MILMUN 13TH CONFERENCE

ADDRESSING THE CHANGING IDEAS OF NATION AND CITIZENSHIP

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ECONOMIC AND FINANCIAL AFFAIRS COUNCIL OF THE EUROPEAN UNION
STUDY GUIDE
Welcome Letter

Dear Delegates,

It is our pleasure to welcome you to the Council of the European Union Committee at MILMUN 2018! We are Justine and Carlos and we have the privilege of serving as the Chairs for the ECOFIN Committee during this week.

Justine is attending her second year of Economics and Finance at Bocconi University in Milan, while Carlos is in his second year studying Politics and Economics at the University of Nottingham. We have been involved in Model UN for some years now: Justine has started as a Delegate in Mexico and then chaired in two conferences in Italy; whereas Carlos has been a Delegate, a Chair and a Deputy Secretary General both in the UK and in the US.

We came up with two topics that we retain are of the utmost importance to the European economic community. The Corporate Tax System and the Completion of the Banking Union are relevant issues, both to keep the financial system safe and to further integrate the Union. These matters are already discussed by the European leaders, but there is still a lot to be done.

This background guide was written as an introduction to these topics. We worked hard, and now it is your turn to do so! You will need to explore the question and get to know the challenges you will have to face. We hope that our work was thorough and will help you in your research.

We cannot wait to meet you all. If any questions arise, feel free to reach out to us.

Best, and see you in April! Good luck!

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Council of the European Union – Economic and Financial Council

History

The Council of the European Union is one of the main institutions of the EU, acting both as an executive and legislative institutional authority. It represents the governments of the Member States and it meets in ten different configurations of the 28 national ministers.¹

The Council historically derives from the “Special Council of Ministers” of the European Coal and Steel Community (ECSC), that was established by the Paris Treaty, in 1951, together with a High Authority (the executive that would later become the European Commission), Assembly and the Court. The Council’s main function at that time was to control the supranational power of the High Authority by issuing opinions on its decisions that did not concern the two raw materials.²

In 1958, The Treaty of Rome was the basis of the European Economic Community (EEC) and the European Atomic Economic Energy Community (Euratom), and their respective Councils. The two new Councils (EEC and Euratom) were given more power in order to counterbalance the authority of the Commission, and became key decision-making bodies.³

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At that time, the negotiations endured some difficulties due to the need of coordination of the three Communities. The first major crisis, known as the “empty chair crisis”, occurred in 1965, when the French President Charles de Gaulle, who disagreed with Commission proposals concerning the Common Agricultural Policy (CAP), refused to attend Council meetings from that time on. Indeed, the absence of France blocked the progress of the Council’s work until the issue was resolved with the *Luxembourg compromise* the year after.⁴

In order to definitely resolve the issue of coordinating activities of the Communities, the Merger Treaty of 1967 created a single European Community, with a single Council and a single Commission, to replace the three Communities: ESCS, Euratom and EEC.⁵

In 1993, the Maastricht Treaty created the European Union and the system of the three pillars: the European Community (first pillar), the Common Foreign and Security Policy (CFSP, second pillar) and the Police and Judicial Co-operation in Criminal Matters (PJCCM, third pillar). Simultaneously, the Council was given the name it holds today: The Council of the European Union (EU Council). The European Community pillar introduced the co-decision procedure of the European Parliament and the EU Council, that reduced their ability of acting independently in order to balance the power between European institutions.⁶

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Once the Lisbon Treaty entered into force, in 2009, the European Council was declared a separate institution from the EU Council, stating a clear difference between the two for the first time.\footnote{European Union, n.d. \textit{The Lisbon Treaty}. [Online] Available at: \url{http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=LEGISSUM:ai0033} [Accessed 26 12 2017].}

The Economic and Financial Affairs Council (ECOFIN) is a configuration of the EU Council, composed of the economy and finance ministers from all the member states, as well as Budget Ministers when budgetary issues are discussed. The Council meetings usually take place once a month in Brussels or Luxembourg.

The ECOFIN is responsible for different EU policy areas, such as economic policy, taxation issues and the regulation of financial services. More specifically, it covers: the coordination of economic policies, monitoring of EU States’ budgetary policy and public finances, as well as legal and practical aspects of the euro. It also adopts, together with the European Parliament, the yearly budget of the European Union.\footnote{European Union, n.d. \textit{ECOFIN} official website. [Online] Available at: \url{http://www.consilium.europa.eu/en/council-eu/configurations/ecofin/} [Accessed 26 12 2017].}
Modus Operandi

The European Union (EU) has a complex, but unique, set-up. Article 13 of the Treaty on European Union establishes the institutional framework of the EU. These institutions are: the European Parliament (EP), the European Council (EC), the Council (of the EU), the European Commission, the Court of Justice of the European Union, the European Central Bank, and the Court of Auditors. From all these bodies, only three are the main law-making institutions; the European Parliament and the Council of the European Union are the legislature branch, and the European Commission is the executive branch. It is also important to note that the European Council does not have any law-making powers but is in charge of defining ‘the EU’s overall political direction’.

The law-making process is relatively similar to that of bicameral parliamentary systems. The executive (the Commission) proposes a law and both legislative bodies (the EP and Council of the EU) can block or amend its adoption.

