Chapter 11

The Reform of EU Own Resources from a Tax Nexus Perspective: Which Fiscal Federalism for the European Union?

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11.1. Introduction

This chapter discusses some of the issues relating to the concept of tax nexus arising from the interconnection between the development of tax harmonization of Member States' domestic tax systems at the EU level and the financing of the EU budget through tax-based own resources. It shows how the concept of tax nexus can be seen in the particular context of the European Union through multiple facets. Then, it links the various dimension of the tax nexus concept to the ongoing debate as regards the reform of the EU own resources system, and it applies them to the different types of taxes that are currently envisaged as potential candidates.

11.2. Tax nexus and EU integration: A conundrum with four dimensions

Traditionally, the concept of nexus in international taxation has been used in the assessment of the validity and effectiveness of a state's jurisdiction to tax. States make use of their sovereignty in tax matters to apply rules to certain persons and situations that are somehow connected to them, usually to their territory. This concept is, therefore, closely related to the notions of territoriality and sovereignty in international law.[1] The sovereign choice of the nexus by states concerns the power to determine the connecting factors according to which a person or a transaction is subject to tax under

1. On the notion of nexus and territoriality in international (tax) law, *see* J. Kokott, *The "Genuine Link" Requirement for Source Taxation in Public International Law*, in *Tax and the Digital Economy* p. 9 et seq. (W. Haslehner, G. Kofler & K. Pantazatou eds., Wolters Kluwer 2019); and O. Marres, *The Principle of Territoriality and Cross-Border Loss Compensation*, 39 Intertax 3, pp. 112-125 (2011). On the existence of international customary rules in tax law, *see* C. Fleming, *To What Degree Does Customary International Law Require Accommodation of a Source Country's Right to Tax High, Tax Low, or Not Tax at All?*, in *A Commitment to Excellence: Essays in Honour of Emeritus Professor Gabriel A. Moens* (A. Zimmermann ed., Connor Court Publishing 2018).

the domestic law of the country, giving shape to the tax system (types of taxes, determination of the tax base and of the tax rate), but it is also a matter of enforcement, the power/right to apply tax rules and to collect revenue.[2] Thus, the nexus has both a legislative and an enforcement dimension (whether at the administrative or judiciary level).[3] As to income taxation, a state shall define the conditions according to which certain items of income are sufficiently connected to its territory to justify taxation.[4] Depending on the connecting factor – either personal or objective – the tax liability will be limited to income raised in the state's territory (i.e. tax liability based on source) or will include worldwide taxation (i.e. residence taxation).[5] Besides the legislative dimension of the nexus, which does not entail a discussion as to the effectiveness of a state's tax claim (albeit that its legitimacy could be put into question in the absence of a genuine link to the state)[6] there is also an enforcement dimension, since – at least in the absence of international agreements – states lack the material power to apply their laws abroad.[7] The distinction between the jurisdiction to prescribe and the

2. *See* L. Schoueri, *Revisiting territoriality as a fundamental principle of International tax law*, in *ITP @ 20 1996 – 2016: Celebrating Twenty Years of the International Tax Program of the New York University School of Law* p. 377 et seq. (D. Rosenbloom ed., New York University School of Law 2016); and A. Maitrot De La Motte, *Souveraineté fiscale et construction Communautaire: Recherche sur les impôts directs* pp. 35-37 (LGDJ 2005), quoting G. Gest & G. Tixier, *Droit fiscal international* p. 15 (Presses Universitaires de France 1990).

3. *See* K. Vogel, *Klaus Vogel on Double Taxation Conventions: A Commentary to the OECD, UN and US Model Conventions for the Avoidance of Double Taxation on Income and Capital* pp. 11-12 (3rd ed., Kluwer Law International 1997). On the territoriality principle, *see also* J. Englisch, J. Vella & A. Yevgenyeva, *The Financial Transaction Tax Proposal under the Enhanced Cooperation Procedure: Legal and Practical Considerations*, 2 British Tax Review 223, pp. 236-240 (2013); M. Lang, *The Marks & Spencer Case – The Open Issues Following the ECJ's Final Word*, 46 Eur. Taxn. 2, pp. 59-60 (2006), Journal Articles & Opinion Pieces IBFD; Marres, *supra* n. 1, at p. 113; and J. Monsenego, *Taxation of Foreign Business Income within the European Internal Market* p. 60 (IBFD 2012), Books IBFD.

4. *See* Vogel, *supra* n. 3, at p. 11: "No 'principle of source state taxation' ('territoriality principle') of international law prohibits application of domestic law for domestic purposes to situations arising in foreign countries, including the taxation of foreign income." *See also* Marres, *supra* n. 1, at pp. 112-113.

5. Vogel, *supra* n. 3, at pp. 9-11; Marres, *supra* n. 1, at p. 113; J. van Houtte, *Principes de droit fiscal belge* pp. 118-120 (Éd. Erasme 1958); and R.J. Vann, *International Aspects of Income Tax*, in *Tax Law Design and Drafting* pp. 718 and 720 (V. Thuronyi ed., IMF 1998).

6. International Court of Justice, 6 Apr. 1955, *Judgment in Nottebohm (Liechtenstein v. Guatemala)*, ICJ Reports 1955, p. 4 et seq. *See also* The American Law Institute, *Restatement of the Law Fourth, The Foreign Relations Law of the United States* § 402 (2017); and Kokott, *supra* n. 1, at p. 16 et seq.

