusted in order to reach more ambitious emission reduction targets in the future, for instance a reduction of 30% in 2020.

Furthermore, the scope of the EU ETS may be further expanded.

[41] See SEC(2010)7000 and COM(2010)700 of 19.10.2010, respectively.

- New Member States may be added and the ETS may be linked to systems in non-Member States (a mandate for negotiations with Switzerland has been agreed recently)[42].

- New sectors may be included in the system. As regards transport, the inclusion of maritime transport is an option. Emissions from maritime transport are estimated at a range between 135 Mt (representing domestic and intra-EU shipping emissions) and 300Mt (including also outgoing shipping emissions). Whether and how to include maritime transport, or whether to impose a carbon tax, is under investigation[43]. The largest potential extension would be the inclusion of the road transport sector, which would be a major change to the architecture of the EU ETS and would for reasons of preserving regulatory stability be introduced with several years of lead-time after a legislative process.

3.2.3. Rate of the resource

The price of emission allowances is determined on the emission trading market based on the supply and demand of allowances. In this sense, this potential own resource is very different from tax-based own resources.

The most important regulatory factors determining the market price (and the revenue) are the ambition level of the cap and the scope of the ETS Directive.

3.2.4. Implementation

The simple revenue-sharing would require indicating in the own resources decision or its implementing regulation which share of the auctioning revenue collected by the Member States should be transferred to the EU budget. The transfer of the resource could be organised in a way similar to that of the GNI-based own resource.

The auction-based revenue-sharing would require, in particular, changing the distribution of auctioning rights foreseen in Article 10(2) of the EU ETS Directive in order to give a specified share to the Commission, and Article 10(3) which specifies that the Member States shall determine the use of revenues generated from the auctioning of allowances. A number of other amendments to the Auctioning Regulation would be necessary.

The centralised revenue collection, as a medium- to long-term option, would go one step further. It would make the Commission the sole auctioneer of emission allowances, thus simplifying the auctioning system. A system of revenue redistribution for 12% of the proceeds on the basis of GDP/capita and "achievement of the Kyoto-Protocol targets"

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42 Linking of the EU ETS with third countries, including Switzerland, would not imply more auctioning revenue accruing to the EU budget.

43 So far, no simple method has been identified for free allocation to the shipping industry; in order to reach an agreement on eventual inclusion in the EU ETS it may be more likely to provide for earmarking a significant share of the revenues for measures to reduce emissions in the sector, such as has been done for CCS and renewables, which could result in very significant effects given the potential for emission reductions in the shipping sector.

could be included in the system. Additional changes to the ETS Directive, the Auctioning Regulation and other legal acts may be necessary[44].

Furthermore, a step-by-step approach could be explored, starting, for instance, from a simple revenue-sharing system, with a view to shifting to an auction-based revenue-sharing or a centralised auctioning revenue collection at a later stage. Such a step-by-step approach should ideally be consistent with the foreseen developments of the ETS. The timing of any development of the new own resources could take into account the following aspects:

- The adjustments applicable upon the approval by the Community of an international agreement on climate change (Article 28 of the ETS Directive). A substantial re-opening of some of the key provisions of the Directive cannot be excluded, in order to move to the more ambitious 30% reduction target in a balanced, transparent and equitable way.

- Pursuant to the Auctioning Regulation, an auction platform will be appointed for a maximum of five years. For protecting the stability of the carbon market and the EU ETS itself, it is imperative to avoid any delay in the joint procurement of the auction platform. The Commission will have to seek approval from (participating) Member States for all major decisions in the procurement process and will not be able to unilaterally impose its own views. This has to be taken into account throughout the discussion on own resources.

- The use of the common auction platform by the Commission would be possible only as from the procurement procedure for the next appointment period[45].

- Pursuant to Article 9, the Commission shall review the linear factor and submit a proposal, where appropriate, to the European Parliament and to the Council as from 2020, with a view to the adoption of a decision by 2025.

3.3. Qualitative assessment of the own resource

3.3.1. Preliminary questions

(1) Earmarking and the ETS

The ETS Directive foresees that, from 2013, a part of the revenues from the auctioning of allowances in the EU Emission Trading Scheme (ETS) should be used, inter alia, to tackle climate change in the EU and third countries. Therefore, some concerns have been raised that the transfer of auctioning revenue to the EU budget could ultimately reduce spending on climate and energy issues in the EU.

[44] In order to make use of the common auction platform, an amendment of the Joint Procurement Agreement pursuant to Article 91(1) of the Financial Regulation and Article 125c of the Implementing Rules, which is to be agreed by the Commission and the Member States, would be required.

[45] Art. 33 of Regulation n°1031/2010 of 12 November 2010 contains a general revision clause, but this clause has not been conceived as a basis for rethinking essential elements of the EU ETS Directive itself.

It should, however, be underlined that the earmarking requirement is not a legally binding obligation, even though Member States must justify in case they would not meet it and this underlines the importance of the requirement to report on the actual spending[46]. In some Member States, there is a political agreement on the spending of auction revenues and/or the auction revenues are directly transferred to the relevant budget/bodies that will take care of the spending. But, overall, it is difficult to identify which part of the relevant spending would be done in absence of this earmarking requirement.

The ETS directive offers a large room for interpretation. It specifies that at least 50% of auction revenues "*or the equivalent in financial values*" should be spent for a number of energy and climate-related purposes specified in the directive (including meeting the targets for renewables and energy efficiency). It also states that the Member States "*shall be deemed to have fulfilled the provisions [on use of auction revenues] if they have in place and implement fiscal or financial support policies... which leverage financial support which have a value equivalent to at least 50% of the revenues generated from the auctioning of allowances…*". This could imply that if Member States have existing policies in place that leverage an equivalent amount then they have met the requirements.

In any event, the case for an own resource based on ETS auctioning revenue would probably be reinforced if it led to a visibly increased, additional allocation of funds to climate and energy action in the EU budget. But even in that case, it is unclear whether total spending on climate related purposes would actually increase. One cannot exclude the possibility that Member States spending on climate and energy priorities would be adjusted accordingly. This issue could be relevant i.a. for the financing aspects of any outcome of the ongoing international negotiations on climate change.

(2) Decision-making procedures

An element which could trigger resistance to auctioning revenue becoming part of the system of own resources, in particular under the auction-based revenue-sharing and the centralised collection variants described above, is the fear that decisions on future developments of the ETS would need to be taken by unanimity rather than qualified majority in the Council.

It is useful to recall the current legal framework:

- The own resources decision (ORD) requires a unanimous decision by the Council and approval by the Member States in accordance to their respective constitutional requirements[47]. Due to these specific requirements, the own resource decision is sometimes considered as a "quasi-treaty". In the past 20 years, reforms of the own resource decision have been agreed in the context of (successful) financial package negotiations covering the financial framework, the multiannual programmes, and all aspects related to the EU financing system, including correction mechanisms. Interestingly, the Lisbon Treaty made explicit the notion that the ORD "*may establish new categories of own resources or abolish new categories*".

[46] Reporting requirements will be elaborated in a revised Monitoring Decision to be adopted under co-decision.

[47] See Art. 311 of the treaty on the functioning of the EU.

- The ORD does not need to include all the details of an own resource. Already today, a number of other legal acts play an important role in the EU financing system[48]. Moreover, a clear functional distinction must be drawn between instruments which govern the own resource as such and harmonising instruments which regulate the tax or other source of finance from which the own resource is drawn. Thus for example, the existing rules on the VAT own resource are quite separate from the legislation governing the charging of VAT.

Accordingly, a measure establishing ETS revenue as an own resource would be wholly separate from the legislation governing the ETS. Even after a (unanimous) European Council decision was taken on including ETS auctioning revenue in the own resources system, the ETS system itself would continue to be regulated in accordance with the appropriate legal base, namely Article 192(1) TFEU, under the ordinary legislative procedure (which entails qualified majority in the Council). That is not to say that the ORD would have no influence on the legislation governing the ETS; on the contrary, depending on the variant adopted, amendments would need to be made to the Auctioning Regulation or the ETS Directive (or both).

3.3.2. Criteria set out in the budget review

(1) Link to the acquis and the objectives of the EU

The EU ETS is an EU scheme and it forms part of the acquis. Given the existence of an EU cluster in the international emission reduction efforts and the high level of externalities involved in CO2 emissions, it could be argued that the EU should not only play a very important role in running the ETS, but it should also collect the revenue.

At the same time, our analysis highlights that, under some variants, there is a risk related to re-opening the ETS Directive. An own resource based on auctioning revenues would have to preserve the key elements of the political agreement on the Climate and Energy Package.

Besides, such an own resource could potentially facilitate additional climate-related actions through the EU budget, thus contributing further to EU climate objectives, in particular if a suitable form of earmarking for this new source of finance could be put in place.

(2) Cross-border aspect and internal market coverage

The EU ETS itself is an EU-wide instrument and the carbon market is truly European, if not wider, in its geographical scope.

Centralized auctioning at European level would be more efficient than auctioning by 27 Member States, in particular if the Commission was the sole auctioneer to auction all allowances. Under such a scenario, no joint procurement procedure with Member States

[48] See in particular Council Regulation 1150/2000 on the implementation of the ORD, Commission Decision 97/245 on TOR-related information, Council Regulation 1026/1999 on Commission OR inspections, Council Regulation 1553/89 on the collection of the VAT-based OR, Council Regulation 1287/2003 on the harmonisation of GNI and Council Decision 2010/196 on the FISIM allocation.

would be required and the implementation cost for Member States would fall away completely[49].

In any event, the use of a *single* auction platform to be used by all Member States (as strongly advocated by the Commission) would already reduce administrative costs for the Member States to a very large extent. Most Member States supported this idea and are expected to make use of a *common* auction platform anyway. Adding the Commission as an auctioneer would add to operational complexity and costs – unless it came in replacement of the Member States auctioneers, which is proposed in the third variant above.

(3) Base harmonisation and application throughout the Union

The ETS Directive would constitute the basis for the implementation of the new own resource.

For the purpose of an own resource, the auctions would be fully harmonised and open without discrimination as regards nationality across the internal market[50].

However, during the third trading period (2013-2020), ten new Member States may on a transitional basis allocate a significant but decreasing volume of allowances free of charge to electricity producers. Poland is determined to do so[51], while a number of other eligible new Member States have not decided so far to make use of this provision. This implies that some installations in some Member States would benefit from a different treatment than others until the end of 2020. This could slow down the implementation of a centralised collection mechanism.

(4) Autonomous resource collection

The simple revenue-sharing would rely fully on the Member States, as is currently the case with the VAT- and GNI-based contributions. This form of payments could be seen as a form of expenditure to be minimized for the Member States.

With the auction-based revenue-sharing, the revenue could be transferred to the EU budget by the auctioneer and it would therefore not need to transit via the Member States budgets. However, each Member State would be able to know exactly how much was transferred by its auctioneer.

Fully autonomous collection would only be possible with a centralised collection of auctioning revenue by the Commission. Even in this case, however, it could be possible for the Member States to estimate the share of the auctioning revenue borne by their economic operators. Due to the transparency in verified emissions reported by covered installations, each Member State could estimate how much money power generators operating on their territory have spent for purchasing the needed allowances.

49 Question would remain how to allow EEA-EFTA states to make use of the common auction platform.

50 The Auctioning Regulation already provides rules in this respect that apply to the common auction platform as well as to any opt-out platform that would not wish to make use of the common auction platform.

51 For Poland, a very rough estimate is that this could concern some 100 million allowances in 2013.

(5) Additional burden on specific sectors

The ETS focuses on a limited number of installations (about 11.000) and sectors. However, using auctioning revenue as a new own resource would have no impact on these as the (re-)allocation of auctioning rights has no sector-specific impact.

In a system of revenue-sharing as in a system of centralised revenue collection, (a part of) the auctioning revenue would accrue to the EU budget rather than to the Member States budgets. The impact would be fully neutral for installations subject to the auctioning system.

It is debatable whether making auctioning revenue an EU own resource would have an impact on the policy developments, e.g. as regards expansion of the scope of the EU ETS and the corresponding reduction in the scope of energy taxation. In case new own resources would make use of the ETS auctioning revenues as well as part of the revenue of the energy tax, negative incentives on the expansion of the ETS could be minimized.

In any event, the decision making process for the EU budget should not jeopardise regulatory stability of the EU ETS, as this would harm all sectors covered by the system.

(6) Administrative burden for the EU administration

The administrative burden of the simple revenue-sharing would be negligible.

There may be limited costs under a system of auction-based revenue-sharing if the Member States ask the Commission to bear a share of the cost of the auction monitor.

The most expensive option *for the EU administration* is the one where the Commission would be in charge of the auctioning. However, the *total* cost for the EU and its Member States would be significantly lower than under the current structure.

3.4. Quantitative assessment of the own resource

3.4.1. Revenue estimates

The precise volume of allowances to be auctioned is not yet known and will depend on the implementation of the rules for free allocation. The amount of allowances auctioned is the difference between the total and the amount handed out for free: a) on the basis of the benchmarks and b) pursuant to the optional derogation for ten new Member States to continue to allocate free allowances to the power sector on a transitional basis[52].

a) The benchmarking decision was adopted in the Climate Change Committee in December 2010. It will only be known with a reasonable degree of certainty towards the end of 2011 how many free allowances will be handed out pursuant to this decision.

b) A Commission guidance document is in preparation; applications by eligible Member States have to be submitted to the Commission by September 2011.

52 Article 10c of the revised ETS Directive specifies that such use would directly reduce the Member State's share in the total volume of allowances to be auctioned.

Ample use of this provision would reduce the auction revenue, in particular in the early years of the third trading period.

Until now, a rough estimate has been that about half of all allowances under the cap would be auctioned at the start of the third auctioning period.

The cap on emissions, taking into account the extended scope, has been determined at just under 2.04 billion allowances. It should be noted, however, that this cap does not include the allowances for aviation, of which also 15% will be auctioned from 2012. The volume will decline by 1.74% per annum, also beyond 2020 (though subject to revision no later than by 2025). The current carbon price is around EUR 15.

12% of the auction rights are distributed in view of achieving a balance in the Energy and Climate Package. See Annex 1 for the distribution over Member States.

In case the EU would decide to aim at a 30% reduction of greenhouse gases by 2020 instead of 20%, the volume of allowances to be auctioned is likely to decrease. The impact on auctioning revenues would, however, be offset by an increase of the carbon price. The Staff Working Paper accompanying the Commission's "Background information and analysis of options to move beyond 20% greenhouse gas emission reductions and assessing the risk of carbon leakage"[53] estimates this increase for the reference year 2020 at EUR 8 billion. This is one of the relevant arguments for Member States when defining their position.

As indicated in the Staff Working Document accompanying the Budget Review Communication, "*the revenue for the EU budget resulting from auctioning could amount to some EUR 20 billion*[54] *in 2020 after the transfer of 12% of the revenues to some Member States in line with the European Council agreement of December 2008. Revenues for earlier years would probably be lower due to the reduced share of auctioning and likely lower price of emission allowances as the EU economy recovers from the crisis*". This estimate would need to be revised upward should a decision be taken to increase the emission reduction objective.

3.4.2. Fair application and impact on correction mechanisms

Under the revenue-sharing mechanisms, the Member States would be able to easily identify their contribution to the EU budget based on the volume that they would auction. (See Annex 1 for an overview per Member States based on historical values).

Even under the centralised auction by the Commission, Member States could still estimate, with some delay, the contributions of their operators using verified emissions data reported by covered installations.

Distributional impacts could prove a sensitive issue for a number of Member States. The share of revenues that would come from Member States installations under this mechanism would be influenced by their shares of ETS emissions. Annex 1 highlights

53 Communication SEC(2010)650 of 26 May 2010.

54 Estimate assuming a price per emission allowance of EUR 20.3 and an auctioning of 65% of total allowances. This estimate does not include the revenue from auctioning in the aviation sector and other potential sectors included in the scope of the EU ETS as of 2013.

important discrepancies between Member States. Redistribution of auction rights between Member States was a key element in the final deal on the climate and energy package, and may also have been a reason not to consider a centralised EU approach. The balance found then would constitute an important element in the design of any own resource based on emissions auctioning revenue.

ANNEX 1

MEMBER STATES' SHARES IN AUCTION RIGHTS

	Shares according to historic share in emissions only	Shares according to Art. 10(2) of the ETS Directive
EU	100,00%	100,00%
AT	1,55%	1,36%
BE	2,57%	2,48%
BG	1,99%	2,96%
CY	0,24%	0,26%
CZ	3,92%	4,57%
DK	1,39%	1,22%
EE	0,62%	0,89%
FI	1,86%	1,63%
FR	6,08%	5,35%
DE	22,24%	19,57%
GR	3,30%	3,39%
HU	1,22%	1,46%
IE	1,04%	0,92%
IT	10,50%	9,42%
LV	0,13%	0,20%
LT	0,31%	0,53%
LU	0,12%	0,17%
MT	0,09%	0,10%
NL	3,72%	3,28%
PL	9,61%	12,21%
PT	1,69%	1,72%
RO	3,23%	4,88%
SK	1,17%	1,50%
SI	0,41%	0,43%
ES	8,51%	8,44%
SE	0,90%	0,87%
UK	11,59%	10,16%

4. EU CHARGE RELATED TO AIR TRANSPORT

4.1. Political context

4.1.1. Aviation in the EU

Air transport performs many important functions in modern societies. Making a major contribution to- and benefiting from the European integration, aviation facilitates economic and cultural exchanges and is a significant source of employment and economic growth in many regions. The aviation industry constitutes also the source of intensive research and technological developments that lead to commercialisation of the state of art advanced products promoting European logistical and technological excellence.

The aviation sector is also an example of how the Community presence and competences help achieving safe, orderly, efficient business air transport operations throughout Europe, while somewhat mitigating unfavourable environmental impact. Air transport is one of the EU's success stories. The liberalisation of the EU air transport market in the early 1990s was a cornerstone of EU transport policy, and has generated broad economic benefits, notably through expanded air services, greater competition and lower air fares. The EU has responded to challenges resulting from 27 separate airspaces in the Single European Sky initiatives, which includes the establishment of the EUR 2.1 billion SESAR Joint Undertaking[55].

Four issues are particularly important for the debate on an EU charge related to air transport:

Firstly, as shown below, several Member States have introduced an airline ticket tax or are introducing it (most recently, Germany on 1/1/2011 and Austria on 31/3/2011). Mushrooming aviation taxes could have a negative impact on the proper functioning of the Internal Market and lead to tax-related distortions of competition in the air transport sector. Setting up a new own resource related to air transport could be an opportunity to ensure a more coherent taxation of the sector across the EU.

Secondly, a new own resource based on the aviation sector could help ensuring a more level-playing field in the area of transport. Aviation currently benefits from a very favourable tax regime (virtually no taxation of kerosene and no VAT on air tickets) compared to, for instance, road- and rail transport.

The Commission adopted recently a White Paper on transport[56], which states that "*many branches of transport [including air transport] are treated favourably in terms of taxation, in comparison to the rest of the economy*". "*Generally, these arrangements provide conflicting incentives with respect to the efforts to improve the efficiency of the transport system and reduce its external costs. The Commission will examine proposals to achieve greater consistency between the various elements of transport taxation*".

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55 EUR 350 million 7th FP, € 350 million TEN-T, EUR 700 million EUROCONTROL and EUR 200 million other.

56 COM(2011)144 of 28.3.2011.

In this context, it should also be recalled that the subsidies granted to various branches of the transport sector as well as their mode of operation differ widely. At the same time, the aviation industry remains historically a sector with very low average rates of return on capital, and it is subject to strong cycles in activity and highly vulnerable to external shocks (e.g. terrorism, health alerts, natural disasters). Nevertheless, current differences create the risk of tax-related distortions of transportation decisions and investments.

Thirdly, in the EU and international context, aviation taxation is often mentioned in relation to two other issues, namely climate change and the financing of development[57]. Even though there has been significant improvement in aircraft technology and operational efficiency this has not been enough to neutralise the effect of increased traffic, and the growth in emissions is likely to continue in the decades to come[58].

It should be recalled that the inclusion of the aviation into the EU ETS will only partly mitigate the industry's climate impact, notably due to the fact that it does not cover its non-CO2 impacts[59]. Aviation will benefit from a large free allocation of emission allowances (85%) under the ETS. While scientific uncertainties remain over such impacts, the Commission made commitments to the European Parliament that it would act on aviation NOx emissions. Thus, having regards to the "polluter pays" principle enshrined in the Lisbon treaty (art. 191 §2), the question arises as to whether an EU own resource could play a role in this respect.

Lastly, these arguments have to be weighed against concerns about the impact on cohesion, competitiveness, mobility and sustainability. The White Paper on transport places a strong emphasis on these themes. An aviation tax could potentially have an adverse economic impact on Member States or regions that are particularly dependent on aviation for their economic development, such as island states or peripheral regions, and regions heavily dependent on inbound tourism. The European air transport industry is also facing growing international competitive pressures, and any tax which falls disproportionately on European airlines relative to their global competitors could intensify those pressures.

Such concerns were raised by the aviation industry, as reflected by the recent Bruges Declaration (October 2010). The European aviation community called for action to "*maintain and improve a competitive European aviation industry to create additional employment opportunities in Europe; in that context, [to] avoid additional burdens (e.g. taxes on aviation) affecting European carriers' competitiveness*". The industry considers that an EU aviation charge would negatively impact a sector which contributes significantly to the EU's socio-economic development[60].

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57 See http://unfccc.int/methods_and_science/emissions_from_intl_transport/items/1057.php and the Landau report on http://www.diplomatie.gouv.fr/en/IMG/pdf/LandauENG1.pdf.

58 While the EU's total greenhouse gas emissions fell by 5.7% from 1990 to 2005, emissions from civil aviation increased by almost 79% - see "EU energy and transport in figures. Statistical pocketbook 2007/2008", p. 186.

59 EU ETS covers only carbon dioxide (CO2) emissions leaving aside other components characteristic for aviation such as NOx, water vapour emitted at high altitude and sulphate and soot particles.

60 Following the adoption of the Budget Review on 19 October 2010, industry stakeholders have expressed their concerns in two joint letters sent to President Barroso.

Therefore, the aviation sector can be expected to oppose strongly to any new tax that would simply be added to existing Member States' taxes and to the Emission Trading System (which will start being applied to the aviation sector from 2012). However, Member States and the industry itself could have an interest to streamline different national tax schemes via an EU aviation duty in order to ensure a level playing field for aviation companies, taking also into account future initiatives to be financed through the EU budget.

4.1.2. Aviation and the own resource debate

The Commission took a favourable stance on the idea of a duty related to aviation in the 2005 report on EU financing[61]. The idea is also mentioned in the EP Resolution on EU financing of March 2007.

More recently, the idea has been supported by several MEPs during the Budget Review consultation process: H. Trüpel (Greens-EFA, DE) and G. Onesta (Greens-EFA, FR) proposed the introduction of "*a new income source only for the additional expenditure considered necessary, e.g. an air traffic levy*". A similar position has been supported by the Union of European Federalists[62].

A duty related to aviation has been pointed out as a feasible new own resource to the EU budget[63]. However, no detailed proposals have been made so far.

4.2. Outline of the proposal

4.2.1. Identifying variants

Two variants appear potentially suitable in the context of the own resource discussion.

- The departure tax is an airline ticket tax per passenger on departures from an EU airport. Inspired by existing taxes (being) set up by a number of Member States, it could permit a modulation depending, for instance, on distance and travel class.

- The flight duty is a tax on each freight and passenger flight entering, operating within and/or leaving the "EU Flight Information Region", i.e. the combined FIRs of the EU Member States, or departing from an EU airport. It could be based on one or several technical variables, such as a distance factor.

On the other hand, two potential variants have been discarded in the context of this analysis.

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61 See COM(2004)505, Vol. II, p. 50. The Commission also actively pursued the idea of an air ticket tax as a means to finance development aid. See for instance SEC(2005)1067 and SEC(2005)733.

62 "*a direct EU-tax should replace the national contributions and establish a direct link between the citizens and the EU. A Eurotax could take the form of…an air traffic levy*". Reply to the budget review consultation, ref: 13.04.2008 - UEF Groupe Europe - Worldwide - (20080413_NG_16). See http://ec.europa.eu/budget/reform/issues/read_en.htm

63 See for instance Begg, I., Enderlein, H., Le Cacheux, J. and M. Mrak (2008), "Financing the European Union budget", Study for the European Commission, Directorate General for Budget, Final Report.

- Kerosene taxation has been discarded for legal reasons. Although fuel used for commercial aviation is generally exempt from excise duties, following the adoption of Council Directive 2003/96/EC ("the Energy Taxation Directive" or "ETD") Member States can already introduce fuel taxation for domestic flights. In the EU only the Netherlands has so far decided to do so. The ETD also allows, subject to mutual agreement, fuel taxation to be introduced for flights between two Member States (intra-Community flights). In such cases it would apply to all EU carriers.

  However, the ETD in its present form[64] does not allow to tax fuel for international aviation. This comes from the past when it has been common practice for aircraft fuel for international flights to be exempted from all taxes - a policy originally established to promote civil aviation during its infancy. The legally binding exemptions are found in the bilateral air service agreements (ASAs). Avoiding discrimination against EU carriers could therefore be difficult on routes where non-EU carriers have traffic rights and continue to enjoy tax exemptions under the relevant ASAs. In this context, the judgments delivered on 5 November 2002 by the Court of Justice of the European Communities in the "Open Skies" cases are significant. They triggered a comprehensive reform of the EU's external aviation relations. As part of this process, more than 500 ASAs between EU Member States and non-EU countries have already been amended to open the possibility of taxing fuel supplied to EU and non-EU carriers on an equal basis (see Box 4 for more details). As acknowledged by the Commission in its 2005 communication "Reducing the climate change impact of aviation", this present specificity and the related timing issues were among the reasons why the Commission suggested instead addressing the climate change impact of aviation by incorporating it into the EU Emission Trading System.

BOX 4: BILATERAL AIR SERVICE AGREEMENTS WITH THIRD COUNTRIES

As regards bilateral air services agreements (ASAs) with third countries, the Commission has been engaged since 2003 in a process of negotiating EU-level aviation agreements with third countries. These agreements have taken two main forms.

- First there are the EU's comprehensive aviation agreements, which replace Member States' bilateral agreements with the third country concerned and establish an EU-wide framework for the provision of air services by the airlines of each side. So far such agreements have been reached with a number of neighbouring countries, (e.g. the European Common Aviation Area covering the western Balkans, Morocco, Jordan and Georgia) and with the United States and Canada (although some of these agreements have yet to enter formally into force).

- Second there are so-called horizontal agreements, negotiated at EU level by the Commission, which amend only certain provisions in the bilateral ASAs between the Member States and the third country concerned. The purpose of these horizontal negotiations is to bring Member States' bilateral ASAs into conformity with EU law in certain respects through a single EU-level agreement which simultaneously amends all Member States' ASAs with the third country concerned.

64 A detailed analysis of possible amendments to the ETD has been proposed by ClientEarth (2010), "Removing barriers to taxing the supply or use of aviation and maritime fuels. Proposed amendments and briefing note to Energy Taxation Directive 2003/96/EC of 27 October 2003", December 2010.

In all of these negotiations, the Commission has sought to include a clause on the taxation of aviation fuel used on intra-EU flights. This clause would allow Member States to make use of the possibility of applying to third country carriers a tax on aviation fuel as foreseen by Directive 2003/96. The Commission has so far negotiated agreements with 45 countries in total. In the majority of cases, the third country has accepted the clause on fuel taxation on intra-EU flights. However, seven of those countries did not accept the clause - Australia, Canada, India, Israel, Pakistan, Singapore and Vietnam. The comprehensive agreement with the United States includes a provision under which the Joint Committee would consider a case where two or more Member States envisage applying a fuel tax to US carriers on intra-EU routes[65]. The Commission had also attempted in its air transport negotiations with the US to remove in its entirety the tax exemption for aircraft fuel, but this was refused by the US.

The removal of the tax exemption for aircraft fuel on flights to and from the EU can, in theory, be achieved through renegotiation of bilateral ASAs with third countries. However, experience of negotiations with third countries to date suggests that this would be a difficult and slow process, and that many third countries would be likely simply to refuse the removal of the exemption.

In conclusion: although the situation is evolving there are still legal and practical barriers to taxing kerosene stemming from international agreements. In view of the existence of alternative approaches which could be more suitable for the development of an EU own resource, this specific variant is not examined further in this context.

- VAT on plane tickets has been discarded due to the fact that it is a less effective way to tax passengers than a passenger tax as examined below. The overview of the application of VAT to passenger transport in the EU can be found in Annex 1. Whilst international sea and air transport services are exempt from VAT in the whole of the EU-27, VAT is paid, subject to varying conditions, on international passenger transport within the EU on inland waterways, rail and road transport in 9 Member States. This raises the question of neutrality of VAT application to passenger transport which will be a part of the ongoing debate on the future of the VAT in the EU launched with the Green Paper on VAT[66]. The outcome of this debate is to be awaited.