The institution that we will be simulating in this committee is the Council of the European Union (not to be confounded with the Council of Europe), which is the ‘voice of the EU member states’ (while the European Parliament could be considered the voice of the EU citizens since it is the

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11 Ibid

only directly elected institution) as here is where the government ministers from the member states meet to legislate.\textsuperscript{13}

As already mentioned, the Council of the European Union can be configured in ten different settings and on each of them the minister responsible for the policy area of discussion is the one representing the member’s position on the issue.\textsuperscript{14} In this occasion, we will meet under the Economic and Financial Affairs Council (ECOFIN) configuration that is responsible for discussing economic policy, taxation, the regulation of the financial services in the EU and the coordination of the EU position for international meetings (i.e.: G20 and IMF).\textsuperscript{15} Even if this is a Council where all the EU members participate, Eurozone countries created the \textit{Eurogroup}, that convenes on the eve of the ECOFIN meeting as an informal body where ministers of euro area countries coordinate economic policies.\textsuperscript{16}

The voting method in the Council was reformed in the Treaty of Lisbon and it is established under Article 16 of the Treaty on European Union (TEU) and Article 238 of the Treaty on the Functioning of the European Union (TFEU). Therefore, we will use the simple majority rule for voting on procedural matters and both the qualified majority system or the unanimity system to pass a resolution.

\textsuperscript{14} Ibid
Unanimity will be used to vote on topic A and, under Article 238(4) of TFEU, an abstention does not prevent the adoption of a resolution.

Qualified majority, which will be used when voting on topic B, is defined under Article 16(4) of the TEU:

“As from 1 November 2014, a qualified majority shall be defined as at least 55 % of the members of the Council, comprising at least fifteen of them and representing Member States comprising at least 65 % of the population of the Union.

A blocking minority must include at least four Council members, failing which the qualified majority shall be deemed attained.”
Introduction

Year 2017 has been tough for some giant tech companies, especially the well-known group known under the acronym GAFA (Google, Amazon, Facebook, Apple).

Last summer, the European Commission requested that Apple should pay €13 billion to the Irish Government, the amount that was considered to consist of “unpaid taxes” and “abused state aid”. Even though Irish corporate tax rate of 12.5% is among the lowest in the European Union, in 2014 the company only paid a tax rate of 0.005% to the Iris Government.¹

Google was also imposed a €2.42 billion fine by the Commission for abusing its dominant position of the main online search engine in order to favour its own prices comparator “Google Shopping.”²

It has also recently been discovered that the company moved €16 billion to Bermuda in 2016, using the “Double Irish” and “Dutch Sandwich” technique. This fiscal avoidance method allowed Alphabet, Google’s parent company, to save up to $3.7 billion in taxes in 2016.³

In October 2018, Amazon also drew the attention of the Commission and the firm was asked to pay around €250 million to the Luxembourg Government that it had received as illegal tax advantages.⁴
These schemes are only some of the many ways to “optimize” taxes, and they consist of using a combination of Irish and Dutch subsidiary companies to partially or entirely avoid tax jurisdictions, take advantage of different national corporate taxation systems and reduce the corporate tax rates considerably.

Generally speaking, a report by the European Commission, published in September 2017, revealed that the average global tech firm, with no physical presence in a country, typically pays a 10.1% tax rate in the European Union, which is less than half of the 23.2% average rate paid by traditional companies.\(^v\)

Therefore, these recent events have not only drawn the attention of the European Commission, but also rose the awareness among European citizens, since the matter became of public interest.

Not only are the companies that follow the law and pay their taxes zealously watching others take advantage of the system, but some are also affected by the “cross-border double taxation” problem (i.e. some firms are subjected to taxation by two different countries due to a lack of coordination). The European Commission is also trying to face this issue which is only regulated by bilateral tax treaties that States have in place.

It is crucial to pay attention to the fact that this is not fiscal evasion, but fiscal avoidance. This means that some multinational companies are able to take advantage of what has clearly been recognized as a loophole in the economic system, creating the phenomenon of harmful tax competition between EU Member States.

These facts make clear why the EU has decided to face this issue and why it has become necessary for us to discuss the harmonization of the corporate tax system.
It is crucial to know the facts in order to understand what concrete advantages a harmonization brings and how it comes to be established. In short, a consolidated tax base would create a unique company taxation system, avoiding the 28 different national taxation codes. This would result in a reduction of compliance costs for companies and the tax administration costs for government. But let’s examine the issue in more detail!

**History of the Problem and Past EU Action**

Is harmonization of corporate tax systems necessary in the European Union? If that is the case, how should such an undertaking be achieved? This is the question that European policy makers have been trying to answer for more than 50 years.

**1960s-1980s period**

The corporate tax system that is in place today was conceived during the first half of the twentieth century, at a time when most companies were industrial and used to sell only tangible products, as opposed to the intangible often digital ones that we now use with every day. Therefore, the corporate taxation system based on this premise has been adequate only until the global transformation process radically transformed the traditional business models.

The urgency for legal modernization that needs to follow the revolution in production and economy in general led to the debate on European fiscal integration that started in 1960s (already then there were problems in the idea of a Single Market).vi

Some studies carried out in that decade, such as the Neumark Report of 1962, were already realizing the necessity to achieve at least a limited degree of harmonization of the corporate tax
The Commission followed this advice by making its first attempts to address the problem with three different directives between 1975 and 1985. However, these were all withdrawn since the Member States at that time were reluctant to work on solving the issue.

1990s

In 1990, the European Commission requested a committee of independent experts to conduct a study on the Internal Market, in order to understand whether or not the differences in corporation tax caused distortions. The Committee’s final conclusion was that distortions were effectively present in the European market, despite the fact that a positive convergence had started to be observed among the different Member States.

The Committee insisted that the Member States could not solve the problem through different national approaches and action was needed at a higher level.

