Political uncertainty in the European Union

Integration versus sovereignty, and what it means for tax

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Five scenarios. One future. Countless possibilities for tax.

For people outside of the European Union (EU), understanding its workings can be complicated and challenging. But this should not be surprising, given the conflicting views within the EU itself. For some, the EU should be on a path to a federation of European states. For others, the ideal is a trading union of independent sovereign nations. This ambivalence existed at the start of the European project in 1957 and has been successfully negotiated to date.

But recent developments are bringing this tension to a head — most clearly with the UK's decision to exit the EU. With the European Commission's launch of the public consultation on the future of Europe in 2017, the citizens of Europe are considering a range of scenarios for the EU — from continuing its current path, to radical shifts in approach by either retrenching to focus only on the single market or by integrating much further. This consultation will be the foundation for a course of action to be rolled out in time for the June 2019 elections for the European Parliament.

For the tax regimes of each EU member state and the EU as a whole, each scenario has significant implications. The scenario ultimately chosen will have broad impacts on, among other areas:

— corporate tax bases and rates (including anti-abuse rules)
— indirect tax bases and rates
— taxation of the digital economy
— State aid rules and enforcement
— EU tax haven blacklisting and impact on third countries
— public country-by-country reporting
— mandatory disclosures
— exchange of rulings
— EU budget financing via value added tax (VAT) or common consolidated corporate tax base (CCCTB)
— coordination of country-specific tax recommendations through the European Semester process
— EU code of conduct for business taxation enforcement
— EU financial transaction tax.

These taxation issues are intrinsically linked to the major issues the EU faces in the areas of migration and refugees, the debt crisis and EU funding, unemployment, and emerging populist and national governments. At the same time, the global context in which the EU operates is quickly changing.

With the EU at the center of important geopolitical shifts, the leaders of international businesses need to think through and prepare for an array of possible implications. The discussion in these pages aims to deliver an informative and insightful analysis of the future direction of the EU and what this might mean for the business environment and the direction of tax policy.

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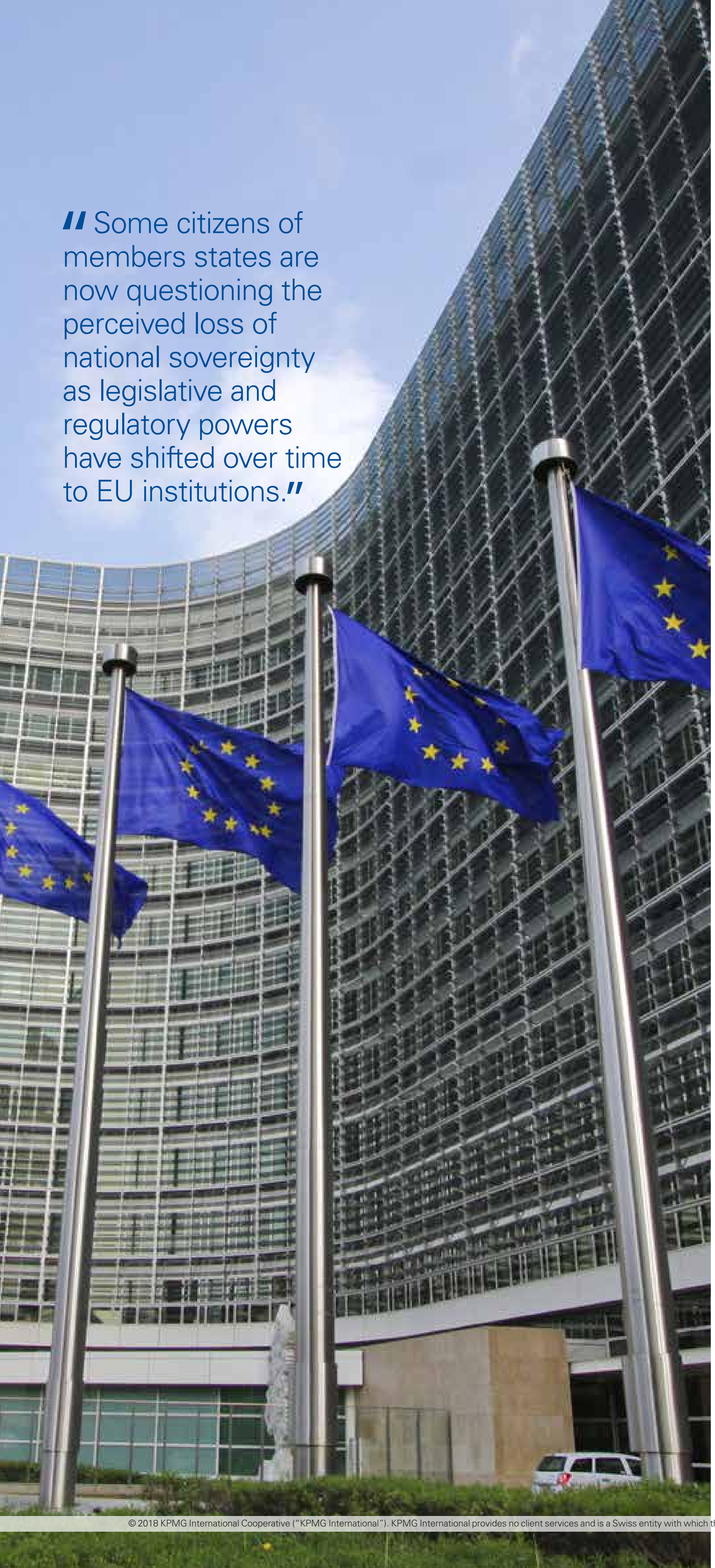
Political tensions in the EU