  As a matter of fact VAT is a tax collected at the various stages of the production and distribution cycle of a good or service, but which as a rule falls on final consumption. This means that in business-to-business transactions preceding the final consumption stage (typically sale of good or service to private consumer) the providing business charges output VAT which as a rule can be deducted by the receiving business as input VAT. Consequently, only the sale of airline tickets to non-business consumers

[65] Article 11(6) of the EU-US Air Transport Agreement reads as follows: "In the event that two or more Member States envisage applying to the fuel supplied to aircraft of US airlines in the territories of such Member States for flights between such Member States any waiver of the exemption contained in Article 14(b) of Council Directive 2003/96/EC of 27 October 2003, the Joint Committee shall consider that issue, in accordance with paragraph 4(e) of Article 18." Article 18(4) reads as follows: "The Joint Committee shall also develop cooperation by: (e) making decisions, on the basis of consensus, concerning any matters with respect to application of paragraph 6 of Article 11."

[66] COM(2010)695 final.

who cannot deduct input VAT will yield revenue. This VAT option is then similar to a straightforward airline ticket tax with the difference however that in the latter case business customers are also taxed which results in higher revenues.

Second, a number of technical complications would need to be addressed. For the sake of simplicity and compliance cost reasons, it seems appropriate to apply the harmonized rules laid down in the EU VAT Directive 2006/112/EC to the surcharged VAT (as an EU resource on top of national VAT) on plane tickets. Currently, the place of supply of passenger transport is the place where the transport takes place, proportionate to the distances covered. The area outside the EU would thus not be taxed. However, this rule is difficult to apply and would possibly need to be adapted in the light of the discussions on the future of VAT. Furthermore, business travelers would pay VAT for example to the operating airline company which is remitted to the EU budget, but would be entitled to deduct this VAT paid. Where and against which tax administrations would they claim the input VAT refund (e.g. a Dutch national working for a UK corporation flying from Brussels to Spain)?

In conclusion, a departure ticket tax is more straightforward and would be levied on a larger tax basis than a VAT on plane tickets.

4.2.2. Tax basis

(1) Departure tax

This tax could be levied on the carriage, from an EU airport, of chargeable passengers on chargeable aircraft:

- A chargeable passenger is anyone carried on the aircraft with the exception of a limited number of exemptions. These could include transit passengers, i.e. the tax could apply to the journey as a whole – when an aircraft makes a stop 'en route' and passengers do not change aircraft, then no additional duty should be due for the leg of the journey immediately after the stop. Similarly, for connecting flights, a passenger who has a ticket would not be a chargeable passenger on the second or subsequent flight of his journey if that flight and the previous flight are connected[67].

- A chargeable aircraft is any aircraft which is designed or adapted to carry persons in addition to the flight crew[68].

The amount due could be dependent on the final destination and class of travel of the chargeable passenger.

[67] Some categories of airline employees could also be exempted, for instance flight crews, cabin attendants, employees escorting a passenger or goods, employees undertaking repair, maintenance, safety or security work and employees ensuring the hygienic preparation and handling of food and drinks. Exemptions could also apply to children below the age of two who are not allocated a separate seat before boarding the aircraft, to passengers who are carried free of charge under a statutory obligation (for example deportees) or to inspect aircraft or crew (for example CAA flight operations inspectors), and to short pleasure flights.

[68] Exceptions can be foreseen for small aircraft with a maximum take-off weight under a specified amount (e.g. ten tonnes) or with fewer than a certain number of seats for passengers (e.g. 20). Private aircrafts can also be exempted.

An exemption (or reduced rates) could be foreseen for flights departing from airports located in specific territories, such as overseas countries and territories of Member States.

Specific rules could also be designed for circumstances beyond the control of the airline (due to weather conditions, mechanical failure, etc.), for military flights and other flights with specific purposes.

(2) Flight duty

This tax could apply to all flights entering, operating within and/or leaving the 'EU Flight Information Region'[69], except for overflights, or to all flights departing from an EU airport. Equal treatment of operators regardless of their nationality would be ensured, consistent with the Chicago Convention.

Certain categories of flights may qualify for exemption from the duty related to aviation as a result of legal obligations for instance the Vienna convention on diplomatic relations that provides for special treatment of flights conducted under the auspices of foreign diplomatic relations or representations. Similar considerations should apply to military forces flights if concurred upon reciprocal agreements of the parties involved[70].

Similar to the departure tax, exemptions (or reduced duties) could be envisaged in relation to the specific origin or destination of the flight.

4.2.3. Duty rate

(1) Departure tax

The departure tax offers a large degree of flexibility as to the rate structure. Typically, rates could depend on the following main factors:

- a measure of distance travelled. This could for instance be defined using a destination band structure, differentiating European destinations vs. non-European destinations, or distance ranges [e.g. 0-2000 km; 2001-4000 km, etc.]. The distance factor could be based on the distance between the capitals of the origin-destination countries or airports[71];

- a differentiation based on the class of travel, to reflect the ability-to-pay of passengers and reduce the impact on tourism. This factor could take into account the seating configuration (seat pitch), the existence of premium classes, etc.

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69 That is, the area corresponding to the combined EU Member States flight information regions.

70 Exemptions could apply to flight under visual flight routes, public or special service flights, emergency service flights, calibration flights, humanitarian relief flights, training, maintenance and circular flights.

71 The UK approach of using the distance between capitals as a basis to determine in which band the flights should be has been criticized for having distorting effects, in particular for the Caribbeans: "The current banding system places the Caribbean at a competitive disadvantage to holiday destinations in the USA, as Washington is significantly closer to London than are any of the Caribbean capitals". See ABTA, "*The Economic and Social Implications of Air Passenger Duty: Passengers, UK plc, and Destinations*".

Specific provisions may be required for connecting flights, *inter alia*.

(2) Flight duty

The amount of the duty would depend on the aircraft technical characteristic and other relevant parameters. The parameters could be calibrated in order to provide the necessary incentive to air operators and according to the budgetary needs. The duty could, in principle, be such that the more efficient planes would pay less, *ceteris paribus*.

The following indicative list of parameters could be considered, although it would have to be ensured that the basis of the duty did not amount in effect to a tax on fuel consumption:

- an indicative measure of resource consumption (the maximum take-off weight - MTOW) or an indicative performance measure such as engine limitation (e.g. maximum static thrust at take-off - MTOT);

- a measure of the origin-destination distance of the flight in question within the "EU Flight Information Region" or another form of measure of distance from the EU airport of departure based on solutions already experienced by Member States (e.g. the UK banding system);

- other relevant readily available parameters based on airplane characteristics (for instance NOx emissions, noise characteristics, etc.).

4.2.4 Implementation

(1) Departure tax

Based on existing experiences, the most straightforward approach would be to levy the tax through the airlines.

In practice, companies operating chargeable aircrafts used for the carriage of chargeable passengers from EU airports would need to register for the departure tax. Registration would need to take place before or within a limited period after the chargeable flight take place, that is, when a chargeable passenger would have been carried on a chargeable aircraft. Non compliance would lead to financial penalties.

Registration could be done using a simple form, to be sent either to the EU administration in charge or to a national administration (to be created in most Member States). Considering the fact that this would be a new tax (possibly coming in replacement of – or credited against national taxes), there could be substantial economies of scale by organizing the tax collection at EU level.

Specific procedures could be set up for companies, which do not have a business establishment in the EU (e.g. for fiscal or administrative representatives), and for one-off flights.

Procedures for accounts and records would also need to be defined, based on existing procedures proved to be workable at national level.

An alternative to this approach could be to rely on EUROCONTROL to compute, bill and collect the tax on behalf of the EU, subject to overcoming the legal and institutional obstacles described below. This approach would appear more convenient in the case of the flight duty but should certainly not be ruled out *a priori* for the departure tax.

(2) Flight duty

Similar to the departure tax, the flight duty could be paid by airlines and collected by an EU administration. However, considering the form of the duty and the experience of EUROCONTROL in imposing formula-based charges on flights, this institution could be used as a collecting agent on behalf of the EU.

The collection system could be inspired by existing solutions already proved to be successfully operational and accepted over the years. In practice, the tax could be based on a simple formula and mainly rely on data currently used by EUROCONTROL or publicly available information on aircraft characteristics.

The potential administrative burden would then only encompass limited costs induced by the expansion of the existing recording, registration and data management schemes such as EUROCONTROL's Route Charges System (RCS)[72] managed by the Central Route Charging Office (CRCO) based in Brussels. The CRCO already establishes, calculates, bills and collects charges levied on aircraft operators using en-route air navigation facilities and services on behalf of Contracting Parties. Each airline receives a bill in euros, no matter how many States were overflown. The data bases required and the technical facilities necessary for precise and timely computing the duty due are already in place. Overall, some 80 % of the revenues of air navigation services providers operating in the Eurocontrol Member States are collected by the CRCO.

Although the flight duty would be a tax instead of a charge (corresponding to a service rendered to operators), the technical aspects would be basically the same, *mutatis mutandis*. The main issues then would be legal and political – i.e. one should ensure that it is legally possible and politically feasible to use the services of EUROCONTROL to collect a new EU own resource. These issues are examined in more detail below.

The flight operator would be liable for the duty on a flight-by-flight basis. Whether or not the cost of the duty would be passed further onto the final consumers would be a commercial decision to be made by the operators.

4.3. Qualitative assessment of the own resource

4.3.1. Preliminary questions

(1) Experience in EU Member States

Several Member States already impose a departure tax or a tax on passengers as shown in the survey displayed in Annex 2.

This survey illustrates that

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72 Central Route Charging Office (CRCO), "Customer Guide to Charges, May 2008, version 3.4" as available on http://www.Eurocontrol.int/crco/gallery/content/public/docs/other/customerguide.pdf.

- A tax on the aviation sector is feasible. The most popular existing form of duty among the Member States appears to be the departure/passenger tax, with a modulation based on range of distances. The flight duty has not been developed at Member State level so far (this measure was considered and rejected in the UK).

- Smaller EU Member States appear to suffer particularly from the (risk of) tax-related displacement of air transport activities to neighbouring countries. Due to the displacements of flights, passenger taxes had to be withdrawn in Denmark, the Netherlands and Malta, and to be reduced in Ireland. Attempts to introduce the tax failed in Sweden and Belgium. In larger States, such as Germany, France or the UK, some displacement of activities are expected or have been observed[73]. It seems that it takes a certain territorial size to successfully implement and maintain a tax over time. This suggests that displacement of traffic could be substantially reduced by establishing such a tax at EU level, although displacement to non-EU airports (e.g. Switzerland or non-EU tourist destinations on the Mediterranean) would potentially occur.

- Passenger taxes in several Member States provide for specific provisions for transit and transfer passengers. This seems to reflect the notion that applying a tax to transit and transfer passengers, who make an substantial contribution to the economic viability of air services operated by the network airlines, could increase the displacement of traffic.

- A differentiation of the rate between travel classes seems to be driven by social and political motives. In case of a passenger departure tax, rate differentiations between European and long-haul flights are important and changes in relative price differences may also lead to substitution of destinations.

- Amounts of the tax can be significant (up to EUR 4 billions yearly in the UK).

- Putting a charge on aviation can be very rapid (a few months were needed to set up the system in Germany).

(2) Lessons from economic theory

The air transport operators are subject to corporate tax on their earnings in the place of the residence. On top of this various indirect taxes or levies have been scrutinized and discussed in recent years[74] – some of them followed by policy initiatives. Keen and Strand (2006) suggest that the aviation industry taxation is sub-optimal due to a series of market failures[75].

- First, many adverse environmental externalities exist, such as air pollution, including carbon emissions and other emission affecting global warming, noise, pollution and

73 One example is a study conducted on behalf of Rheinland-Pfalz, which estimates that the German ticket tax will lead to a decrease in air traffic of 4.5-6 million passengers and a related loss of 10,000-15,000 jobs in Germany.

74 Commission Staff Working Paper 1067, "A Possible Contribution Based on Airline Tickets as a New Source of Financing Development: Technical Reflections in the Run up to the UN High Level Event," and Commission Staff Working Paper 467 "New Sources of Financing for Development: A Review of the Options".

75 M. Keen and J. Strand (2006), "Indirect Taxes on International Aviation", WP/06/124, IMF.

congestion at airports. If the justification of an aviation charge is to improve allocative efficiency by correcting for externalities, then the optimal policy would be to tax the externalities directly. As the principal environmental externalities associated with aviation are those related to noise, local air quality and climate change, a tax should therefore ideally be applied directly to the emissions of specific gases. Having said that, under the principle of subsidiarity local environmental externalities are best addressed by local instruments, such as modulation of airport charges, and not by an EU-wide tax. However, competition between airports and between local authorities may make local taxation of externalities particularly difficult and this could call for a national or EU approach.

One should also recall that the climate change impacts of aviation CO_2 emissions will be mitigated by the participation of the industry into the ETS[76]. Including a parameter related to (NOx) emissions in the flight duty could, in theory, fill in a gap in the existing framework, but the scientific basis for such a measure is subject to debates. A slightly less optimal policy would be to tax kerosene, which is at the source of emissions. (However, as indicated above, the legal framework still constitutes an impediment in this respect.) Lastly, a tax which is not directly related to the production of the environmental externalities, such as a passenger tax, would be a blunter instrument which would have an effect only by dampening demand and so would not give operators an incentive to improve environmental performance[77].

This theoretical analysis is confirmed by impact estimates related to the UK APD and potential alternatives[78]. This study demonstrates that "*aviation taxes are unlikely to substantially change aviation emissions. The sensitivity analysis does reveal a crucial assumption; if we assume that domestic holidays and foreign holidays are not substitutes for one another, then a boarding tax would have a perverse effect on emissions. That is, the higher the tax, the higher the emissions. However, if domestic and foreign holidays are substitutes, then a boarding tax may reduce emissions. We also find, not unexpectedly, that an emissions tax would have the desired result of reducing emissions, even if domestic and foreign holidays are not substitutes. An emissions tax thus has the desired impact, and can be designed to raise the same revenue as the boarding taxes currently under discussion*". The exact design and the differentiation of rates according to distance and/or class of travel may have important consequences regarding environmental externalities.

- Second, imposing taxes on the aviation sector could reduce the existing imbalance observed in transport taxation and facilitate a modal shift to other modes of transportation. However, such a shift is likely to remain modest since aviation and other modes of transportation are not close substitutes beyond a few hundred kilometres. In addition, from a equity point of view, basing an EU own resource on one individual sector has to be weighed against the benefits the sector derives from EU policies and the contribution that it makes to the EU's economy and wider EU policy objectives.

76 85% of the aviation emissions are exempted from auctioning under the ETS directive.

77 See Communication on Reducing the Climate Change Impact of Aviation, SEC(2005)1184.

78 Mayor, Karen and Tol, Richard S.J. *Economic and Social Research Institute, Dublin, Ireland*. The impact of the UK aviation tax on carbon dioxide emissions and visitor numbers. April 2007.

Besides, economic arguments also relate to the broader economic impact (the spill-over effects) of the aviation sector. Reliance on air transport differs significantly inside the EU and so does the dependence of national and regional economies. This is most evident for peripheral regions and for countries where the tourism sector is particularly important for the level of GDP. Whereas a number of traditional tourist destinations within and outside the EU could be negatively affected by a tax on air transport[79], local tourism of (local) residents could increase through substitution in a number of EU Member States.

Moreover, since air transport is a network business, there may be a disproportionate effect on those Member States which have the largest hub airports, e.g. London, Paris and Frankfurt.

In general, effects on the industry and specific operators would very much depend not only on the design of the tax but also on the business model of aviation sector operators. There is for instance potentially an issue about equitable treatment between passenger airlines, many of whom also carry freight on their aircraft, and all-cargo airlines. A ticket tax, contrarily to a flight duty, would apply to passenger airlines but, by definition, not to all-cargo operators. Furthermore, scheduled airlines, which often operate emptier planes, could be put at a disadvantage with a flight duty compared to charter companies, which operate fuller planes. Conversely, a departure tax could fall more heavily on charter companies than on scheduled airlines.

If the option of an air transport tax were to be pursued further, a number of issues would need to be addressed in terms of its design and applicability. This would include whether different rates should apply to different flight distances, to different classes of travel, and whether it should apply to passengers in transit or transferring.

(3) Legal issues

Certain legal provisions reduce possibilities to tax aviation. Those may result from international conventions, EU legal provisions or bilateral air service agreements.

- An important distinction has to be made between (i) charges, which constitute remunerations for services, e.g. for the use of airports or for air navigation services and (ii) taxes, which constitute payments made by citizens to the public purse and cannot be considered remuneration for a service but are intended to provide for the general expenses of public authorities. The departure tax and the flight duty fall clearly in the second category. A flight duty would raise no different concerns than a passenger tax, assessed on each flight of a passenger (with differentiations perhaps as to the distance flown), so that both can be considered jointly in this specific context.

- Whereas the Chicago convention (Article 15, paragraph 3) provides that "*No fees, dues or other charges shall be imposed by any contracting State in respect solely of the right of transit over or entry into or exit from its territory of any aircraft of a contracting State or persons or property thereon*", statements made by the ICAO appear to support the conclusion that this clause does not stand in the way of "passenger taxes" or "flight duties", contemplated as genuine taxes. Indeed, the ICAO

[79] To take extreme cases, according to research produced by Oxford Economics in May 2010, it is estimated that tourism in Barbados will account for 47.9% GDP in 2010; 37.8% in St Lucia; and 78.4% in Antigua & Barbuda.

Council Resolution on Taxation of International Air Transport ostensibly moves on the premise that such *taxes* are not incompatible with the convention.

- However, "passenger taxes" applied by Member States have given rise to litigation in national Courts, with conflicting interpretations of Article 15(3), and thus conflicting results. Notably: the UK "Air Passenger Duty" has been declared compatible with this provision by the High Court of Justice in 2007; by contrast, in a judgment of 2005, the Belgian Council of State declared incompatible with Article 15(3) the yearly tax on the operation of aircraft imposed by the Belgian local Council of Zaventem, the amount of which depended on the number of passengers carried. It seems that the problem has equally arisen in the Netherlands, where a national judge has dismissed an application against the Passenger tax imposed by that State, based on Article 15(3) of the Chicago Convention.

- In summary, it can be noted that passenger taxes appear not to be considered contrary to the Chicago convention by the ICAO bodies, but that their compatibility with Article 15(3) of the convention has been disputed in national Courts, with diverging results. "Flight duties" such as those apparently envisaged would not call for an analysis different from passenger taxes.

- Lastly, regarding the compatibility of these taxes with customs law, a flight duty or passenger tax would be levied on events associated to transport activities, but not on goods as such, be it directly or indirectly. A comparative examples illustrates this difference: whereas flights or travels by passengers with an airplane (in operation) may be subject to a "flight duty" or "passenger tax", the importation of a dismantled aeroplane into the customs territory (with the help of an appropriate vehicle) would not be subject to these levies. Therefore, the duty is neither a customs duty nor comparable to it and cannot thus be contrary to customs law.

However, some observers consider that a flight duty could be more vulnerable on legal grounds than a departure tax, as it could be more prone to being characterised as effectively a tax on fuel consumption. Proposing, as was done in 2008 in a UK consultation document (see Annex 2), that a flight duty be based on the maximum take-off weight (MTOW) of the aircraft was regarded as a reasonable proxy for the environmental impact of a flight, but at the same time could potentially also be seen as a rather imperfect proxy for an aircraft's fuel consumption. Basing the duty specifically on an aircraft's CO_2 emissions (putting aside the difficulties of doing so in the absence of any agreed methodology for measuring individual aircraft CO_2 performance) could have made the link to fuel consumption more explicit. Although this approach is not envisaged here, the possible inclusion of environmental variables would need to be carefully considered in the light of this argument.

(4) Role of EUROCONTROL

As indicated above, a practical option that could be envisaged is to have the passenger tax or the flight duty be levied by EUROCONTROL on behalf of the EU. This could in particular be suitable for the flight duty as EUROCONTROL currently operates a number of *charges* (as described in the legal section above), which have a number of common features with the *tax* under consideration.

Under such a model, EUROCONTROL could compute, bill and collect the duties from the operators. Factual information on this organization is provided in Box 5 below.

However, this would be a practical option only if certain legal and institutional obstacles could be overcome, as explained below.

BOX 5: THE EUROPEAN ORGANISATION FOR THE SAFETY OF AIR NAVIGATION (EUROCONTROL)

EUROCONTROL is a civil-military intergovernmental organisation with 39 Member States across the European continent: 26 Member States of the EU as well as Albania, Armenia, Bosnia and Herzegovina, Croatia, Moldova, Monaco, Montenegro, Norway, Serbia, Switzerland, The former Yugoslav Republic of Macedonia, Turkey, Ukraine. Estonia is the only EU country not being a member[80].

It was established by the "EUROCONTROL International Convention relating to Cooperation for the Safey of Air Navigation" of 13 December 1960. This Convention was amended on 12 February 1981. In 1997, the amended Convention (hereafter "the Convention") was revised to take into account changes in the political and operational environment of air traffic management[81]. On 8 October 2002, the Member States and the European Community have signed a Protocol on the Accession of the European Community to the revised EUROCONTROL Convention[82]. The headquarters and the Central Route Charging Office (CRCO) are located in Brussels.

Its mission is to harmonise and integrate air navigation services in Europe, aiming at the creation of a uniform air traffic management system for civil and military users, in order to achieve the safe, secure, orderly, expeditious and economic flow of traffic throughout Europe, while minimising adverse environmental impact. In terms of strategic priorities, "*coordinated implementation of the Single European Sky and the Single European Sky ATM Research Programme (SESAR), has the highest priority. It will drive the change from the current system to the future one*."

- From a legal perspective, instituting EUROCONTROL as a collecting agent would suppose changes at two levels. First, at the level of EUROCONTROL itself, the new task would have to be agreed to by the EUROCONTROL Member States, which may require an amendment of the Convention. Let us just note here that collecting taxes for the EU does not seem in the remit nor in the objectives of Eurocontrol, whose role is to support its 39 Member States in improving air traffic management. Articles 2.1.i, 2.2.c and 2.3.b of the Eurocontrol Convention limit the scope of the Organisation's role as a "collector" to 1) assisting at their request its Member States or third States having an agreement (and not a third party); 2) in the collection of charges (and not taxes); and 3) due only in relation to air navigation services. Any

[80] The Estonian Air Navigation Services is organised by a 100% State owned company. See www.eans.ee and http://www.Eurocontrol.int/prc/gallery/content/public/Docs/ace2006/factsheets/factsheet/EANS_2006.pdf. For the levying of taxes relating to the Estonian airspace, special measures would therefore be necessary.

[81] http://www.pca-cpa.org/upload/files/03%20Eurocontrol.PDF. Although not all parties have ratified the Convention, some of its provisions have already been implemented.

[82] Again, it should be stressed that the Convention has not been ratified by all member countries.

change to these articles could require a Diplomatic Conference and the agreement, signature and ratification of the modified Treaty by the 39 member States of Eurocontrol. Alternatively, an *ad hoc* extension by the Eurocontrol decision-making bodies of the tasks of the Organisation would require the unanimous approval of the 39 Member States.

Although obtaining a unanimous agreement of all members of EUROCONTROL would not be a simple task, 26 of the 39 member countries are EU Member States and most of the other members have close ties with the EU. It is possible, but far from certain, that they may also see some advantage in having a say in the development of a system, which they could join on a voluntary basis.

- Second, the Union would need to conclude an agreement with EUROCONTROL, so as to create the necessary legal obligation for EUROCONTROL to collect the levies in question, as well as in order to fix the modalities of the collection.

From an economic point of view, the best alternative could be setting-up a new EU agency charged with calculating and billing the tax to operators. This would involve higher total administrative costs (partial duplication with EUROCONTROL functions), higher compliance costs for the airlines (which would have to face two billing systems, one for the charges operated by EUROCONTROL, one for the tax operated by the new agency). And it would also sideline non EU members of EUROCONTROL, which may also potentially benefit from a broad-based tax on the aviation sector operated by an organisation they belong to.

(5) Link to the ETS

In general, aviation sector taxation would indirectly interact with ETS, to the extent that less CO2 emissions as a consequence of the tax could lower prices of ETS emission allowances in the very long term, and conversely. In this sense, a part of the aviation tax payments by the industry could be compensated by a reduction in its payments to buy emission allowances.

Regarding more specifically the departure tax, there is no additional link to the EU ETS.

The aviation duty would not tax CO_2 emissions already covered in the ETS. But it could in theory tax other greenhouse gas emissions. The inclusion of aviation in the EU ETS covers only CO_2 emissions, whereas there are other non CO_2 climate impacts associated with aviation, such as those from NOx emissions, soot and water vapour, the latter of which contributes to the formation of contrails and cirrus clouds.

However, there remains significant scientific uncertainty surrounding these non-CO_2 impacts, and it could be premature to base a policy instrument upon them at this point in time. (Indeed, the Commission decided in 2009 to postpone the development of a specific policy instrument to address the climate impacts of aviation NOx emissions pending further scientific studies.) In the light of evolving scientific and political circumstances, it remains to be seen whether it would be appropriate to include variables such as NOx in a flight duty formula.

(6) Risks of market relocation

Relocation issues could stem from neighbouring, non-taxing jurisdictions (Switzerland, North Africa, Eastern Europe and the Middle-East). The tax level should therefore take account of the costs of travel[83] to or from such countries that could be motivated in order to avoid the tax. The extension of the European Common Aviation Area (ECAA) to include progressively more non-EU states opens the possibility that such airlines may reconfigure their networks away from intra-EU routes to routes within and between the non-EU ECAA states.

The potential for market relocation is particularly high for connecting traffic at EU hub airports where passengers have alternatives outside the EU (e.g. traffic between Asia and the Americas). The EU aviation industry faces already today many competitive disadvantages compared to alternative airport hubs in the Middle East (Dubai, Doha, Abu Dhabi). Additional taxes could delocate part of the transit traffic away from EU hub airports, with associated impact on revenues and profitability of EU airlines.

Existing regimes of airline ticket (departure) taxes take account of transit passengers, and connecting flights: in Germany for example, for stop-over flights starting in Germany account is taken of the final destination to determine the tax rate as long as the flights are booked together. For flights with a stop in Germany, there is no tax on departure in Germany unless the time of stay in Germany exceeds 12 respectively 24 hours depending on the entire distance covered.

Low cost airlines could be more affected than traditional ones by a departure tax, both because the tax would represent a higher share of the average ticket price, and because of a higher price elasticity of demand, unless there is a tax rate differentiation. On the other hand, with a flight duty, these effects could be compensated by the fact that low cost carriers often operate with fuller planes than the network carriers (see above).

(7) Island states, peripheral regions and distant territories

Peripheral Countries and regions that are more dependent on aviation for transport, e.g. overseas countries and territories of Member States, could be more affected by a tax. This remoteness and economic dependence on air transport could be taken into account in the design of the tax.

To the extent that a distance variable would be retained in the duty formula, a higher burden could be expected for peripheral regions and distant territories. The impact could be partially or fully mitigated through a banding system or specific duties or other provisions for specific types of territories.

As an illustration, the UK exempts flights departing from airports in the Scottish Highlands and Islands from Air Passenger Duty. In France the Solidarity tax on aircraft tickets is due by public air transport companies and assessed on the number of passengers boarded from France (i.e. Metropolitan France, French overseas departments, and French overseas collectivities of St-Barthélemy and St-Martin). On the other hand, for

[83] This cost would not only be financial but could also involve other factors, such as difficulties arising to travelling outside the EU, obtaining a passport, etc. Considering the tax amounts envisaged, such costs may end up being disproportional compared to the tax.

passengers to destinations within Metropolitan France, the DOM/TOM, another State member of the EU, or a State signatory to the EEA, a State signatory to the EEA, or Switzerland the same (reduced) rate applies.

4.3.2. Criteria set out in the budget review

(1) Link to the acquis and the objectives of the EU

There is a link to the Europe 2020 Strategy for a smart, sustainable and inclusive economy and to the re-launch of the internal market (2010 Monti report) through better coordination of existing tax measures.

The departure tax and the aviation duty would contribute to the functioning of the internal market by reducing current tax-induced distortions of competition between the aviation sector and other modes of transportation. It would thus indirectly promote greener means of transport such as the railway system for shorter distance travels. This would be in line with the above-mentioned White Paper on transport.

Depending on its specific design, a flight duty could, in addition, serve various EU policy objectives. It could possibly provide incentives to reduce greenhouse gas emissions not covered by the ETS and favour the operators using the less polluting and more efficient air transport technologies.

At the same time, as the Memorandum to the Commission accompanying the White Paper on transports states, "the paramount goal of European Transport Policy is to help establish a system that underpins economic progress, enhances competitiveness and offers high quality mobility services while using resources more efficiently". An aviation tax would have to take into account these important policy objectives of promoting cohesion and competitiveness.

At the same time, a major priority of EU air transport policy is to achieve a more performing and sustainable air transport system through the Single European Sky. The Commission Communication on the ATM Master Plan indicates an objective to "provide ATM services to the airspace users at a cost of at least 50% less" by 2020[84]. All efforts of the Single European Sky aim at increasing the cost efficiency of air navigation service provision and reducing the cost of flying. A new EU air transport tax would have to be set against the benefits from EU air transport policy, which it could be considered as partially funding. However, this assessment might differ if the revenue coming from an air transport tax were to be used to further support measures aimed at financing investments in improving the environmental impact of aviation such as use of sustainable alternative fuels or acceleration of fleet renewals.

(2) Cross-border aspect and internal market coverage

Most of the activity is international, and thus does not naturally belong to any one nation, making it a natural target for international taxation. It should also be recalled that operators structure their activities on a supranational basis and that the regulation of aviation activities is also supranational to a very large extent. The EU plays a key role in this context, notably with the SES initiatives and in the context of EUROCONTROL.