The main guidelines given by the Committee were: removing obstacles to cross-border business investment and shareholding, setting a minimum level for statutory corporation tax, creating a common set of rules for a minimum tax base, and encouraging transparency. The two focuses of the European Union on the matter of the corporation tax should have been to prevent tax evasion and to suppress of the double taxation of cross-border income flows. However, it was not recommended to aim for a “total harmonization” framework, since intermediate steps were needed to reach that long-term objective.

Therefore, in 1990, the Commission started to take measures. Since it was impossible to make the existing initiatives advance, a Communication proposed that every initiative should pass
through a consultative process among the Member States. This premise led to the adoption of two directives and one convention: The Merger Directive, the Parent-Subsidiary Directive and the Arbitration Convention.

The Merger Directive aimed to create a common taxation system for mergers, divisions and reorganisations, in order to eliminate the fiscal barriers that impeded these operations for companies placed in different Member States.

The Parent subsidiary directive, that was then improved in 2003, aimed to remove the fiscal obstacles for profit distributions among companies’ groups, especially “preventing double taxation of parent companies on the profits of their subsidiaries.”

The Arbitration Convention was also established with the aim of resolve controversies on double taxation.

A second huge step was made in 1997 with the Tax package and the Code of Conduct for business taxation. This initiative would allow every Member State that adopts it to remove the fiscal measures that created harmful tax competition, making the countries work in parallel on the same issue.

2000-2010 period

In 2001, a Commission’s Communication on the coordination of direct taxation systems in the internal market was released, containing new plans for company taxation. The Communication restated the need to remove all fiscal barriers and to fight against the harmful tax competition. It also underlined the fact that, to do so, it is not necessary to adopt a full-harmonisation, but just an
alignment, since each Member State must maintain its freedom to choose the tax system it retains most appropriate. \textsuperscript{xiv}

Two years later, another Communication took stock of the 2001 announced strategy. It ensured that the strategy was being followed and that it contained the appropriate initiatives. In particular, it included proposals of a “Home State Taxation Pilot Scheme” that could be used by small and medium companies to calculate their EU taxable profits based on their home state taxation system. The companies using it would benefit from a big reduction of tax compliance costs and a simplification of the taxable profit calculation process. \textsuperscript{xv}

In February 2005, the Commission relaunched the Lisbon Strategy in order to create better jobs. The principal aim was to adapt the economy to the changes occurring both in the environment and in the population. The political measures proposed concerned three areas: the innovation for growth, the improvement of Europe’s investing and working attractiveness, and the creation of more and better jobs.

The Commission also suggested that Member States should seek funding for the creation of prosperous competition, even though it was not possible to find an agreement on financial perspectives for the following years. \textsuperscript{xvi}

\textbf{2011: The turning point – The Common Consolidated Corporate Tax Base}

It was in 2011 that the action to concretely start to eliminate the obstacles impeding the achievement of the Single Market finally started to take place with the introduction of the Common Consolidated Corporate Tax Base (CCCTB). \textsuperscript{xvii}
This ambitious and revolutionary project was the culmination of work that took more than a decade to develop. It was achieved with the collaboration of experts from national administrations, the business world, and companies’ associations.

The CCCTB is a single set of common rules used to calculate the tax base for companies in the EU. It would allow all European enterprises to respect a single set regulations, instead of considering 28 different schemes. However, the Member States’ power to apply their own corporate tax rates would not be affected by the measure, since the main aim of the said measure is to make the national taxation systems more coherent.

The CCCTB designed at that time would have been optional and available for all societies in the European Union, regardless of the size of the company.

The CCCTB would tax the whole profit that a business group creates in the EU after which, the consolidated tax return would be distributed between the Member States in which the company operates, following an apportionment formula based on three factors: fixed assets, labour costs, and sales.

Unfortunately, the project was perceived as too ambitious, and was therefore declined due to a lack of unanimity of the Member States. However, the advantages that the project would bring to the companies in the EU have largely been recognized, and that is why a new attempt was made in 2015.

2015: The Action Plan
In June 2015, the Commission adopted an “Action Plan on Fair and Efficient Tax System in the European Union”, which contained a reform initiative on the issue, in order to fight against fiscal evasion, to ensure durable profits, and to reinforce the internal market.xviii

After having restated that the top priority for the EU was the complete realization of the Single Market, it became clear that a framework for the concrete completion of a fairer and more efficient corporate taxation system could not be avoided any longer.

Over the years, a situation of general discontent has been growing among the policy makers, the citizens, and the companies of the European Union. On the one hand, the lack of fairness and the recurring profit-shifting cases contributed to the public dissatisfaction, while the double taxation issue kept irritating the companies.

The lack of coordination was considered the major obstacle in pursuing the realization of the Single Market. Thus individual Member States, acting in their own best interest and not that of the Single Market, went to the detriment of global needs, only contributing to increase the harmful and aggressive use of corporate tax systems. The status quo, that consist of the opposing issues of tax avoidance and the issue of double taxation, created an unbearable situation for many decades.

Moreover, another major issue concerning the tax competition was affecting the Member States, already under pressure of competition. In fact, some countries gradually lowered their national corporate tax rates in order to raise their business attractiveness. This, together with fiscal avoidance, led to a lower income for the governments from taxation that some countries compensated through an increase of tax burden on more traditional companies and on labour. This measure compromised the efficiency of the taxation system, as well as negatively impacting
not only their growth, but also their work. In fact, a higher fiscal pressure disincentivises employment and investments. Naturally, the companies that were not able to aggressively compete in tax planning were disadvantaged.