7. Vogel, *supra* n. 3, at p. 12. *See also* F.A. Mann, *The Doctrine of International Jurisdiction*, in *Jurisdiction in International Law* pp. 140-141 (W.M. Reisman ed., Ashgate 1999). *See also* A.H. Qureshi, *The Freedom of a State to Legislate in Fiscal Matters under*

jurisdiction to enforce national law, and the inherent limitation of the latter to the territory of the state enacting the rule (which is commonly referred to as the "revenue rule", especially in Anglo-Saxon countries),[8] is recognized under general international law.[9]

Within the European Union, issues concerning the territorial limits of tax sovereignty (nexus) have arisen both at the legislative level, as regards the powers of EU institutions in the area of taxation (in particular when the Commission proposed a financial transaction tax in the early 2010s),[10] and before the Court of Justice of the European Union, relating to the compatibility of Member States' tax laws with EU law. In several judgments, the Court recognized the right of a Member State "to exercise its taxing powers in relation to activities carried out in its territory",[11] often in connection with abuse.[12] In other cases, however, the Court rejected the territoriality

General International Law, 41 Bull. Intl. Fiscal Docn. 1 (1987), Journal Articles & Opinion Pieces IBFD.

8. The revenue rule has been inferred from the decision in UK: UKHL, 20 Jan. 1955, *Government of India v. Taylor*, [1955] AC 491. *See* P. Baker, *The Transnational Enforcement of Tax Debts*, British Tax Review 5, p. 313 (1993); and P. Baker, *Changing the Norm on Cross-Border Enforcement of Tax Debts*, 30 Intertax 6/7, pp. 217-218 (2007).

9. Permanent Court of International Justice, 7 Sept. 1927, *S.S. Lotus* (France v. Turkey), PCIJ Series A, No. 10; and R.S. Martha, *The Jurisdiction to Tax in International Law* p. 67 (Kluwer 1989).

10. European Commission, Explanatory Memorandum on the Proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax, COM(2013) 71 final, p. 11, sec. 3.3.2. (14 Feb. 2013), Primary Sources IBFD, according to which "territoriality is fully respected". For a critique, *see* J. Englisch, J. Vella & A. Yevgenyeva, *The Financial Transaction Tax Proposal under the Enhanced Cooperation Procedure: Legal and Practical Considerations*, 2 British Tax Review 223 (2013). In the decision, rendered on an action for annulment by the United Kingdom against the decision to allow enhanced cooperation in the area of financial transaction tax, the Court refused to rule on the arguments submitted by the United Kingdom on a potential violation of international customary law and territoriality (*see* UK: ECJ, 30 Apr. 2014, Case C-209/13, *United Kingdom of Great Britain and Northern Ireland v. Council of the European Union*, Case Law IBFD).

11. FI: ECJ, 18 July 2007, Case C-231/05, *Oy AA*, para. 54, Case Law IBFD; NL: ECJ, 8 Nov. 2007, Case C-379/05, *Amurta SGPS v. Inspecteur van de Belastingdienst/Amsterdam*, para. 58, Case Law IBFD; FI: ECJ, 18 June 2009, Case C-303/07, *Aberdeen Property Fininvest Alpha Oy v. Uudenmaan verovirasto and Helsingin kaupunki*, para. 66, Case Law IBFD; FR: ECJ, 10 May 2012, Joined Cases C-338/11 to C-347/11, *Santander Asset Management SGIIC and Others v. Direction des résidents à l'étranger et des services généraux*, para. 47, Case Law IBFD; and FI: ECJ, 21 Feb. 2013, Case C-123/11, *Veronsaajien oikeudenvalvontayksikkö and Valtiovarainministeriö v. A Oy*, para. 41, Case Law IBFD.

12. *See* UK: ECJ, 12 Sept. 2006, Case C-196/04, *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*, para. 55, Case Law IBFD; and NO: EFTA Court, 9 July 2014, Joined Cases E-3/13 and E-20/13, *Fred. Olsen and Others v. the Norwegian State*, para. 166. *See also* E. Traversa, *Territoriality, abuse and*

argument as a justification, for example, as a limit to the deduction of expenses or tax incentives related to situations arising within the territory of the Member State concerned.[13]

However, in the European Union, the discussion of the tax nexus concept goes beyond the traditional dichotomy of the legislative and the enforcement jurisdiction to tax.[14] Two additional dimensions – which are borrowed from the theory of fiscal federalism – must be reckoned with, namely (i) the territorial dimension of the internal market, which is the criterion used in the Treaty on the Functioning of the European Union (TFEU)[15] to attribute legislative competence in the area of taxation to the European Union (the third dimension); and (ii) the territorial dimension of the own resources funding the EU budget (the fourth dimension).

As for the third dimension, the attribution of the power to levy taxes at a central or supranational level has played an important role in the shaping and evolution of federal systems, particularly in its external and internal cross-border dimension (duties on imports and taxes on cross-border trade).[16] The economic theory of fiscal federalism addresses the attribution of functions and fiscal instruments between different levels of government from both a positive and normative perspective.[17] Unlike other international organizations, by forming an internal market the European Union has created a supranational legal framework that has the goal and effect of ensuring the mobility of persons, goods, services and capital throughout the Member

coherence, in *Research Handbook on European Union Taxation Law* pp. 75-93 (C. Panayi, W. Haslehner and E. Traversa eds., Edward Elgar 2020).

13. For a thorough discussion, *see* E. Traversa, *Tax Incentives and Territoriality within the European Union: Balancing the Internal Market with the Tax Sovereignty of Member States*, 6 World Tax J. 3, pp. 315-240 (2014), Journal Articles & Opinion Pieces IBFD.

14. W. Schön, *Neutrality and Territoriality – Competing or Converging Concepts in European Tax Law?*, 69 Bull. Intl. Taxn. 4/5 (2015), Journal Articles & Opinion Pieces IBFD.

15. Treaty on the Functioning of the European Union, OJ C 115 (13 Dec. 2007), Primary Sources IBFD [hereinafter TFEU].

16. The most notable example in European history of political unification through indirect tax harmonization is the German *Zollverein*, a customs union between German states, promoted by Prussia, which went on to set the foundations of the German Empire. Other examples of customs unions are the Austrian Customs Union (1854) and the customs union between Moldavia and Wallachia (which later became Romania) (1847). *See* L. Kohr, *The History of the Common Market*, 20 The Journal of Economic History 3, pp. 441-454 (1960).