[84] See COM(2008) 750.

Unsuccessful attempts at introducing aviation taxes in various Member States and observed displacements of activities make it clear that the national level is not the optimal level for imposing such taxes. Due to the cross-border nature of aviation, a cross-border instrument is needed on as broad a geographical scale as possible. The EU or broader European level appears suitable in this respect.

An important feature of the aviation duty is that it would involve an equal treatment of all operators active in the 'EU Flight Information Region' (i.e. the region corresponding to all Member States' FIRs). Consequently, the risks of activities displacement would be considerably reduced. Similarly for a departure tax, the EU scale envisaged for the measure would limit displacement of flights to neighbouring countries.

(3) Base harmonisation and application throughout the Union

There is currently no harmonised base applicable to the entire EU.

However, several departure taxes exist in Member States and could underpin the development of an EU-wide departure tax.

Charging systems already available at EUROCONTROL could, in theory, constitute the basis on which to build an EU flight duty.

(4) Autonomous resource collection

Several collection models could be envisaged for both variants:

- A decentralized model could rely on Member States administrations to compute and collect the tax from the operators and the transfer corresponding revenues to the EU budget. It would be more suitable for the departure tax than for a more complex, formula-based flight duty. This would be the most straightforward system and it could rely on the experience gained in some of the Member States (FR, UK, DE). But it would also be the least efficient system as there would be no economies of scale and the resource would not be autonomous. It would also entail higher costs for airlines having to deal with 27 tax administrations.

- A centralized model based on an independent EU collection, for instance through an EU agency, could compute and collect the tax from the operators. There would be substantial economies of scale. The collection would not have to rely on Member States administrations (even if some forms of collaborations could be involved) and it would not require complex arrangements with EUROCONTROL.

- A centralized model based on EUROCONTROL would have the advantage of using existing infrastructures and the extended know-how of an institution based in Brussels and closely linked to the EU. It would offer the possibility to extend the geographical coverage of the tax beyond the EU borders. This approach would seem particularly suitable for a formula-based flight duty, which presents many common features with existing charges imposed by EUROCONTROL. It would be the cheapest approach for administrations (no new administration needed[85]) and for

[85] The potential administrative burden posed by possible solutions would only encompass limited costs induced by the expansion of the existing recording, registration and data management

companies (the tax would be part of the single bill received for each flight). It should be underlined that the CRCO has established well operated and efficient system of resources collection and recovery of amounts due. All these activities have been achieved within limited overall collection costs of EUR 18.3 million in 2006 (as compared to EUR 18.2 million in 1997). In the same period unit costs reduced by 38% and the rate of recovery increased from 98.8% to over 99.8%. However, as explained above, this approach would rely on overcoming substantial legal and institutional obstacles.

Except in the first option, the tax revenue would not need to transit via the Member States budgets.

(5) Additional burden on specific sectors

Provided that the operators do not fully reflect the aviation duty in their prices, the duty could have an impact on their profitability. A useful measure of profitability is the so-called value of the flight (average profit per flight excluding the costs of ownership of an aircraft). As there is no commonly accepted standard for this value, which varies a lot over time and between routes, estimates must be treated with caution. The values vary from EUR 814 for a flight according to IATA[86] (at 2006 prices) to EUR 1,113 for domestic flight, EUR 2,226 for Inter-European flight and EUR 13,357 for Inter-continental flight[87] according to UK Department of Transport. These values are based on airline profits and they do not include costs to society, for instance negative externalities related to pollution, noise or climate change impact. In economic terms, a more theoretically correct method of valuation would be based on passengers' willingness to pay and the elasticity of demand for air transport[88].

Another way to put a potential EU charge on air transport in perspective is to compare to the turnover of the sector. The total revenue generated by European air transport is currently around EUR 120 bn a year. If the aim is to raise revenue of EUR 15 bn a year in 2020, the tax would represent about EUR 8 bn today (see below). This would represent around 6-7% of the sector's revenue. While a high proportion of the aviation tax or duty could be expected to be passed on to consumers, this illustrates that the tax base is relatively narrow.

The demand for aviation is considered, in general, not very price sensitive, which facilitates passing the tax burden to the consumers and reduces tax-induced distortions in behaviours. This is partly because, according to data on the socioeconomic distribution of air transport users, increased ticket prices would be borne predominantly by the wealthier segments of the population. An additional explanatory factor is that both GDP and

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schemes such as EUROCONTROL's Route Charges System (RCS) managed by the Central Route Charging Office (CRCO). See Central Route Charging Office (CRCO), "Customer Guide to Charges, May 2008, version 3.4" as available on http://www.Eurocontrol.int/crco/gallery/content/public/docs/other/customerguide.pdf.

86 IATA Cost Benefit Task Force, 1999

87 Study on Airport Slot Allocation by SD-Scicon for the UK Department of Transport, 1991

88 "Standard Inputs for EUROCONTROL Cost Benefits Analysis", Value of Add. Flight, as available on http://www.Eurocontrol.int/ecosoc/gallery/content/public/documents/CBA%20examples/Standard%20Values%202007.pdf

disposable income are projected to continue to increase in real terms into the future[89]. On the other hand the price elasticity of traffic is neither uniform nor constant; it varies with the type of traveller and also with the prevailing fare level. The air travel price elasticity on short-haul routes are higher than on long-haul routes. This largely reflects the greater opportunity for inter-modal substitution on short haul routes (e.g. travellers can switch to rail or car in response to air travel price increases)[90].

In any event, the air transport business is likely to be affected through demand decrease. The precise impact of these reductions in demand on the airline industry is difficult to predict, but it is certain that for an industry with high fixed costs, even a small reduction in demand could have a significant impact on the profitability of air carriers[91]. Consequently, airlines will not welcome the imposition of an additional levy. However, depending on the design of the tax and its link to existing national systems, some operators may welcome a proposal that could ensure a more level playing field of aviation taxes in the EU. Also, the tax may bear more heavily on some segments of the industry than others, thus entailing shifts in competitive positions (see above).

At the same time, the impact of the tax should not be exaggerated. Let us just recall that the UK the Air Passenger Duty (departure tax) came into effect on 1 November 1994 and the UK still has airports - Heathrow Airport and Gatwick Airport (London) - in the list of the world's thirty busiest airports for passenger traffic[92]. Also, any EU aviation tax would affect all operators active on the EU territory, including extra-Community ones.

As regards the impacts on other economic sectors which rely on air transport, in particular the tourism industry[93], they are the result of two effects: first, a net reduction in air travel demand and, second, destination switching. The main impact on tourism is likely to come from reduced air travel demand, also taking into account substitution with land transport. The impact on tourism through destination switching – in both variants - would mainly concern non-EU travelers, as for EU travelers, international flights would be covered by the tax (although possibly at varying rates and with departure switches in case of a departure tax). On the other hand, acceptable tax differentiation between intra-Community and international flights could help maintaining (and perhaps even reinforcing) the attractiveness of European tourist destinations (for European tourists). The effects depend on the substitutability of destinations. And price increases of tickets should be compared with the price of a travel package and not simply with the price of the ticket alone.

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89 Commission Staff Working Document. Summary of the Impact Assessment: Inclusion of Aviation in the EU Greenhouse Gas Emissions Trading Scheme (EU ETS) {COM(2006) 818 final}{SEC(2006) 1684}
http://ec.europa.eu/environment/climat/pdf/aviation/sec_2006_1685_en.pdf

90 IATA Economic Briefing No 10, "Air Travel Demand"
http://www.iata.org/NR/rdonlyres/102A92AE-494C-4265-8AAA-D57960B9432F/0/air_travel_demand_summary.pdf

91 SEC(2005) 1067, p.6

92 based on finalized 2008 data and on number of passengers enplaned and deplaned with passengers in transit counted only once.

93 The EU tourism industry generates more than 5% of the EU GDP, with about 1,8 million enterprises employing around 5,2% of the total labour force (approximately 9,7 million jobs). The Commission has set up an action plan to increase the competitiveness and capacity for sustainable growth of EU tourism: 'Europe, the world's No 1 tourist destination – a new political framework for tourism in Europe' COM(2010) 352 final.

In case of a flight duty which also includes freight transport, additional economic sectors would be affected, as the tax could marginally increase the cost price of products in theory resulting in higher output prices or less profitability for the producers. Again, one should compare the amount of the tax with the total value of the goods transported. In any event, the flight duty could have an impact on both imported and exported products. Locally produced goods could thus gain a limited advantage compared to imported ones.

Overall, the potential reduction in the growth of the aviation sector and the negative impact on its profitability, as well as the impact on users of air transport, would have to be weighted against the contribution of the resource to the budgetary consolidation efforts in the EU, the impact of the duty on externalities, the increased demand for alternative modes of transportation, and destination switching in the tourism area. Particular attention could be paid to the specific impact of a passenger tax on travel via airports hubs and on the inbound tourism. Both issues are further examined in Annex 3.

3.2.6. Administrative burden for the EU administration

Independent of the exact approach followed to levy an aviation tax, let us recall that there is no evidence of high administrative costs in countries applying a departure/passenger tax. The tax is basically collected via the carriers. And regarding existing *charges* collected by EUROCONTROL, the administrative cost is limited (see above).

However, depending on the collection model chosen, the impact on the EU administration would vary. It could be limited in a decentralized model, moderate with a centralized collection managed directly by the Commission (or an EU agency), and very limited if it relied on EUROCONTROL (a marginal addition to the existing low collection costs of less than 0.3%). In any event, the collection cost could be covered by the tax revenue.

4.4. Quantitative assessment of the own resource

4.4.1. Revenue estimates

In general, it should be noted that aviation activity is highly cyclical (see Annex4) around a steady high growth path. It can be expected that this would be reflected in the revenue collected with any aviation sector tax. However, it should be recalled that as long as a GNI-based residual own resource exists, variations of revenues related to a new own resource would be borne by the Member States.

(1) Departure tax

A preliminary estimate can be done using the passenger numbers departing from EU airports[94]. Towards the end of the year 2008, the economic crisis started to show its effects, but the volcanic ash shock only came later in 2010.

Intra-EU transport: 515 million

From EU to other Europe: 45 million

[94] Eurostat Statistics in Focus 91/2009, "Economic crisis stops air transport growth - Air transport in Europe in 2008".

From EU to North Africa: 17 million

From EU to North America: 30 million

From EU to Central America & Caribbean: 5.5 million

From EU to South America: 5.4 million

From EU to Sub-Saharan Africa: 7 million

From EU to Central Asia (ex-CIS) and Near & Middle East: 12 million

From EU to South Asia: 4 million

From EU to Far East: 13 million

From EU to Australia: 1 million

For the sake of calculation the first three categories (intra-EU, other Europe, North Africa) are classified as short-haul, Central Asia and Near & Middle East as medium-haul and the rest as long-haul.

This generalization does not take account of Member States' situation: from Ireland, the East Coast of Canada is closer than Egypt. From Greece, Egypt is short-haul. Furthermore, demand impacts of a tax are also neglected.

The German rates are used as an example: short-haul: EUR 8, medium-haul EUR 25 and long-haul: EUR 45. The resulting amount would be EUR 7,881.5 million. This estimate is consistent with previous Commission analyses[95].

Another estimate, using only the distinction between intra EU and national flights, for which a tax of EUR 20 would apply, and international flights, for which a tax of EUR 40 would apply, leads to an estimated revenue of EUR 15 bn (2009 Eurostat data, no reduction of demand).

To put these figures into perspective, the Commission's impact assessment for the inclusion of aviation in the EU ETS estimated that by 2020 the impact on ticket prices for a return flight within the EU could be an increase of between EUR 1.8 and EUR 9, and for a return flight to New York an additional EUR 8 to EUR 40 depending on the market price for CO_2 allowances. The tax needed to generate EUR 15 billion as an own resource would therefore be higher than, and in addition to, the increase in ticket prices expected as a result of the ETS, a polluter-charge.

Forecast average annual growth of 4.3% is foreseen for Europe by Airbus from 2009 to 2028. Applying this growth to this third scenario produces the following maximum revenues to 2023 (again without having applied any price elasticity to reduce demand).

[95] See Commission Staff Working Paper SEC (2005)467 on "New Sources of Financing for Development: A Review of Options". Based on figures available at the time, the paper estimated that if a tax rate of EUR 10 was applied on intra-Community flights and of EUR 30 on international flights, expected revenues would be about EUR 6 billion per year, taking into account demand reaction.

Year	Estimated maximum revenue (Mio euros)
2009	15,028.0
2010	15,674.2
2011	16,348.2
2012	17,051.2
2013	17,784.4
2014	18,549.1
2015	19,346.7
2016	20,178.6
2017	21,046.3
2018	21,951.3
2019	22,895.2
2020	23,879.7
2021	24,906.5
2022	25,977.5
2023	27,094.5

(2) Flight duty

A first rough estimate can be made with 2006 data published by the CRCO[96] relating to the distance billed (7.98 billion km), amount invoiced (EUR 5.73 billion), the number of the flights under FIR regime (9.6 million), the average IFR flight distance (815 km) and adjusted unit rates[97] (EUR 44.86 as of December 2006). For a Unit Rate of Tax of EUR 100, i.e. corresponding to EUR 1.0 per km for a 2 jet engine airliner, the estimated total aviation duty revenue would amount to EUR 12.8 billion. The corresponding average duty per flight would be EUR 1,331.

It should be underlined that this first calculation is based on total flights in the Central Flow Management Unit (CFMU), so it includes all EUROCONTROL members, not just EU airspace. It also includes overflights, which would likely not be subject to an EU flight duty without major international repercussions.

A second, probably more accurate, calculation would be based on 2010 data from EUROCONTROL. This puts the number of flights at 8.1 million (including all-cargo and business aviation flights). Raising EUR 12.8 billion would then imply an average duty per flight of EUR 1,580. To make this calculation comparable to the departure tax revenue estimates, the range could be the same, i.e. 8-15bn. Again this calculation takes no account of elasticity effects.

The amount collected for the aviation duty can be expected to be significantly higher in the post-2013 period than these figures computed for 2006 considering the fast growing

96 Of the current 38 Member States of EUROCONTROL, 34 States participate in the multilateral route charges system . "The Central Route Charges Office. A pan-European economic role" as available on http://www.Eurocontrol.int/crco/gallery/content/public/docs/other/introcrco.pdf

97 "Adjusted unit rates applicable to December 2007 flights" as available on http://www.Eurocontrol.int/crco/gallery/content/public/docs/unit_rates/adj_unit_rates_2007.pdf

trend of aviation activity. (The previous table illustrate the fast expected growth of the passenger traffic over 2009-2023).

It should be noted that this estimate is based on a charge covering all flights, including those that depart from- and land at an EU airport. Yet other estimates could have been obtained in the case of a flight duty imposed only on flights departing from the EU, this time taking into account the total flight distance (as estimated for instance with a banding system) rather than the distance flown only over the 'EU Flight Information Region'.*4.4.2. Fair application and impact on correction mechanisms*

As a general remark, for both types of air transport taxes examined here, the burden of the tax will most likely fall on the customers of the air transport service. In case the customer is a final consumer (e.g. a tourist) he will also ultimately carry the burden of the tax. If the customer is not a final consumer, e.g a business traveler or a business using freight transport services, the ultimate burden may be the final consumer of goods or services produced by the business customer. This will depend on a number of factors, such as competition conditions in the relevant business sector. The ultimate taxpayers will be located all over the world, with the largest part being EU citizens and companies. The total burden for citizens and businesses of any particular Member State would thus be very difficult to estimate.

At the same time, data on air passenger and flight departures for each Member States are readily available. Given that some Member States already have departure taxes in place, it is reasonable to conclude that they would regard the associated revenues as in some sense belonging to them, irrespective of whether the passengers or airlines concerned are from that Member State or elsewhere.

(1) Departure tax

Within the EU, London Heathrow remained the busiest airport in terms of passenger numbers (about 67 million in 2008), followed by Paris' Charles de Gaulle airport (about 60 million), and then Frankfurt, Madrid's Barajas airport and Amsterdam's Schiphol airport (all three with between 53 million and 47 million passengers). They attract a lot of international flights (except for Madrid's Barajas airport). In terms of air passengers per inhabitant, in 2008 Cyprus, followed by Malta and Ireland show very high scores[98]. However, the exceptional situation of Cyprus, Malta and Ireland points to their isle status.

The countries concerned might feel that with any aviation tax they disproportionally contribute to the EU budget. On the other hand, they make more use of natural resources which could motivate a higher contribution to the EU society. More importantly, the customers are most likely established all over the world, and so are the companies operating the flights[99]. This is another reason to dissociate the revenue from a particular country.

98 Europe in figures - Eurostat yearbook 2010, p. 498 and 502.

99 Think of a German businessman flying from London to Rome (and over part of Belgium and France) using a Swiss airline. Should the departure tax be allocated to the country of origin or destination of the flight, the country of origin of the passenger (or its company), the country where the airline is headquartered, etc?

(2) Flight duty

In addition to passenger flights, the flight duty would also tax air freight transport.

For air freight transport, German airports, followed by the UK, France, the Netherlands, Belgium, Italy, Luxemburg, Spain attract most traffic in the EU 27 in 2009 in terms of tons[100]. The exceptional situation of the Netherlands, Belgium and Luxemburg might be due to the central EU location and presence of distribution hubs. Again, it is difficult to associate this highly cross-border activity with a specific country, be it the country of origin, destination or otherwise of the flight.

Due to the characteristics of the duty (formula based on technical variables for which national allocation appears impossible) and the central collection system which is envisaged, the national origin of funds would be almost impossible to estimate. An aviation duty would not lend itself to net balances calculations. This may be seen as a positive feature in the context of the net balances debate.

100 http://epp.eurostat.ec.europa.eu/tgm/graph.do;jsessionid=9ea7974b30db15a3b3bae5fe421fbd44e0bc6f569eee.e34SbxiPb3uSb40Lb34LaxqRb3eRe0?tab=graph&plugin=1&language=en&pcode=ttr00011&toolbox=type).

ANNEX 1

OVERVIEW OF THE APPLICATION OF VAT TO PASSENGER TRANSPORT IN THE EU

1. The current legal framework

Transport services, like any other service supplied by a taxable person within the EU, are subject to VAT. Transport may be domestic (departing from and arriving in the same country) or international (departing from and arriving in different countries). International transport covers transport going from one Member State to another as well as transport going to (outward) or coming from (inward) outside the EU.

Where VAT is applied, the supply of passenger transport is taxed pursuant to where the transport effectively takes place, proportionate to the distances covered (Article 48 of the VAT Directive) and may be subject to a reduced rate of minimum 5% by the Member States as provided for in point (5) of Annex III to the VAT Directive 2006/112/EC.

The VAT Directive nevertheless leaves a scope for passenger transport to continue to be exempted through derogations accorded to Member States. It reflects the exemptions already in place in Member States before 1 January 1978 or accepted upon the accession of new Member States. Those exemptions are to be found in Articles 371 to 390 and, from 1 January 2011, including Articles 390a and 390b of the VAT Directive 2006/112/EC. The exemptions are not limited to air transport of passengers.

In addition, exemptions related to international transport, allowing certain passenger transport providers to purchase some goods and services (e.g. the supply of goods for fuelling and provisioning) free of VAT, have been in force since the introduction of VAT for international sea and air transport (not for road and railway transport).

This means that the VAT treatment of passenger transport combines different exemptions, depending on the kind of means of transport used to provide the transport and the place where the transport is deemed to take place:

- Exemption of passenger transport provided by transport providers to their customers, subject to certain conditions (output exemption);
- Exemption of some supplies to transport providers, subject to certain conditions (input exemption).

2. Historical overview

Under the definitive arrangements, passenger transport is according to Article 393(2) of the VAT Directive supposed to be taxed in the Member State of departure for that part of the journey taking place within the EU. In 1992, the Commission therefore proposed to tax passenger transport at the place of departure[101], but the Council could not reach an agreement on the proposed modification. One of the main issues standing in the way of an agreement was the patchwork of exemptions actually in force in the different Member States.

[101] COM(92) 416-rev2 as amended by COM(94) 378

A study[102] was carried out for the Commission in 1997 and confirmed the differences in treatment between Member States and also between the different means of transport. Given the absence of political will from Member States to change that situation, no new initiative was undertaken by the Commission in this field.

In July 2000, the Commission stated its intention to put forward a number of new proposals and to review existing proposals in the VAT area[103]. The rules on the place of supply of services were identified as one of the potential future priorities.

In its consultation paper[104] the Commission again suggested to tax the supply of passenger transport services taking place in the EU, irrespective of the means of transport used, at the place of departure. For domestic transport, this rule would not change the situation while, for international transport, it would ensure that passenger transport services to a large extent could be taxed where they are actually consumed, without the complication of having to split up the price according to the distances covered in each Member State.

Summarising the results of this public consultation[105], the Commission however noted that although *"some businesses supported this idea, there was also serious opposition mainly from airline companies fearing that the new rules could encourage Member State to abolish the current exemption*", most found *that "the real issue is that of the different rates and exemptions applied by Member States and the inequity in VAT treatment between air, sea and road/train transport".*

Against this background, it was decided not to propose to change the rules concerning the place of taxation of passenger transport[106]. The Council agreed with this approach when adopting the new rules concerning the place of supply of services[107].

3. The current situation

The VAT treatment of passenger transport differs from one Member State to the other[108].

Domestic passenger transport is taxed in almost all Member States, whatever means of transport are used. Denmark, Ireland and Malta however exempt domestic passenger transport, except some transport by road. International passenger transport, on the other hand, is in most cases exempted by Member States. Whilst international sea and air transport services are exempt of VAT in the whole of the EU-27, VAT is paid, subject to varying conditions, on international passenger transport within the EU on inland waterways, rail and road transport in 9 Member States.

102 KPMG. 1997.A study of the VAT Regime and Competition in the Field of Passenger Transport http://ec.europa.eu/taxation_customs/resources/documents/pass_tran_kpmg_final.pdf

103 COM(2000) 348 Final, 7 July 2000 'A strategy to improve the operation of the VAT system within the context of the internal market'.

104 Commission Consultation Paper: VAT – The Place of Supply of Services to Non-Taxable Persons http://ec.europa.eu/taxation_customs/resources/documents/vat_place_of_supply_en.pdf

105 http://ec.europa.eu/taxation_customs/resources/documents/common/consultations/tax/rep_vat_place_of_supply_en.pdf

106 See explanatory memorandum of proposal COM(2005) 334 final (point 2.2.).

107 Directive 2008/8/EC.

108 Description of current situation can be found under http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/how_vat_works/rates/vat_rates_en.pdf

Where international passenger transport is taxed, it is often difficult for Member States to effectively ensure the actual taxation when a transport starting and ending outside their territory is supplied by a transport provider not established in that Member State.

Specific exemptions related to international transport are provided for in Articles 148 to 150 of the VAT Directive. These exemptions which are applicable throughout the EU, apply to the input of certain businesses which provide international passenger transport by air or by sea, allowing them to purchase, free of VAT, vessels and aircraft as well as goods for the fuelling and the provisioning of these means of transport and services to meet their direct need or that of their cargo. The application of these exemptions varies across the EU, given that Member States may limit their scope and adopt the detailed rules for their implementation.

These input exemptions are intrinsically reserved for international air and sea transport at the exclusion of other means of transport, like trains or busses. They provide a cash-flow advantage for certain parts of the transport sector, with businesses benefiting from exemption not having to pre-finance the VAT before being able to exercise their right of deduction. Given the importance of the amount involved, this advantage is far from negligible.

It means that the current situation with a number of exemptions applied quite broadly in the sector of passenger transport raises the question of the neutrality of the applicable VAT treatment and its sustainability in a long term.

ANNEX 2

SURVEY OF AVIATION SECTOR TAXES IN THE EU MEMBER STATES

Member State	Tax basis, rate and other relevant information	Estimated yearly revenue
UK Air Passenger Duty (APD) (originally introduced on 01/11/1994)	APD is structured around 4 distance bands, set at intervals of 2,000 miles from London, each with a reduced rate for the lowest class of travel and standard rate for other than the lowest class of travel. Transit and transfer passengers are excluded[109]. Current rates, which increased with effect from 1 November 2010, are as follows: Band A (≤2000m): £12/£24 Band B (2001-4000m): £60/£120 Band C (4001-6000m): £75/£150 Band D (≥6001m): £85/£170 The Treasury is planning to raise £3.8 billion in 2014-15 from air travel, compared to £1.9 billion in 2008[110]. The UK Government considered amending its Air Passenger Duty to replace it with a per-plane tax, and conducted a public consultation in 2008[111]. The Government ultimately decided not to proceed with a per-plane tax for a variety of reasons which were set out in its formal response to the consultation. However, new plans to replace the current Air Passenger Duty with a per-plane levy that would encourage airlines to operate fuller aircraft and consequently to cut carbon emissions seem to have been included in the coalition agreement [112].	£1.9 billion in 2009/10[113]
France Solidarity Tax on air tickets to fund international development (from 01/07/2006)	The tax varies according to distance and class of travel (economy = lower rate, business or first = higher rate): Intra-European: 1 EUR/10 EUR Outside Europe: 4 EUR/40 EUR It is assessed on the number of passengers boarded from France (including overseas Departments). The tax is levied on all public air transport companies. The passengers on connection are not included in the basis of the tax. Besides, France also levies a Civil Aviation Tax and an air nuisance tax ("taxe sur les nuisances sonores")[114].	EUR 300 million

109 http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageExcise_ShowContent&id=HMCE_CL_000505&propertyType=document

110 http://www.telegraph.co.uk/finance/financetopics/budget/7847273/Cost-of-air-travel-set-to-rise-because-of-hidden-aviation-tax-bombshell.html

111 The consultation document can be found here: http://webarchive.nationalarchives.gov.uk/20100407010852/http://www.hm-treasury.gov.uk/d/consult_aviation310108.pdf and the summary of responses can be found here: http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/pbr08_aviationduty_395.pdf

112 http://www.businessgreen.com/bg/news/1806570/us-prepares-fight-uks-green-aviation-tax-plan

113 The UK government envisages bringing the APD revenue to £3.8 by 2015, possibly using a flight duty instead of the passenger duty.

Germany Environmental Ticket Tax (from 01/01/2011)	With effect from 1 January 2011, the tax will vary according to distance[115]: Short-haul: 8 EUR Medium-haul: 25 EUR Long-haul: 45 EUR Germanwings and Ryanair already announced their intention to move some of their flights to neighbouring countries to avoid the tax[116].	Target is to raise EUR 1 billion
Ireland Air Travel Tax (from 30/03/2009)	Originally the tax varied according to distance as follows[117]: All flights less than 300km from Dublin: 2 EUR All other flights: 10 EUR However, the Irish Government recently announced that with effect from 1 March 2011 this will be replaced with a single flat rate of 3 EUR[118].	EUR 125 million forecast by Government in 2010.
Austria Flight departure "Eco-tax" (announced Nov 2010)	Implementation date has yet to be decided[119]. The tax will be in two distance bands: Short-haul: 8 EUR Long-haul: 40 EUR	Not known
Denmark Ticket tax (Introduced in 1998, repealed in 2007)	The tax, which formerly added DKK 150 to the price of a return trip on a domestic route, was reduced by 50% on 1 January 2006 and completely eliminated from 2007. The tax was repealed mainly due to the shift of passengers to the Swedish airports Malmö and Göteborg[120].	EUR 70 million

114 The Civil Aviation Tax is assessed on the number of passengers boarded and the tons of freight and mail loaded from France. http://www.aviation-civile.gouv.fr/html/prospace/budget/taxe_ac_ang.htm

115 http://www.bundesfinanzministerium.de/nn_4134/DE/Wirtschaft__und__Verwaltung/Steuern/20100906-Luftverkehrsabgabe.html

116 http://www.airliners.de/verkehr/netzwerkplanung/germanwings-weicht-nach-maastricht-aus/22753. More than half the Ryanair flights serving Berlin will vanish in the new timetable. In October, the airline cut its services to the Frankfurt area. It said it would now trim services to the Dusseldorf area by 20 per cent. The cuts to 34 routes connecting to Germany would mean 3 million fewer passengers carried, the airline said.

117 http://www.revenue.ie/en/tax/excise/leaflets/air-travel-tax.html

118 The reduction will be reviewed at the end of 2011. The Irish government has also recently announced plans to introduce an incentive scheme with the Dublin Airport Authority to encourage traffic at Dublin, Shannon and Cork airports in 2011. The Grow Incentive Scheme will mean the airports will waive all airport charges for passenger traffic once an overall threshold of 23,5 million passengers is reached during 2011. (http://www.etnw.co.za/NewsDetails.aspx?newsId=43122)

119 http://online.ibfd.org/kbase/

120 Ryanair and Sterling each have said that "they were reluctant to add flights to Denmark because of the tax". http://atwonline.com/international-aviation-regulation/news/denmark-eliminates-passenger-tax-1108

Netherlands Flight tax (introduced in July 2008 and withdrawn in July 2009)	It was levied on departing passenger. Transfer passengers were exempt from the levy. The tax was imposed on the company that runs the airport. The rate was: EUR 11.25 for EU Member States and up to 2500 km; EUR 45 for long-haul flights. The economy and the recession have been cited as the reasons behind the abolition of the tax[121]. A small noise nuisance tax on civil aviation still seems to be in place[122].	EUR 300 million
Malta Passenger Service Charge[123] (Introduced in 1997 and abolished in 2008)	Not known	EUR 5.7 million (2008)
Sweden	The Swedish government attempted to get a Departure Tax through parliament in 2006. The proposal was withdrawn following a change of parliamentary majority and considerable pressure from the aviation/tourism sector.	
Belgium	Belgium decided not to proceed with the suggestion to levy an Air Travel Tax in January 2009.	