Therefore, the 2015 Action Plan identified five key areas or pillars to focus on:

1. Implementing and relaunching the CCCTB project, through a step-by-step initiative, in order to reduce discontentment. The Commission also announced an important innovation, by making it mandatory instead of optional, at least for multinational companies;
2. Ensuring an equitable fiscalism at the place where profits are generated, meaning that profits need to be taxed where the value is effectively created;
3. Creating a better environment for business through measures aiming for the suppression of fiscal obstacles in the Single Market, in order to make it become more attractive for a company to expand in another country;
4. Improving fiscal transparency to better fight against abuse and evasion;
5. Improving the coordination among the EU and optimize the existing ways of cooperation, as a first essential step to successfully address the fiscal avoidance and fiscal evasion issue.

2016: The Corporate Tax Reform Package

In September 2016, a Corporate Tax Reform Package was published. It obviously included the CCCTB, but proposals were also made on two different subjects.
The first one addresses the need to definitively solve the double taxation issue, while the other tackles the ways to avoid asymmetries existing with third countries.

The Corporate Tax Reform Package also announced the relaunch of the CCCTB. This is planned to happen by a two-step process: first, the common base needs to be implemented, later on it will be consolidated.

In its definitive version, the CCCTB is mandatory (at least for the largest companies). It will focus on supporting the Research and Development (R&D), as well as encouraging stable financing.

2017: Fair and Efficient Tax System in the EU for the Digital Single Market

Referring to the *Introduction* in September 2017, the Commission published a Communication, “A Fair and Efficient Tax System in the European Union for the Digital Single Market.” This should be the basis for debate between Member States in order to grant, on the long-term, a fair and equitable tax on digital economy. This represents one of the top 10 priorities of the work-programme of the Commission.xx

The main difficulties concerning digital taxation for the policy makers lies in the choice of the home taxation jurisdiction for a dematerialised economy. Three objectives guide this approach to digital economy: ensuring competitiveness of European companies, reinforcing the integrity of the Single Market, and granting the durability of this fiscal system.

The principles contained in the Communication are expected to be followed by legislative proposal within the next year. Some other quicker ways to act are also often debated, such as the adoption of specific tax on advertisement messages.
Current Situation and Challenges

After having covered the historical background that characterizes the issue, it is now important to understand what the Council position is, what the Member States’ points of view are and what needs to be done.

It is clear that the core element for the achievement of fiscal harmonization resides in the Common Consolidated Corporate Tax Base reform. To understand how the Member States are split on the issue, it is important to analyse their reaction to the 2016 relaunch proposal. One of the most recent and important discussions on the issue was held on 25 May 2017.

As a matter of fact, the CCCTB proposal encountered a severe objection coming from seven European countries: Ireland, Denmark, Sweden, Luxembourg, Malta, the Netherlands and the United Kingdom.

The “Yellow Card procedure” which is in place today establishes that if one third of the national parliaments raise objections to a Commission’s proposal, they have the power to suspend it. For the CCCTB 2016 proposal, the one-third quorum (9) was not reached. Historically, this veto procedure was only used three times, but it is still rare that so many parliaments object a European proposal.

In fact, these countries presented formal objections to the European Commission by expressing their scepticism on the proposal’s compatibility with the subsidiarity principle, according to which “In areas in which the European Union does not have exclusive competence, the principle of subsidiarity […] defines the circumstances in which it is preferable for action to be taken by the Union, rather than the Member States.”
Commission spokesperson for taxation Vanessa Mock answered to this objection by stating that “The CCCTB is fully in line with the principle of subsidiarity. The legal base is Art. 115 TFEU – improving the functioning of the Single Market”.xxiii

Ireland may have the deepest and strongest objection. Actually, the country fears that the CCCTB would remove its power to determine its own taxation rate. It is thought that this first step towards corporate taxation harmonisation would later lead to a single common EU tax rate at which profits would be taxed. Even if it was restated many times by the proposal supporters that the plan would not be followed by the introduction of a single European corporate tax rate, Ireland is still not convinced. It is well known that Ireland’s extremely low taxation rate (12.5%) is really advantageous for foreign investors that leads to substantial foreign investments to Ireland.

Historically, United Kingdom and Ireland have been a solid duo in opposing the CCCTB proposal. However, the recent UK referendum on leaving the EU may make Ireland lose its most reliable ally on the issue.

In 2016, Danish Minister for Taxation, Karsten Lauritzen stated that the country would consider leaving the EU as well if the European Common Consolidated Corporate Tax Base was put into effect.xxiv One year later, the Danish Finance Minister Kristian Jensen affirmed that he initially liked the general concept, but he was of the opinion that there would be practical issues in the implementation of the project.xxv
Just like Ireland, the Swedish Finance Minister Magdalena Andersson together with the Netherlands and Denmark also fears that the project would result in a huge revenue loss on corporate taxation income.

If the CCCTB is to be introduced, Malta on its side would also lose more than half its corporate tax base income. That is because companies in Europe would not decide to declare their profits in countries with lower corporate tax rate leading to the reduction in Malta’s business attractiveness.xxvi

As far as Luxembourg is concerned, the Finance Minister Pierre Gramegna stated during a discussion on harmonisation in May 2017 that the proposal was unclear and “lead to confusion”. He thinks that harmonisation may result in strengthening EU institutionally but on the other hand it would go to the detriment of the economic aspects. Moreover, he noted that the cost of the CCCTB introduction would be as high as 0.8% of the national GDP.xxvii

On the other side, the main supporters of harmonisation are also the countries with the highest corporate tax rates in Europe.