17. For an overview of the different economic theories on fiscal federalism, *see* E. Ahmad & G. Brosio, *Handbook of Fiscal Federalism* (Edward Elgar 2006); and W.E. Oates, *An Essay on Fiscal Federalism*, 37 Journal of Economic Literature 3, pp. 1120-1149 (1999).

States.[18] According to article 26 of the TFEU, the internal market "shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaties". The internal market aims at creating the conditions of a unified economic area between Member States, which is similar to what occurs within a sovereign state. This includes the abolition of tax borders between Member States, or – at least – the removal of tax obstacles to cross-border trade.

In order to achieve this objective, Member States have transferred legislative powers to the European Union, including those in the area of taxation. According to the principle of conferral, these powers have to be exercised within the boundaries defined by the EU Treaties. Therefore, a nexus with the internal market for the adoption of legislatives acts in the field of taxation represents a condition to be fulfilled to ensure the validity of EU tax measures. Moreover, the European Union has no competence to enact rules that would apply to territories excluded from its jurisdiction.[19]

The fourth dimension of the nexus in EU tax law refers to the (absence of a) link between the origin of the EU own resources and the destination of the revenue collected. The problem of redistribution between territorial entities is a well-known political issue in federal states. It becomes an even bigger issue in the EU framework where the argument of national solidarity cannot be invoked as efficiently as in nation states. There is an apparent tension between designing an efficient EU-wide resource system (which allocates funds to where they are needed the most) and ensuring its legitimacy among all Member States (which tend to measure the benefits of their membership according to the idea of *juste retour*).

18. *See*, for example, C. Wyplosz, *The Centralization-Decentralization Issue*, European Economy Discussion Paper 14 (26 Sept. 2015), available at https://ec.europa.eu/info/publications/economy-finance/centralization-decentralization-issue_en (accessed 4 July 2022); P. Salmon, *Decentralization and Supranationality: The Case of the European Union*, in *Managing Fiscal Decentralization* pp. 99-121 (E. Ahmad & V. Tanzi eds., Routledge 2002); and R. Hemming & R.P.B. Spahn, *European Integration and the Theory of Fiscal Federalism*, in *Macroeconomic Dimensions of Public Finance: Essays in Honour of Vito Tanzi* pp. 110-128 (M.I. Blejer & T. Ter-Minssian eds., Routledge 1997).
19. *See*, for example, E2: ECJ, 29 Apr. 2004, Case C-338/01, *Commission of the European Communities, supported by European Parliament v. Council of the European Union*, Case Law IBFD; and UK: ECJ, 21 July 2005, Case C-349/03, *Commission of the European Communities v. United Kingdom of Great Britain and Northern Ireland*, Case Law IBFD.

This consideration is to be found in the famous Spaak Report,[20] which paved the way towards the Treaty of Rome in 1957. The report recommended, among other things, the institution of an EU fund to help certain areas and industries to transform their economic model (mostly based on the production of steel and coal), and it explicitly specified that: "For the European Fund to be worthy of its name and to be able to play the part expected of it, there must be no territorial link between the origin of the funds and their utilisation." Interestingly enough, in a much more recent report written for the 2020 German presidency about the future of the reform of the EU own resources, Clemens Fuest and Jean Pisani-Ferry also addressed the relationship between Member States as regards their contributions to, and benefits from, the European Union: "Dominance of Gross National Income (GNI) contributions encourages thinking about the EU budget in terms of net balances, though EU spending creates added value that benefits the EU economy as a whole."[21]

This condition has also been referred to as "non-attributability". As Schratzenstaller and Krenek explain:

> Revenues of a given tax are not directly attributable to specific countries if the tax is levied on activities or bases which are not exclusively connected to individual countries. This is obviously the case for a flight ticket tax levied on carbon emissions, a border carbon adjustment, and a surcharge on national fuel taxes; as the carbon emissions targeted by these taxes are not restricted to individual countries. Nuclear power tax revenues are not directly attributable to a specific country as well, as they are addressing external effects which partially are cross-border in nature. Also, financial transactions and the use of national stock exchanges often have a cross-border dimension, which makes it difficult to attribute the revenues from taxing them to individual countries.[22]

These four different conceptions of the tax nexus form a conundrum that will necessarily have to be overcome to increase the share of tax-based resources in the future reform of the financing of the European Union.

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20. Intergovernmental Committee on European Integration, *The Brussels Report on the General Common Market* (21 Apr. 1956).
21. C. Fuest & J. Pisani-Ferry, *Financing the European Union: New Context, New Responses*, Policy Contribution 16 (Sept. 2020), available at https://www.bruegel.org/wp-content/uploads/2020/09/PC-16-2020-110920.pdf (accessed 4 July 2020).
22. M. Schratzenstaller & A. Krenek, *Tax-based Own Resources to Finance the EU Budget: Potential Revenues, Summary Evaluation from a Sustainability Perspective, and Implementation Aspects*, WIFO Working Papers 581/FairTax Working Paper 25 (2019). *See also* M. Schratzenstaller et al., *Sustainability-oriented EU taxes*, FairTax Project, (WIFO/Mendel University 2016-2018), various working papers are available at https://www.umu.se/en/fairtax/results/ (accessed 4 July 2022).

11.3. The EU own resources system: Origin and evolution

11.3.1. History

From the outset, the drafters of the EU Treaties intended to endow the European Communities with own resources of a fiscal nature. Article 49 of the Treaty Establishing the European Coal and Steel Community (ECSC)[23] explicitly provided that the High Authority of the ECSC could be financed by a levy on the production of coal and steel, a genuine European tax levied on each ton of steel paid directly by the steel companies to the Community[24] budget.