121 SEO Economic Research carried out a survey that reported that the flight tax was responsible for a decline of 2% on the number of visitors who have passed through Dutch airports, year on year. The survey went on to conclude that the flight tax, if it carried on, would be to the detriment of the Dutch economy to the tune of about EUR 1.3 bn. See http://www.seo.nl/nl/publicaties/rapporten/2009/2009-09.html. Many travellers chose to board their flights in nearby countries with Dusseldorf and Brussels being popular. Amsterdam airport said that 1.3 million passengers (-18%) were lost. See http://www.airportwatch.org.uk/news/detail.php?art_id=4444

122 http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/info_docs/tax_inventory/list_minor_taxes_en.pdf.

123 http://ec.europa.eu/taxation_customs/taxinv/getcontents.do?mode=normal&kw1=checked&kw2=-&kw3=-&year=2010&coll=MT+-+Airport+tax+%28Passenger+Service+Charge%29)

ANNEX 3

PASSENGER TAX - IMPACTS ON COMPETITIVENESS

There are essentially two main impacts on the competitiveness of the European aviation sector vis-à-vis non-EU industry arising from an EU passenger tax – on intercontinental markets in which EU hubs compete with non-EU hubs, and on inbound tourism.

The first impact arises due to the increase in the cost of travelling via airport hubs in the EU relative to travelling via alternative hubs outside the EU. This issue was addressed in the Commission's impact assessment concerning the inclusion of aviation in the EU ETS[124], based on estimates produced by MVA Consultancy. Based on an estimate that approximately 1% of all passengers departing from EU airports were travelling from one non-EU airport to another and transferring at the EU airport, the impact assessment concluded that at an allowance price of €30, the number of departing passengers at EU hub airports would decrease by 0.07% at most.

However, a study on the inclusion of aviation in the EU ETS carried out in 2008 on behalf of the Association of European Airlines[125] stated that 8% of passenger traffic arriving at EU airports from non-EU origins is connecting to non-EU destinations. If an EU passenger tax were to be levied on these passengers in respect of their flights departing EU airports, then such passengers would be more likely to choose alternative routings via hubs in non-EU countries, e.g. Switzerland or the Middle East. The extent to which they would do so would of course depend on the level of the tax and the suitability of alternative flight schedules. The AEA study did not seek to quantify this effect.

The UK Civil Aviation Authority (CAA) addressed the issue of connecting passengers in its response to the 2008 consultation on changes to UK aviation duty[126], and again in a specific study in November 2008 on Connecting Passengers at UK Airports[127]. This did not contain figures for the numbers of passengers connecting between non-EU origins and destinations, but showed (a) that the proportion of connecting passengers at London airports was higher than that assumed by MVA Consultancy, and (b) that the proportion of passengers at Heathrow connecting between two long haul flights in 2007 was 6.2% (the proportion of non-EU to non-EU connectors will be higher than this, given that short haul destinations from London include non-EU points). While Heathrow is by no means representative of EU airports generally, this would seem to indicate that the 1% assumption made in the Commission impact assessment may be an underestimate.

In terms of the economic impact of hubs, the CAA study did not seek to quantify the costs and benefits associated with connecting traffic, but rather to identify where these arise and their likely level of significance relative to each other. It cited previous studies that had attempted to quantify costs and benefits, as follows:

"*Connecting passengers, by supporting a wider network and higher frequency of services than could be provided by direct passengers alone, contribute to the 'connectivity' of an*

124 SEC(2006)1684, 20.12.2006, Annex 9

125 Inclusion of Aviation in the EU ETS: Cases for Carbon Leakage, Ernst & Young/York Aviation, October 2008, available at http://files.aea.be/Downloads/EY_FULL_TEXT_OCT08.pdf

126 http://www.caa.co.uk/docs/5/20080424CAAResponseOnAviationDutyFinal.pdf

127 http://www.caa.co.uk/docs/5/Connecting_Passengers_at_UK_Airports.pdf

airport or airport system. IATA has recently attempted to quantify[128] *the benefits of connectivity to GDP growth and labour productivity. Its statistical analysis estimates that the 25% increase in connectivity experienced by the EU accession countries between 2001 and 2004 has boosted their long-run GDP by 2.75%, and that, in general, a 10% increase in connectivity relative to GDP will boost labour productivity levels by 0.07%.*"

"*Inevitably, the difficulty of isolating aviation's effects from all the others acting on a country's economy create a degree of uncertainty around such results. More concrete evidence may be the value which businesses in particular place on the range and frequency of air services, indicated by their willingness to pay high premium and flexible ticket prices to use those services. It is also supported by various surveys of businesses, such as the IATA study on network benefits and the London First report. A short review of these and other studies, such as those by Oxford Economic Forecasting or York Aviation, into the trade and productivity benefits of air services can be found in the Department for Transport's response to the provisional findings of the Competition Commission in its market investigation into the airport services provided by BAA*[129]."

The second impact on competitiveness arises from the impact on inbound tourism. A passenger tax increases the cost of visiting the EU, so that overseas residents who have a choice of destination will be more likely to choose an alternative non-EU destination. The AEA study referred to above also addressed this aspect and stated that around 25% of passenger traffic at EU airports is generated by non-EU residents travelling into the EU for leisure.

Several of the existing passenger taxes at national level (e.g UK, Germany) seek to minimise the risk of adverse impacts on their airport hubs by exempting transfer and transit passengers from the scope of the tax. This would avoid the first impact identified above, but would not address the impact on inbound tourism.

Indeed, it is worth noting here that it was because of the exemption for transfer and transit traffic that the UK's proposal in 2008 to move to a per-plane tax gave rise to concerns that such a tax would be more detrimental to the competitiveness of the UK's aviation sector (and hence the wider UK economy) than the existing passenger tax. The arguments on this point are summarised in the UK Government's summary of responses document. However, the summary does not contain any quantifications of the impacts.

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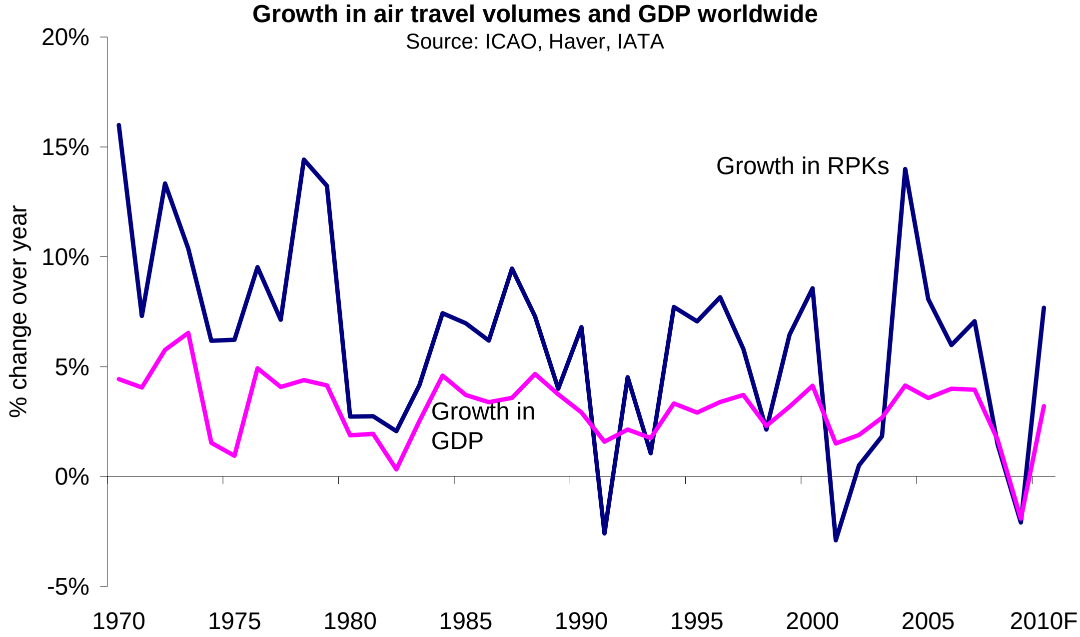
128 IATA Economic briefing 3: Airline Network Benefits and Economic briefing 8: Aviation Economic Benefits available from www.iata.org/economics, which attempted to estimate the relationship between connectivity of a country and growth in both long run GDP and labour productivity.

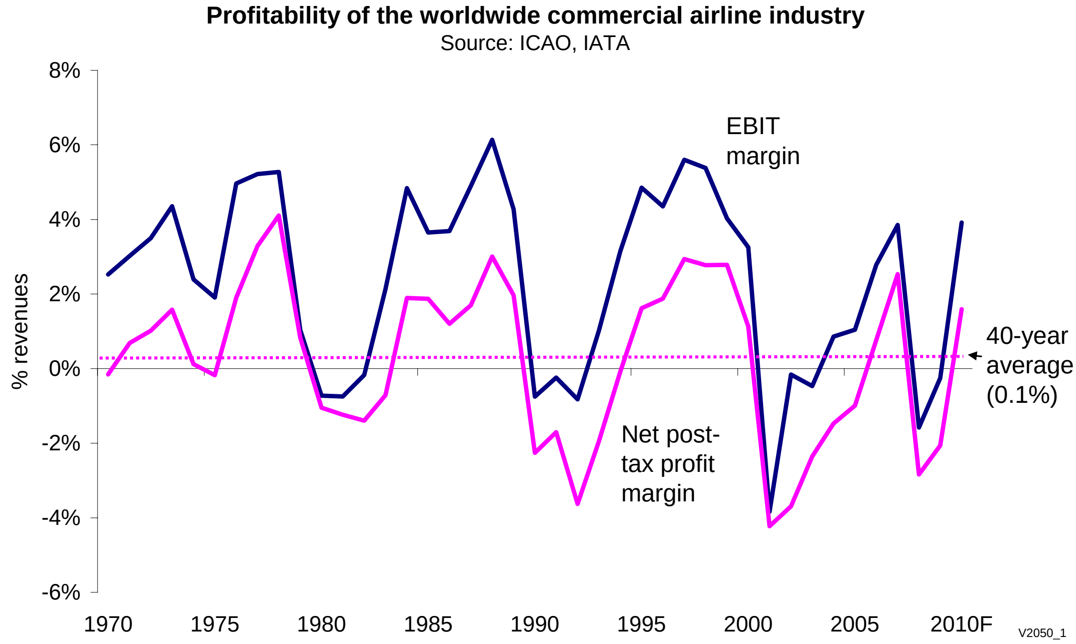
129 http://www.dft.gov.uk/pgr/aviation/airports/ccinvestigation.pdf - pages 35-38.

ANNEX 4

AVIATION ACTIVITY IS HIGHLY CYCLICAL

The following charts, based on IATA data, demonstrate the cyclical nature of air transport demand and profitability, and also show that the cycles of air transport demand are more extreme than those of the economy generally.





5. NEW VALUE ADDED TAX RESOURCE

5.1. Political context

5.1.1. VAT in the EU

The development of a common VAT system has been one of the cornerstones of the Internal Market and an important aspect of the development of an own resources system. The essential piece of VAT legislation in the Union since 1 January 2007 has been Directive 2006/112/EC. That 'VAT Directive' is effectively a recast of the Sixth VAT Directive of 1977 as amended over the years. The recast brings together various provisions in a single piece of legislation. Directive 2006/112/EC in turn was amended several times in the last few years[130].

VAT represents a major source of revenue for national budgets and in many Member States it is the most important revenue. Since the economic and financial crisis, several Member States have recently strongly increased VAT rates or are considering it, either as a reaction to the crisis or in the context of a longer-term shift towards indirect rather than direct taxation. A majority of Member States have now a standard rate at or above 20%.

In the past, Member States have failed to agree on a move towards a definitive, simpler and more harmonised system operating across the EU in the same way as within a single Member State. Even less far-reaching proposals tabled by the Commission in order to try to improve the current VAT system were either not adopted or often watered down.

The search for a compromise on which an agreement by unanimity can be reached often required the insertion of further options or derogations into VAT law, affecting the uniformity of the VAT system within the EU. As a result, the VAT system remains complicated and burdensome in particular for cross-border supplies.

This complexity and the burden of compliance obligations are the main elements considered harmful to the single market and to the competitiveness of EU businesses. Those shortcomings also hinder the collection of the VAT and, on average, due in part to fraud, about 12% of the theoretical VAT revenue is uncollected, with several Member States above 20%.

With the publication of the Green Paper on the future of VAT, the Commission has launched a debate with all the stakeholders including Member States on the evaluation of the current EU VAT system and the possible ways forward[131].

The Green Paper stresses that "*after some 40 years, the time has come to have a critical look at the VAT system with a view to strengthening its coherence with the single market, its capacity as a revenue raiser by improving its economic efficiency and robustness, and its contribution to other policies whilst reducing the cost of compliance and of collection. In this way, reforming the VAT system can play a crucial role supporting the delivery of*

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130 A consolidated version without legally binding value was published in January 2010 in the EU Official Journal: http://eurlex.europa.eu/Result.do?T1=V3&T2=2006&T3=112&RechType=RECH_consolidated&Submit=Search

131 See COM(2010)695 and SEC(2010)1455 of 1.12.2010. The consultation was completed on 31 May 2011.

the Europe 2020 strategy and a return to growth through its potential to reinvigorate the single market and underpin smart budget consolidation in the Member States. Any such improvements require a comprehensive VAT system that can adapt to changes in the economic and technological environment and is solid enough to resist attacks of fraud of the kind experienced in recent years."

5.1.2. VAT as an own resource

There is a long history of propositions related to the VAT as an own resource since the introduction of a VAT-based own resource in the own resource Decision of 21 April 1970. The VAT-based own resource was the main source of revenue for the EU budget in the 1980s and at the start of the 1990s, providing between 48% of own resource revenues in 1980 and 70% in 1990.

The share of VAT-based financing has been reduced in each new own resources Decision since the introduction of a GNI-based own resource in 1988, mainly to accommodate poorer Member States concerned about the regressivity of the VAT-based own resource.

A system of a "modulated EU VAT" as an own resource has been promoted by the European Parliament as early as 1994. It was proposed to impose different rates on different categories of goods in order to mitigate the regressive effect of the tax. The 1994 Langes Report stated that "*a proportion of a largely harmonised VAT, imposed on the basis of tax declarations and clearly denoted on each individual invoice as EU taxation would at present be the most convincing form of own revenue*".

The European Parliament, as well as the Commission defended the idea of a new resource based on VAT during subsequent revisions of the own resources Decisions. However, the specific structure of rates (modulated or not) and the details regarding the implementation of such a tax have not been re-examined in much detail.

In the discussion for the financial framework 2007-2013 the Commission stressed that a new resource based on VAT constituted one of three main options for reform. Commission work undertaken in 2004 suggested that the technical preparation required for the implementation of such a resource would not be particularly complex[132]. However, no concrete proposals were tabled.

More recently, in the context of the Budget Review preparation, the MEP Lamassoure (EPP, FR) resolution mentioned the idea of a resource based on VAT on top of the list of possible options for an alternative own resource[133]. A number of MEPs, NGOs and academics took positions in favour of a new resource based on VAT during the Budget Review consultation[134]. Prominent MEPs defended the same idea in a joint report published in April 2011[135].

[132] See "Financing the European Union. Commission report on the operation of the own resources system", COM(2004)505, Vol. II, section 2.3.1.

[133] EP resolution of 29/03/2007 on the future of the European Union's own resources, P6_TA(2007)0098.

[134] MEPs H. Trüpel (Greens-EFA, DE) and G. Onesta (Greens-EFA, FR) indicated that "Greens want to combine payments based on member states' Gross National Income (GNI) with a slice out of one or more of the most promising candidate levies or taxes, such as a share of national VAT". MEP D. Daianu (ALDE, RO) stated that "so far only VAT responds to sufficiency and stability

The issue of visibility of the EU budget financing and the possible link to EU citizens/taxpayers has been a central motivation for past proposals. However, it is worth mentioning that there is often no legal requirement to issue an invoice for supplies to non-taxable persons. There is thus no guarantee that retailers would mention an "EU VAT" on the receipts.

Discussions also highlighted that adding a new VAT resource in a context where a majority of Member States have already a standard rate at or above 20% and are often reluctant to further harmonisation, could lead to considerable opposition. On the other hand, such approach might give a new push towards more harmonisation of VAT which would be beneficial for the smooth functioning of the Internal Market and could reduce compliance costs for business.

5.2. Outline of the proposal

5.2.1. Identifying variants

The starting point of this analysis is set out in the technical annex attached to the Budget Review communication. It states that *"a combined VAT rate could consist of the national and the EU rate. The Member States could determine the national rates as today. An EU rate could be defined separately in the framework of the own resource Decision and/or its implementation rules. The Member States would collect the EU VAT and transfer the proceeds to the EU budget. The EU VAT payments could be clearly denoted on each individual invoice, next to the national VAT payment"*[136].

This resource would thus be markedly different from the existing VAT-based own resource which is in practice a contribution from the Member States largely based on statistical calculations. It would create a direct link between EU and national VAT policies and the EU budget.

As a starting point, three main variants are envisaged in this analysis:

- **The modulated VAT (1st version)** would allow for different EU rates to be applied to different categories of goods and services **in line with the existing differences in the Member States**. For instance the EU rate could be zero for zero-rated goods. In other words, this variant would imply an acceptance of the fact that the VAT rate charged on the same goods and services in the EU would be different as a result of the differences in the VAT rates structure existing in the Member States, and also but to a lesser extent, differences in exemptions/option to tax due to some options and derogations left in the VAT Directive[137]. As will be shown below, this variant would be faced with serious legal limitations.

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criteria". See also the contributions of the Advisory Council on International Affairs (NL), the South Finland EU office, the Union of European Federalists Group Europe, the Quaker Council and 50 European university professors (mainly from IT).

135 "*Europe for growth: for a radical change in financing the EU*", report prepared by J. Haug, A. Lamassoure and G. Verhofstadt with the collaboration of D. Gros and P. De Grauwe, G. Ricrad-Nihoul and E. Rubio coordinated by C. Perrin, *Notre Europe*, April 2011.

136 See SEC(2010)7000 of 19 October 2010.

137 Council Directive 2006/112/EC.

- **The single-rated VAT** applicable to all goods and services would not be affected by the national differences in VAT rates. One possibility would be to apply this single EU rate to all goods and services, not allowing a special treatment for reduced- or zero-rated goods[138]. Therefore, the EU rate could be set at a lower level. However, differences in exemptions could still have an impact if transactions exempted/taxed on option at national level were also exempted/taxed at EU level. Another approach would consist in applying the single rate to a subset of goods and services, for instance those that are subject to standard rates in all the Member States. This would be a smallest common denominator or "core" VAT approach. Two main approaches have been assessed in terms of administrative and compliance costs to implement the single-rated EU VAT: a parallel VAT system to that of the Member States and a revenue transfer mechanism.

- **The modulated VAT (2nd version) applied in the same way across the EU** with a specific rates structure. The rates would also not be affected by the national options or derogations concerning the rates structure. Differences in exemptions would also have an impact.

Other variants have been mentioned in the public debate but do not seem suitable as potential own resources:

- **The VAT on gambling** appears particularly impractical. Gambling is generally exempted from VAT for technical reasons i.e. because of the problem of the identification of the taxable amount. That is why other taxes are often applied to this sector. This variant has in fact little to do with the idea of a new VAT resource, since it would apply to a single – very limited – sector (compared to VAT which has a very general scope).

- **The VAT on imported goods** would face insurmountable legal or practical difficulties, as explained in Box 6 below.

BOX 6: EU VAT ON IMPORTED GOODS?

1st option: Adding a new VAT resource on top of the existing VAT on imports

A specific VAT resource only applied on imported goods would infringe the international commitments of the EU Member States under the WTO and would therefore be illegal. Article III of the GATT provides that "*the products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products.*"

In addition, it would have to be refunded to taxable persons carrying out taxed transactions in order to avoid cascading effects and respect the basic principle of neutrality. The new VAT resource would therefore actually be paid by final consumers (private individuals or businesses with no right of deduction such as small businesses) entering the EU with goods or purchasing goods dispatched from third countries. Such a

138 Notwithstanding the rules applicable to exports outside the EU.

system would thus provide a limited source of revenue (see below 2nd option). Moreover, it could be open to avoidance schemes (importation by an intermediary).

2nd option: Taking a share of the (existing) VAT on imports

To avoid the legal issue raised above, the new VAT resource would represent a portion of the net national VAT receipts collected in the Member State of importation.

Firstly, the VAT resource would have a very narrow base. In most cases, the VAT on the final consumption of manufactured goods for end users coming form third countries is charged at a latter stage after the importation. Moreover, Member States exempt from VAT the importation of small consignments, the importation of goods of which the supply within their territory would be exempt and of goods entering the EU in luggage of travellers below certain thresholds. 'Zero-rated' goods are also taxed at such a rate on importation.

Secondly, although it would be neutral for all importers, it means that the new VAT resource would actually be borne by the Member States of importation on the basis of the value of taxed importations carried out by final consumers. It would entail an unequal treatment between Member States. Those having the closest ties with third countries, such as having a land border with a third country or an airport used by international carriers, or particular consumption patterns with relatively more consumers ordering goods from third countries, would appear to contribute more to the EU budget than other Member States with a similar GNI[139].

3rd option: importation as a new calculation base for a VAT own resource

As an alternative, to broaden the tax base, it could also be foreseen that the Member State of importation would transfer a slice of the gross VAT receipts collected i.e. including the VAT actually refunded to taxable persons.

The new VAT resource would thus merely constitute a new method of calculation of the VAT-based own resources, again without any visibility or link for EU citizens. The contribution of Member States to the EU budget would be calculated according to the total value of national VAT collected on importation of goods into their territory. However, unlike the current method, because of the inclusion of the VAT actually refunded to taxable persons, it would be based on purely theoretical fiscal revenues.

Such a method would moreover once more entail an unequal treatment between Member States. The Member States having the closest ties with third countries, such as having a land border with a third country or, in particular, an international major seaport, or an airport used by international carriers, would likely contribute more to the EU budget than other Member States with a similar GNI. For example, considering the import values of 2009 (Eurostat), the Netherlands could be the 3rd major contributor the EU budget.

As a matter of fact, the Member States would contribute on the basis on the import values of the goods taxed when entering the EU through their territory including those

[139] The so-called "Rotterdam effect" has been the source of many discussions related to customs duties.

consumed elsewhere, in other Member States. The VAT exemption when the goods imported are then dispatched to a taxable person in another Member State could very partly mitigate this shortcoming. However, such an exemption is actually optional for importers and in the Member States having a strong policy of simplification of the VAT formalities on importation (e.g. via the VAT declaration and deduction at the same time on the VAT return), such a procedure is likely to be less used. Therefore, such a method would also have a negative impact on the simplification of formalities undertaken by the Member States.

For all these options, the issue of controls would also be an important issue, which is described further in section 2.4.

5.2.2. Tax base

In general, the taxable base of transactions subject to VAT is harmonized in the EU. This means that for a taxable transaction the amount used to determine VAT is the same everywhere.

However, a specific transaction is not necessarily treated in the same way in all the Member States. The main differences between the Member States are as follows:

- Most Member States apply a system of exemption for very small firms. Firms below a certain threshold are not required to levy VAT on their sale of goods and services and consequently cannot deduct input-VAT on their purchases. This threshold varies a lot between the Member States;

- Some Member States continue taxing operations that others exempt and vice-versa (Art. 137, part A and B of annex X, VAT Directive);

- In the computation of the VAT amount that can be deducted on goods and services used by businesses both for taxed transactions or non-taxed transactions, Member States may apply different methods and in particular choose to take certain subsidies into account. This has an impact on the amount of VAT paid by those ‘partial final consumers’;

- In the same way, some Member States differently limit or exclude the deduction of VAT on some operations undertaken by operators that would normally benefit from a full deduction. This would typically be the case for the purchase of cars, or hotel and restaurants expenses;

The extent of adjustments required for calculating the VAT-based contributions[140] suggests that only three Member States, Finland, Malta and the UK, make a significant use of possibilities of exemptions or special treatments that are offered by the current EU legislation. Furthermore, differences in the economic structure between Member States would have far greater impacts on the share of the new VAT resource revenue per Member State than remaining differences in Member States' VAT systems[141]. Important factors can explain these differences: consumption, investment and savings patterns; extra revenues due to tourism, etc.

140 See Annex I.

141 See Annex III.

However, more importantly, from a legal point of view, it is not conceivable, under the principle of equal treatment, that a new own resource would impose different burdens on taxpayers i.e. the final consumers, with comparable consumption patterns in different Member States (see below). Dealing with the differences in the scope of exemptions for those supplies that are exempted in some Member States and not in others (e.g. as a result of an option in Article 137 and as a result of Annex X), a harmonisation of these differences would therefore be necessary but might be difficult to achieve.

5.2.3. Tax rate(s)

Some Member States apply a "zero rate" for some products, for instance food, children's clothing and footwear, newspapers, etc. In this case, there is actually a VAT exemption with deduction of the tax paid at the preceding stage. Specific schemes may also be foreseen for farmers ("flat rates") and "super-reduced", "reduced" or "parking" rates can be applied in some circumstances. The majority of taxable goods and services are taxed using a higher, "standard" rate.

In theory, one could envisage that in a modulated VAT system the level of contribution of final consumers to the EU budget would be determined by the national VAT system – and the VAT rates structure in particular (1st variant). This would mean, for instance, that a Danish citizen would pay the new VAT resource at a standard rate on food. A reduced modulated VAT rate would apply in many other Member States and a modulated VAT zero-rate would apply in the UK or Ireland. This would have the great advantage of respecting national preferences on the rate structure and reproducing them for the VAT resource.

However, there is a major objection to this theoretical approach, namely the legal obligation, resulting from the treaties, of an equal treatment of EU citizens (see box 8). If a modulation were to be applied, it would need to be applied equally in all the Member States to avoid imposing different burdens on final consumers with comparable consumption patterns in different Member States. This issue could be at least partially solved if the list of goods included in the different VAT rate categories was completely harmonised at EU level and applicable without any option for the Member States. A standard rate combined with a compulsory list for goods and services, for which a reduced rate would apply, would cater for this. It would imply that zero rates would have to be abolished. However, differences between Member States in the level of the standard and reduced rates may continue to exist.

A single rated VAT system would not encounter the same problem: all goods and services would be taxed at the same VAT rate. From a political point of view, the EU would have to take the responsibility of charging VAT on goods zero rated at national level (food, children clothing, medicines etc.). Alternatively, the EU could itself decide if and on which range of goods and services to apply a reduced or a zero rate (2nd version of the modulated VAT).

BOX 7: HOW TO COPE WITH THE ZERO-RATED GOODS ISSUE?

In theory, there are five possible approaches to cope with the existence of zero-rated goods in some Member States:

1. Requiring that the system of zero-rated goods be abolished prior to the implementation of a new VAT resource. The advantage would be to ensure a higher degree of convergence of national VAT systems and a better efficiency of the VAT system, which the Commission has been striving for decades. However, this could prove extremely difficult politically as applying only the EU rate to these zero-rated goods. That would entail that in some Member States, whole economic sectors move de facto to taxation, albeit under a reduced rate, with likely a proportional increase in prices;

2. Zero-rated goods would not be subject to the new VAT resource in the Member States where this system exists. Equivalent taxpayers would not be treated equally across the EU regarding the new VAT resource: EU taxpayers would have to pay the EU rate on all purchases of goods including first necessity goods whereas other taxpayers living in a handful of Member States would be released for some of those goods. This would contravene the principle of equal treatment. Besides, the financial advantage for those Member States[142] with zero-rated goods could be substantial, thus leading to concerns regarding fairness;

3. Zero-rated goods would not be subject to the new VAT resource in all the Member States. Any good benefiting from the zero-rate in one Member State would give rise to an equivalent treatment in all the Member States. The "most favoured treatment" would thus apply everywhere to avoid any problem of horizontal equity. This approach would involve higher administrative costs since 2 different set of tax rates may need to be applied in every Member State. It would also reduce the overall revenues for a given common EU rate. Furthermore, it conflicts with the general accepted idea that broad based taxes are more efficient. Such a reduction of the tax base would have to be compensated with a higher VAT rate.

4. Taxing the zero-rated goods at the standard (single) new resource rate (2nd variant). This would imply that, de facto, entire sectors of the economy of some Member States that were previously released from taxation would be taxed with likely a direct increase in prices. Political resistance to this would likely be significant.

5. Taxing the zero-rated goods at a reduced rate across the EU with the other goods and services already subject to reduced rates (e.g. 0.5%, 2nd version of the modulated VAT resource). Impacts on prices would be limited. Political resistance from certain Member States may be less significant. Businesses selling "zero-rated" goods are already registered (to deduct input VAT and for other taxed operations they might carry out). The additional administrative burden such a way forward would imply for businesses would be therefore rather limited. However, businesses would have to apply two different rates structures.