As for France, the President Emmanuel Macron promised during his campaign that he would pursue a harmonisation of corporate taxation. He campaigned on the proposal of a high single unified tax rate in Europe.xxviii

In 2017, the French Minister for Economy, Bruno Le Maire stated that his objective was “a common corporate tax with Germany in 2018, as a basis for harmonisation at the level of the Member States of the Euro zone” xxix
Germany’s corporate tax rate is indeed one of the highest in Europe reaching approximately between 30 and 33%. 

Therefore, France and Germany are committed to pursue a common limited position on corporate taxation before the end of 2018 in order to accelerate the first step toward fiscal harmonisation in the UE.

In the case of Italy, during the discussion on CCCTB in May 2017 the Minister of Economy and Finance, Pier Carlo Padoan retained that the reform would stabilise the EU tax framework. However, he admitted that there is a trade-off between the desire of maintaining a certain degree of flexibility and the benefits that a common set of rules would bring.

An important observation was also raised by the Czech Republic Minister of Finance Milena Hrdinkova. She emphasized the fact that even if the CCCTB has not been established, the fact of discussing it for six years has led to a certain convergence of Member States’ corporate taxation systems. That is the reason why she is confident about the achievement of the project, since some major work has already been done and the objective seems more reachable.

Germany’s Finance Minister, Wolfgang Schäuble who has always been supportive on the project admitted that over-discussing the issue had become counter-productive. He affirmed that it was essential from that moment on to focus on the priorities to achieve a healthy common market.

To sum up, it is clear that economies such as Italy and Germany would benefit from the proposal, while others such as Malta and Sweden would see their corporate tax bases lowered by at least one third, resulting in big losses for the governments.
The Council is therefore split into two main blocks so it is crucial to objectively analyse the advantages and disadvantages. To do so, it is important to take into account the bigger picture and the long-term benefits, not only the short-lived national interests.

As stated again by Gramegna, the CCCTB would clearly lead to an institutional convergence and action on the main problems such as the double cross border taxation or the harmful tax competition.

It is clear that in order to achieve such goals some countries need to abandon the advantages they have. Every form of progress has a cost and the achievement of a Single Market can be pursued only if sacrifices are made for the EU common wellbeing.

Among the two opposite sides, Macron for example believes that all corporate tax rates should be close to the German one, while other countries hope for an ideal corporate tax system that includes a broad base and a low corporate tax rate.

The main challenges that the committee will have to face consist of the conflict between the supporters of harmonization and the countries that do not want to let go of the advantages they have due to a non-common corporate tax base.

Even if some Member States are reluctant, the Union can still adopt measures on taxation such as the one on a Common Corporate Tax Base (CCTB – the first step of the CCCTB proposal approach). However, it is always preferable that unanimity is reached among Member States, especially because the subsidiarity principle would allow the countries against the proposal to keep their taxation under national legislation.
To pursue a full harmonisation, all countries need to find common ground on the issue, and that will be the delegates’ aim throughout the conference. The issue may concern the EU but it eventually can also be considered as part of the global picture since fiscal avoidance is a worldwide issue that negatively influences economic stability.

**Questions A Resolution Must Answer (QARMAs)**

Here are some key questions to guide the delegates in writing the draft resolutions.

- What is the Council of the EU general point of view on fiscal harmonisation?
- What are the main obstacles to be overcome to start pursuing a fiscal harmonisation in the EU? How can they be resolved?
- What are the principal arguments against fiscal harmonisation? Do they infringe the national interest?
- The CCCTB approach is a first step towards harmonisation. How should it be implemented? What could be done next?
- What are the main advantages for the Member States’ governments in pursuing fiscal harmonisation? What are the main advantages of traditional companies in pursuing fiscal harmonisation?
- What are the common benefits of a fiscal harmonisation for all the EU countries? On what aspects is it possible to focus on in order to make all the countries agree and find a common ground?
Introduction

The Economic and Monetary Union (EMU), as the term union implies, seeks the integration of the economies of a specified region (Europe in this case) and the establishment of a unified monetary policy. A unified monetary policy means that countries in the union should have a single interest rate, joint control of the supply of money, and a joint control of nominal exchange rates against countries with different currencies.¹

The Treaty of Lisbon (also known as the Reform Treaty) dictates on Article 3 of the Treaty on European Union (EU), one of the two treaties that were reformed in 2007, that ‘The Union should establish an economic and monetary union whose currency is the euro’. This article refers to the requirement that European Union member states should adopt the euro (except the United Kingdom and Denmark, who are exempt under the Maastricht Treaty from being part of the EMU and have legally opt-out).²³

There are seven main institutions that are responsible for the EMU. The most relevant are the European Commission (in charge of monitoring that Member States comply with the EMU), the Council of the EU in Economic and Financial configuration (which coordinates the policy-making with the European Parliament (EP) and determines if a country meets the criteria to join the euro; convergence criteria regulated under Article 140 (1) of the TFEU), and the most
relevant of all institutions, the European Central Bank (ECB) (responsible of setting monetary policy and is the main supervisor of the Eurozone financial institutions). 4

The ECB had to be set as a fully independent institution due to its position as central bank of 19 states, all with different political objectives. This is really important as its mission, together with the national central banks, is to maintain price stability in the Eurozone as a whole (there is only one inflation target for all members). 5 This objective is reached, mainly, by the use of interest rates as the main monetary policy instrument. As well, it is important to note that the treaties only give European institutions, the ECB in this case, the role of controlling monetary policy, but it does not give it control of implementing fiscal policies. However, there is an exception to this when member states request a bail-out (even though article 105 of the TFEU specifies that EU Member States should not be liable for the debts of other members, this is called the no bail-out clause).

The global financial crisis that started with the U.S. subprime defaults in 2007 and then spread around Europe in the 2009, exposed how interdependent the European economies are. It was of relative importance how Eurozone banks were exposed to this interdependence.