Instead, the 1957 Treaty of Rome[25] provided for a transitional period during which the European Economic Community (EEC) was financed by national contributions before moving to a system of own resources. Article 201 of the Treaty of Rome mandated the Commission to study "under what conditions the financial contributions of the Member States referred to in Article 200 could be replaced by own resources and, in particular, by revenue from the Common Customs Tariff after the latter has been established". The same article provided for a mixed procedure for the adoption of these provisions as follows: (i) a proposal from the Commission; (ii) a consultation of the European Parliament; and (iii) a unanimous recommendation from the Council of the European Union (the Council), with a formal approval

23. *Treaty Establishing the European Coal and Steel Community* (18 Apr. 1951), Primary Sources IBFD [hereinafter ECSC]. The ECSC was signed in Paris on 18 April 1951 and came into force on 23 July 1952. The "common market" provided for in the Treaty was inaugurated on 10 February 1953 for coal and iron and on the following 1 May for steel. The Treaty had a duration of 50 years and ended on 23 July 2002. The ECSC subsequently became part of the European Union.

24. In this context, it seems useful to take up R. Perissich's theory, according to which the ECSC Treaty had several significant differences from the EEC Treaty. One difference, of significance here, concerns financial interventions. According to Perissich: "As is well known, in the EEC Treaty state aid is prohibited only when it distorts competition and the Commission has a certain margin of flexibility to authorize it. In the ECSC Treaty, however, they were banned outright; only joint aid financed from the ECSC budget, which was fed by levies on the coal and steel industries, was permitted. One explanation for this strange balance lies in the fact that the negotiators, fresh from the war, feared a crisis of shortages and not one of overcapacity; the treaty was splendid, but also short-sighted … ." *See* E. Russo, *I beni pubblici europei (con una postilla di Riccardo Perissich)*, 91 Astrid Rassegna 8 (2009), available at http://www.astrid-online.it/static/upload/protected/Russ/Russo_I-beni-pubblici-europei_postilla-Perissich.pdf (accessed 4 July 2022).

25. The Treaty of Rome establishing the European Economic Community (EEC) was signed on 25 March 1957 together with the Treaty establishing the European Atomic Energy Community (TCEEA). The name of the Treaty was later changed to the Treaty Establishing the European Community (TEC), after the entry into force of the Maastricht Treaty, and then to the TFEU, when the Lisbon Treaty entered into force.

by the Member States in accordance with their respective constitutional requirements. However, it must be noted that customs duties were not the only viable solution presented; the application of a production or trade tax similar in kind to the ECSC "levy" was also envisaged.

Then, for 17 years (from 1958 to 1974), the European Communities (the EEC and the EAEC) were financed through a system of financial contributions with political criteria, i.e. based on agreements between states and not on objective macroeconomic data such as their respective Gross Domestic Product (GDP).[26] The Community gave itself own resources for the first time with the Decision of 21 April 1970[27] on replacing the Member States' financial contributions with own resources.[28] No substantial changes to the system have been made since the 1980s (with the addition of the Gross National Income (GNI) own resource),[29] despite the fact that the Treaty on European Union (TEU) and the TFEU were amended by the Lisbon

26. To get a better idea of these criteria, Italy paid 28% of the total contributions to the operating budget (as did France and Germany) However, Italy was favoured in the Social Fund, paying a percentage of 20% of the contributions (unlike France and Germany, which each paid a contribution of 32%), and it had a de facto advantage in financing the common agricultural policy paying a percentage of 21.5%, since contributions were partly linked to net imports from third countries, thus penalizing Germany (31.7%) and France (28%).
27. With this decision, the Council of the European Union set for the last time a general contribution key for ensuring a balanced budget, giving Belgium 6.8%, France 32.6%, Germany 32.9%, Italy 20.2%, Luxembourg 0.2% and the Netherlands 7.3%.
28. For an overview of the main interventions, several own resources decisions have been adopted since 1970. The first seven were Council Decisions, namely (i) 70/243/ECSC, Euratom: Council Decision of 21 April 1970 on the replacement of financial contributions from Member States by the Communities' own resources, OJ L94/19 (28 Apr. 1970); (ii) 85/257/EEC, Euratom: Council Decision of 7 May 1985 on the Communities' system of own resources, OJ L128/15 (14 May 1985); (iii) Council Decision of 24 June 1988 on the system of the Communities' own resources, OJ L185/24 (15 July 1988); (iv) Council Regulation (EC, Euratom) No 2729/94 of 31 October 1994 amending Regulation (EEC, Euratom) No 1552/89 implementing Decision 88/376/EEC, Euratom on the system of the Communities' own resources, OJ L293/1 (12 Nov. 1994); (v) Council Decision of 29 September 2000 on the system of the European Communities' own resources (2000/597/EC, Euratom), OJ L253/42 (7 Oct. 2000); (vi) Council Decision of 7 June 2007 on the system of the Communities' own resources (2007/436/EC, Euratom), OJ L163/17 (23 June 2007); and, finally, (vii) 2014/335/EU, Euratom: Council Decision of 26 May 2014 on the system of own resources of the European Union, OJ L168 (7 June 2014), which, as expressly provided for in the Decision, must ensure adequate resources for the proper development of EU policies, without prejudice to the need for strict budgetary discipline. Additionally, the evolution of the own resources system can and should contribute to a broader budgetary consolidation effort undertaken by Member States and, to the extent possible, to the development of EU policies. *See* European Commission, *Commission Staff Working Paper "Financing the EU budget": Report on the operation of the own resources system*, SEC(2011) 876 final/2 (27 Oct. 2011) [hereinafter European Commission Working Paper].
29. *See* European Commission Working paper, *supra* n. 28, at p. 3.

Treaty in order to empower the Council to adopt new own resources (former article 269 of the TEC, now article 311 of the TFEU).[30]

11.3.2. Legal basis: Article 311 of the Treaty on the Functioning of the European Union

According to article 311 of the TFEU:

> The Union shall provide itself with the means necessary to attain its objectives and carry through its policies.
>
> Without prejudice to other revenue, the budget shall be financed wholly from own resources.
>
> The Council, acting in accordance with a special legislative procedure, shall unanimously and after consulting the European Parliament adopt a decision laying down the provisions relating to the system of own resources of the Union. In this context it may establish new categories of own resources or abolish an existing category. That decision shall not enter into force until it is approved by the Member States in accordance with their respective constitutional requirements.
>
> The Council, acting by means of regulations in accordance with a special legislative procedure, shall lay down implementing measures for the Union's own resources system in so far as this is provided for in the decision adopted on the basis of the third paragraph. The Council shall act after obtaining the consent of the European Parliament.