What pulls EU member states together? What could pull them apart?

The 60th anniversary of the EU in 2017 was a cause for celebration. Europe, so long divided by conflict including two catastrophic World Wars, has enjoyed nearly 70 years of peace. The EU has successfully reintegrated the Eastern and Central European states that had been cut off from their roots by half a century of communism. With 450 million citizens, the EU today is the world's largest single trading block. The European project's economic success has fueled even more harmonization of monetary policy, social and consumer protection, health and environmental policies and, importantly, foreign security and defense.

But this anniversary was marred by a set of circumstances that the EU had never faced before.

- A large EU member state, the United Kingdom, decided to leave the EU, while rising populism in other EU member states further threatened the EU project at its core.
- The 2008 financial crisis that triggered the Euro crisis and led to many EU-related austerity measures has left deep scars and concerns about future stability.
- The ongoing EU migration debate was deepening. What started as an intra-EU issue in 2004 with the accession of ten new European member states has become increasingly acrimonious as it widened into the refugee crisis caused by conflict in the Middle East and North Africa.



> "Some citizens of members states are now questioning the perceived loss of national sovereignty as legislative and regulatory powers have shifted over time to EU institutions."

Some citizens of members states are now questioning the perceived loss of national sovereignty as legislative and regulatory powers have shifted over time to EU institutions. For them, the EU is increasingly distant and bureaucratic, and unable to deal with the key issues facing it.

While the EU has held together through difficult times, the series of crises it currently faces cast its future development in doubt. These crises are adding urgency to debates over whether the EU should carry on with the status quo, do less and leave more space for national sovereignty, or integrate further to find common solutions.

Refugee and migration crisis

The European Commission predicts population growth, geopolitical tensions and climate change will increase migration and asylum seeking in the future. The Commission says 1.2 million people migrated to Europe in 2015 alone — the highest volume since World War II.

Some countries have significantly higher net migration than others (see Table 4 — Foreign born percentage of population (2016) in Appendix B). Countries along the Mediterranean Sea — like Italy and Greece — are bearing the brunt of refugees arriving by boat from North Africa. Countries along Europe's Eastern boarder have seen many coming over land.

While there was an attempt to agree on quotas between member states to accept asylum seekers, no agreement was reached. As a result, many land frontiers were closed and Italy is turning some boats away from port. The frontline states are criticized when they turn people away, and they believe they are being left to handle the crisis alone. This is causing debate about solidarity and responsibility among the member states and driving discussion over the future of border management and free movement within Europe. Should member states adopt a centralized approach, or should each member state be left to decide on its own?

Concerns about the levels of both intra-EU migration and refugees are also provoking populist sentiment and anger toward traditional political parties. For example, in Germany, the Chancellor, Angela Merkel — who had championed an open immigration policy — lost her overall majority in the German elections in 2017, leaving a potential vacuum in the leadership of the EU. What matters in this context is not so much the actual national situation, but its impact on the ground in specific communities and public perceptions of the issue (see Table 4 — Foreign born percentage of population (2016) in Appendix B).

Debt crisis and EU funding

The impact of the 2008 financial crisis continues to be felt, with recovery remaining slow in some countries (see Table 1 — Change in GDP per capita in purchasing power standards and Table 2 — Public debt as a percentage of GDP in Appendix B).