This situation led policymakers in Brussels to start working towards preventing similar crises in the future. In 2012, the European Commission made a communication to both ‘legislative’ bodies of the EU, the European Parliament and the Council of the European Union. The communication, titled ‘a roadmap towards a Banking Union’, calls for ‘shifting the supervision of banks to the European level’. 6
Now, the completion of the banking union seems closer than ever. The President of the European Council, Donald Tusk, has repeatedly declared that its completion is “possible and necessary” adding that this would also be the “first reality check” to prove if the Eurozone can be “further transformed”.7

History of the problem and past EU action

By now, it should be clear what the banking union is and under what conditions it was created. The role of this section is, in a way, to list key events that led to the banking union that we have now.

The first step towards the banking union was taken in June 2009 when the European Council accepted the recommendation that was included in the publication of the Larosière report. This report, published in February 2009, received its name after the chair of the High-Level Group on Financial Supervision in the EU. Recommendation 10 of said report states:

“Member States and the European Parliament should avoid in the future legislation that permits inconsistent transposition and application; the Commission and the level 3 Committees should identify those national exceptions, the removal of which would improve the functioning of the single financial market; reduce distortions of competition and regulatory arbitrage; or improve the efficiency of cross-border financial activity in the EU. Notwithstanding, a Member State should be able to adopt more stringent national regulatory measures considered to be domestically appropriate for safeguarding financial
stability as long as the principles of the internal market and agreed minimum core standards are respected.”

The Single Rulebook, which applies to all (not only euro area) Member States, had the aim of establishing a common regulatory framework for the financial sector. The end aim was to complete the single market in this particular field by, mainly, requiring capital requirements for all banks in the EMU, protecting deposits, and preventing the failure of banks.

The first action after the Council’s recommendations came from both legislative bodies of the EU (the European Parliament and the Council of the EU). EU regulation 1092/2010 established the European Systemic Risk Board (ESRB) on the 24 November 2010.

The ESRB is an independent EU body under the ECB whose task is to, as its name implies, to prevent systemic risk (defined by Tomuleasa as the phenomenon that is related to systemic shocks that affect many institutions, markets and systems simultaneously) that may cause instability in the financial system, and to conduct the appropriate macro-prudential policies (this is the set of policies used to reduce the systemic risk in the entire financial system).

On the same day that the ESRB was established, EU regulation 1093/2010 from both legislative bodies of the EU created the European Banking Authority (EBA). This is one of the three European Supervisory Authorities (ESAs) that the European Council recommended in March 2009. The other two being the European Insurance and Occupational Pensions Authority (EIOPA), and the European Securities and Markets Authority (ESMA). These three ESAs
conduct the micro-prudential supervisions (supervision of individual institutions) of the EU financial system and are responsible to enforce the single rulebook.\textsuperscript{12}

The EBA replaced the Committee of European Banking Supervisors (CEBS) and its role is to regulate and create rules for financial institutions that operate in the EU.\textsuperscript{14} However, the supervision of this rules and regulations is under the competence of the ECB.\textsuperscript{14} This EU institution is based in London but will soon be moved to Paris as a consequence of the Brexit vote.\textsuperscript{15}

The previous four institutions (EBA, EIOPA, ESMA and ESRB) are all part of the European System of Financial Supervision, the framework for financial supervision in the EU.\textsuperscript{12}

The fact that those institutions are not able to conduct day-to-day supervision in EU countries led Eurozone countries to go even further. In 2012 they started developing a banking union with a single supervisory mechanism (SSM) and a single resolution mechanism (SRM). It is important to understand that even if the previous four institutions and the Single Rulebook are applicable to all EU Member States, these two mechanisms are only for Eurozone countries and any EU Member State that may wish to participate in a ‘close cooperation agreement’.\textsuperscript{16} However, full membership is not possible without joining the euro since the ECB only has binding powers on Eurozone countries.\textsuperscript{17}

The Single Supervisory Mechanism (SSM) is the only, common, system of banking supervision in Europe and its form by the ECB and national authorities.\textsuperscript{18} One of the main roles that this mechanism covers, which is a flaw that the ESAs and the ESRB have, is day-to-day supervision
that make it responsible of supervising about 4,700 institutions among all participating Member States. However, not all institutions are supervised by the ECB. Indeed, the ECB only supervises those credit institutions considered as ‘significant’ and national competence authorities (NCAs) supervise those that are ‘less significant’ under the watch of the ECB.  

Refer to the Guide to banking supervision, November 2014 box 1 for more information regarding the criteria that qualifies an institution as ‘significant’.

The Single Resolution Mechanism (SRM) is the system that ensures the correct resolution of EU credit institutions with the main objective of protecting taxpayers from paying the costs of the failure through the prevention of bank runs, contagion, the strengthen of confidence in the financial sector, among other objectives. 

The SRM consists of the Single Resolution Board (SRB) and a Single Resolution Fund (SRF). The SRB (or the Board) is the main decision-making organ of the SRM. The Board decides on how resolutions take place when banks are failing (or determines if a bank is likely to fail) and is the ultimate responsible organ for banks in the banking union. At the same time, the FUR (or the Fund) is an established supranational fund that is used as an instrument of last-resource for failing banks. This fund is financed by the financial sector and it should consist of at least a 1% of the total amount of deposits in the credit institutions that are members of the banking union.  