The determination of the EU own resources is a matter reserved for the Council acting unanimously, merely requiring a consultation of the European Parliament – except when it comes to the adoption of the implementing measures. The European Parliament's powers have increased over time on the expenditure side, and the Parliament is now placed on an (almost) equal footing with the Council as regards the establishment of the multiannual financial framework[31] and the annual EU budget.[32]

The relatively undefined nature of the term "own resources" does not exclude that those resources originate directly or indirectly from tax

30. Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community, OJ C306 (2007).
31. Art. 312 TFEU.
32. Arts. 310 and 314 TFEU. However, it could be argued that the abolition of the distinction between compulsory expenditures and non-compulsory expenditures in the EU budget by the Treaty of Lisbon has reduced the autonomy of the European Parliament as regards the latter type of expenditures (over which the European Parliament used to have the final say).

revenues. However, the existence of other provisions in the EU Treaties granting legislative powers in the area of taxation, jointly with the principle of conferral (article 5(2) of the TEU), does not allow for the possibility to infer a genuine power to levy EU taxes from article 311 of the TFEU.

11.3.3. Types of resources

The current system consists of four main sources of revenue: (i) traditional own resources; (ii) a VAT-based own resource; (iii) a GNI-based own resource; and (iv) since 2021, a plastic contribution. Moreover, an overall cap on resources and expenditures has been established: under the rules agreed for the period 2014 to 2020, the European Union could mobilize own resources for payments of up to a maximum amount of 1.2% of the sum of all Member States' GNI. This cap will be raised to 1.4% for the period 2021 to 2017, with temporary increases allowed, to be determined at a later stage according to a formula contained in article 3 of Council Decision (EU, Euratom) 2020/2053.[33]

Traditional own resources are customs duties, which are currently the closest thing there is to a genuine EU tax. The European Union has an exclusive competence regarding the determination of the scope and structure of customs duties, and the associated revenue directly accrues to the EU budget after a 25% (since 2021) deduction, which is supposed to remunerate for collection costs. Moreover, as an essential element of the internal market and the external commercial policy, legislation in the area of customs duties (like the Union Customs Code and its implementing regulations)[34] is not considered to be of a fiscal nature and, therefore, is jointly adopted by the Council (with a qualified majority) and the European Parliament under an ordinary legislative procedure. Customs duties totalled EUR 19,867 billion in 2020, which was around 11.4% of the total EU resources for that year.

33. Council Decision (EU, Euratom) 2020/2053 of 14 December 2020 on the system of own resources of the European Union and repealing Decision 2014/335/EU, Euratom, OJ L424 (15 Dec. 2020) [hereinafter Council Decision (EU, Euratom) 2020/2053].
34. Regulation (EU) No 952/2013 of the European Parliament and of the Council of 9 October 2013 laying down the Union Customs Code, OJ L269/1 (10 Oct. 2013); Commission Delegated Regulation (EU) 2015/2446 of 28 July 2015 supplementing Regulation (EU) No 952/2013 of the European Parliament and of the Council as regards detailed rules concerning certain provisions of the Union Customs Code, OJ L343/1 (29 Dec. 2015); and Commission Implementing Regulation (EU) 2015/2447 of 24 November 2015 laying down detailed rules for implementing certain provisions of Regulation (EU) No 952/2013 of the European Parliament and of the Council laying down the Union Customs Code, OJ L343/558 (29 Dec. 2015).

The other two EU resources take the form of compulsory national contributions by the Member States to the EU budget, and these amounted to 80.4% of the total EU revenue in 2020.

The VAT-based own resource is calculated on the basis of a uniform rate of 0.3% applied to the corrected VAT base of each Member State, with the VAT base capped at 50% of each country's GNI. According to the Commission, "the VAT based contribution is complex, requires an important administrative work necessary to harmonize the calculation basis, and offers little or no added value compared to the GNI based own resource. Furthermore, due to the statistical nature of the basis, the resource is fully independent of, and does not support VAT policies at EU or Member States level".[35] The financial relevance of the VAT-based own resource has steadily declined since the 1980s, and it currently accounts for approximately 12% of total EU own resources. Despite various proposals from the Commission,[36] the Council has not yet seized the opportunity to transform it into a truly tax-based own resource, which would – at least in part – directly accrue to the EU budget.[37]

The GNI-based own resource – which was originally supposed to have a purely supplementary role – currently accounts for more than 70% of the EU budget. It is calculated by applying a uniform rate to Member States' GNIs. This rate is adjusted each year in order to achieve a balance between revenue and expenditure. However, several exceptions have been established. In the wake of a rebate provided to the United Kingdom, which is no longer a Member State, some other EU Member States have benefitted from flat-rate corrections as follows: for the period from 2021 to 2027 (i) EUR 565 million for Austria; (ii) EUR 377 million for Denmark; (iii) EUR 3,671 million for Germany; (iv) EUR 1,921 million for the Netherlands; and (v) EUR 1,069 million for Sweden.[38]

35. European Commission Working Paper, *supra* n. 28, at p. 4.
36. *See* Commission proposals on the system of own resources of the European Union: European Commission, Proposal for a Council Decision on the system of own resources of the European Union, COM(2011) 510 (29 June 2011), Primary Sources IBFD [hereinafter European Commission Proposal]; and European Commission, Proposal for a Council Decision on the system of own resources of the European Union, COM(2018) 325 (2 May 2018), Primary Sources IBFD. *See also* European Commission, Report from the Commission, Financing the European Union. Commission report on the operation of the own resources system, vols. I and II, COM(2004) 505 final (14 July 2004), Primary Sources IBFD.
37. The relation between the EU budget and the taxpayers is not direct, and is instead indirect, as the VAT-based own resource is a contribution made by the Member States.
38. Council Decision (EU, Euratom) 2020/2053.