The euro has made cross-border trade easier within the Eurozone, helping to drive economic growth and prosperity. However, some blame the euro in part for economic disparity between member states. Having a single currency has allowed more productive northern countries such as Germany to benefit by being able to sell to less productive Southern ones without exchange rate movements automatically rebalancing the economies. Countries like Greece have been able to borrow on the euro's strength. Private and government debt have increased significantly as a result

The financial crisis therefore became a euro crisis as the European Central Bank (ECB) was compelled to bail out several countries, such as Greece, Portugal and Spain, to prevent governments from defaulting on debt and banks from failing. Financial support came with conditions from the ECB and European Commission. These conditions led some to claim that the countries hit hardest by the financial crisis could have managed the crisis using their own monetary policies, but they were denied the flexibility. Ongoing austerity measures are blamed on the EU while more prosperous countries feel they have seen disproportionate amounts of their wealth diverted to support others.

There is now the possibility of a new financial crisis in Italy. Whether or not this is averted, a fundamental question remains. Will it be possible to continue maintaining a single currency between 19 countries with different economies and levels of productivity without having automatic mechanisms for transferring wealth from richer to poorer parts of Europe, as would happen within a single country or a true federation?

Unemployment crisis

Compared with a year ago, the unemployment rate fell in all member states, according to Eurostat figures for June 2018.[1] The largest decreases were seen in Cyprus (from 11.0 percent to 8.2 percent), Portugal (from 9.1 percent to 6.7 percent) and Croatia (from 11.1 percent to 9.2 percent). Rates are still relatively high, however, at 8.3 percent on average in the Eurozone and 6.9 percent in the current 28 EU member states — far higher than the unemployment rate in the United States, which was 4.0 in the same period.

Nevertheless, some of the countries that suffered the worst effects of the financial crisis continue to see high unemployment, with rates for 2017 of 21.5 percent for Greece, 17.2 percent for Spain and 11.2 percent for Italy. Unemployment rates among youth are even higher (see Table 3 — Unemployment rate — 2017 in Appendix B).

Emerging populist and nationalist governments

The past year's electoral results in several countries — notably Italy — and continuing anti-EU sentiment in several Eastern European states reflect the continued rise of populism in the West — a potential threat to the European project. While some see the recent election results in France and, to a lesser extent, Germany, as wins for globalization, the campaigns and Chancellor Merkel's lost majority clearly show a rise in anti-establishment and anti-immigration sentiment within key EU economies. Meanwhile, there are concerns that recent reforms in some Central and Eastern European countries are shifting them toward soft authoritarianism.

Although most EU economic results generally remain strong, some fear that these issues have the potential to trigger adverse EU events on the scale of Brexit if the public does not believe their concerns are being heard.

EU in a global context

As well as internal pressures, the EU faces several global issues, raning from the rising prospect of more protectionism and trade wars to conflicts and instability, especially in the Middle East due to shifts in political and military influence. The question is whether such challenges will push the 27 member states remaining after Brexit (EU27) to unite with a single strong voice or to fragment as member states put their national interests first.

[1] Eurostat, "Euro area unemployment at 8.3%", media release, 31 July 2018.

Who does what in the EU?[2]

Shared versus exclusive competences

Who's responsible for what in the EU depends on a fundamental principle of EU law known as 'conferral'. Under this principle, the EU acts only within the limits of the competences that EU countries have conferred on it in the European Treaties.[3] Competences that are not conferred on the EU by the treaties remain the responsibility of the EU countries.

As a result, the EU can only act within the limits of these competences as follows:

- **EU exclusive competences**, which override national sovereignty for EU member states in areas such as the customs union, competition policy, monetary policy for the Eurozone, fishery and commercial policy and the conclusion of international agreements (including free trade agreements).
- **EU shared competences that only give EU member states sovereign discretion** where the EU has decided not to exercise its own competence, such as internal market (including taxation), social policy, regional policy, agriculture, environment, transport and consumer protection, energy.
- **EU shared competences that allow the EU member states to act unilaterally** without EU decision making in areas such as research and development and humanitarian aid.
- **EU shared competences that limit the EU's role to coordinating member states' activities** in areas such foreign, security and defense policies, and economic, employment and social policies.
- **EU supporting competences where EU member states have sovereign discretion** and where the EU only supports, coordinates or complements their activities in areas such as culture, tourism, education and sport.

Competence for tax

When it comes to tax policy, the EU has competence for customs duty, excise duty and VAT. One set of customs tariffs applies across the EU, whatever the point of entry, and no duties apply for intra-EU trade. However, VAT and excise duties are not wholly harmonized. Member states can set their own rates (within agreed limits) and decide whether or not to apply certain exemptions.

The primary competence for all other taxes lies with member states. These taxes include corporate and income taxes, capital gains tax, wealth taxes and transaction taxes. The EU only has competence where it is necessary to coordinate or harmonize policy for the establishment and functioning of the internal market. Any such proposals need unanimous agreement of all member states.