The SRM works in the following steps:

1. The ECB, which is the supervising institution under the SSM, notifies the SRB that ‘a bank is failing or likely to fail’;

2. At an executive meeting it is decided whether a private solution is possible;
3. ‘If the conditions for a resolution are not met the bank is liquidated according to national laws’;

4. If the conditions are met a resolution process is adopted. 21

The SRM was not fully in force until the 1 January 2016 even though some provisions were in force since 2015. Since then it has only been used once - less than 24 hours after the Spanish Banco Popular was declared as ‘failing or likely to fail’ by the ECB on the 6 June 2017, the SRB made its resolution decision. 22 This was considered a ‘first test’ for the SRM and was described as a ‘credibility boost’ for the European banking sector after its success since shareholders and not taxpayers were the ones affected by its decision, fulfilling the main objective of the Mechanism as it was described before. 23, 24

This integration process was not free of differences of opinion. One of the main causes of disagreement was the creation of a common fund to save European banks. Germany, principally, found it unfair since they believed that their high credit-rating institutions should not take the burden of saving banks from other economies. Their opposition could be well-founded on Article 105 of the TFEU. However, other Eurozone countries, primarily Italy, believed that in order to prevent a possible financial crisis, caused by the interconnection of the single market, the establishment of this fund was required. 25

A second cause of disagreement was when the Commission wanted the European Central Bank, a supranational institution, as the institution in charge of monitoring mechanisms while some argued, again Germany was the member state opposed and asked to make concessions, that a
different body should be the one responsible for resolutions. Finally, consensus was reached with the creation of a new independent body under the control of the ECB, the Single Resolution Board.

The third cause of disagreement was on deciding between the creation of an intergovernmental institutions or a supranational institution. Again, compromise was made with the creation of two institutions that provide some checks and balances as member states continue to have a ‘strong discretion’ on the decision-making processes of the banking union.

**Current Situation**

Currently, the Council of the European Union is working towards improving and further developing the banking union. In this section, the current proposals discussed are going to be presented but your role as delegate of different EU Member States will be to discuss them and even propose other alternatives.

After the European Council emphasized the necessity for further cooperation of economic policies at the Council’s summit on October 2014, Jean-Claude Juncker, President of the European Commission, prepared the Five Presidents’ Report. This report ‘sets out a plan for strengthening Europe's Economic and Monetary Union’ and was written in collaboration with the President of the EC, Donald Tusk, the President of the Eurogroup, Jeroen Dijsselbloem, the President of the European Parliament, Martin Schulz, and the President of the ECB, Mario Draghi.
The report presents ways of improving four Unions (Economic, Financial, Fiscal and Political) but developed together in different stages. Therefore, three stages were also presented.

*The First Stage*, which took place between the 1 July 2015 and the 30 June 2017, was designed as a way of improving the application of current Treaties and instruments while ensuring that they are being implemented. It basically was meant to take small steps on each of the four Unions, except the Financial Union, which had to be completed. 29

The objective of completing the Financial Union by the end of June 2017 was not fulfilled as there was great disagreement, especially from Germany and the Netherlands, on to what extend should the last stage of the Banking Union be implemented. 30 This last step that is supposed to complete the Financial (and Banking) Union is the creation of a common deposit insurance scheme. The creation of a European deposit insurance scheme (EDIS) would improve the actual system of National Deposit guarantee schemes that every EU has to protect deposits of up to €100,000.31

Germany is the member state that disagrees the most with the European Commission on this issue. They believe that, as it was previously agreed, this last step should only be implemented until the previous step, risk-reduction, has been achieved “to a sufficient degree”, and they believe this has not happen yet.30 Their views of the level of risk-reduction are not accepted by most EU countries, especially those with a considerable amount of sovereign debt, since it calls for stricter rules on banks level of leverage (defined as the ratio of assets to capital; high leverage
banks are more likely to default when the value of their assets decrease by shocks to the economy), especially with respect to government and non-performing bond holdings.  

German policymakers are not the only ‘big players’ against the immediate introduction of the common deposit insurance, the EDIS. The President of the ECB, Mario Draghi, shares Germany’s views that Europe first needs to solve the issue of non-performing loans as he believes that ‘risk reduction and risk-sharing should go in parallel.  

This makes clear that the issue they are concerned about is that, even if they believe that no one country should take all the burden if one of its bank failed, they do not want that their (in this case German) taxpayers end up saving other countries from their own problems.  

One of the main countries in favour of the immediate introduction of EDIS is Italy, which is also one of the countries that are of greatest concern to the ECB as it believes that Italian banks should hold more collateral against non-performing loans.  

Even if banks are reducing the amount of risky bonds, Member States do not find an agreement on how to limit the holdings of sovereign bonds by banks. This disagreement could be considered well-founded since a reduce on the amount of government bonds that banks hold in their balance sheets would reduce demand which is translated into lower bond prices which at the same time means higher interest rates and, therefore, higher costs of borrowing for national governments. This would be a great issue for countries like Greece, Italy, and any other Member States with a considerable amount of national debt.
But the rise of borrowing costs is not the only ‘fair’ argument that Member States at both sides of the argument make. Germany believes that implementing the deposit insurance before Member States’ banks adopt the new requirements they are calling for, will create moral hazard. Moral hazard is the risk that occurs after a measure is implemented and involves that those banks who are more likely to default on their NPLs will be less likely to reduce the risk if they are protected by a common insurance against their default.

The European Commission, in its first progress report on the tackling of non-performing loans, announced that the ratios of NPLs is falling in nearly all Member states and specifies that this adds up to all the progress made on reaching the last stage of the Banking Union. 34

*The Second Stage* of the Five Presidents’ report, which is also the current stage, was updated by a European Commission White Paper that suggested that this stage should take place between 2017 and 2019. 35

The financial union recommendation includes implementing further measures to reduce risk and to reduce the amount of NPLs as it was previously discussed, due to the fact that an agreement introducing the EDIS was not achieved in the first stage. 35 During this stage, an agreement on a the EDIS needs to be made. 35
Apart from the financial union issues, the White Paper also includes in its roadmap further recommendations in order to fully achieve the economic and fiscal union, as well as democratic accountability and effective governance.  