5.2.4 Implementation

Given that the scope and the rules of deduction of national VAT and the new VAT resource would have to be different, the variants under consideration would require that the taxable persons identify in their accounts and VAT returns for each supply and each purchase each tax separately in order to complete parallel declarations determining their

[142] The zero-rated supplies represent a significant share in the total taxable base for four countries, namely Ireland, Cyprus (until 31 Dec. 2010), Malta and the United-Kingdom.

net position for each VAT. The new VAT resource rate and the amount paid could be shown on each individual invoice next to the national VAT payment. Offsetting deductible national VAT against the new VAT resource and vice-versa would not be possible since the tax administrations would transfer to the EU budget the net VAT resource collected. As the tax administrations, the taxable persons would therefore have to actually deal with a double VAT system.

It would likely raise a series of legal and practical problems in terms of collection. The collection of VAT is today primarily the competence of the Member States. The complete legal framework of that collection would need to be reviewed since it would have to ensure the collection of the national VAT and the new VAT resource. An original and complete legal framework covering the rules on the scope and exemptions of the new VAT resource, the deductions, the obligations of taxable persons and the role of the national tax authorities, etc. would need to be created to ensure the proper collection and control of the new VAT resource and equal conditions and taxation throughout the Union.

Furthermore, a priority between the national VAT and the new VAT resource would need to be established to settle conflicting situation, e.g. partial payments. The EU system of deduction could again not be based on national legislations (like the modulated VAT option) as this raises the issue of equal treatment among tax payers. For instance, some taxpayers would be able to deduct VAT on their purchase of cars or on hotel bills while other would have no or a limited right of deduction.

As an alternative to this parallel system of VAT, a solution with similar results in terms of revenue but with limited impact on businesses and less impact on national tax administrations could be envisaged. It would require the latter to regularly transfer a share, corresponding to a specific rate, of the VAT receipts collected and stemming for transactions subject to the new VAT resource.

To address the requirement of the ‘visibility’ of such a contribution for EU citizens, requiring a statement on invoices and receipts given to customers that a part of the VAT paid is to be transferred to the EU budget could be considered. This would require amending the VAT Directive as regards the content of invoices but could be achievable due to its limited impact in terms of compliance costs on business.

Unlike the existing VAT-based own resource, the revenue stream would not be capped and would not be the result of adjustments to obtain a purely theoretical VAT base. It would result from the actual VAT paid by all the European final consumers and then collected by the national tax authorities.

The question of the controls by the Member States and the supervisory responsibilities of the Commission as well as the question of the financial responsibility Member States may have to face in case of forgone new VAT resources revenues need to be addressed. Where the collection to be the responsibility of the Member States, like it is currently the case with the Traditional Own Resources (mainly import duties), a framework of supervisory compliance control directly of indirectly carried out by the Commission would be required, given the latter's responsibility for the execution of the EU budget. This means that a control system would be required that is at least equivalent to the current system for TOR and that would also include system-based audits. Moreover, where individual transactions to be the core of a new VAT resource system, the (financial) responsibility of member States for the non collection of new VAT resource foregone in case of inappropriate management and administrative errors could be implied, as is currently the case in TOR.

5.3. Qualitative assessment of the own resource

5.3.1. Preliminary questions

(1) International experience with two-tiers VAT systems

Experience with multi-tiers sales taxes regimes is common in federal States, e.g. the US. VAT can also be found in combination with sales taxation in Canada. There is no known experience of VAT systems applied by two tiers of government.

- No experience can be drawn from the Brazilian government' draft proposal to, inter alia, merge three federal contributions into a "federal VAT" while reforming the VAT collected by the states. No documentation is immediately available on the effects of such a proposal which so far has not been adopted. Brazil has currently a tax limited to manufactured products (IPI) levied at a federal level on every stage of the producing process and on import transactions and a tax on the sales of goods and selected services at all stages of the production and distribution process (ICMS) levied at the state level[143].

- In Canada, the harmonized sales tax (HST) replacing the federal goods and services tax (GST) and provincial sales tax in certain provinces is administered by the federal government. The provinces receive their share from the federal government on the basis of consumption figures and a distribution formula. Quebec collects its own VAT and the federal GST and remits the latter net of the cost of collection to the federal government. Experience may be drawn from that system but the overall trend in Canada has been to consolidate the tax with a redistribution mechanism employed to reallocate receipts on the basis of political agreement.

(2) Lessons from economic theory

No economic literature on the implementation of such a system seems immediately available. The "single-rated VAT" and the "modulated VAT" resource would however likely have impacts on prices and thus on consumption patterns. Experience may be drawn from studies conducted in Member States having, as a reaction to the economic crisis, recently increased their standard rate e.g. Germany (3 points), UK (2.5 pts), Estonia (2 pts), Greece (4 pts), Spain (2 pts), Latvia (3 pts), Lithuania (3 pts), Hungary (5 pts), Romania (5 pts). No references are available at that stage.

If the tax was set once more at a higher level by adding the new VAT resource, evading it would become more attractive and black economy might increase. Collection costs would therefore rise and the efficiency of the tax would be affected. However, the fact that lower fraud levels can be observed in some of the highest VAT rates countries, e.g. DK, suggests that cultural and governance issues and an efficient administration of the

143 http://www.civiceducation.org/wp-content/uploads/2010/11/lessons_ICMS_islamabad_30_OCT.ppt#313,1,Slide

tax allow a VAT system based on high standard rates play a more relevant role than the level of the tax itself.

(3) Legal issues

As explained in 2, in absence of harmonisation of the tax base and the tax rate structure, an important legal question would be raised regarding the principle of equal treatment (see Box 8)[144]. A question therefore arises as to how further VAT harmonisation could be achieved under unanimity rule.

The VAT Directive is based on Article 113 of the Treaty on the functioning of the European Union which requires that the Council adopts provisions for the harmonisation of the legislation concerning turnover taxes to the extent of such harmonisation is necessary to ensure the establishment and the functioning on the internal market and to avoid distortion of competition.

Changes to the VAT Directive that could be envisaged (rate approximation/harmonisation and harmonisation of exemptions notably) for an efficient and fair application of a new VAT resource could be made under this provision.

The new VAT resource itself would have a separate legal base in the own resource decision.

BOX 8: A KEY LEGAL PRINCIPLE – EQUAL TREATMENT OF EU CITIZENS

The general principle of equality is a fundamental principle of Union law and applies to the institutions of the Union in the same way as it does to Member States (see for example Case C 304/01 Spain v Commission [2004] ECR I 7655). That principle requires that comparable situations must not be treated differently and that different situations must not be treated in the same way unless such treatment is objectively justified.

A modulated VAT resource based on national legislations would mean that the rate of the VAT charged on the same goods and services purchased in the EU would depend on the VAT rates structures of the Member States where the supply takes place, and on the exemptions applied therein (because of options and derogations in the VAT Directive).

The level of contribution of EU final consumers to the EU budget would thus be primarily determined by the national VAT of their residence (and its VAT rates structures in particular).

In practice, a Danish resident would pay the VAT resource at a standard rate when purchasing food. A reduced modulated VAT rate would be paid by citizens living in other Member States applying a reduced rate on such goods. Moreover, no VAT ('zero-rate') would be paid in the UK or Ireland for example.

Therefore, final consumers, with strictly similar consumption patterns, purchasing the same goods or services, which would therefore be in a similar situation, could bear a

[144] Alternatively, a separate system of exceptions and exemptions would need to be developed for the EU VAT, in parallel to the existing system.

different burden of tax collected for the EU Budget only because of their Member State of residence and the options and derogations it makes use of.

The fact that national rates of VAT and their impact on the amount of tax paid by individuals differ is the result of the territorial nature of taxation. Within the scope of each national system, the principle of equality is observed. However, if it is desired to impose a tax at the level of the Union, the principle of equality must be observed at that scale. There is no apparent objective justification for differentiation based on the place of the supply in the EU or on the place of residence of the final consumer in the EU. Consequently, a tax to be paid by all EU final consumers could not, without offending against the principle of equality, vary in its impact according to the different tax structures of the Member States.

(4) Harmonization and other reforms needed

A harmonised VAT base could be necessary to comply with the principle of equal treatment if a new VAT resource system was developed with the same base and thus with no particular rules on the exemptions and right of deduction. This would require:

- the abolishment of the options of the VAT Directive which allow Member States to exempt certain transactions which should normally be taxed and vice versa;
- a further harmonisation of the special schemes for small businesses, which are exempt from VAT under a certain threshold (different from one Member State to another) and other flat-rate schemes although, since those regimes depend on the specific situation of the supplier, it might be less necessary;
- a harmonisation of the rules of deduction of input VAT, in particular on goods and services for mixed use (business/private purposes and taxed/exempted transactions) to allow the equal treatment of the businesses not having a full right of deduction;

This form of VAT resource would also mean in practice that zero-rated goods and services (i.e. exempted with credit) would be taxed.

If that were to be the case, it would be a major challenge from a political point of view. Discussions with member States have in recent years been concentrated on areas in which more flexibility could be provided to them (labour-intensive services, restaurant services).

A new VAT resource could however be envisaged without such a far reaching harmonization, but it would at least require a set of specific rules on scope, deduction and exemptions for the VAT resource to avoid unequal treatment of EU citizens. As a result, some goods would be exempted from the national VAT and not from the new VAT resource and vice versa (due to the options to tax and the rules chosen) and the zero or reduced rated goods and services could still be taxed).

Given the likely reluctance of some Member States to apply a new VAT resource on such goods and services and to accept the high degree of harmonisation required for the functioning of a broad based VAT similar to national systems, it could also be envisaged to narrow the base of the new VAT resource to those transactions which are taxed under a standard rate in every Member States. Supplies of goods or services subject to a reduced or zero rate or exempted at national level on the basis of an option would thus be exempted from the new VAT resource.

Besides reducing the new VAT resource base (by circa 55%), the main negative consequence would be that all taxable persons, but in particular those established in the Member States making less use of optional exemptions and reduced or zero rates, would need to apply two different sets of rules as regards the scope of the EU and national VAT.

They would have to check whether the transactions subject to national VAT do not benefit from an exemption from the new VAT resource due to a particular option or derogation used by one or several Member States. The current VAT system already strongly fustigated for its complexity would be even more burdensome. However, such a complexity may be partly tackled through a system of revenue transfer (see above section 5.2.4).

Such a narrow base would closely link EU polices for VAT with EU budget policies. The new VAT resource revenue would automatically be increased when the national VAT bases are broadened and the scope of zero or reduced rates diminished by the Member States making use of the same options or derogations or by new European VAT rules imposing such moves.

If the idea of a VAT own resource were to be pursued, it would undoubtedly have an impact on the broader debate on the future of VAT launched by the Green Paper, in particular in the area of the compliance costs and administrative burdens. The future VAT system would have to be designed taking into account the aspect of the new VAT resource. It would need to be examined whether its implementation would not require the need for EU law in areas today primarily left to the competence of national authorities (collection, control, sanctions).

5.3.2. *Criteria set out in the budget review*

(1) Link to the acquis and the objectives of the EU

Rules on VAT are an integral part of the *acquis*. Since the 1970s, the development of VAT has been linked to the development of a VAT-based resource to finance the EU budget and the Single Market objectives.

Although a new VAT resource would be different from the VAT-based resource, it should not be forgotten that the VAT-based resource was constructed due to the persistent disagreement of the Member States to achieve a full harmonization of the VAT system and to transfer a given (uncorrected) percentage of their national VAT to the EU budget.

Besides, the importance of the VAT-based resource in EU financing has decreased over time. It amounts to 10.9% of the total revenue[145] in the budget 2011 against 50.7% in 1979. Moreover, a clear dissatisfaction with the existing resource has been expressed in

[145] And 12.7% of total national 'contributions'.

the context of the Budget Review consultation, with a large majority of Member States expressing a preference for its elimination.

Consequently, the strong link to the *acquis* should not conceal the fact that the ambition to develop a genuine new VAT resource has not delivered over the past 40 years. And it is difficult to see, from a technical point of view, the emergence of compelling new arguments in relation to the *acquis* that could justify a new attempt at developing this particular option. However, the political context in which this reflection takes place is also exceptional. In the face of a severe financial and economic crisis accompanied and followed by important consolidation efforts, having a new look at a key revenue source for both the Member States and the Union is fully justified. Considering the existing important issues related to VAT at both level, new approaches could be seriously considered.

Changing the VAT Directive in view of harmonizing the VAT base for the implementation of the new VAT resource would allow the reduction of administrative burdens and distortion of competition in the current VAT system and help achieving EU policy priorities related to the functioning of the internal market.

Alternatively, in absence of a fully harmonised system, developing, for instance, a single-rated VAT resource could be seen as an emblematic example of an efficient and simple broad-based VAT next to the national VAT systems. It may constitute an incentive for Member States to broaden national VAT bases and reduce the scope of zero rates, as goods or services exempted or subject to a zero-rate at national level would be taxed at EU level. Should Member States follow the EU approach of a broad based single rate the administrative burden for business could be reduced. Such a move would also serve the common need for balancing national budgets and a fiscal consolidation.

However, a new VAT resource added as an extra layer to the current VAT system, without full harmonisation, could represent a major additional complexity for business as about 35 million taxpayers, including the smallest retailers, would in effect have to deal with a double VAT system. Thus, there are clear trade-offs between what could be envisaged in the short-term and the potential longer-term impact of the system, provided Member States adjust their system to that developed at EU level.

(2) Cross-border aspect and internal market coverage

Like the VAT, the new VAT resource would cover the whole single market. Cross-border transactions are at present in principle taxed in the Member State of destination. Like in the current VAT system, it would be difficult for the Member States to levy the new VAT resource on cross-border supplies (at present exempted by the supplier, subject to reverse charge or taxed whilst being carried out by non established businesses) without the assistance of the Member States of origin via the administrative cooperation. Moreover, the EU could legitimately play a bigger and more active role in coordinating the administrative cooperation between Member States thereby better targeting non-compliant businesses and reducing the current administrative burdens on cross-border activities for compliant businesses trading within the single market

(3) Base harmonisation and application throughout the Union

The VAT legislation is part of the *acquis* and it applies to the entire Union. Nevertheless, the VAT directive allows for a number of differences between Member States in the application of VAT (see above).

- As shown in Annex 1 the implementation of VAT is almost the same in all the Member States. In 2006, for 18 Member States out of 25, adjustments ("corrections" and "compensations") needed to obtain a harmonised (statistical) VAT basis amounted to less than 3% of the uncapped final basis.

- Only three Member States displayed significant deviations, namely Finland (9.6%), Malta (10.1%) and the UK (13.2%). These countries make a large use of possibilities of exemptions or special treatments that are offered by the current EU legislation.

- The special scheme for farmers ("flat rate" system) only applies in a limited number of Member States and with limited financial consequences (0.2% of the total taxable base for the EU-25).

These differences explain why the VAT-based contribution is a rate of call applied to a statistically harmonised basis rather than the actual tax basis.

As indicated above, changing the VAT Directive in view of harmonizing the VAT base for the implementation of the new VAT resource (modulated or single rated VAT) would certainly allow the reduction of distortion of competition in the current VAT system and help achieving EU policy priorities related to the functioning of the single market. But it would also prove extremely challenging. And, in practice, this could constitute a major difficulty in setting up a new VAT resource. However, with a specific set of rules on the tax base, the resource could be applied independently of the national VAT exemptions/taxation based on options and derogations available to Member States so that a full harmonisation process would not be systematically required for implementing the single-rated or modulated (2^{nd} version) VAT. Such an approach would nonetheless entail additional administrative burdens for businesses (see below) unless the system of revenue transfer was chosen.

(4) Autonomous resource collection

Direct collection and control of the new VAT resource by an EU administration does not look feasible because in that case the EU would need dedicated central and local services and staff similar to national tax administrations including control services.

However, the EU administration competences would be limited to the new VAT resource and national tax administrations are often organised according to types of taxpayers (large businesses, SMEs, households etc.) and not according to the types of tax. Moreover, taxable persons would have to deal for their VAT obligations with two different tax administrations.

On the other hand, leaving the competence entirely to the national administrations of a new VAT resource which would appear separately in the accounts of the taxpayers might raise some concerns about the motivation of the national tax officials for auditing the correct application of the resource. Experiences in the area of administrative cooperation, whereby a tax administration has to perform some tasks for the benefit of other Member States, demonstrate this is a legitimate concern.

In any event, the new VAT resource revenues collected would be immediately attributable to specific Member States.

(5) Additional burden on specific sectors

The impact of such a new VAT resource would be widely spread throughout the whole EU economy without a specific impact on a particular business sector.

Regarding more specifically businesses selling ‘zero-rated’ goods, they are in principle VAT registered (to deduct input VAT and for other taxed operations they might carry out). Given also the low rate (e.g. 1% or less) they would have to charge, the impacts the EU VAT (single and modulated 2nd version) would create in terms of additional VAT obligations or of prices, would be relatively limited.

However, with a new VAT resource conceived as a parallel system to that of the Member States, about 35 million taxpayers would have to charge 2 types of VAT, ensure deduction of input VAT separately (national from national and EU from EU) and have therefore two sets of accounts for determining their net position.

The reduction of administrative burden related to VAT is one of the priority areas under the Better Regulation Agenda. VAT accounts for almost 60% of the total burden measured for the 13 priority areas.

It is undeniable, but at this stage not quantifiable, that with the three variants envisaged thus far, a new VAT resource would result in a substantial increase of administrative burdens for all EU businesses.

(6) Administrative burden for the EU administration

Assuming that the direct tax collection for the EU level and the reimbursement of input VAT will be administered by national tax authorities, the EU would have to perform similar tasks than those performed for controlling the collection and calculation of existing own resources.

Considering the extent of national VAT systems and the wide implications of building up a new VAT resource, it can be expected that such tasks would require significantly more human resources than those that are currently used for the determination of own resources.

5.4. Quantitative assessment of the own resource

5.4.1. Revenue estimates

Table 1 shows revenue estimates for one variant, namely a single-rated VAT resource applied to a harmonised basis. The total revenue for 2009 amounts to 0.40% of GNI for the EU-27. The VAT burden in some Member States would clearly be higher than the average. This is the case in particular for LU, MT and CY. On the other hand, some countries would benefit from lower VAT charges, for instance LV, SK and RO.

Table 1: Revenues collected by Member States with a single rate VAT (2009), EU rate: 1%

	Total in million euros	Total in % of GNI
BE	1.419	0,40%
BG	163	0,44%
CZ	601	0,40%
DK	904	0,37%
DE	10.481	0,40%
EE	68	0,42%
EI	682	0,43%
EL	1.104	0,46%
ES	3.783	0,34%
FR	8.276	0,41%
IT	5.513	0,35%
CY	141	0,82%
LV	59	0,22%
LT	116	0,33%
LU	194	0,61%
HU	378	0,36%
MT	41	0,71%
NL	2.268	0,39%
AT	1.234	0,43%
PL	1.429	0,37%
PT	828	0,51%
RO	432	0,29%
SI	172	0,44%
SK	207	0,29%
FI	773	0,40%
SE	1.307	0,38%
UK	7.917	0,43%
EU-27	50.489	0,40%

Sources: DG BUDG calculations based on CIRCA database
Note: estimates based on the uncapped final basis used for the VAT-based own resource.

As there is a strong correlation between VAT bases and GNI, it can be expected that a new VAT resource could bring stable and sufficient revenue for a budget evolving broadly in line with GNI.

5.4.2. Fair application and impact on correction mechanisms

The national origin of the resource would be fully known by the Member States. Although the Member States' payments to the EU budget would evolve broadly with the evolution of their GNI, important differences would be observed between Member States. In the past, regressivity concerns have been used to suggest that poorer countries may bear an unfair share of the budget burden in a VAT-based financing system. This explains in part the progressive shift of EU financing to a GNI-based resource, which is generally seen as fairer than a resource based on VAT.

However, the issue of regressivity seems not to be so clear-cut, as illustrated in Annex IV. The slight negative relationship between potential VAT revenues, expressed in % of GNI, and the GNI per capita of the Member States, seems not to be statistically significant and in some cases could be partly due to factors such as tourism or cross-border shopping boosting consumption (and VAT revenues). However, these effects are difficult to disentangle from structural differences in consumption or savings patterns.

ANNEX 1

STATE OF HARMONIZATION OF VAT IN THE EU

Table 1 displays the extent of adjustments ("corrections" and "compensations") which are undertaken in order to obtain an equivalent basis of calculation for the VAT-based contributions – which would correspond to equivalent rules and practices in all the Member States.

- Corrections are adjustments related to the revenue obtained from VAT (and they are converted into base equivalent to allow for comparisons). The main types of corrections relate to small companies or to farmers.

- Compensations are adjustments related to the tax base. They mainly highlight the impact of annex X of the VAT directive.

It highlights that the implementation of VAT is almost the same in all the Member States.

- In 2006, for 18 Member States out of 25, the total corrections and compensations amounted to less than 3% of the uncapped final basis.

- Only three Member States displayed significant deviations, namely Finland (9.6%), Malta (10.1%) and the UK (13.2%). In these cases, the upwards adjustments reflect that these countries make a large use of possibilities of exemptions or special treatments that are offered by the current EU legislation.

Table: Corrections and compensations in the calculation of the "uncapped final basis" (EU-25, 2006)

	Corrections			Compensations			Corrections + Compensations
	Total in national currency	Equivalent in base and EUR[1]	In % of final basis[2]	Total in EUR	In % of final basis[2]	Final basis[2]	Total
BE	-46.653.904	-282.412.038	-0,2%	-2.976.460.666	-2,2%	133.192.917.346	-2,4%
CZ	46.900.000	14.131.891	0,0%	167.450.930	0,3%	65.536.337.498	0,3%
DK	1.270.400.000	681.269.196	0,7%	1.795.118.894	2,0%	91.166.344.881	2,7%
DE	-203.291.840	-1.409.458.516	-0,1%	2.262.868.785	0,2%	1.018.029.026.640	0,1%
EE	0	0	0,0%	54.770.968	0,8%	7.166.088.860	0,8%
IE	16.009.859	103.294.745	0,1%	318.432.339	0,4%	86.949.081.628	0,5%
EL	-39.424.630	-275.596.495	-0,3%	1.596.642.243	1,5%	106.794.124.790	1,2%
ES	3.162.037.443	30.214.494.026	5,0%	1.198.551.959	0,2%	608.754.865.710	5,2%
FR	-569.061.935	-3.828.586.370	-0,4%	-7.701.133.546	-0,9%	881.984.345.148	-1,3%
IT	-1.658.982.396	-11.086.045.708	-1,8%	-26.435.105.703	-4,4%	600.321.039.698	-6,3%
CY	440.006	6.671.715	0,1%	97.982.917	0,8%	12.138.377.306	0,9%
LV	598.120	5.173.246	0,1%	319.976.813	3,8%	8.354.344.050	3,9%
LT	70.242.272	128.506.254	1,1%	-43.249.473	-0,4%	11.317.917.681	0,8%
LU	-1.099.441	-9.342.397	-0,1%	269.932.228	1,7%	15.641.322.452	1,7%
HU	12.428.775.864	260.604.722	0,7%	136.419.839	0,4%	38.810.086.385	1,0%
MT	0	0	0,0%	339.081.523	10,1%	3.373.554.757	10,1%
NL	108.868.647	700.525.365	0,3%	1.023.881.000	0,4%	258.580.513.360	0,7%
AT	-19.709.874	-114.552.328	-0,1%	-3.754.304.860	-3,3%	114.311.463.274	-3,4%
PL	54.478.728	92.096.771	0,1%	-1.201.971.132	-0,8%	143.189.216.054	-0,8%
PT	117.129.540	751.799.049	0,8%	438.251.600	0,5%	89.892.819.967	1,3%
SI	-4.643.704.872	-121.797.519	-0,7%	-357.060.731	-2,2%	16.554.564.685	-2,9%
SK	0	0	0,0%	246.631.883	1,3%	18.325.105.059	1,3%
FI	1.535.153.494	7.727.308.618	10,6%	-733.858.320	-1,0%	73.048.368.840	9,6%
SE	-4.099.969.000	-2.062.423.322	-1,5%	1.412.610.110	1,1%	133.346.946.759	-0,5%
UK	11.962.927.221	129.137.845.374	13,6%	-3.448.526.471	-0,4%	949.383.515.417	13,2%
Sum for EU-25	**19.492.063.303**	**150.633.506.280**	**2,7%**	**-34.973.066.872**	**-0,6%**	**5.486.162.288.245**	**2,1%**

Source: Data from VAT statements in CIRCA database (2008) and calculations DG Budget.
Notes: [1] Obtained by dividing the corrections by the weighted average rate (WAR). [2] Before capping bK

ANNEX 2

STRUCTURE OF VAT RATES IN THE MEMBER STATES

Table 2 presents the shares of the different VAT rates in % of the whole VAT taxable base.

- It shows that 68.6% of the taxable base was taxed using standard rates in 2006 (EU-27).
- Important differences could be observed between the Member States. In Denmark, a rate of 25% applied to 99.3% of the taxable base. In other countries, such as France or Luxembourg, relatively complex multi-rates structures could be observed. The special scheme for farmers ("flat rate" system) only applied in a limited number of Member States and with limited financial consequences (0.2% of the total taxable base for the EU-27). Zero-rated supplies represented a significant share in the total taxable base for four countries, namely Ireland (9.2% of the total taxable base), Cyprus (16.0%), Malta (22.2%) and the United-Kingdom (20.4%).

Table: Share of the different VAT rates in % of the whole VAT taxable base (EU-27, 2006)

Member State	Zero[1]	Miscellaneous[3]	Reduced[2]	standard
BE	0,7	0,0	30,7	68,6
BG	0,0	0,0	1,6	98,4
CZ	0,0	0,0	33,8	66,2
DK	0,7	0,0	0,0	99,3
DE	0,0	0,1	17,6	82,3
EE	0,0	0,0	6,4	93,6
EI	9,2	0,1	49,3	41,4
EL	0,0	1,1	44,7	54,2
ES	0,0	0,2	57,7	42,0
FR	0,0	0,0	31,3	68,6
IT	0,0	0,0	42,9	57,1
CY	16,0	0,9	17,8	65,3
LV	0,0	0,5	19,0	80,5
LT	0,0	0,0	15,0	84,9
LU	0,0	0,1	25,8	74,1
HU	0,0	1,8	27,1	71,1
MT	22,2	0,0	8,8	68,9
NL	0,0	0,0	25,8	74,2
AT	0,0	0,9	27,8	71,3
PL	0,8	2,8	38,0	58,4
PT	0,0	0,2	40,2	59,6
RO	0,0	0,0	4,4	95,6
SI	0,0	2,6	32,3	65,1
SK	0,0	0,0	3,0	97,0
FI	1,3	0,0	21,7	77,0
SE	2,4	0,0	19,0	78,6
UK	20,4	0,0	3,4	76,2
Total EU-27	4,0	0,2	26,8	69,0

Source: DG BUDG calculations based on CIRCA database

Notes: [1] *Zero rate refers to VAT exemption with refund of the tax paid at the preceding stage*

[2] *Sum of the shares of super-reduced, reduced and parking rates bases*

[3] *Mainly "flat rate" for farmers*

[4] *The standard rate includes the 20% and the 25% rates.*

ANNEX 3

VAT IN THE ECONOMY

Table 3 highlights that there are structural differences between Member States that would have far greater impacts on the share of VAT revenue per Member State than existing differences in Member States' VAT systems. The fully harmonized VAT bases expressed in percentage of GNI vary significantly between the Member States.