Further, the principles of subsidiarity and proportionality need to be respected. This means the EU can only intervene where individual member states cannot provide an effective solution by themselves and the measure cannot go beyond what is required to achieve its aims.

Despite their prerogative over most tax matters, member states must ensure their laws comply with the EU fundamental freedoms of movement (i.e. of people, capital, goods and services). For example, taxes cannot discriminate against residents of other member states or conflict with the State Aid rules.

Under some scenarios, it is possible to foresee increased coordination or harmonization of corporate tax to safeguard the internal market's operation — although the unanimous agreement of member states would be needed unless there was a change to European Treaties to remove this requirement. However, EU legislation on other areas, such as personal tax, could probably only occur if the treaties were changed to make such taxes primarily an EU competence.

For more detail on the how the EU is governed and how it functions, see Appendix A. For examples of the inability of EU institutions to compel individual member states to live within their means, see Table 2 in Appendix B.

[2] https://ec.europa.eu/taxation_customs/general-information-taxation/eu-tax-policy-strategy_en
[3] As defined in Articles 2–6 of the Treaty on the Functioning of the EU.

The EU at a crossroads: Five scenarios for the future

Five visions. 450 million points of view.

In March 2017, the European Commission launched a public consultation on Europe's future, opening debate on the foundations of the EU project. The introductory words of EU Commission President Juncker set the scene:

There are important challenges ahead of us, for our security, for the well-being of our people, for the role that Europe will need to play in an increasingly multipolar world. A united Europe at 27 needs to shape its own destiny and carve out a vision for its own future.[4]

The consultation outlines several scenarios for the EU, setting out a spectrum from doing less to doing more. The consultation and subsequent public and parliamentary debates are intended to lead to EU Council conclusions on a course of action to be rolled out in time for the EU's 450 million citizens to consider in advance of the June 2019 European Parliament elections.

The scenarios start with the premise that the 27 member states will move forward together, without any other member states following the UK and leaving the EU. In the paper's conclusion, the Commission warns:

In an uncertain world, the allure of isolation may be tempting to some, but the consequences of division and fragmentation would be far-reaching. It would expose European countries and citizens to the specter of their divided past and make them prey to the interests of stronger powers.[5]

How this consultation will play out and what outcomes will be put forward remain to be seen. In the table on page 8, we explore the potential implications of these scenarios on the business environment and the development of tax policy in the EU.

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[4] European Commission, *White Paper on the Future of Europe: Reflections and scenarios for the EU 27 by 2025*, 1 March 2017.

[5] See note 4, at page 26.

"The scenarios start with the premise that the 27 member states will move forward together, without any other member states following the UK and leaving the EU."

The five scenarios — what do they mean for tax?

The EC's *White Paper on the Future of Europe* sets out five future scenarios. This spectrum of possibilities is largely based on the level of convergence and divergence, although some scenarios involve both features at different levels or for different country groups. The five scenarios and their potential implications for tax and business are as follows. See Appendix C for more details about what each scenario might mean for specific tax issues, such as tax base, rates and other EC tax proposals.

Scenario 1: Carrying on

EU's future state?

- The EU sticks to its course.
- The 27 member states and the EU institutions focus on implementing and upgrading the current reform agenda.

Implications for tax?

- The EU's current reform agenda includes strengthening the single market, driving multilateral free trade with the world, and combatting tax fraud, aggressive tax planning and base erosion and profit shifting (BEPS).
- Further initiatives might be introduced to harmonize tax bases, eliminate tax incentives, coordinate digital economy taxation, and to expand State Aid investigations, the use of the modified nexus approach for intellectual property and mandatory disclosure.
- These initiatives would extend to dealings with third-country tax jurisdictions, such as the EU tax haven blacklist, where the EU effectively holds non-EU countries to EU standards of fair tax competition and exchange of information.

Implications for business?

- While this scenario could yield considerable benefits, some areas will increase the tax burden for business.
- Among other things, for example, the EU would effectively become the global tax watchdog in combatting harmful tax practices and in promoting more disclosure of multinational tax affairs.

Scenario 2: Nothing but the single market

EU's future state?

- The member states cannot agree to do more in many policy areas, so the EU increasingly focuses on deepening certain key aspects of the single market.
- There is no shared resolve to work further together in areas such as migration, security or defense.
- Cooperation is often managed bilaterally.
- The focus is on the free movement of capital and goods, and maintaining a level playing field.
- The free movement of workers and services is no longer guaranteed.

Scenario 2: Nothing but the single market

Implications for tax?