The choice to favour the GNI-based own resource over the VAT-based own resource was justified by the regressive effect and complexity of the latter. On the one hand, the consumption share in relation to GNI is larger in economically weaker Member States, and, on the other hand, the GNI-based own resource is particularly suitable from the point of view of fairness of contributions because it is simple and transparent. Moreover, it can be understood as a measure of how much each Member State benefits economically from the Union. For this reason, GNI is also of crucial importance in the financing of EU COVID-19 aid measures.

The plastic contribution – applicable from 2021 – depends on the weight of plastic packaging waste generated in each Member State that is not recycled. A uniform call rate has been set at EUR 0.8 per kilogram. Annual lump sum specific reductions are also granted to certain Member States.[39]

Council Decision (EU, Euratom) 2020/2053 also regulates the borrowing of funds under the NextGen program and Recovery Fund, defined as an "extraordinary and temporary additional means to address the consequences of the COVID-19 crisis", setting a EUR 750 billion ceiling. Besides the financial means listed in the own resources decision, the EU budget is also funded by other revenues, which accounted for approximately EUR 14 billion in 2020. Among these other revenues is a tax on EU civil servants. This is the only genuine EU tax, and for which the European Union has complete tax sovereignty; however, it is not considered an own resource.

In their legal consequences, however, other revenues and own resources differ significantly because the principle of budget balancing applies to own resources only (that is, article 310 of the TFEU applies to own resources only).

11.4. The loose relationship between the own resources system and EU tax harmonization

Although the European Union has legislative powers in the area of taxation, these powers do not pursue a financial or budgetary objective. They are exercised with a legal and economic objective, which is the achievement of the internal market. As article 113 of the TFEU on the harmonization of indirect taxation explicitly states – similarly to article 115 of the TFEU, which serves as a legal basis to adopt acts in the area of direct taxation – the

39. Art. 2(1c) and (2) Council Decision (EU, Euratom) 2020/2053.

European Union may adopt acts "to the extent that [they are] necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition in a way that is functional to the completion of the internal market".[40]

Both provisions provide for a special legislative procedure that involves the Council acting unanimously as the sole legislative body and the European Parliament providing a consultative role. Therefore, a clear separation exists – with minor overlaps – between the rules defining the extent of the powers in the area of taxation and those determining the own resources through which the EU budget is financed. The nature of these own resources and their relationship to taxation is quite different. Customs duties are the closest thing to a genuine EU tax that we know of today. Because, also from a constitutional perspective, custom duties remain national taxes, the European Union has the exclusive competences regarding the structure of the custom duties, their rates, the way they are collected and the revenue generated by them and by different Member States to the EU budget.

Moreover, there is a clear link between customs duties and the competence transferred to the European Union (in particular, trade policy), the customs union and the internal market. Customs duties currently represent approximately 12% of the total EU budget. The VAT-based resource, despite its name, has little to do with VAT. It is not part of the VAT revenue collected by the Member States and is fully independent from EU or domestic VAT policies. In addition, the GNI-based own resource is totally independent from EU tax competences.

As the precedent set by customs duties shows, nothing in the Treaty prevents a new EU own resource from being tax-based. However, this would require the adoption of common – if not identical – rules on the structure of the tax at the EU level, which could only be achieved using a legal basis already existing in the EU Treaties. Article 311 of the TFEU is indeed not a valid legal basis for the harmonization or creation of taxes, as it merely deals with the attribution of financial means to the European Union. Currently, those are article 113 of the TFEU for indirect taxes, article 115 of the TFEU for direct taxes and article 192 of the TFEU for environmental taxes – which all provide for unanimity of the Council and a mere consultation of the

40. *See* G. Kofler, *EU power to tax: Competences in the area of direct taxation*, in *Research Handbook on European Union Taxation Law* p. 11 (C. Panayi, W. Haslehner & E. Traversa eds., Edward Elgar 2020).

European Parliament.[41] However, the question may be asked whether such a procedure is appropriate for establishing the base and the rate of a future EU tax. Articles 113 and 115 of the TFEU enable the Council to adopt tax legislation for a specific purpose. Indeed, article 115 of the TFEU confers powers to the Council to "issue directives for the approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the internal market".

Moreover, such directives should comply with the subsidiarity and proportionality principles laid down in article 5 of the TEU. It appears legitimate to raise the question of whether new legislation solely aiming at harmonizing the structure of a future EU tax would help to attain the objective of the achievement of the internal market, and whether its adoption at the EU level would meet the subsidiarity and proportionality criteria.[42] In this respect, there is a relationship to be established between the third and fourth dimension of the nexus in EU tax law: future tax-based own resources should derive from taxes that have (i) a type and a structure clearly identifiable with cross-border situations connected to the achievement of the internal market; and (ii) revenues that cannot easily be linked to the territory of a single Member State. In other words, new own resources should be based on taxes that are more efficiently designed and collected – even through a decentralized administrative structure – at the EU level and that would fund competences attributed to EU institutions.

11.5. A nexus perspective on the reform to the EU own resources system

Despite the clear distinction made in the EU Treaties as regards the legal basis between EU own resources and EU powers in the area of taxation, there has been a political demand for a close link between the decisions on how the EU budget is used and the decisions on how the EU budget is

41. *See*, among others, M. Lang et al. (eds.), *EU-Tax* (Linde 2008); and C. Sciancalepore, *Le risorse proprie nella finanza publica europea* p. 198 et seq. (Cacucci 2021).
42. Similar doubts have been expressed as regards the adoption of the Anti-Tax Avoidance Directive (2016/1164) (ATAD), which can be seen as an empowerment to Member States to strengthen their domestic tax systems and to adopt anti-abuse measures, even in an EU cross-border context, without harmonizing or coordinating their corporate tax systems. From such a perspective, the question may legitimately be asked as to whether the ATAD really serves the purpose of achieving the internal market. *See* E. Traversa, *The prohibition of abuse of rights in European Tax Law: sacrificing the internal market for the fight against base erosion and profit shifting?*, 9 Studi Tributari Europei 1, p. 13 (2019), available at https://ste.unibo.it/Article/view/10682/11222 (accessed 4 July 2022).

funded.[43] This goes hand in hand with strengthening the link between EU revenue and EU taxing competences.