Table 3: Size of VAT bases in the Member States, EU-27, 2003-2009 (uncapped final base as a % of GNI)

	2003	2004	2005	2006	2007	2008	2009
BE	39,1	40,8	41,9	42,0	41,9	40,9	39,8
BG	n.a.	n.a.	n.a.	n.a.	59,1	57,6	43,6
CZ	n.a.	60,9	57,1	61,2	49,8	47,4	40,3
DK	38,4	38,6	39,7	41,3	42,4	40,5	37,4
DE	44,3	42,8	42,8	43,5	41,5	41,4	40,2
EE	n.a.	48,9	53,7	57,6	58,9	51,8	41,7
EI	52,8	54,5	56,7	57,3	58,4	57,0	43,4
EL	53,9	53,7	51,7	54,1	56,0	53,6	45,7
ES	57,1	59,1	61,4	63,6	61,4	50,8	34,5
FR	45,9	47,2	47,8	48,7	48,0	46,4	41,1
IT	43,2	38,5	39,1	41,1	43,3	39,4	35,2
CY	n.a.	77,7	83,7	87,4	92,4	102,2	82,3
LV	n.a.	40,7	45,6	52,3	52,5	45,5	22,2
LT	n.a.	41,3	43,5	47,9	51,3	53,4	32,9
LU	73,4	68,3	47,3	61,2	62,2	68,1	61,4
HU	n.a.	43,1	42,6	46,5	45,6	46,7	36,3
MT	n.a.	73,0	80,4	78,7	73,6	75,7	71,5
NL	46,6	46,0	48,4	47,2	48,0	48,9	38,7
AT	41,6	44,4	45,6	45,5	44,8	45,0	43,0
PL	n.a.	50,1	51,0	54,6	57,2	54,9	36,7
PT	57,7	58,5	62,7	61,7	61,6	62,9	51,0
RO	n.a.	n.a.	n.a.	n.a.	41,1	45,4	28,6
SI	n.a.	51,9	55,9	54,5	52,6	52,7	44,5
SK	n.a.	41,0	45,1	42,6	40,6	38,1	28,7
FI	43,4	42,3	43,2	43,7	42,2	42,9	40,5
SE	41,7	42,1	42,9	42,2	42,2	43,2	37,8
UK	49,3	50,2	49,1	49,5	49,9	48,9	43,5
EU-27	44,2	46,1	46,6	47,5	47,7	45,8	39,6

Note: [1] the uncapped final basis is calculated using net VAT revenues of the Member States. Net revenues=gross revenues-reimbursements. In some case, like in LU in recent years, reimbursements can lead to substantial year-on-year variations of net revenues.
Source: DG BUDG calculations based on CIRCA database

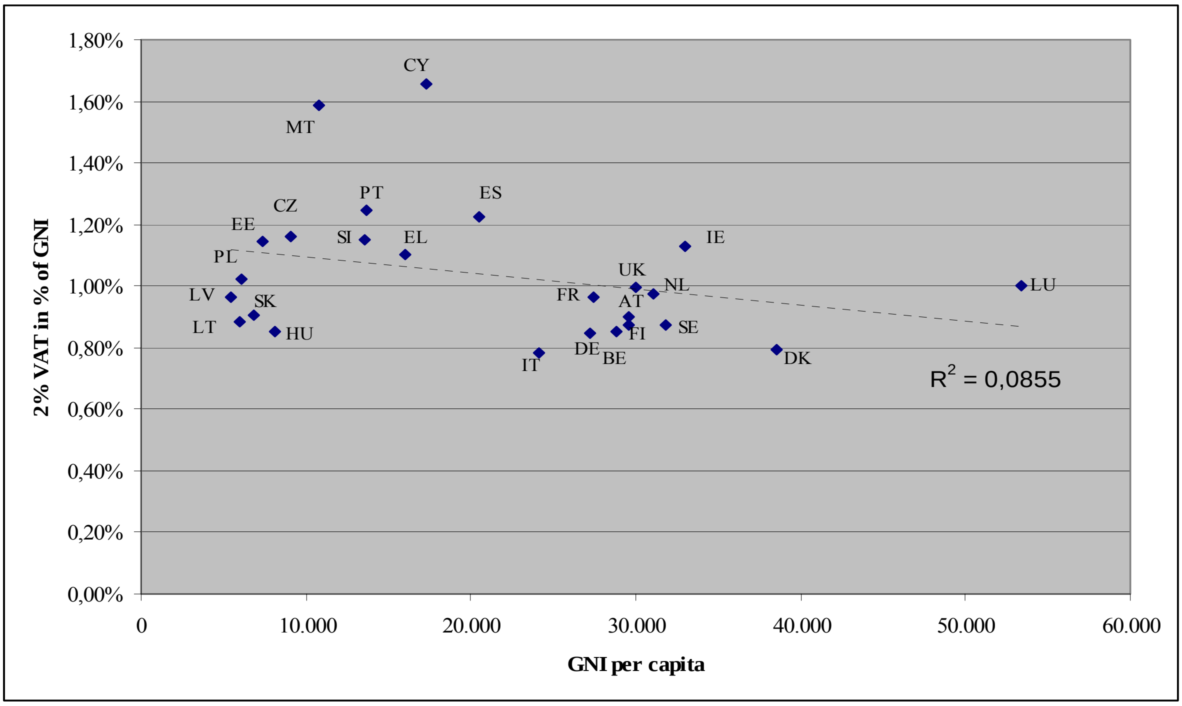
ANNEX 4

REGRESSIVITY

Graph 2 below shows that with full VAT base harmonization there would be a slightly negative - but not statistically significant - relationship between the potential revenues from the hypothetical new VAT resource, expressed in % of GNI, and the GNI per capita of the Member States. The fact that all countries above the 1.20 % level, which to a significant extent drive the slight negative slope, are characterised by a substantial tourism sector, suggests that expenditure by non-residents might partly explain the high level of this ratio; if this were confirmed, it would arguably circumscribe further the relevance of the regressivity argument. However, these effects are difficult to disentangle from structural differences in consumption or savings patterns.

In the past, the regressivity argument has been used to suggest that poorer countries may bear an unfair share of the budget burden in a VAT-based financing system. This explains in part the progressive shift of EU financing to a GNI-based resource, which is generally seen as fairer and simpler than a resource based on VAT.

Graph: VAT revenues (in % of GNI) and GNI per capita, EU-25, 2005



Source: DG BUDG calculations based on CIRCA database
Notes: [1] the harmonized VAT base is the uncapped final base. Each dot represents a Member State.

6. EU ENERGY TAX

6.1. Political context

6.1.1. Energy taxation in the EU

Traditionally, energy taxes have been levied for several reasons, in particular to raise revenue, but also to influence the behaviour of economic agents towards a more efficient use of energy and cleaner energy sources.

In order to ensure the proper functioning of the Internal Market several key aspects of energy taxation are already governed at EU level under Council Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity[146] (hereafter also referred to as "the Energy Taxation Directive" or "the ETD").

The ETD lays down harmonised rules for the application of excise duty to energy products and electricity. In general, it makes energy products used as motor fuel or heating fuel as well as electricity consumed in similar situations subject to taxation. Other uses of energy products and electricity (e.g. energy products used as raw material in certain production processes) are out of scope of the ETD. The Directive also defines what exceptions are allowed and under which conditions. Mandatory exemptions apply in particular to energy products and electricity used to produce electricity. Optional exemptions apply in particular in favour of energy-intensive business. The ETD also sets minimum levels of taxation for energy products used as motor or heating fuel and for electricity. Above the minima Member States are free to set their national rates as they see fit.

Since the adoption of the ETD, the underlying policy framework has changed radically. More efficient and cleaner energy consumption has become a key factor for long-term sustainability of our economies. The EU has now very clear policy objectives in the areas of energy and climate change and has committed itself to achieve ambitious targets by 2020 under the Climate Change Package. The creation of a EU Emission Trading Scheme is a key instrument in this direction. It is therefore necessary to align the ETD to this new policy framework. This is the purpose of its ongoing revision, which should lead to the adoption of a formal Commission proposal to amend the ETD during the first semester of 2011. A revised ETD revision shall provide an internal market framework for energy taxation that enables Member States to use energy taxation more effectively for environmental purposes and promotes energy saving. It should also allow for revenue generation in a way that does not distort competition between energy sources and energy consumers, improving as such the functioning of the internal market.

The objectives of the ETD revision can be further specified in the following way:

(1) Ensure consistent treatment of energy sources in the ETD by taxing them on the basis of their CO2 emissions and energy content, in order to provide a real level playing field for different energy consumers.

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[146] OJ L 283, 31.10.2003, p. 51.

(2) Provide an adapted taxation framework for renewable energies. The ETD should reflect the positive characteristics of renewable energies in the general structure of the tax system.

(3) Provide a framework for the use of CO2 taxation to complement the carbon price signal established by the ETS. The new structure should provide a framework for Member States to apply CO2 taxation to all areas where the EU ETS does not apply including in particular areas currently excluded from the scope of the ETD. At the same time overlaps between both instruments should be avoided to ensure consistency and avoid losses in cost-efficiency.

6.1.2. Energy taxation and own resources

Although the Energy Taxation Directive was not prepared for the purpose of introducing new own resources, it nevertheless creates suitable conditions by harmonising tax bases and establishing minimum rates.

In 2004, the Commission suggested that an EU levy be imposed on motor fuel used for road transport[147]. Motor fuel used for road transport includes leaded and unleaded petrol, diesel, LPG and natural gas as well as biofuels used for transport. This EU levy would be a share of the excise duties currently imposed on motor fuel.

The main issue for discussion identified by the Commission in 2004 was the level of taxation in the context of defining an own resource as well as the concrete operation of the system, including the practical arrangements for the possibility of displaying the EU levy on receipts and invoices. The Commission concluded that "EU rates below half of the minimum rates would be enough to finance half of the current EU budget".

The Commission also mentioned that for at least one subcategory of motor fuel for road transport there is a strong case for complete harmonisation also of the excise duties at EU level. Diesel used for professional transport is a tax base with a significant degree of mobility mainly due to the possibility of hauliers and coach operators engaged in international activities to take advantage of the very significant differences in national excise duties on diesel by filling up in Member States where prices are lower (see below). Hence, it stated, "a single EU-wide rate on diesel used for professional transport, as already proposed in the Commission proposal for a Council directive to introduce special tax arrangements for diesel fuel used for commercial purposes[148], would avoid distortions in the internal market".

Since 2004, not much progress has been achieved towards the harmonization of excise duties on diesel used for professional transport[149]. But, as indicated above, the rapidly evolving political context and the ongoing work on the in-depth revision of the Directive provide a new framework for discussion of an EU Energy Levy. The envisaged modified system of energy taxation, which would include a CO2 tax plus an energy tax, could open new opportunities and entail additional issues for setting up a new own resource.

[147] COM(2004)505 Vol. I and II, 14.07.2004.

[148] COM(2002) 410 final of 24 July 2002.

[149] The Commission tabled proposals in 2007 [COM(2007)52 of 13 March 2007]. The forthcoming proposal to review the ETD will integrate its main thrust and replace the proposal.

6.2. Outline of the proposal

6.2.1. Identifying variants

It is important to stress that the draft proposal for the revised ETD provides for an explicit distinction between energy taxation specifically linked to CO2 emissions attributable to the consumption of the products concerned (CO2-related taxation) and energy taxation based on the energy content per GJ of the products concerned (energy-related taxation). An EU Energy Levy could focus on either of- or both these elements.

Any work on CO2-related taxation needs to take into account not only the ongoing work to revise the Energy Taxation Directive (ETD), but also recent developments in the EU Emission Trading Scheme (ETS). In a context where important efforts are made to ensure a maximum of coherence between CO2 taxation of non-ETS sectors and the burden imposed to sectors covered by the ETS, an own resource proposal cannot focus just on one of these dimensions only.

Three main variants of the EU Energy Levy are examined below. In order to avoid any confusion between these rather different options, very distinct names are used:

- **EU Energy Levy**. This variant would consist in applying a single EU rate to the quantities of energy products released for consumption in each Member State. In order to reduce the operating cost of the levy, the final calculation of the own resource could be determined centrally, possibly on an annual basis, based on the total quantity of products released for consumption. [Alternatively, in line with the revised ETD, an EU rate could be applied to the quantities of energy products released for consumption in each Member State, based on the energy content of the products.]

- **EU CO2 Levy**. This variant would consist of attributing to the EU budget (part of) the revenue from applying the minimum rate of CO2-related taxation defined in the ETD. In addition, (part of) the proceeds from auctioning emissions allowances under the ETS could be added. (An own resources solely based on the future CO2 component of the ETD would lead to an unjustified exemption of all installations subject to ETS.) The link between the EU CO2 Levy and the use of (a part of) the auctioning revenues under the ETS is discussed in Box 9 below. In addition, a chapter deals specifically with the auctioning revenue under the ETS.

- **CO2-based contribution**. A single rate could be applied to the overall CO2 emissions of a Member State, including those covered by the EU ETS and those not covered by the EU ETS. The calculation of the own resource could be determined centrally, based on the total quantity of CO2 emissions. The corresponding contribution would be transferred by each Member State from their national budgets, without this being linked directly to any specific source of revenue on Member State level. This would therefore be comparable to today's GNI-based contributions. As an aggregate measure, it would not be designed as a tax, unlike the two other variants.

BOX 9: ADVANTAGES OF A CONSISTENT APPROACH FOR THE EU CO2 LEVY AND THE ETS

An own resource based on CO2 would achieve maximum consistency if it covered all CO2 emissions.

This means that an EU CO2 Levy should preferably be considered as a candidate own resource in combination with an own resource based on the proceeds from auctioning emission allowances in ETS sectors. And, conversely, if an own resource based on auctioning revenue under the ETS was considered, it would be consistent to complement it with an own resource from revenue from CO2 taxation that, according to the forthcoming proposal revising the ETD, would apply to all non-ETS sectors.

Combining both elements would be more equitable than an own resource based on revenue from auctioning emission allowances only, as the own resource collected in each Member States would not depend on the importance of its ETS sector but cover all CO2 emissions. Whether or not the total revenue or only part of the revenue of both elements would become an own resource would depend, *inter alia*, on the total level of expected revenue and the share of overall own resources it is deemed to cover.

The draft ETD proposal provides for an exemption from CO2 taxation for energy consumption in the sectors covered by the EU ETS sectors. As such, it perfectly aligns the scope of the CO2 taxation to the EU ETS. Hence, energy consumers will always be subject to only one system (EU ETS or CO2 taxation) and will never be subject to both systems at the same time.

6.2.2. Tax basis

A key issue for the EU Energy Levy is the scope of the levy. The 2004 Commission proposals, which is also reflected in the Staff Working Document accompanying the Budget Review communication, placed the focus on "the main motor fuels used for road transport, namely leaded and unleaded petrol and diesel". Such an approach reflected the importance of these products in revenue terms, and the complexity of a number of provisions related to other products. However, several alternatives can be envisaged. Annex 1 presents the pros and cons of including in the scope of an EU Energy Levy other motor fuels used for road transport and including energy products used as motor fuel for other purposes than road transport, heating fuels and electricity.

Taking into account the disadvantages of the variants extending the energy levy to all motor fuels or to all energy products, restricting the scope of the energy levy to petrol and diesel used for road transport would be the simplest approach.

But one should not overlook the fact that an energy levy based on motor fuels used for road transport has a number of important drawbacks as well. A number of important evolutions are ongoing that can be expected to accelerate in the medium term, such as the enhanced used of biofuels and the emergence of electric cars. Currently, Member States may provide for tax reductions or exemptions for biofuels and a systematic beneficial treatment to biofuels will be proposed in the forthcoming revision of the ETD. Even though it would be recommendable to reflect such beneficial treatment in the own resources calculation, this would further complicate the calculations and require the definition of an EU tax policy for biofuels (for which pros and cons are very much debated). The emergence of electric cars would over time erode revenue from an own resource on fuels used for road transport. Adapting the ETD to this evolution would be relatively easy (as electricity is already within the scope of the ETD), but it might be more complex to align the own resources legal framework to this evolution.

Regarding the EU CO2 Levy, the consistent application of a harmonised tax on CO2 on energy products of EUR 20/T_{CO2}, would constitute an argument in favour of a wide base for the resource. Ideally, all CO2 emitted through combustion should be included in the scope of the tax (like for ETS). And, as indicated above, the EU CO2 Levy should also be based on the transfer of (part of) of the emission auctioning revenue under the EU ETS to avoid that only specific parts of the economy contribute.

Regarding the CO2-based contribution, a system inspired by the current calculation of the VAT-based and the GNI-based own resource could be set up. It would involve proposals of the Commission based on publicly available data and Member States estimates where relevant. The exact scope of the resource, i.e. the exact definition of the total emissions to take into account for the purpose of the own resource calculation, would need to be determined.

6.2.3. Tax rate(s)

In general, a practical feature to address would be how to align the EU Energy or CO2 Levy to the different minima listed in Annex of the ETD.

- Regarding the EU Energy Levy, as the different minima are based on complex considerations (ex. different treatment of gas oil used as a motor fuel or for heating purposes) it could be difficult, for instance, to apply a unique tax rate per amount of energy content. Any variation could on the other hand render it more difficult for the consumer to identify clearly the EU share in the overall taxation. However, the revised ETD could bring about a considerable simplification of the structure of rates, distinguishing according to the use of the energy product, which could attenuate this concern.

- Regarding the EU CO2 Levy, the revised ETD envisages one minimum rate applicable to all products categories. This rate that could be attributed to the EU budget and would be highly visible.

For both variants, as well as for the CO2-based contributions, the rate to be applied would depend primarily on a revenue objective. As an illustration, in the spirit of the 2004 Commission proposals, the rate imposed could correspond to one half of the minimum rate applicable:

- For the EU Energy Levy, this would mean a rate evolving in steps to reach 4.8 €/GJ on the 1st of January 2018 for motor fuels used, mainly, for road transport (Table A of the Annex to the proposed revised ETD). As a possibility, the tax could also cover other energy products, using a rate of 0.075 €/GJ (Tables B to D).

- For the EU CO2 Levy, half of the minimum CO2 tax rate would correspond to €10/T_{CO2} for all energy products (except electricity, which is a secondary energy product the generation of which is covered by the ETS). This could for instance be aligned with the transfer of half of the revenue of auctioning under the ETS. Sharing the revenues with the Member States administrations would reduce risks of tax avoidance and facilitate mechanisms of administrative cooperation (and, possibly, enhance collection of the levy by the Member States on behalf of the EU).

6.2.4 Implementation

The EU Energy Levy and the CO2-based contribution could be based on already existing EU *acquis* and might therefore be easier to implement but the former would negatively impact on the forthcoming proposal to revise ETD. They would require computations at the Member State or at EU level based on statistics on energy consumption and CO2 emission, respectively. The EU CO2 Levy would require a modification of the ETD as projected in the forthcoming proposal for revision.

The EU Energy Levy would consist in applying a single EU rate to the quantities released for consumption in each Member State over a certain period, e.g. one year (or to the energy content component after a revised ETD would be applicable).

- Excise duty becomes chargeable at the time of release for consumption of the products. It is this point in time that should be taken into account for the purpose of calculating the amount of own resources. The reason is that the rules for the levying and collection of duty are not harmonised. This would also imply that a duty which has become due but has not been paid would also be taken into account for own resources purposes (unless corrections are allowed for this).

- This approach would be simple to administer for the taxpayers as well as for the administrations as existing procedures for release for consumption would not be affected and the final calculation of the own resources share would only have to be determined centrally, on an annual basis, based on the total quantity of products released for consumption.

- It should be noted that, alternatively, the EU Energy Levy could be directly paid to the EU by the companies releasing the products, which would involve higher operating costs and a (further) revision of the ETD (see below).

The EU CO2 Levy would build on the intended modification of the ETD providing for a dual rate structure (CO2-related and energy related taxation), based on a Commission proposal (foreseen in April/May).

- Companies releasing energy products for consumption would be obliged to separately declare the tax resulting from the application of the EU rate of CO2-related taxation, of the remaining national part of CO2-related taxation and of the energy-related part of taxation.

- Such an approach would slightly increase the administrative burden for these companies since an additional EU rate would be added in their calculation of the CO2-related and energy-related taxation. It would also result in an increased burden for Member States' administrations in terms of control and may somewhat complicate the control of the correct application of the own resource by the Commission[150].

- This variant would reflect the current structure of EU climate policy instruments with the main distinction between ETS and non-ETS sectors (with the intention to apply CO2 taxation to the latter). However, the climate policy approach is only fixed until 2020; since the time perspective for the new own resource is longer, flexibility would be needed to adapt the structure of own resources to changes in the EU's climate policy later.

6.3. Qualitative assessment of the own resource

6.3.1. Preliminary questions

(1) Lessons from economic theory

Currently, the rates applied for most energy products differ a great deal from one Member State to another. As an illustration, for diesel, 2 countries do not comply with minimum rates because of transitional periods granted in order to take into account their specific situation. 16 countries apply a rate between EUR 300 and EUR 400 excise tax per 1000 litres. The other 11 countries tax at a level in excess of EUR 400 per 1000 litres, the highest in the UK with EUR 679 (situation in January 2011, see Annex II)[151].

Differences between Member States are an important element when it comes to the economic assessment of a new own resource. The economic impact will very much depend on its impact on the absolute level of (energy or CO2 taxation) and the effective degree of harmonization of the tax rates in the EU.

The impact will ultimately depend on how Member States will restructure their tax rates following the introduction of the new own resource.

- If, for instance, they applied the EU (Energy or CO2) Levy on top of existing rates and used the additional revenue from lower GNI-based contributions to lower charges on labour, positive environmental and economic effects (in terms of GDP and employment) could be expected. This scenario is comparable to one of the options examined in the Impact Assessment of the revision of the ETD (option 4 – introduction of a CO2 tax on top of the rates applied by MS). This option shows positive economic impacts (for the EU-27: increase in GDP of 0.27% and of employment of 0.39% by 2030) if the additional revenue is used to reduce employers' social security contributions. Economic impacts are less pronounced if additional

[150] As an alternative, the part of the own resource based on CO2-related taxation could be calculated by the Member States on the basis of the quantities of energy products released for consumption (as in EU Energy Levy), taking into account their respective CO2 emission factors as laid down in EU legislation (See Commission Decision 2007/589) and applying the minimum rate of CO2-related taxation to these quantities.

[151] Information per Member State can be found on the Commission website:
http://ec.europa.eu/taxation_customs/taxation/excise_duties/energy_products/rates/index_en.htm
http://ec.europa.eu/taxation_customs/resources/documents/taxation/excise_duties/energy_products/rates/excise_duties-part_ii_energy_products_en.pdf
http://ec.europa.eu/taxation_customs/resources/documents/taxation/excise_duties/energy_products/rates/excise_duties_energy_products_en.pdf

revenue is used for fiscal consolidation or lump-sum payments to households to compensate for higher taxation.

- Additional positive effects could derive from an approximation of taxation levels in the EU. This could for instance arise if some Member States with relatively low tax rates considered the EU levy as a top up on national rates, while higher tax Member States reduced their national rate to make room for the EU levy.

- If the Member States decided to simply restructure their tax rates (dividing up current rates into a national and an EU share), no direct economic impacts would be expected as the consumer prices would not be affected and reduced income from energy or CO2 taxation would be compensated by the reduction in the GNI contribution. However, an indirect effect could be observed due to a change in the gross contributions from the Member States (or their taxpayers) to the budget.

(2) Legal issues

The application of an EU Energy Levy, which consists in the allocation of a part of the revenue to the EU budget, would not as such require any changes to the ETD or to the horizontal excise provision (Directive 2008/118/EC). Although the ETD contains a number of optional exemptions and tax reductions, this should however not require any corrections if one bases the calculation of the energy levy on the quantities released for consumption including the quantities benefiting from an exemption or tax reduction in order to ensure an equal application across the EU.

The EU CO2 Levy presupposes the adoption of a revised ETD by the Council and the EP providing for an explicit distinction between CO2-related taxation and energy-related taxation. Although, the Commission could propose an entry into application of the revised ETD on 1/1/2013, it is difficult to predict the effective date of entry into application due to the complexity of the proposal, its political sensitivity and the need to reach unanimity in the Council.

The CO2-based contribution could be realised via the own resource decision and its implementing provisions.

6.3.2. Criteria set out in the budget review

(1) Link to the acquis and the objectives of the EU

The EU Energy Levy could be based on the current scope of the ETD. The allocation of a part of tax receipts to the EU budget would not in itself further the policy objectives pursued by the ETD (better functioning of the internal market; reduce distortion of competition between energy consumers and suppliers; support environmental policy and energy efficiency). However, as explained above, under some assumptions, a positive impact could be obtained if the introduction of the EU Energy Levy led to an increase of the total energy taxation (i.e. with appropriate recycling of the revenue) or a more harmonized structure of rates among the Member States.

The EU CO2 Levy and the CO2-based contribution are more clearly linked to the EU climate policy and could, in the medium term, be considered to support EU policies, for instance if more stringent emission reduction objectives – such as a 30% reduction of

GHG emissions by 2020 – were translated into higher rates for the resource. In the longer term (mainly beyond 2030), the EU objective to decarbonise the economy would, however, start to conflict with the revenue raising needs in case one of these two options were chosen (a reduction by 80 – 95% of emissions is envisaged by 2050).

The EU CO2 Levy and the CO2-based contribution (including a revenue-sharing mechanism for emissions auctioning) have the advantage that they cover all CO2 emissions and level out differences between Member States related to different shares of products in the final energy consumption (e.g. in the EU Energy Levy – if based on quantities consumed like in the current ETD - a higher diesel share as compared to petrol would lead to lower own resources payments due to lower consumption in l/100Km).

They would also provide a strong incentive for Member States to take measures to reduce overall CO2 emissions.

(2) Cross-border aspect and internal market coverage

The EU Energy Levy would be cross-border in nature, in particular regarding products for which important cross-border shopping can be observed. This is in particular the case for motor fuel used for road transport. The huge capacity of big trucks allows them to cover distances of between 1.500 and 3.000 kilometres on a single tank. Hauliers involved in international activities or situated in or near the border of low-taxing countries refuel in low-tax countries in order to benefit from a significant competitive advantage.

The allocation of a part of the proceeds of energy taxation to the EU would not by itself lead to lower rate differentials between Member States and, hence, to reduced tank tourism. Whether or not such effects would occur would depend on how Member States react, in particular whether or not they apply the EU levy on top of existing rates or not.

The EU CO2 Levy and the CO2-based contribution would be cross-border in nature because they would cover CO2 emissions.

(3) Base harmonisation and application throughout the Union

The development of an own resource would be facilitated by the existence of a harmonised base applicable on the entire EU.

The EU Energy Levy could cover all energy products used as motor fuel in the scope of the ETD and, by extension, also energy products used as heating fuel. The ETD provides for an EU-wide framework for the taxation of motor and heating fuels. National variations exist (e.g. some Member States apply reduced rates for commercial diesel). These would however not affect the EU Energy Levy as it is applied to the total quantity released for consumption during a year.

Provided a revised ETD including a distinction between a energy and a CO2 component was adopted, it would also make the development of the EU CO2 Levy straightforward.

A CO2-based contribution could be set up based on currently available and agreed data.

(4) Autonomous resource collection

Two approaches can be envisaged for the collection of both the EU Energy Levy and the EU CO2 Levy:

- The annual computation of the levy based on the (energy or CO2 content) of the quantity of product released for consumption. In this case, the levy would be somewhat similar to the current VAT-based contributions since it would constitute a revenue transfer by the Member States on the basis of one tax. However, there would be no need for corrections and compensation as for the VAT contributions since everything would be calculated on the basis of quantities of products released for final consumption (independent of the national tax regime) and in any case it would not be valid for the CO2 levy where no exemptions are foreseen.

- The autonomous collection of the tax by the EU. In this case, a part, say 50% of the tax rate currently envisaged in the revised ETD, could be paid by the companies to the EU. There are about 6.000 companies in the EU releasing petrol and diesel for consumption. If extended to other energy products, this number increases to about 56.000. The administrative burden on these businesses would be (marginally) increased if they would have to calculate and pay the EU part of the excise duty separately. It would also be burdensome for the EU administration to collect the levy directly from these companies. Forms of administrative cooperation with the Member States administration would have to be explored to minimize the operating cost of the levy. In this case, although the levy would not transit via Member States accounts, the amount levied in each Member State would be easy to compute.

The CO2-based contribution constitutes a direct payment by Member States to the EU from their national budgets (as the GNI own resource). It therefore by definition does not entail any direct collection of revenue by the EU from taxpayers.

(5) Additional burden on specific sectors

The EU Energy Levy, the EU CO2 Levy and the CO2-based contribution would primarily constitute a transfer of revenue from the Member States to the EU budget. They would not, by themselves, imply a change in the tax burden for the energy sector or any sector covered by the ETD.

The ultimate impact on specific sectors would entirely depend on how Member States would adjust their tax rates following the introduction of the own resource (see section 3.1.1). The impact of an EU Energy or CO2 Levy on the energy industry would require particular attention due to the evolution of the energy sector.

In its recent energy strategy 2020 the Commission has announced a need for EUR 1 trillion until 2020 to replace obsolete capacity, modernise and adapt infrastructures and cater for increasing and changing demand for low carbon energy[152]. Most of these investments will have to be paid by the energy consumers through higher prices. The expected price increase of energy will be in addition reinforced by an increased share of renewables with higher production costs and rising prices for fossil fuels.

[152] See COM (2010) 639.

Already now petroleum products are substantially taxed in most Member States – especially products used as propellant, and with the recent crisis, several Member States have decided to further increase this taxation (VAT in particular).

Given the current budgetary situation in most Member States it cannot be expected that they all will reduce the national taxation of energy to make room for an EU Energy Levy but of course at the same time the abolition of the VAT-based Own Resource opens up budgetary possibilities to redesign the tax system for instance in other areas. In the Commission's view reductions of labour costs and charges would achieve the best macroeconomic result. The possible impact on the competitiveness on parts of the EU industry which depends i.a. on competitive energy prices is being addressed by appropriate rules in the forthcoming revision of the Energy Tax Directive. Table 1 gives a first indication of the impact on energy prices if around EU 14 billion were to be found through an additional energy tax with a heavier tax placed on solid fuels and petroleum products.

Even though the price increase would be limited to 0.5% to 2%, it would inevitably impact the necessary transformation of the energy sector into a nearly carbon free industry. The impact of the introduction of a substantive EU Energy Levy on the competitiveness of the European industry should therefore be analysed in more detail if this option is considered further. Especially as major competitors (USA, China, India) are apparently not willing to transform their industries in a comparable time span, the potential loss of competiveness of European industry must be taken seriously into account.

Table 4: Summary estimate of the maximum impact of an EU Energy Levy on energy prices (in the extreme assumption of a full top-up of the EU component)

	Current Prices (EU27)[153]	**Levy (€/ktoe)**[154]	**Price Increase**	**Levy (b€)**[155]	**Sector concerned**
Solid fuels		0.02		0.9 b€	Industry
				0.2 b€	Households & Services
Petroleum Products	1.25-1,4 €/litre	0.02	1.9%	8.0 b€	Industry & transport
Natural Gas	52.21 €/MWh	0.01	1.6%	1.7 b€	Households & Services
	39.46 €/MWh		2.2%	0.9 b€	Industry
Electricity	167 €/MWh	0.01	0.5%	2.5 b€	All
	103 €/MWh		0.8%		
Total				**14.1 b€**	

Source: DG ENER

153 EU27 Average price for gasoil and unleaded 95, on the 20/12/2010; EU27 Average Households or Industry price for the second semester of 2008

154 0.01€/ktoe represents 0.86€/MWh for gas and electricity; 0.02€/ktoe represents ±0.025€/litre.