- This scenario would see emphasis on reducing regulation at EU level, leaving or even widening differences in tax policies.
- Whether and to what extent an EU-coordinated approach would be possible to harmonize tax bases and fight BEPS is unclear.
- This scenario would potentially open the door for increased tax competition between EU member states and reduce focus on, for example, fighting tax havens globally.
- The EC white paper flags the risk of a "race to the bottom" for taxation in this scenario, depending on the EU's resolve to prevent harmful tax practices.
- In the past, the EU Council Group and the Organisation for Economic Co-operation and Development's (OECD) Forum of Harmful Tax Practices have worked to roll back a range of preferential tax measures relating to intra-group coordination, distribution and services, holding company regimes, financial services and sector-specific measures (e.g. maritime transport, aviation, films). Continuation of these efforts would not be guaranteed.

Implications for business?

- Some businesses might benefit from increased tax competition among member states.
- Managing taxes within the EU would become more complex.

Scenario 3: Those who want more do more

EU's future state?	— The EU27 proceeds as today but where certain member states want to do more in common, one or more coalitions would work together. — Specific policy areas for cooperation could include defense, internal security and social matters. — A group of countries, including those in the Eurozone and possibly others, might decide to work more closely on taxation and social matters.
Implications for tax?	— This scenario may entail an EU operating at multiple speeds, which is already possible through an 'enhanced cooperation' procedure where a minimum of nine EU member states can establish advanced integration or cooperation. — In practice, this procedure has proven rather strict and burdensome, with only limited results. — The EU has always seen diverging views on the necessity of coordination in taxation matters. Germany, France, Italy and Spain, supported by the Nordic countries, have driven harmonization efforts in recent years, while the UK, supported by several smaller EU member states, has sought to limit this drive.
Implications for business?	— More harmonized tax rules and rates may reduce compliance costs and limit tax evasion. — However, complexity could arise if several EU member states continue introducing EU coordination measures that others choose not to join. — In the latter case, businesses would need to manage their taxes amid more fragmentation, uncertainty and increased taxation barriers. — This scenario might open the door agreement on the EU financial transaction tax for a limited number of EU member states.

Scenario 4: Doing less more efficiently

EU's future state?	— Where there is consensus on the need to better tackle certain priorities together, the EU27 decides to focus its attention and limited resources on a reduced number of areas. — As a result, the EU27 can act more quickly and decisively in its chosen priority areas. — In other areas, the EU27 stops acting or does less.
Implications for tax?	— EU member states are unlikely to give up sovereign rights on direct taxation. — However, this attitude may not extend to indirect taxes and customs duties, which are already an exclusive competence of the EU. — A decision that direct taxation is not a priority for the EU would likely slow the current momentum toward combating tax fraud, aggressive tax planning and BEPS, and increasing tax transparency.
Implications for business?	— EU member states could potentially be left with more powers to determine their own direct tax policies including a renewed focus on tax competitiveness. — Competition my lead to lower direct tax rates. There would be administrative savings if VAT is fully harmonized.

Scenario 5: Doing much more together

EU's future state?	— Where there is consensus that neither the EU27 as it is nor European countries on their own are equipped to face the challenges of the day, member states decide to share more power, resources and decision making across the board. — This results in much more coordination on fiscal, social and taxation matters, as well as European supervision of financial services.
Implications for tax?	— For taxation, this scenario could allow progress on matters that are currently in deadlock in the Council, such as the EU CCCTB. — An ambitious tax agenda could be developed where direct taxation could potentially follow the route of indirect taxes, gradually harmonizing the tax base, including finding solutions for taxing the digital economy, and eventually converging the corporate tax rate. — This scenario might significantly affect, for example, enforcement of the EU Code of Conduct principles for business taxation, which is currently governed by so-called 'soft-acquis' and political agreement. These principles could be embedded into EU legislation, making it EU hard law. — The EU could further pursue the idea of financing the EU budget via EU revenue from VAT or CCCTB. — The European Commission's current European Semester country-specific tax recommendations could be elevated from an advisory nature to a more directive approach, leaving EU member states with less discretion.
Implications for business?	— For businesses, this could eventually lead to the ideal of a truly harmonized tax base and converged tax rate within the EU, which has been the European Commission's aim for decades.