Over the years, the Commission has unsuccessfully proposed the harmonization of a carbon tax,[44] a CO2-based car taxation,[45] a financial transaction tax (including under enhancement cooperation),[46] a common consolidated corporate tax base (CCCTB) (twice, in 2011 and 2016)[47] and, more recently, two types of digital taxes.[48] In the 2017 reflection paper on the future of EU finances,[49] the Commission elaborated on several scenarios, more or less ambitious, some of them proposing to use the revenue generated by these so-called new taxes as a basis for EU own resources.

Council Decision (EU, Euratom) 2020/2053 explicitly mentions that additional own resources will have to be adopted or envisaged. Those funds will be needed for the repayment of the financing costs of the NextGeneration EU borrowing and for the Social Climate Fund.[50] As recital 8 states:

43. European Commission, Report from the Commission on the working of the own resources system, COM(2004) 505 final p. 51 (6 Sept. 2004); and European Commission, Reflection Paper on the future of EU finances, COM(2017) 358, point 4.3. (28 June 2017) [hereinafter European Commission Reflection Paper on the future of EU finances].
44. European Commission, Proposal for a Council Directive introducing a tax on carbon dioxide emissions and energy, COM(1992) 226 final (2 June 1992).
45. European Commission, Proposal for a Council Directive on passenger car related taxes, COM (2005) 261 final (5 July 2005).
46. European Commission, Proposal for a Council Directive on a common system of financial transaction tax and amending Directive 2008/7/EC, COM(2011) 594 final (28 Sept. 2011); and European Commission, Proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax, COM(2013) 71 final (14 Feb. 2013).
47. The original European Commission, Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), COM(2011) 121 (16 Mar. 2011), Primary Sources IBFD; and the relaunch: European Commission, Proposal for a Council Directive on a Common Corporate Tax Base (CCCTB), COM(2016) 683 (25 Oct. 2016), Primary Sources IBFD; and European Commission, Proposal for a Council Directive on a Common Corporate Tax Base, COM(2016) 685 (25 Oct. 2016), Primary Sources IBFD. The Commission will withdraw the 2016 proposals and is instead working on a new approach (Business in Europe: Framework for Income Taxation, to be presented in 2023), which will, however, retain the principles of a common tax base and of formulary apportionment. *See* European Commission, Communication on Business Taxation for the 21st century, COM(2021) 251, p. 13 (18 May 2021).
48. European Commission, Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services, COM (2018) 148 final (21 Mar. 2018), Primary Sources IBFD.
49. European Commission Reflection Paper on the future of EU finances, *supra* n. 43.
50. European Commission, Proposal for a regulation of the European Parliament and the Council establishing a Social Climate Fund, COM(2021) 568 final (14 July 2021).

> The European Council of 17 to 21 July 2020 noted that, as a basis for additional own resources, the Commission will put forward in the first semester of 2021 proposals on a carbon border adjustment mechanism and on a digital levy with a view to their introduction at the latest by 1 January 2023. The European Council invited the Commission to put forward a revised proposal on the EU Emissions Trading System, possibly extending it to the aviation and maritime sectors. It concluded that the Union will, in the course of the multiannual financial framework for the period 2021-2027 ('MFF 2021-2027'), work towards the introduction of other own resources, which may include a Financial Transaction Tax.

In December 2021,[51] the Commission proposed to add to the existing own resources a fraction of the revenue generated from allowances to be auctioned from the emissions trading (25%) and a 75% share of the revenue from the sale of carbon border adjustment mechanism certificates, as well as national contributions to the EU budget based on the share of the residual profits of the largest and most profitable multinational enterprises reallocated to Member States as end market jurisdictions under the 2021 OECD Pillar One agreement (15%)[52] – as it will be implemented in the European Union.[53]

Moreover, the Commission will present a proposal for a second basket of new own resources by the end of 2023, which could include a financial transaction tax and an own resource linked to the corporate sector, based on the announced Business in Europe: Framework for Income Taxation proposal.[54]

All of the proposed new own resources seem prima facie to comply with the third and fourth dimensions of the nexus described in section 11.2., as

51. European Commission, Proposal for a Council Decision amending Decision (EU, Euratom) 2020/2053 on the system of own resources of the European Union, COM(2021) 570 (22 Dec. 2021).
52. The aim of Pillar One is to attribute some taxing rights to the country of destination through a new nexus rule based on sales, independently from the existence of a permanent establishment. *See* OECD, *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* p. 1 (OECD 2021). *See also* OECD, *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS* para. 194 (OECD 2020). For a more detailed analysis, *see* the contributions of Otto &Van de Vijver (ch. 3), Gadžo (ch. 2) and Monsenego (ch. 4).
53. The Commission has announced a proposal for 2022. *See* Press Release, *Commission proposes swift transposition of the international agreement on minimum taxation of multinationals* (22 Dec. 2021), available at https://taxation-customs.ec.europa.eu/news/commission-proposes-swift-transposition-international-agreement-minimum-taxation-multinationals-2021-12-22_en (accessed 8 Aug. 2022).
54. European Commission, Communication on the next generation of own resources for the EU budget, COM(2021) 566, p. 5 (22 Dec. 2021).

has already been evidenced in previous studies.[55] However, a caveat has to be made as regards own resources based on a tax on corporate income that would be apportioned among the Member States. Using criteria to link income to the national territory of a Member State – whether based on sales, payroll, assets or other criteria – and then calculating an amount to be paid as an own resource to the EU budget would inevitably trigger discussions as regards the *juste retour* of EU expenditures. This is even more pertinent to a harmonized tax that would be replacing an existing national tax. The argument is slightly less relevant when it comes to an own resource based on a tax on *additional* corporate income generated by new EU rules, as is the case for the future directive implementing the OECD Pillar One consensus.