*The Third Stage*, taken should the previous one be completed, will take place no later than 2025 and, its most relevant point for our topic, encourages the implementation of the EDIS (which has to be agreed upon in the second, and current, stage).  

This last stage also includes important measures to complete the integration of the Economic and Monetary Union. From these measures, it is relevant to highlight the creation of a permanent chair of the *Eurogroup*, its adoption as an official configuration of the Council of the EU, and the creation of a European Monetary Fund, as the main points of the measures that would increase accountability and improve the governance of the Union.  

Delegates should now research their country’s position and attempt to answer the questions specified in the next section and do further research of their own.  

**Questions A Resolution Must Answer (QARMAs)**  

- Have the two legs of the banking union that have already been implemented, the SSM and SRM, been successful in your country’s opinion?  
- Should the EU continue integrating towards completing the Economic and Monetary Union, in accordance to the Commission roadmap (see Annex 1), and in particular the Banking Union?
• Are the arguments against the EDIS selfish when countries against it try to argue that they would be saving other countries from their own problems? What about risk spillovers?

• Does your country have issues with Non-Performing Loans? If so, is it addressing the issue and how?

• Should banks reduce their holdings of sovereign bonds in their balance sheets?

• Will the benefits of implementing the EDIS, as proposed by the Commission, exceed the costs to individual Member States?

• What measure could be considered as an alternative to the EDIS?

Recommended readings


# Annex 1. A Possible Roadmap Towards the Completion of the Economic and Monetary Union by 2025

## Period 2017-2019

<table>
<thead>
<tr>
<th>Financial Union</th>
<th>Economic and Fiscal Union</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banking and Capital Markets Union</td>
<td>Economic and Social Convergence</td>
</tr>
<tr>
<td>✓ Implementation of further risk-reducing measures for the financial sector</td>
<td>✓ Further strengthening the European Semester of economic policy coordination</td>
</tr>
<tr>
<td>✓ Strategy to reduce non-performing loans</td>
<td>✓ Greater technical assistance</td>
</tr>
<tr>
<td>✓ Setting up of a common backstop for the Single Resolution Fund</td>
<td>✓ Work on convergence standards</td>
</tr>
<tr>
<td>✓ Agreement on a European Deposit Insurance Scheme</td>
<td>PREPARATION OF THE NEW EU MULTIANNUAL FINANCIAL FRAMEWORK</td>
</tr>
<tr>
<td>✓ Finalisation of Capital Markets Union initiatives</td>
<td>✓ Stronger focus on support to reforms and greater links with euro area priorities</td>
</tr>
<tr>
<td>✓ Review of European Supervisory Authorities – first steps towards a single European capital markets supervisor</td>
<td>FISCAL STABILISATION FUNCTION</td>
</tr>
<tr>
<td>✓ Work towards establishing Sovereign Bond-Backed Securities for the euro area</td>
<td>✓ Reflection on establishing a fiscal stabilisation function</td>
</tr>
</tbody>
</table>

### Democratic Accountability and Effective Governance

- ✓ Strengthened and more formalised dialogue with the European Parliament
- ✓ Progress towards a stronger external representation of the euro area
- ✓ Proposal to integrate the Fiscal Compact into the EU legal framework

## Period 2020-2025

<table>
<thead>
<tr>
<th>Financial Union</th>
<th>Economic and Fiscal Union</th>
</tr>
</thead>
<tbody>
<tr>
<td>Continuous Implementation of Capital Markets Union Initiatives</td>
<td>Economic and Social Convergence</td>
</tr>
<tr>
<td>Roll-out of the European Deposit Insurance Scheme</td>
<td>✓ New convergence standards and link with central stabilisation function</td>
</tr>
<tr>
<td>Transition to the Issuance of a European Safe Asset</td>
<td>CENTRAL STABILISATION FUNCTION</td>
</tr>
<tr>
<td>Changes to the Regulatory Treatment of Sovereign Exposures</td>
<td>✓ Decision on design, preparation of implementation and beginning of operations</td>
</tr>
</tbody>
</table>

### Democratic Accountability and Effective Governance

- ✓ Full-time permanent chair of the Eurogroup
- ✓ Eurogroup established as an official Council configuration
- ✓ Fully unified external representation of the euro area
- ✓ Integration of remaining intergovernmental arrangements in the EU legal framework
- ✓ Setting-up of a euro area Treasury
- ✓ Setting-up of a European Monetary Fund

Source: European Commission
Concluding Thoughts

Dear delegates,

We hope that this background guide was complete, useful in preparing for the conference and provided you with a clear understanding of the issues that will be under discussion. These topics are current but also of great importance for the future integration of the European Union.

We want to stress the fact that this guide does not fully address all the aspects that the topics cover but is instead meant to provide you with an initial understanding.
In order to become a successful delegate, in the next few months you will need to further analyze these issues in order to fully understand the topics when the time comes to discuss them. It is important that you research and prepare so as to produce your position papers of the best quality.

We look forward to meeting you in April and welcoming you to Milan. We hope that you will have a good time, that you will feel comfortable, and willing to do your best in our committee.

We are at your disposal for any further questions, information or clarifications you may need. Do not hesitate to contact us.

See you soon!

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Carlos Torrado Ortega – carlostorradoortega@gmail.com
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