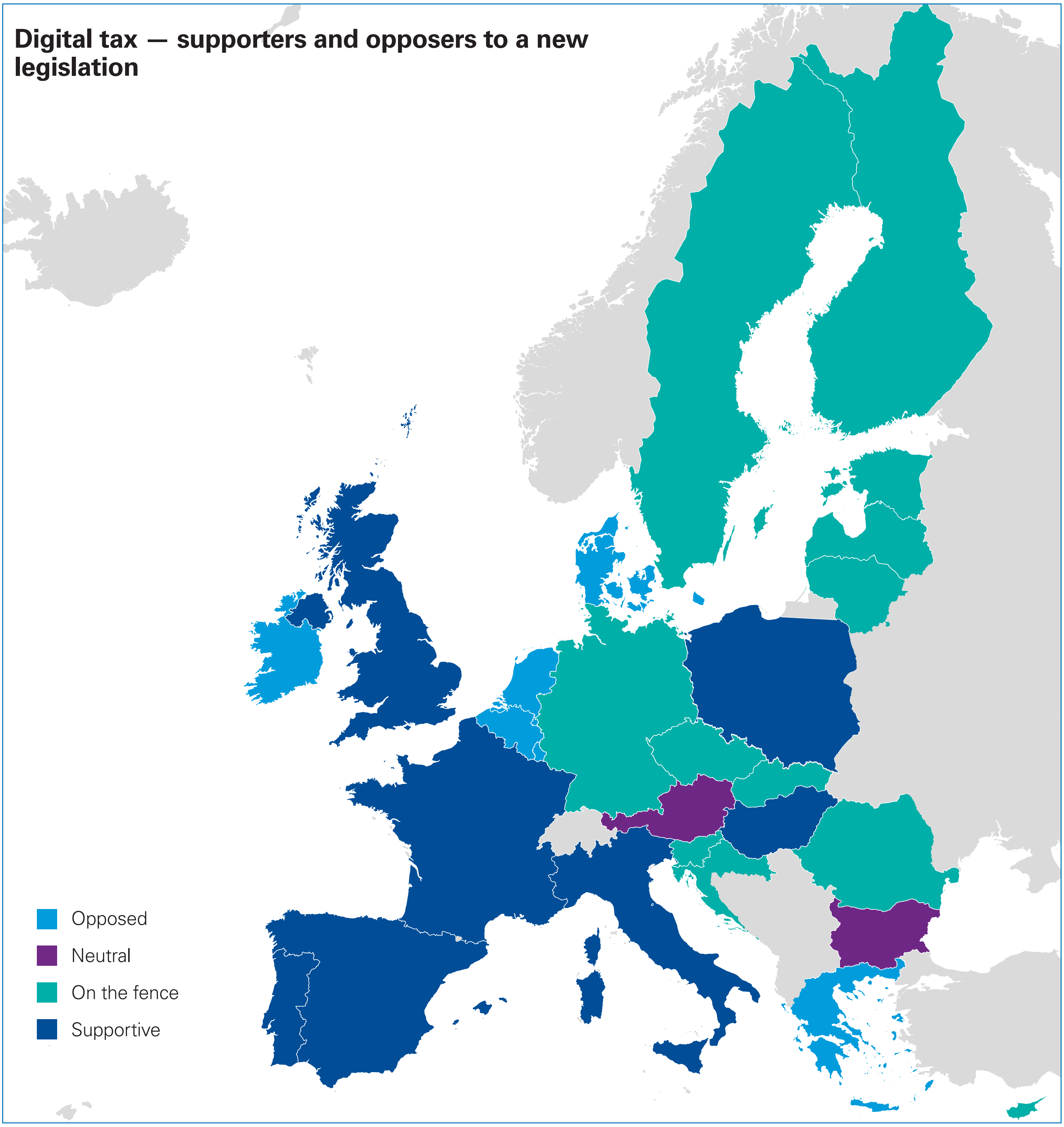
EU Tax challenges: dealing with digital taxation

How to tax the digital economy is one of the thorniest questions to be tackled under the OECD's BEPS project. Both within the EU and globally, there is still no consensus on whether and how to tax businesses with a substantial digital business footprint but with no physical presence in a jurisdiction.

As the OECD continues its work, the EU has proposed its own digital tax strategy, with both a short-term digital service tax and long-term plan to eventually tax digital businesses operating within the EU based on a new digital permanent establishment concept.

Passing these proposals would require unanimity from all EU member states, and prospects of success seem unlikely. Some countries are opposing the concept, advocating instead for alternatives that look to where value is created by adapting agreed concepts of value creation to the digital environment. Others want to change the balance of source versus revenue taxation, focusing on where value is created but even more so where revenues are generated.

Digital tax



Source: POLITICO research (2018) *Europe's digital tax map: Where countries stand.* 12 April 2018.

EU Tax challenges: Doing business after Brexit

Two key areas of change in the business relationship between the EU and UK are the movement of people and movement of goods.

Movement of goods

After Brexit, the cross-border movement of goods between the UK and the EU will probably slow.

— Agricultural goods are expected to be hit especially hard.

— Businesses with complex international supply chains involving the transfer and assembly of value-adding inputs back and forth between the EU, UK and other countries may see rising border delays and costs.