Nevertheless, corporate income tax (CIT) remains an excellent candidate for an additional own resource. The issue is, rather, whether it would not be more straightforward to directly apply a rate on the consolidated corporate income at the EU level, and then let Member States apply their own rate and derogations to the taxable base attributed to them. One could even suggest a bolder approach by advocating for an EU CIT for large multinational enterprises, as the late Frans Vanistendael did in one of his last publications:

> The concept of a single EU corporate income tax at EU level, all the revenue of which would flow to the EU budget, allows for a much simpler and straightforward regulation than the CCCTB. To the extent that the amount of revenue of this tax would exceed the needs of the EU budget, it could be compensated by a reduction of the GNI contribution of the Member States to that budget, reducing in the right proportion the national budgetary burdens of the Member States. Finally, a uniform EU corporate income tax is a decisive step to achieve eventually the economic integration of the internal market between the Member States, which is one of the fundamental objectives of the TEU.[56]

The recent consensus on Pillar One and Pillar Two may provide a source of momentum to push for a solution of this type. Indeed, apart from the

55. *See*, for example, Commission Staff Working Document, *Financing the EU budget: report on the operation of the own resources system* – Accompanying the document *Proposal of a Council Decision on the system of Own Resources of the European Union* COM(2018) 325 final, SWD (2018) 172, p. 31 (2 May 2018), available at https://ec.europa.eu/info/sites/info/files/staff-working-document-system-own-resources-may2018_en.pdf (accessed 4 July 2022), which states the following: "Nevertheless, the Financial Transaction Tax-based Own Resource could be a viable 'candidate' which fulfils many criteria (in particular its mobile tax base and cross-border nature) which can only be regulated effectively – or taxed efficiently – at EU level. As such, it would have a marked EU added value dimension."
56. F. Vanistendael, *An EU Corporate Income Tax Filling the Hole in the EU Budget: An End to Tax Competition and "Tax Abuse"?*, 75 Bull. Intl. Taxn. 11/12 (2021), Journal Articles & Opinion Pieces IBFD.

traditional hostility of certain Member States towards any form of convergence (which the recent OECD/G20 negotiations have largely contributed towards overcoming), there were significant technical hurdles to the EU CIT harmonization in the European Union due to the great diversity of national systems. However, the agreed mechanisms, and, in particular, the introduction of a 15% effective tax rate threshold under Pillar Two have allowed for the finding of a common language as regards the determination of the tax base. Building on that *acquis* to agree on uniform EU CIT rules seems much more within reach than before, when Member States were discussing the 2011 and 2016 CCCTB proposals without a common starting point.

Another tax which has a strong link to the internal market is VAT. VAT is the most harmonized tax, besides customs duties, and it is already used as a basis to calculate one of the own resources. In comparison with all the other taxes, not much would be needed to make the most significant EU own resource from it, both in terms of yield and visibility for EU citizens. It is certainly worth remembering the solution devised in the 2011 Commission's proposal,[57] which was unfortunately ignored by the Member States. The idea concerned a slight modification of the current system of own resources in addition to a single innovation, which the Member States were not ready to discuss at the time. Namely, that of transforming the VAT resource into a (quasi) European tax, with the establishment of a specific European rate on top of the national one, at a maximum of 2% (of the taxable amount). This proposal by the Commission has merits in terms of its simplicity, its feasibility and its link to the internal market. The EU VAT system is indeed largely harmonized, instruments for cooperation between Member States exist and a common VAT culture between national administrations is slowly developing.

Moreover, the impact of this proposal in terms of revenue can be precisely estimated. Such a solution would certainly require changes, such as further harmonization as regards exemptions and exclusions and increased cooperation between Member States' VAT administrations and the Commission, as well as a modification to the structure of the VAT own resource in the Council Decision (EU, Euratom) 2020/2053. However, this would not constitute a legislative revolution: it would rather represent an evolution of a process that started decades ago.

In addition, and even though this argument is often used against such a solution, VAT is a tax that is paid by everyone: every consumer, rich or poor,

57. European Commission Proposal, *supra* n. 36.

but also every business, in one way or another. A VAT-based own resource could provide a stronger sense of EU citizenship, in comparison to other, and more sectoral, levies that would give the impression that the European Union has been created for large businesses, such as digital companies or banks. A lighter version of this idea would be to apply this EU rate only to certain transactions or taxable persons, which by nature or by size are more likely to have a strong link to the internal market.

From a nexus perspective, both CIT and VAT are, therefore, ideal candidates not only for additional own resources, but also for genuine EU taxes. To a certain extent, such a reform of the own resources mechanism would allow the European Union to go back to its origins. The ECSC – created in 1951 and then absorbed by the EEC – was financed through a mechanism that was a perfect illustration of the four dimensions of the tax nexus in the EU context: namely, a levy on the production of coal and steel, at a modest rate (less than 1%) fixed by the High Authority of the ECSC, the forerunner of the Commission, which directly collected it from undertakings active in those sectors and used it to fund a common European industrial policy.[58]

58. Art. 49 ECSC, signed in Paris on 18 April 1951. *See also* High Authority Decision No 2-52 ECSC of 23 December 1952 determining the mode of assessment and collection of the levies provided for in Articles 49 and 50 of the Treaty (30 Dec. 1952), available at https://www.cvce.eu/content/publication/2005/7/25/ba99ed32-9c6f-4798-b77d-27a15401a566/publishable_en.pdf (accessed 4 July 2022); and High Authority Decision No 3-52 ECSC of 23 December 1952 on the amount of and methods for applying the levies provided for in Articles 49 and 50 of the Treaty, (30 Dec. 1952), available at www.cvce.eu /en/obj/high_authority_decision_no_3_52_ecsc_23_december_1952-en-9fc48d14-f5f8-47d1-8251-0c905e120577.html (accessed 4 July 2022).