155 Based on 2008 Eurostat final energy consumption data.

(6) Administrative burden for the EU administration

The administrative burden for the EU would be very limited in the case of a centralised annual computation of the own resource, the approach envisaged for the EU Energy Levy and the CO2-based contributions.

If the tax is collected directly from the taxpayers by the EU, as is envisaged for the EU CO2 Levy, the EU administration will have to deal with up to 56,000 taxpayers. This could entail a substantial cost. However, the possibilities to cooperate with national administrations (which would continue collecting levies as well), should not be underestimated.

6.4. Quantitative assessment of the own resource

6.4.1. Revenue estimates

(1) EU Energy Levy

Table 2 below shows that existing receipts from excise duty on diesel and petrol are higher than the total amount of EU own resources for 2009. They amount to about 1.39% of GNI (see column 5) whereas total own resources amounted to about 1% of GNI. An EU Energy Levy could thus potentially cover a large part of EU revenue needs. The table also shows the estimated proceeds of the application of a uniform EU Energy Levy on petrol and diesel used as road motor fuel of EUR 50/1000 l. Total proceeds would amount to EUR 17.5 billion (column 13) representing about 0.15% of the EU GNI (column 15) and about 15.1% of the 2009 own resources[156].

This estimate was based on total revenue as communicated by Member States to the Commission[157]. The following should however be observed:

- The calculation is based on revenue and not on quantities released for consumption (which could be the basis for the calculation of an own resource). A number of Member States report revenue from excise duty in petrol and diesel globally (IT, AT, SK, PL). For these Member States, it was assumed that the share of petrol and diesel in these Member States is equal to the weighted average percentage share of the tax revenue of these two products separately in EU-27 based on the respective share in all other Member States.

- The revenue from excise on diesel also includes revenue from diesel used for other purposes than motor fuel for road transport (in particular heating fuel). However, rates on heating fuel are generally very low, compared to the rates for motor fuel for road transport. Hence, the impact on the overall results would anyhow be limited.

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156 This would represent between 9.1% (DE) and 18.3% (CY) of the current excise duty revenues from taxation of petrol and diesel in the Member States (column 14). The higher the current rates, the lower the relative loss of revenue and vice versa.

157 Based on information by Member States regularly furnished to DG TAXUD and published in compiled format: http://ec.europa.eu/taxation_customs/taxation/excise_duties/energy_products/rates/index_en.htm

Further estimates can be made of the effect of extending the energy levy to include, respectively, all other motor fuels and all energy products and electricity:

- Adding all other motor fuels used for road transport, i.e. LPG and methane, would generate another 417 million euro (or 2.3% of a total of 17.93 billion euro) assuming the application of a rate of EUR 50 per Kg LPG (the whole revenue comes from LPG as the use of methane as motor fuel is marginal).

- Adding energy products used as motor fuel other than for road transport, energy products used as heating fuel and electricity would require making assumptions on the EU rate for every singly product and use, as well as taking into account exemptions and tax reductions. Assuming that the own resource contribution from these other sources should be relatively at the same level as the levy on motor fuels for road transport (11% of total revenue), the additional amount of own resource would be around EUR 3.9 billion or 17.8% of a total of EUR 21.83 billion).

(2) EU CO2 Levy

The impact assessment on the effects of the revision of the ETD estimated the revenue from an additional carbon tax of EUR 22 per t_{CO2} applied by all the 27 Member States on top of the existing national rates at EUR 61.8 billion in 2020. This revenue would come in addition to the proceeds from auctioning emission allowances under the EU ETS. Hence, it is clear that only a share of the revenue from CO2-related taxation under the revised ETD would have to constitute an own resource. Moreover, the estimate does not take into account that the receipts will be diminished through special measures being applicable to sectors exposed to carbon leakage (similar to ETS).

Using EUR 10 per t_{CO2} the total estimated revenue could amount to EUR 28 billion for the EU-27. As indicated above, this back of the envelope estimate does not account for a number of factors.

	CO2 tax revenue 10 euro per t_{CO2} (mln. Euro)
BE	817
BG	192
CZ	500
DK	285
DE	4,667
EE	74
EL	537
ES	2,424
FR	3,910
IE	341
IT	3,710
CY	34
LV	109
LT	153
LU	109
HU	480

MT	10
NL	1,078
AT	528
PL	1,512
PT	463
RO	895
SI	160
SK	224
FI	264
SE	487
UK	4,004
total	**27,965**

(3) CO2-based contribution

The rate of the own resource should be fixed at a level generating the revenue expected. Taking into the quantity of emissions and the current and foreseeable price of carbon, a range of EUR 15 to 40 bn could reasonably be envisaged.

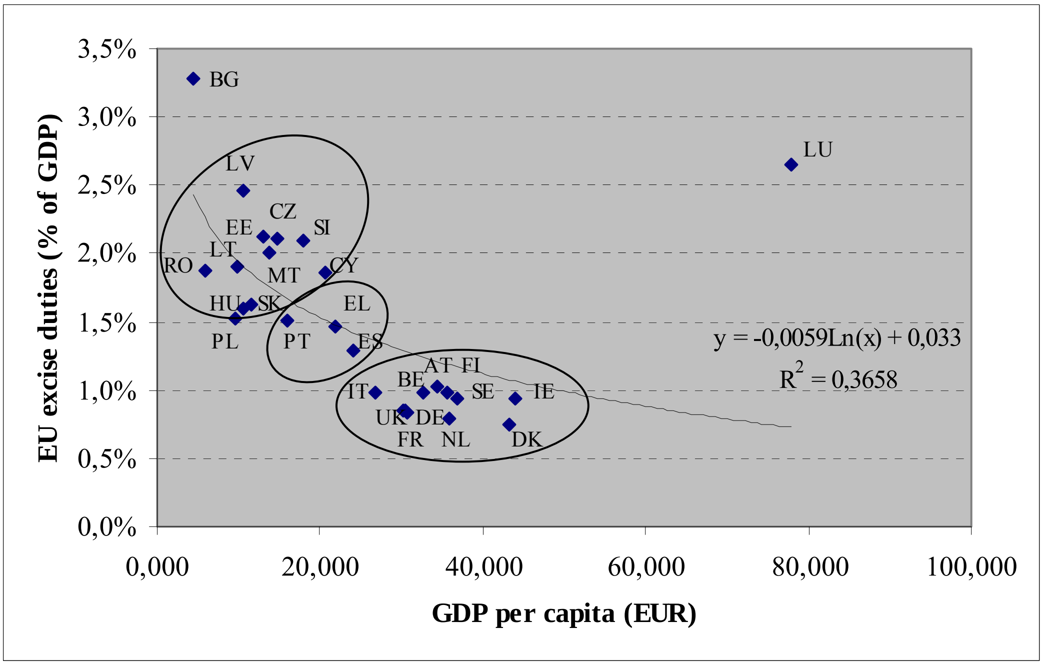
6.4.2. Fair application and impact on correction mechanisms

Except in the case of direct revenue collection by the EU administration (envisaged mainly for the EU CO2 Levy but also feasible for an EU Energy Levy), Member States would know the origin of the own resource. Even with a centralized collection mechanism, Member States would be able to make estimate of the national origin of the resource.

In all variants, there would also be an impact on the relative share of each Member States in total own resources. Member States having relatively higher energy/motor fuel consumption and/or CO2 emissions would pay more than today and Member States having relatively low CO2 emissions would pay less (as the relative share in the balancing GNI own resource remains equal).

Figure 1 below shows a negative correlation between the potential revenue related to EU excise duties on fuel used for road transport and GDP per capita. The amount of money accruing from an EU energy tax would be lower as a percentage of GDP in richer Member States than in poorer Member States. However, the contributions in absolute amounts (EUR per capita) would be significantly higher for the richer Member States.

Figure 1: EU excise duties and GDP per capita (2008)



Source: DG Budget on the basis of Primes Model and DG ECFIN Spring 2008 Forecasts

It is also interesting to note that groupings of countries can be observed in Figure 1. These correspond to the new Member States (upper left), the cohesion phasing-out countries (middle) and the traditional net contributors (lower right). It should be recalled again that the resource (at least the EU CO2 Levy) could be levied on individual taxpayers treated in a similar way throughout the EU-27.

Table 5: Revenue estimates for the EU Energy levy

	Revenue from excise duty on petrol and diesel in 2009												
	Gross National Income (GNI)	Annual revenue (million Euro)					Tax rate (per 1000 litres)		Tax rates per 1000 kg	Estimated consumption (million litres and kg)			
		Petrol	Diesel	LPG and methane	Total	As a % of GNI	Petrol	Diesel	LPG and methane*	Petrol	Diesel	LPG and methane	Total
	(1)	(2)	(3)	(4)	(5)=(2)+(3)+(4)	(5)=(4)/(1)	(6)	(7)	(8)	(9)=(2)/(6)	(10)=(3)/(7)	(11)=(4)/(8)	(12)=(9)+(10)+(11)
BE	342.261	1.029	2.799	5	3.833	1,12%	614	335	125	1.677	8.349	38	10.064
BG	33.113	295	579	69	943	2,85%	350	307	174	843	1.886	395	3.125
CZ	129.046	1.185	1.760	11	2.957	2,29%	483	406	155	2.454	4.337	72	6.863
DK	226.447	1.172	1.345	18	2.536	1,12%	557	380	489	2.105	3.540	37	5.682
DE	2.430.940	17.826	16.933	129	34.889	1,44%	655	470	180	27.236	35.998	718	63.952
EE	13.538	153	148	0	301	2,23%	398	370	125	384	401	2	786
EL*	226.644	2.080	1.137	5	3.222	1,42%	410	302	125	5.072	3.765	41	8.878
ES	1.029.541	2.703	9.384	1	12.089	1,17%	425	331	57	6.365	28.352	16	34.733
FR	1.922.845	7.008	16.410	11	23.429	1,22%	607	428	108	11.551	38.305	101	49.958
IE	132.601	1.075	1.115	0	2.190	1,65%	509	409	125	2.113	2.725	0	4.839
IT*	1.494.576	8.699	10.222	517	19.438	1,30%	564	423	228	15.424	24.165	2.272	41.861
CY	16.640	154	109	0	263	1,58%	299	245	125	517	444	0	962
LV	19.954	158	239	2	400	2,01%	379	330	127	418	725	19	1.162
LT	27.010	200	256	46	502	1,86%	434	330	304	460	777	152	1.389
LU	26.765	239	615	0	854	3,19%	462	302	102	517	2.035	2	2.554
HU	88.291	810	1.145	5	1.961	2,22%	451	375	177	1.796	3.058	30	4.884
MT	5.451	43	46	1	89	1,64%	459	352	125	94	130	6	230
NL*	556.518	4.028	3.158	33	7.219	1,30%	701	424	154	5.749	7.453	217	13.419
AT*	271.459	1.424	1.673	241	3.338	1,23%	442	347	261	3.221	4.821	924	8.966
PL*	299.518	2.312	2.716	271	5.300	1,77%	488	338	192	4.735	8.037	1.413	14.185
PT	162.331	942	1.472	5	2.418	1,49%	583	364	109	1.615	4.039	45	5.699
RO	113.652	688	1.191	33	1.913	1,68%	336	284	128	2.051	4.195	259	6.505
SI	34.704	375	643	1	1.019	2,94%	462	433	125	811	1.486	6	2.302
SK*	62.575	414	486	0	900	1,44%	515	481	259	805	1.011	0	1.815
FI	171.383	1.435	929	174	2.537	1,48%	627	364	125	2.288	2.551	1.393	6.232
SE	296.151	2.345	1.562	14	3.921	1,32%	568	446	164	4.132	3.502	84	7.718
UK	1.587.886	12.362	13.942	27	26.332	1,66%	422	684	304	29.307	20.384	90	49.781
Total	11.721.841	71.154	92.016	1.622	163.171	**1,39%**				133.741	216.471	8.331	358.543

	EU energy levy = 50€/1000 litres (million Euro)					
	Petrol	Diesel	LPG and methane	Total	As a % of total revenue	As a % of GNI
	(13)=50*(9)/1000	(14)=50*(10)/1000	(15)=50*(11)/1000	(16)=(13)+(14)+(15)	(17)=(16)/(4)	(18)=(16)/(1)
BE	84	417	2	503	13,1%	0,15%
BG	42	94	20	156	16,6%	0,47%
CZ	123	217	4	343	11,6%	0,27%
DK	105	177	2	284	11,2%	0,13%
DE	1.362	1.800	36	3.198	9,2%	0,13%
EE	19	20	0	39	13,0%	0,29%
EL*	254	188	2	444	13,8%	0,20%
ES	318	1.418	1	1.737	14,4%	0,17%
FR	578	1.915	5	2.498	10,7%	0,13%
IE	106	136	0	242	11,0%	0,18%
IT*	771	1.208	114	2.093	10,8%	0,14%
CY	26	22	0	48	18,3%	0,29%
LV	21	36	1	58	14,5%	0,29%
LT	23	39	8	69	13,8%	0,26%
LU	26	102	0	128	15,0%	0,48%
HU	90	153	2	244	12,5%	0,28%
MT	5	6	0	11	12,8%	0,21%
NL*	287	373	11	671	9,3%	0,12%
AT*	161	241	46	448	13,4%	0,17%
PL*	237	402	71	709	13,4%	0,24%
PT	81	202	2	285	11,8%	0,18%
RO	103	210	13	325	17,0%	0,29%
SI	41	74	0	115	11,3%	0,33%
SK*	40	51	0	91	10,1%	0,15%
FI	114	128	70	312	12,3%	0,18%
SE	207	175	4	386	9,8%	0,13%
UK	1.465	1.019	4	2.489	9,5%	0,16%
Total	6.687	10824	417	17.927	11,0%	**0,153%**

* Note: The data for tax revenue for NL is for 2008, the data for the annual tax revenues for IT, AT, SK, PL are based on estimations, petrol data for EL includes both leaded and unleaded petrol

* Note the tax rates applied are for LPG as the methan consumption as a motor fuel is rather low

* Note, the tax revenues from diesel comprise the revenue both from heating and motor fuel

Total EU Own Resources 2009:		116.096,04 million Euro	
Revenue from EU energy levy:		17927,17 million Euro	**15,4%**

Revenue from all energy products and electricity 2009	198.824,47 million Euro	
Share of the total tax revenues from petrol diesel, LPG and natural gas in the	**82,1%**	

ANNEX 1

DEFINING THE SCOPE OF THE EU ENERGY LEVY

1. Advantages and disadvantages of including other motor fuels, i.e. adding LPG and natural gas (methane), as kerosene is generally not used as motor fuel in road transport

Advantages

It would seem logical to include all motor fuels for road transport in the basis of an own resource as this level out differences in consumptions patterns between Member States.

Disadvantages

Revenue-wise petrol and diesel are the most relevant taxes for Member States today. Additional revenue from adding other motor fuels would be very small.

Adding other motor fuels would make the (slightly) system more complex for Member States, with the need to report separately releases of consumption of products whose use as motor fuel is marginal.

The ETD currently allows Member States to apply a beneficial treatment for LPG and methane. These products are therefore mainly consumed in Member States making use of this option. However, the draft proposal revising the ETD gradually removes this option and proposes to systematically treat these products as any other motor fuel (taxation based on CO2 emissions and energy content). Hence, it can be expected that their use as motor fuel will further reduce.

2. Advantages and disadvantages of including energy products used as motor fuel for other purposes than road transport, heating fuels and electricity

Advantages

It would be more consistent to include all energy consumption in the own resources calculation.

No need to distinguish releases for consumption for different uses (e.g. diesel for road transport; diesel for heating; diesel for commercial/industrial uses), provided that the same own resources rate would apply to all uses (which is not obvious as rates for diesel for road transport are generally much higher than for other uses).

EU transport policy aims at reducing today's almost total dependence of road transport on petrol and diesel. In the longer term, if successful, this transport policy would therefore undermine the tax base of the own resource solely based on fuel for road transport, which might trigger the need for an increase in rates or a broadening of the tax base.

Disadvantages

The ETD allows many more exemptions for heating fuels than for motor fuels for road transport. For all these cases correction mechanisms would have to be agreed upon. Furthermore, obligatory exemptions exist for aviation fuels (kerosene) and sea navigation and it would therefore be illogical to include them into the tax base for an own resource. On the other hand, limiting the own resource to petrol and diesel, has the advantage that the tax base would be strongly harmonised and few corrections would be needed as petrol and unmarked gasoil (road diesel) has to be taxed in almost all cases (few exceptions include e.g. agriculture).

Fuel use in transport has a significant cross-border dimension given today's pattern of traffic flows. For heating use such a cross-border dimension is much less obvious.

As far as the economic impact of an energy-based own resource is concerned, including heating fuels is difficult as increasing costs for domestic heating has a regressive distributional impact. This is not the case for motor fuels (cf. the Impact Assessment of the ETD revision for details). Given the distribution of competencies the EU would have to leave it to Member States to address undesired social consequences of a potential surcharge on heating costs via their social systems.

ANNEX 2

NATIONAL TAX RATES ON PETROL AND DIESEL (JANUARY 2011)

Member State	**Tax rate petrol Minimum 359 €/1000l**	**Tax rate gasoil Minimum 330€/1000l**
BE	613	392
BG	363	314
CZ	528	448
DK	576	392
DE	669	470
EE	422	392
EL	670	412
ES	424	331
FR	606	428
IE	576	465
IT	564	423
CY	359	330
LV	379	329
LT	434	302
LU	464	392
HU	438	355
MT	469	382
NL	718	423
AT	482	425
PL	421	327
PT	585	364
RO	359	302
SI	478	420
SK	550	386
FI	627	364
SE	539	492
UK	679	679

7. EU CORPORATE INCOME TAX (EUCIT)

7.1. Political context

7.1.1. Corporate income taxation in the EU

The Corporate Income Tax is traditionally one of the most important taxes, although it yields only 9.2% of total tax and social security contributions[158], much less than VAT or personal income tax. The main reasons for its importance include the fact that it has a direct effect on corporations and therefore on general competitiveness, and the so-called *backstop function* it carries out in tax systems, i.e. to prevent income from being capitalised in corporations to avoid personal income tax.

From 2000 to 2009 (last value available), national CIT revenues have oscillated, on average, between 2.8% and 3.7 % of GNI (see table in annex). This range of variation is not uncommon given that the revenue from this tax is highly dependent from the business cycle. Therefore, it is to be expected that 2010 revenue data, when they become available, will fall even 2.8%, given the impact of the current economic and financial crisis.

The cross-country variation in revenue is even stronger: in 2009, it ranged between 0.7% in Germany to 7.8% in Luxembourg. This wide spread of results reflects many factors besides differences in tax rates: allowances and rules on cost deductibility play an important role, as well as other structural or institutional factors, such as the corporatisation rate, the presence of developed financial centers, or the existence of attractive tax and regulatory regimes for multinationals.

The technical complexity of the CIT and the possibility it offers for tailoring tax regimes to achieve specific policy objectives result in very different national CIT frameworks, creating complex interactions between national systems. Any reform of the CIT therefore has widespread implications, not only for the national corporate tax itself, but also with regard to other national systems and, within a country, will inevitably affect other tax regimes such as the personal income tax. Ultimately, it will also have an impact on investment, employment and growth.

Therefore, it is not surprising that corporate taxation is a very sensitive policy area. Some Member States are, as a matter of principle, against any legislative proposals in this area (e.g. UK). Furthermore, Ireland made the approval of the Lisbon Treaty depend on safeguards protecting its rights to determine its corporate tax system[159]. Owing to the need for unanimity, it took, for instance, almost 30 years of discussions[160] to produce the first European directives on business taxation, the 1990 Parent/Subsidiary and Merger Directives[161]. Another stepping stone was the agreement at the end of 2004, following 7 years of negotiations, on a comprehensive tax package including a code of conduct on business taxation.

158 2008 value. Source: *Taxation Trends in the European Union,* Luxembourg, 2010.

159 The Ireland –'Guarantee' is a Decision of the Heads of State or Government of all Member States which was annexed to the Conclusions of the European Council of 18/19 June 2009.

160 The Neumark report (1962) proposed the harmonisation of business taxation in the Community.

161 These Directives (90/435/EEC and 90/434/EEC respectively) were the result of proposals that had been on the Council table since 1969 (see OJ C 39, 22.3.1969).

Despite important achievements, much remains to be done to improve the EU regulatory environment in the area of corporate taxation. The existence of 27 separate national tax systems with different provisions determining taxable profits and different tax rates puts EU multinational enterprises at a disadvantage compared to companies operating in only one Member State or in large countries such as the US. EU companies face many obstacles to their cross-border activities and may suffer from double taxation and over taxation as a result of the current lack of coordination among the various corporation tax systems in the EU. The current system imposes significantly higher compliance costs both on companies operating across borders in the EU and on national tax administrations[162].

To tackle these problems the Commission prepared, *inter alia*, a legislative proposal bearing on a Common Consolidated Corporate Tax Base (CCCTB), which suggests introducing a harmonized tax base across countries that could be used by companies in the EU on a voluntary basis while allowing the Member States to apply their individual corporate tax rates. During the last years of preparing the CCCTB proposal the Commission always emphasised that it would not touch the sovereignty of Member States to set corporate tax rates. The prospects for adoption by the Council of the CCCTB could be materially damaged if the Commission were to propose a EUCIT making use of the CCCTB. The CCCTB is explained in more details in Box 10 below.

7.1.2. EU Corporate Income Tax (EUCIT)

Past Commission analyses show that differences in the nominal tax rates on profits (statutory rates, surcharges and local taxes) are an important factor in explaining diverging effective tax burdens among the Member States – and the related effects on the allocation of productive capital in the internal market[163]. Therefore, some observers concluded that setting a minimum tax rate and a harmonised tax base, i.e. creating an EU corporate income tax (EUCIT), could bring important economic benefits for the EU[164]. Moreover, EUCIT could generate considerable revenues. However, as shown below, setting up a EUCIT would also face a host of conceptual, practical and political problems.

In any event, the analysis of the pros and cons of EUCIT would depend on the specificities of the system put in place and, in particular, the scope of the tax and the degree of harmonisation achieved. It is evident that variants of an EUCIT with a deeper impact on the national tax systems will be more negatively considered than variants which build upon existing national corporate tax systems.

Finally, it is useful to keep in mind the views expressed by a number of stakeholders:

- Member States' governments and Parliaments are generally opposed to legislative proposal in the direct tax area due mainly to the perceived loss of sovereignty.

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162 See European Commission (2004), "European Tax Survey", Commission Staff Working Paper, SEC(2004)1128.

163 See European Commission (2001), "Company taxation in the internal market", Commission staff working paper, COM(2001)582.

164 The Commission has steadfastly refrained from proposing tax rate harmonisation for corporate taxation, giving preference to alternative approaches (CCCTB), which would consistently tackle several corporate tax obstacles and tax-induced inefficiencies in the Internal Market, such as double taxation, the lack of cross-border loss consolidation, tax-related obstacles to business restructuring and significant compliance costs associated with international activity. .

- Business and industry are generally opposed to any obligatory harmonisation on tax bases and rates (e.g. the CCCTB is supported under the condition that the companies can decide to opt in to the CCCTB or not). The main reasons are the loss of flexibility and tax competition advantages – tax planning opportunities and specific tax incentives offered by Member State for sectors, e.g. tonnage tax regimes, or activities, e.g. R&D tax incentives.

- The European Parliament, which is traditionally supportive for greater tax harmonization has consistently supported the CCCTB[165]. In addition, the Lamassoure report of 29 March 2007 recalled that taxes on corporate profits were taken into consideration for the purpose of developing a new own resource[166].

- The European Commission mentioned a resource based on corporate taxation as a possible longer-term option in its last report on EU financing[167].

Overall, a EUCIT proposal is likely to encounter considerable opposition due to marked national differences and diverging preferences in the area of corporate taxation. This is well illustrated by the difficult progress towards a CCCTB. This explains why the Commission considered in 2004 that "a fiscal resource based on corporate income is to be seen as a much longer-term option" than an option based on VAT or energy consumption.

7.2. Outline of the proposal

7.2.1. Identifying variants

The analysis of the EUCIT would depend on the specificities of the system put in place. As already indicated by the Commission in 2004, decisions would need to be taken on "the definition of a possible EU (consolidated) tax base; the implications for the current network of bilateral tax treaties linking EU Member States with other countries; the implications for national rules regarding personal income taxation; the rate of the tax and the allocation of the base or the revenue between the Member States; the responsibilities regarding the collection of the tax and related legal and administrative issues"[168].

There is only one meaningful approach for a EUCIT. It would consist of three main features:

- a common corporate tax base (EUCIT base) that would be compulsory for all companies in the EU. In absence of an EUCIT base, the tax imposed on similar operations performed in different Member States would vary. This would contravene the equal treatment principle and introduce distortions in the Internal Market;

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165 See for instance the letter of the Socialist Group to Mr. Barroso demanding a CCCTB (harmonisation of the base) and the resolution'Written declaration pursuant to Rule 123 of 8 ECON coordinators demanding a CCCTB with harmonised rates. See the Rules of Procedure on corporation tax rates in the EU' 0101/2010 from 13.12.2010 (Url: . http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+WDECL+P7-DCL-2010-0101+0+DOC+PDF+V0//EN&language=EN)

166 European Parliament resolution of 29 March 2007 on the future of the European Union's own resources (2006/2205(INI)), § 39.

167 See COM(2004)505, 14.07.2004.

168 See "Financing the European Union. Commission report on the operation of the own resources system", COM(2004)505, Volume II, p. 59.

- a harmonised EUCIT rate. This would allow equal treatment of companies across the EU and this minimum EU rate would in practice constitute a floor in total corporate rates in the EU.

- additional national CIT rates that would vary across Member States. Member States would be left free to adjust their rates, taking into account the implications of the EUCIT and other relevant features of their national tax system.

An EUCIT system would therefore entail adjustments to the tax base and possibly to the national rate of corporate income tax. This could have important implications for the tax treatment of dividends at national level. National tax treatment of dividends is tightly linked with the corporate rate and the tax base, forming a coherent, logical whole. For instance, countries with a high CIT rate often tend to introduce imputation systems to avoid double taxation at the level of the shareholders, while countries with flat tax systems typically adopt wider tax bases, lower rates and exempt dividend income from taxation at the level of the shareholders. The introduction of an EUCIT may therefore require substantial changes in the tax systems of Member States.

Although this approach looks similar to the Common Consolidated Corporate Tax base (CCCTB) proposal (see Box 10), it is actually very different in a number of critical areas. In particular, it would go significantly beyond the scope of the CCCTB exercise, and would directly contradict a number of recent statements from the Commission that the work on the CCCTB is restricted to defining only the base leaving the levying of tax entirely to Member States.

BOX 10: WHAT IS THE CCCTB?

The European Commission believes that the only systematic way to address the underlying tax obstacles for companies operating in more than one Member State is to provide them with a consolidated corporate tax base for their EU-wide activities.

This policy was established in 2001 [COM(2001)582] and refined in subsequent communications [COM(2003)726 and COM(2007)223]. The European Commission proposed a common system for calculating the tax base of businesses operating in the EU on 16 March 2011 [COM(2011)121]. The CCCTB is designed to encourage cross-border commercial activity within the Internal Market and allow companies to operate within a single framework.

The proposal presents a number of significant advantages in terms of tax compliance:

- Companies will apply a single set of common rules and deal with only one tax administration ('one-stop-shop');

- Profits and losses generated in different Member States will be offset automatically as a result of consolidation;

- There will be no need to price transactions at 'arm's length' within the group because the sharing of the tax base between two or more Member States will be done through a formula;

- Costs and uncertainties linked to lawsuits brought before the ECJ will be reduced, as the CCCTB will be specifically complying with the Treaty.

From a technical viewpoint, the main elements of a CCCTB are as follows:

1. Double taxation

Double taxation (and double non-taxation) will no longer be a risk within the consolidated group, since all intra -group transactions will be eliminated. The 'tax base' (i.e. the individual tax results of each group member) would be defined as follows: (i) all revenues are taxable except if expressly listed as exempt; (ii) fixed assets are depreciable for tax purposes subject to certain exceptions. Depreciable assets are distinguished between those subject to depreciation individually and those placed in a pool. Losses may be carried forward indefinitely. No loss carry-back is allowed.

2. Consolidation

A 2-part test - based on control (>50% of voting rights) and either ownership (>75% of capital) or rights to profits (>75% of rights giving entitlement to profit) - determines the entitlement to participation in the group.

3. Anti-Abuse

A General Anti-Abuse Rule (GAAR) is supplemented by measures designed to curb abusive practices of a cross-border nature: (i) Limitations apply to the deductibility of interest paid to associated enterprises in a low-tax third country which does not exchange information with the Member State of the payer; specific rules define the concept of a 'low-tax third country'; (ii) Controlled Foreign Companies (CFCs) legislation requires that the CFC, resident in a low-tax third country, is controlled at 50% of its voting rights, owned at 50% of its capital and gives 50% profit entitlement to the taxpayer. In addition, 30% of CFC income should be tainted.