— As the UK and EU seek to negotiate a solution, the Irish border presents one of the most significant problems. Currently, the UK-EU border between Northern Ireland and the Republic of Ireland is regarded as non-existent, especially by small businesses in these jurisdictions. The imposition of barriers to cross-border movements of goods, services and people would raise extreme sensitivities, especially given the Irish historical context.

Some of the possibilities for a new trade arrangement between the UK and EU are:

— The EU and UK could enter a relationship similar to that between the EU and the European Economic Area and Norway, with both participating in the common market subject to exceptions. However, the UK is unlikely to accept this arrangement as it would still bind the UK to decisions made by the European Commission and the European Court of Justice in areas such as trade and migration of people.

— The UK could pursue an agreement with the EU under the World Trade Organization's model, similar to the EU's agreement with Canada. However, with the EU accounting for 43 percent of the UK's exports and about half of its imports,[6] market access is critical and the amounts of red tape involved in trading across borders would be unworkable.

— Establishing a customs union between the UK and the EU, similar to those in place within the EU and Africa, would allow for tariff-free trading within the union. Again, however, this would restrict the UK's ability to enter free trade agreements with other jurisdictions, such as the US and Australia, which would likely be a showstopper for the UK as far as such a union is concerned.

The UK has proposed a customs and trade arrangement involving full regulatory alignment. In effect, the proposal would see continued single market membership in all but name for the movement of goods but no such alignment for services. This scheme would allow the UK to pursue other free trade agreements but with significant restrictions on its freedom to negotiate different regulatory standards, given its promised alignment with the single market rules. In effect, the UK would become a rule-taker.

Movement of people

In the short term, it seems likely that there will be little, if any, curtailment of movement. In the absence of a deal, the UK government has signaled its intention to adopt unilateral measures to guarantee the rights of EU citizens and free movement until at least 2020. Apart from the political complexities involved, it is arguably beyond the capacity of the UK government to implement anything more stringent in the short to medium term.

This situation has UK employers grappling with how they will continue to do business in the EU, and whether and where they should shift some of their operations and workforce. It is important for businesses to prepare for the end of free movement as it is currently known in 2020 by:

— Making sure they are aware of how EU employees already resident in the UK will be affected, as well as those in their cross-border workforce

— Preparing for a possible reduction in availability of EU employees by considering how that will affect their operations

— Factoring increased costs and timelines of bringing EU citizens to the UK from January 2021 into budgets going forward

— Understanding the tax implications of any employment-related transfers, including short-term commuting arrangements and secondments for longer terms.

[6] "Brexiteers claim that trade on WTO terms would be fine. Wrong," *The Guardian*, 30 November 2017.

Conclusion

Geopolitical trends were once at the margins of business thinking. Now they're front and center.

The five scenarios and the raft of possible implications clearly demonstrate that the business environment in the EU will be complicated to navigate in the short and medium terms.

If scenario 1 wins out, the current reform agenda would continue, with the EU27 pursuing a multilateral free trade agenda, more measures to fight tax fraud and aggressive tax planning, and more movement toward harmonizing tax bases and eliminating tax incentives. There may be an increase in public disclosure of multinational tax affairs.

If the EU votes for scenario 2 which emphasizes the single market, we are likely to see more focus on a limited group of tax measures and less focus on harmonizing tax bases and eliminating tax incentives. This could lead to increased tax competition among countries that may provide benefits to some businesses but at the cost of complexity.

Scenario 3, which involves some coalitions doing more through the EU, would result in a dual-speed EU, with some countries introducing greater coordination measures, but others refusing to join. This would lead to increased fragmentation, divergence and tax uncertainty.

If the EU member states follow a course of 'doing less more efficiently' as set out in scenario 4, significant cooperation in direct taxation would be unlikely but harmonization might continue in indirect taxation.

Lastly, if scenario 5 comes to pass, greater coordination on fiscal, social and taxation matters, as well as European supervision of financial services, would likely lead to a truly harmonized tax base and rate with higher levels of simplicity.

Until relatively recently, scenario 1 and 5, which involve the EU doing more seemed the most likely, But lately, scenarios 2 and 4, which involve the EU doing less, have come to the fore. Based on the current situation, it seems that the dual-speed model of scenario 3 may well be the path of the future.

Uncertainty complicates planning. Plan for uncertainty.

Predicting which of the 5 scenarios will eventually materialize would require a crystal ball. We believe that, in the medium term, the EU will likely continue along the lines of scenario 1 because, to a greater or lesser extent, all other options would need new provisions in EU treaties, directives, regulations and/or resolutions. Given the EU fatigue of many EU member states, this does not seem likely in the next few years.