4. Formulary Apportionment (FA)

The FA comprises 3 equally-weighted factors (i.e. assets, payroll and sales): (i) Labour is computed based on both payroll and the number of employees (each item counts for half); (ii) Assets consist of all fixed tangible assets, meaning that intangibles and financial assets are excluded from the FA; Sales are taken into account to increase the taxing entitlement of the MS of destination.

Formulary Apportionment would not apply to the revenue from the EUCIT to be used as an own resource for the EU budget – that would flow in its entirety to the EU. The apportionment would only be needed to divide between Member States the revenue from any national CIT applied to the EUCIT base "on top" of the EUCIT. An issue that would have to be examined in more detail is whether and how to allow carry-forward of losses incurred under national CIT prior to the entry into force of the EUCIT.

5. Administration

The 'one-stop-shop' practice will allow groups with a taxable presence in more than one MS to deal with a single tax authority across the EU (i.e. principal tax authority (PTA)), being that of the EU parent of the group termed 'principal taxpayer'. A consolidated tax return will be filed with that authority.

The Directive contains procedural rules on various matters: (i) How taxpayers should submit their notice to opt into the CCCTB and subsequently their annual tax returns; (ii) A ruling mechanism, coupled with an interpretation panel and a scheme for the exchange of information, will be operated by the competent authority (CA) in each group member;Audits will be initiated and coordinated by the PTA; In terms of dispute settlement, disputes between Member States will be referred to Arbitration whilst those between taxpayers and Member States will be dealt with by an Administrative Appeals Body at a 1st instance and, at a 2nd instance, will have to be brought before the national courts of the principal taxpayer.

The main alternative to such a system would be attributing a fixed share of the national company tax revenues to the EU budget (without harmonising the tax base), that is, a revenue-sharing mechanism. Such a system would lead to considerable differences in Member States contributions to the EU budget, reflecting the existing differences in national CIT systems. Furthermore, any national tax policy decision (on base and rates) would directly influence the EU budget revenues. There would be an inbuilt incentive to reduce the rate/base in a Member State (while increasing the taxation of distributed profits in the hands of shareholders via the personal income tax) and, thereby, reducing the financial contribution of this Member State to the EU budget.

7.2.2. Tax base

The core features of a EUCIT tax base would be:

- An obligatory application of the common tax base (no option as proposed for the CCCTB) for all companies resident in the EU and EU permanent establishments of non EU resident companies.

- Agreement on the deductibility of other national taxes ('Gewerbesteuer', Stamp duty, property taxes) from the EUCIT base;

- Obligation of all transparent entities in the company tax area to be underlying corporate tax (Single entrepreneurs and partnerships) at the common rule;

Agreement on the taxation of third country revenues as part of the EUCIT. Complex legal issues derive from the fact that tax relief for cross-border transactions is provided for in bi-lateral double taxation conventions between Member States and third countries. In these conventions, the national taxes falling in the scope for tax relief are mentioned and it is generally understood that a tax replacing a listed national tax is either included in the scope of the convention by interpretation, or a formal amendment of the double taxation conventions has to be implemented by a protocol. It is unclear whether a EUCIT would falling within the scope of the bilateral double taxation conventions and hence tax relief from double taxation in third countries would be available. Third countries might argue that an EU-wide tax is not a national tax as stipulated in the tax conventions.

7.2.3. Tax rate

Member States would be free to set their preferred tax rates on top of the EU rate ("split-system"). The level of the tax rate would need to be determined taking into account the revenue objective and the other relevant variables.

7.2.4 Implementation

The Member States would be charged with collecting the EUCIT on behalf of the EU. This would probably raise a series of legal and practical problems. The collection of CIT is today the competence of the Member States; hence, the complete legal framework of tax collection would need to be reviewed and adapted.

The breadth of the topic does not allow describing the different alternatives for collections systems for a EUCIT tax. Any 'own' European system' could be criticised for not making use of the systems already in place in the Member States. It could be considered a waste of resources to establish a separate system to raise and collect an EUCIT, in parallel to national systems taxing exactly the same taxpayers. On the other hand, making use of national collection system would be more efficient and effective, but the question is whether a sufficient level of harmonisation could be ensured. Relevant elements to be agreed would include the legal nature of collection (a national tax collected on behalf on the EU budget or an EU levy would be collected as a national collection agent), the relationship with national procedures and sanctions (e.g. can the avoidance or evasion of a tax be sanctioned by national provisions implemented for tackling avoidance or evasion of national levies and taxes?), the collection period (calendar year or divergent tax years), a possible collection fee or additional revenues from late payments, the application of mutual agreement rules and procedures when companies are transferring registered office or place of effective management and control to another Member State.

7.3. Qualitative assessment of the own resource

7.3.1. Preliminary questions

(1) International experience with multi-tier corporate taxation

The Community has a multitude of corporation tax systems with different levels of complexity: on one side flat tax countries, on the other high-tax countries like France or Germany with different taxes applied on the 'same profit base' like CIT and Trade Income Tax (Gewerbesteuer) or 'Taxe professionelle' and specific/unique features like interest or patent boxes and interest limitations.

As such, it is nearly impossible to describe a general experience of Member States with multi-tier corporate taxation. In addition, such a reporting on the experience of the Member States with such taxation would also have to take into account whether there is an imputation of the CIT or local tax paid or whether there is no crediting of taxes at other levels and whether the combined system for corporate taxation and shareholder taxation is built upon a classical system or an imputation systems or a mixed approach (half-classical systems like 'Halbeinkünfteverfahren'). Without any clear picture of the planned elements of an EUCIT it is not possible to provide a general valid description of the experience of Member States and the economic assessment of multi-tier corporate taxation systems in the Union.

Concerning third countries, there are two prominent examples with multi-tier corporate tax systems – the US and Switzerland.

- For the US, it is difficult to draw conclusions from the application of the multi-tier tax US system for the EU. The main tax is the 35% Federal Corporate Income Tax and the States charge between 0% and 4% as State tax. For this relatively small State CIT there is a range of issues, such as tax planning schemes in place and anti-abuse measures enacted by fiscal authorities, cases of over-taxation and double taxation due to non-harmonised tax bases, sectors with state-cross-border activities like mail order business exempted from state CIT, complicated formula apportionment solutions for cross-border tax bases[169]. In addition, the US tax system with worldwide income taxation and application of the credit system for providing tax relief in international operations combined with the detailed common law approach for regulations is per-se difficult to administer.

  The EU approach would aim at a significantly lower level of complexity. One significant difference is that in an EUCIT, the sharing of revenue between the central and the State level would be reversed: the EU portion of the revenue would be much smaller than the Member State portion, unlike the US case where the federal level receives the lion's share of the revenue; in effect the national CIT would act as a surcharge on the EUCIT, with the surcharge being much larger than the common EU tax rate.

- In Switzerland, the lack of harmonised tax schemes in the cantons and a strong competition between cantons for foreign direct investment, in combination with a divergent economic structure in the cantons, have resulted in 'high tax' jurisdictions like Zürich and 'tax haven' cantons like Zug. The EU is involved in a tax dispute with Switzerland due to these differences in cantonal taxation. Compared to the EU, there is also a certain level of flexibility in the Swiss political and tax system, which allows adjusting more rapidly to economic or political developments. It can be doubted whether the Swiss experience can be used in full for a EUCIT. There is a certain divergence in the Swiss cantonal taxation rules and the Swiss Federal tax, which does not fit in with the harmonised tax base approach for the EUCIT at Member State level, as well as for the EUCIT revenues.

(2) Lessons from economic theory

There is a growing economic literature on the CCCTB and other tax reform proposals, which might be relevant for the EUCIT[170]. The literature on the CCCTB is relevant because it postulates defining a common EU corporate tax base, a precondition for the EUCIT. However, the results studies carried out so far cannot be extended *sic et simpliciter* to the EUCIT case because they assume adoption of a common base only for multinationals, whereas the EUCIT would necessarily have to apply to all businesses in the EU to be a fair system.

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169 An insight on the US and Canadian formula-apportionment systems can be found in Martens Weiner, J. (2005), DG Taxation and Customs Union, Taxation paper n°8.

170 A considerable amount of research has been developed in the last years to analyse both the technical options for a common tax base and its economic effects. See Agúndez-García, A. (2006), DG Taxation and Customs Union, Taxation paper n°9, for a review of the literature.

Analyses of an obligatory EU CCCTB show slightly negative effects on European GDP and employment, and neutral impacts on welfare[171]. These results, based on the simulations performed using a computable general equilibrium model[172], cannot however be extended mechanically to the EUCIT for various reasons.

The economic effects of an EUCIT would depend critically on the final level of corporate taxation. In theory, Member States could keep their current level of taxation constant by recycling the lower contributions they paid to the EU fully into lower corporate income tax rates. Alternatively, they might use the savings from the lower contributions to the EU to cut other taxes or to finance expenditures, which would result in an increase in the effective CIT rate. Given that the CIT is the most distortionary of the main types of taxes, any increase in the marginal CIT tax rate would have a substantial negative impact on GDP and employment.

However, in a longer term perspective, tax competition between Member States due to a greater comparability of effective tax rates based on the harmonised EUCIT-base might create some pressure towards lower rates.

From a political economy viewpoint, it has been argued that a EUCIT would give corporations a strong incentive to lobby for limitations to EU spending, as any expenditure reduction would result in immediate and significant cuts to the CIT rate. Opposition to the Common Agricultural Policy, for instance, might intensify as the business community may resent being taxed to support agriculture[173].

(3) Legal issues

Some legal issues are similar to the CCCTB:

- Hierarchy of rights and obligations derived from general agreements (like investment protection agreements) and double taxation conventions between EU Member States and third countries concluded before and after the entering into force of the CCCTB Directive with conflicting rules and provisions of an EUCIT Directive.

- Transitional problems (tax holidays or tax breaks granted to companies before the entering into force of the EUCIT Directive).

- The question of obligatory conversion of transparent entities in the company profit/trade income sector of the EU into corporate tax payers (possible under national constitutional rules?).

Others are very specific to a EUCIT proposal:

- There is the question of diverging delivery modes of public services in different Member States by private companies or the public sector (e.g. electricity and water supply, public transport, health and social services, service provided by companies owned by towns and

171 See tables 7 and 8 in the Impact Assessment, Accompanying document to the 'Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), Brussels 14.1.2011.

172 Like any economic model, the CGE ignores certain economic mechanisms, include specifications which are not undisputed and cannot take away the uncertainty about the strength of certain behavioural effects of tax policies. For these reasons, numerical outcomes should be taken with proper care, and interpreted in the light of the modelling assumptions.

173 See Cattoir, Ph. (2009), "Options for an EU financing reform", *Notre Europe*.

villages like Metro, busses). Any attempt to adjust the size and approaches for the public sector economic activities in the Member States to ensure an equal financial contribution to the EU budget, would be technically complex and politically difficult to implement. As an example, one could mention that in some Member States lucrative public utilities are owned by towns or cities and the financial surpluses from these activities are used to compensate financial losses in other areas like cultural or social service or the example of the medical sector with services provided for by self-employed doctors compared to services provided free of charge by a public national health service. Any attempt to compensate for such different approaches by introducing a 'fictitious trade income profits' element in the EUCIT from these activities in some Member States would open up difficult discussions and disputes.

7.3.2. Criteria set out in the budget review

(1) Link to the acquis and the objectives of the EU

The adoption of an EUCIT would improve the functioning of the internal market. But the question is whether at the current level of economic and political interaction in the EU such a far ranging measure (obligatory tax base harmonisation and harmonised EUCIT rate) for mandatory harmonisation of the tax base could be proposed without interfering with the functioning of other elements of national tax systems (mainly dividend taxation). In theory an EUCIT would be beneficial, while in practice proposing it would probably make any progress in company taxation more difficult.

Besides, if the tax applied only to multinational enterprises (MNEs), there would be level-playing field concerns as companies would pay different taxes on the same territory depending on whether they are MNEs or not. This is why EUCIT should apply to all companies, the vast majority of which are SMEs active only in one Member State with no cross-border transactions (80% of all SMEs). The switch to a compulsory CCTB would create considerable administrative costs for those companies. Therefore, one could argue that the measure would be disproportionate in view of the objectives pursued.

(2) Cross-border aspect and internal market coverage

There are a number of advantages resulting from the introduction of a EUCIT:

- The compulsory harmonisation of tax base rules would solve a number of tax-induced distortions and bring other advantages, such as a reduction of mismatches from the application of non-harmonised tax systems in the case of cross-border hybrid financing or hybrid entities.

- It could facilitate cross-border activities for all the MNEs and the SMEs active in more than one Member State. It could also make it easier, for the more than 80% of all SMEs not yet involved in cross-border business, to venture in other Member States than their State of origin as the same tax base rules would apply.

Although these advantages are included in the CCCTB proposal, the EUCIT would go further in the scope and ambition of the proposal.

- The main advantage of a EUCIT against an optional CCCTB would be that the sharing of the tax base between MS and consequently all provisions related to apportionment of the

CCCTB would be obsolete. However, this requires that no additional national corporate taxation exists anymore.

The impact assessment results show that the compulsory application of (a pre-consolidation base-broadening) CCCTB to both multinational and domestic groups would be associated with a contraction in GDP in the range of 0.3 percentage points a reduction in employment around 0.05-0.08%. The same background study provides additional simulations for a CCCTB coupled with rate harmonisation (at the unweighted EU average, or 24.2%). Such reform would prove neutral for employment, and neutral or only slightly positive for welfare (0.1%) and GDP (0.2%), but would negatively affect corporate tax revenues (-0.5-0.6%). The effects on the macroeconomic variables are worse in case the harmonised rate is fixed at a higher level so as to grant ex-ante budget neutrality of the reform.

However, it should be noted that the model is calibrated to reflect the design of the CCCTB, particularly its application to firms belonging to a group (i.e. fulfilling the 75% ownership threshold). Hence, the reported figures might not correctly reflect the potential effect of the EUCIT.

(3) Base harmonisation and application throughout the Union

There is currently not a harmonised base for corporate taxation in the EU. As indicated above, Member States differ widely in a number of respects. Achieving the necessary degree of harmonisation on a EU-wide scale would appear extremely difficult to achieve for the foreseeable future.

The very nature of a EUCIT would require the coverage of the EU as a whole. Exceptions at national level in the context of an EU-wide taxation system would not appear feasible, *prima facie*. First, they could lead to unequal treatment of similar taxpayers based on their nationality and/or location, which would contravene with the equal treatment principle. Second, they would induce distortions of competition. However, harmonised horizontal measures for start-up companies or air and water transport, for which separate taxation rules are foreseen in OECD model convention, exceptions could be imagined. But, as with all tax breaks, from the viewpoint of transparency and accountability, it is often more appropriate to show direct subsidies or financial support openly in the budget than to install in one tax years a tax break for which it is difficult to calculate the amount of financial support and to identify the beneficiaries.

(4) Autonomous resource collection

With millions of EUCIT taxpayers and annual tax declaration, it would be impossible to establish EU fiscal authorities structures in the EU for the purpose of a direct collection. Indeed, direct collection of the EUCIT by an EU administration would involve dedicated EU central and local tax services and staff similar to national tax administrations including control services. Taxable persons would have to deal for their CIT obligations with two different tax administrations. The legal issues, too, appear very delicate.

On the other hand, leaving the competence entirely to the national administrations of an EUCIT which would appear separately in the accounts of the taxpayers might raise serious concerns about the motivation of the national tax officials for auditing the correct application of the EUCIT. Experiences in the area of administrative cooperation, whereby a tax administration has to perform some tasks for the benefit for other Member States, demonstrate this is a legitimate concern. A mechanism, comparable to the one existing for customs duties, whereby a percentage is kept by the national tax administration for the collection cost might be required to overcome this problem.

In any event, the EUCIT revenues collected would be immediately attributable to specific Member States.

(5) Additional burden on specific sectors

As stated above, the results of the CCCTB applied to multinational and domestic groups of firms usually predict a reduction of employment (short term or static analysis). In particular, simulations from the IA report show a marginal reduction in employment (0.05-0.08%; see section *3.2.2.* above).

Concerning the impacts on specific sectors the most expensive would be the transformation of transparent companies in DE, LU and AT into corporate tax payers. With about 2 millions Single entrepreneur and 375.000 Personengesellschaften in Germany (data 2004 – source Wikipedia) the cost of transformation of all transparent entities into corporate tax payers could amount to EUR 118 billions[174]. The tax deductibility of these EUR 118 billion would be a huge transitional cost for Germany.

In addition, with a harmonised EUCIT rate there could be increased incentives for profit shifting and delocalisation from an intensified tax competition with third countries, e.g. Singapore, Hong Kong, Switzerland, Channel Islands. If the project led to general increase of the average EU tax level on company profits, it would put the EU at a disadvantage as an investment place compared to third countries. This could lead to the transfer of registered office or head quarters, or mobile tax bases such as investment decisions for group finance companies or holding companies.

(6) Administrative burden for the EU administration

As explained above, tax collection by the Commission services is not an option (millions of tax payers and annual declarations).

If the EUCIT was collected by national authorities within the national tax assessments as a separate line and the whole EUCIT revenue of a Member State at the end of a budget year/tax year would be transferred to the EU Budget, the work could probably be managed and controlled by 10 officials. But many major taxpaying companies in the EU do not settle their tax affairs for several years so either the transfer of the amount raised would be delayed by several years or the EUCIT would have to take precedence over the national tax – i.e. be collected on account etc. Ultimately, the administrative burden for the EU administration could be substantial, even if the national administrations play a central role.

[174] Assuming the typical cost of a tax deferred conversion of a single entrepreneur or a Personengesellschaft in a GmbH (corporate tax payer) at EUR 50,000 for the adviser fees, registration and notary cost and internal cost like training, software changes, letter heads, etc.

7.4. Quantitative assessment of the own resource

7.4.1. Revenue estimates

With 'Corporate Income Tax revenues representing between 2% and 3% of the GDP in the EU, the revenues from a EUCIT could easily reach billions per years. A baseline calculation could be done on the basis of national or Eurostat data depending on the CIT base and rate applied, and the decision whether the EUCIT rate would top up national rates or be a part of the national domestic rates charged.

The IA on the CCCTB does not provide relevant data on this point, because it was prepared under the assumption that only internationally active groups would participate in the CCCTB, whereas an EUCIT would necessarily have to apply to all corporations. However, it is clear that an EUCIT would have more than sufficient potential to raise the required level of tax revenue. In 2008, corporate income tax in the EU raised 342.1 billion euro. Given that the average statutory CIT rate currently amounts to around 23%, a back-of-the-envelope calculation suggests that, assuming a comparable size of the tax base[175], an EUCIT rate of less than 2% should be largely sufficient to consistently raise EUR 15 billion in revenue, even though CIT revenues are one of the most fluctuating tax revenue sources in the economic cycle.

As long as a residual own resources will exist, namely the GNI-based contributions, any fluctuation of the EUCIT (or any other own resource) can be automatically compensated by a fluctuation in this residual resource. The variability in revenue would however have the disadvantage of obliging the Member to transfer sharply fluctuating amounts in terms of the GNI resource, complicating financial planning.

7.4.2. Fair application and impact on correction mechanisms

From the analysis carried out for the CCCTB IA based on the Amadeus and ORBIS databases it is possible to get some insights on the current distribution of corporate tax bases across the EU. When industrial groups are considered, the largest bases are to be found in Germany (18.3% of total EU base) and in the UK (16.3%), with Finland, France and the Netherlands accounting each for less than 10% of the aggregate base. In the case of financial groups, more than one-third of the base is concentrated in the UK, with Germany following at 13.6%. Simulations for the distributional effects of CCCTB on the base show that the formula with employee costs, assets and sales by destination equally weighted leads to an increase in the tax bases (for industrial and financial groups combined) mostly in the MS in Central and Eastern Europe, as well as in Germany, Spain, France, Greece and Italy (see CCCTB IA).

175 The CCCTB tax base definition is comparatively wide, so the tax base for an EUCIT is likely to be somewhat wider than the weighted average of the current national tax bases; on the other hand, the EUCIT would presumably allow cross-border loss compensation, which only few national systems allow today. There is also the issue of the inclusion of some partnerships in an EUCIT to safeguard comparabitility. Overall, the net effect seems likely to be a comparable or slightly wider EUCIT tax base.

Annex 1:

CORPORATE TAX REVENUE AS A PERCENTAGE OF GROSS NATIONAL INCOME, 1995-2009

CIT as % of GNI	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
AT	2.2	3.3	2.4	2.4	2.4	2.4	2.3	2.6	2.7	1.9
BE	3.1	3.1	3.0	2.8	3.1	3.2	3.5	3.5	3.3	2.5
BG	2.8	4.0	3.0	2.8	2.6	1.9	2.3	4.7	3.3	2.7
CY	6.6	6.6	6.2	4.4	3.9	4.8	5.7	7.2	7.5	6.6
CZ	3.6	4.2	4.5	4.8	5.0	4.7	5.1	5.4	4.4	3.9
DE	1.7	0.6	0.6	0.7	0.9	1.1	1.3	1.3	1.1	0.7
DK	3.3	2.8	2.9	2.9	3.2	3.9	4.3	3.8	3.2	2.4
EE	0.9	0.7	1.2	1.7	1.7	1.5	1.6	1.8	1.7	1.9
EL	4.1	3.3	3.4	2.9	3.0	3.3	2.8	2.6	2.6	2.5
ES	3.2	2.9	3.3	3.2	3.5	4.0	4.3	4.9	3.0	2.4
FI	5.9	4.2	4.2	3.4	3.5	3.3	3.4	3.9	3.5	2.0
FR	2.8	3.0	2.5	2.1	2.3	2.3	2.9	2.9	2.7	1.3
HU	2.3	2.4	2.4	2.3	2.2	2.2	2.5	3.0	2.8	2.2
IE	4.4	4.3	4.5	4.4	4.3	4.1	4.5	4.1	3.3	3.0
IT	2.5	3.3	2.7	2.4	2.4	2.3	2.9	3.3	3.1	2.5
LT	0.7	0.5	0.6	1.4	1.9	2.1	2.8	2.7	2.8	1.8
LU	8.0	8.2	9.7	9.4	6.5	6.7	6.5	6.6	6.7	7.8
LV	1.6	1.9	2.0	1.5	1.8	2.0	2.4	2.8	3.2	1.5
MT	3.0	3.2	3.8	4.5	4.2	4.7	5.2	6.3	7.0	7.2
NL	4.2	4.2	3.5	3.0	3.2	3.6	3.6	3.5	3.5	2.2
PL	2.4	1.9	2.1	1.8	2.3	2.5	2.5	2.9	2.8	2.4
PT	3.8	3.4	3.4	2.8	2.9	2.7	3.0	3.7	3.8	3.0
RO	3.0	2.5	2.7	2.9	3.3	2.8	2.9	3.2	3.1	2.7
SE	3.8	2.6	2.0	2.2	2.9	3.6	3.6	3.7	2.8	3.0
SI	1.2	1.3	1.6	1.8	2.0	2.8	3.0	3.3	2.6	1.9
SK	2.6	2.6	2.5	2.9	2.7	2.8	3.0	3.1	3.2	2.5
UK	3.6	3.4	2.8	2.7	2.8	3.3	3.9	3.4	3.5	2.8

ANNEX: OTHER POTENTIAL CANDIDATES NOT RETAINED

1. An overview of potential candidates

The previous chapters of Part III presented possible variants for each of the six financial means put forward in the Budget Review communication. The result is a substantial list of potential candidates, which also includes potential candidates that the working group considered unsuitable for legal or other technical reasons. Box 11 presents an overview of the analysis done so far. Information on potential candidates not retained can be found in the respective chapters.

This annex briefly mentions others potential candidates, which do not fall within the scope of one of these six financial means but which have sometimes been mentioned. It explains why the working group did not retain them for further analysis.

Box 11: Six candidates as new own resource – and their variants

Financial sector taxation

Financial Transaction Tax (narrow-based FTT, broad-based FTT)

Currency Transaction Levy: not examined in details for legal reasons

Financial Activities Tax (addition method, rent-taxing FAT and risk-taxing FAT)

Revenue from auctioning under ETS

Revenue-sharing mechanism (simple revenue sharing, auction-based revenue sharing)

Centralised revenue collection

Taxation of the aviation sector

Passenger/departure tax

Flight duty

Kerosene taxation: considered unsuitable as candidate for legal reasons

VAT on tickets: considered unsuitable for technical reasons

EU VAT

Modulated EU VAT (1st version): considered unsuitable for legal reasons

Modulated EU VAT (2nd version)

Single-rated EU VAT

VAT on gambling: considered unsuitable for technical reasons

VAT on imported goods and services: considered unsuitable for technical reasons

EU Energy Tax

EU CO2 Levy

EU Energy Levy

CO2-based contribution

EU Corporate Income Tax

2. A resource based on seignorage

It has sometimes been suggested that the total monetary income or the seigniorage of the Eurosystem (European Central Bank and National Central Banks (NCBs) of the Euro-area) could be transferred to the EU Budget.

- The monetary income (or the more narrowly defined seigniorage) would not be distributed to the NCBs who are currently the subscribers of the ECB capital and who normally transfer it (partly) to their national government or shareholders.
- Countries outside the Eurozone would contribute to this new own resource through a contribution based on their share in GNI. As an alternative, the share of the Eurozone seignorage/monetary income in the GNI of Euro-members would be calculated. The non-Euro-members would have to contribute an equal share of their GNI, but in order to determine the national contributions within this group of countries, the same distribution key as the ECB capital key would be applied (equal weight of GNI and population).

This proposal has not been retained for the following reasons:

- Legal and institutional difficulties: The "Statute of the European System of Central Banks and of the European Central Bank" would have to be changed. The statute provides, in its article 32.5, for the distribution of the ESCB's monetary income to its shareholders, which are the NCBs. This statute is laid down in a protocol to the treaties. A change concerning the allocation cannot be done with the simplified amending procedure laid down in the statute itself but would require a change of the protocol with "quasi treaty-status".
- The necessary change to the "Statute of the European System of Central Banks and of the European Central Bank" could prove extremely difficult. The proposal could also be seen as an attempt to reduce the independence of the European Central Bank. Although in principle the independence of the ECB and the NCBs would be not modified by transferring the seigniorage/monetary income of the Eurosystem to the EU budget, it is likely that in the public perception any change in the provision of the Eurosystem will raise questions about the ECB independence and its commitment to price stability.
- It would involve a two-tier mechanism: A different treatment would be imposed on eurozone and non-eurozone Member States in the financing of the EU budget.
- Limited revenue: The monetary income or seigniorage could only finance a small part of the budget and would need to be combined with other sources. The central bank profits of

all Eurosystem members is estimated between 4% and 30% of the EU budget in the years 1997 to 2006[176]. And seignorage is only a part of this profit.

- Ownership issue: Because in some Member States the National Central Bank is owned by private shareholders (e.g. Belgium), the transfer of part of the monetary income to the EU budget is not straightforward. It would need to be clarified whether a notional profit could be distributed to the private shareholders or national governments. It could be expected that substantial legal and financial questions would be raised.

- Different cost structure of NCBs: In order to avoid that some national central banks would run deficits if they cannot count on their share in the Eurosystem's seigniorage or monetary income, a consolidated profit and loss account of the Eurosystem would be needed. This would entail complex changes in the way the Eurosystem works.

The possibility of using seignorage as an own resource was carefully examined by the Commission on a number of occasions, in particular for the "Agenda 2000" and in the context of the preparation of the 2004 report on EU financing. At the time, it was decided not to include this idea in the options for alternative own resources mainly on two grounds: the institutional issues that it would raise and the limited corresponding revenue. It should also be recalled that the European Central Bank and national central banks are traditionally firmly opposed to such proposals.

3. An EU communication tax

The idea to use taxation of communication services as a source of revenue for the EU budget was analysed in detail by the European Parliament (1997)[177]. EU-wide communications tax bases could include road transport, air transport, telecommunications in all its forms and, possibly, broadcasting. However, “sea and rail transport can probably be dismissed as being unevenly spread geographically, and having favourable environmental characteristics that [EU] governments want to encourage”.

More recently, the idea of a communication tax in the form of a SMS tax was also mentioned.

Concretely, the European Parliament (1997) indicates that for telecommunication services, the tax would be a fixed amount per telephone ‘line’. The EU telecommunication tax would be clearly identified on the bills. The tax on road transport would be a vehicle tax harmonised at the EU level. Member States could set surcharges on the tax, or raise other vehicle taxes. For air transport, a European air tax would be a per capita tax on travellers (see chapter III.4).

This approach was not pursued further, notably because the justifications for the communications tax seem rather blurred. Although air travel and vehicles taxation can somehow be related to EU environmental objectives of limiting air pollution, it is not the case for a telephony tax. In the latter case, there are no clear externalities that would justify imposing a new tax. In fact, it would seem rather contrary to the objectives pursued by the EU. It should also be recalled that a charge on air transport is examined in chapter III.4 and energy taxation is examined in chapter III.6.

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[176] Financing of the European Union budget. Study for the European Commission, DG BUDG, 2008.

[177] European Parliament, Directorate General for Research (1997), The own resources of the European Union: analysis and possible developments, Working Document, Budget Series, W-4, 09-1997.