However, scenario 1 does not address the political tensions related to the economy, migration, populism and global shifts. Unless these are resolved or mitigated by external forces, pressure within the EU is likely to increase – polarizing opinions toward scenario 2 or 5. If neither of these camps becomes dominant, the way may open for the more pragmatic approaches under scenarios 3 or 4.

One thing is certain. All of these scenarios require deep thinking and planning for business, focusing on how geopolitical trends might play out in the short, medium and long terms. Many companies are taking steps to manage their exposure by consulting specialists to help them better understand potential threats. They are also spending more time on scenario planning — considering what's likely, what alternatives are credible, what's unlikely and what's worst case — so they can chart their best course forward.

Appendix A: EU institutions and roles

For outsiders looking in, understanding how the EU is governed and how it functions can be difficult. Indeed, over the course of 60 years and through the successive European Treaties that define the EU mandate and competences, a highly complex governance and operational structure has evolved.

Understanding this division of policy and legislative competence between the EU and the individual EU member states, and the roles of the institutions, offers insights into how much sovereign discretion the EU member states still have to set their own agendas and domestic policies.

Understanding the EU project

Today, the EU is governed and run through a series of institutions agreed to in the treaties. These institutions include the Council of the European Union (legislative body), the European Commission (executive branch), the European Parliament, the European Court of Justice and the European Central Bank.

How do the EU institutions function?

	Membership	Function	Strengths	Weaknesses
European Council	Heads of state or government of EU countries, European Commission president, High Representative for Foreign Affairs & Security Policy	Highest decision-making body. Defines the general political direction and priorities of the EU but does not pass laws	Primary decision making body	Significant differences in level of engagement between council members and national governments
European Commission	A team or 'college' of commissioners, one from each EU country	The executive branch of the EU. Promotes the general interest of the EU by proposing and enforcing legislation as well as by implementing policies and the EU budget	Politically independent	Perceived as bureaucratic and non-transparent
Council of the EU	Government ministers from each EU country, according to the policy area to be discussed	Voice of EU member governments, adopting EU laws and coordinating EU policies together with the European Parliament, the Council is the EU's main decision-making body	Connected with national governments	Perceived as allowing larger member states to set the agenda
European Parliament	751 Members of the European Parliament	Directly-elected EU body with legislative, supervisory, and budgetary responsibilities. Vote on whether new legislation should be passed	Democratically elected	Perceived as remote from local concerns. The only EU institution with a direct electorate mandate, but perceived as the weakest party in EU policy making
European Court of Justice	*Court of Justice*: 1 judge from each EU country, plus 11 advocates general	Ensures EU law is interpreted and applied the same in every EU country	Independent of member state influence	Increasing member state challenges to its authority (e.g. UK, Poland)
	General Court: 47 judges, increasing to 56 in 2019 (2 judges from each EU country)	Ensures countries and EU institutions abide by EU law		
European Central Bank	ECB president and vice-president and governors of national central banks from all EU countries	To manage the euro, keep prices stable and conduct EU economic and monetary policy	Facilitates greater economic integration and was crucial in leading recovery from the financial crisis	Challenged by some member states as having overstepped its mandate

Source: Europa.eu, KPMG International 2018

What's changing and why does it matter?

The roles of these institutions have changed over time.

For example, the European Commission is having a greater say in business policy than in the past. The Commission has historically focused on promoting the single common market, taking responsibility for ensuring all individuals and businesses operating within the EU have opportunities to thrive across member states. However, the 2008 financial crisis disrupted the EU's prospects for linear growth, and the Commission's priorities have broadened. In line with the principles of proportionality and subsidiarity, the Commission took on international trade as a competence since it is much more effective for member states to enter trade talks with a single negotiator.

The Commission has also increased its remit in the areas of immigration and defense. Immigration is an area of shared competence between the EU and member states, and the ongoing migration crisis, fueled by strife in North Africa and the Middle East, has posed significant challenges within the EU. Periodic surges in irregular migrants created such significant problems that only a coordinated, EU-wide response can help resolve, and the European Commission has therefore taken on a greater role.

In other areas, some of the Commission's responsibilities are being ceded to other bodies. For example, the EU Parliament has taken a bigger role in making decisions and amending legislation. Among recent examples, the EU's 'REACH Act' on the Registration, Evaluation, Authorization and Restriction of Chemicals used in manufacturing was perceived as quite stringent when the European Commission initially proposed it. However, lobbying by members of the manufacturing industry led the EU Parliament to make amendments that significantly softened the legislation.

Part of this shift in legislative responsibility has occurred because, historically, the European Commission has not done enough to communicate the benefits of its proposals. The voices of the Members of European Parliament are filling the vacuum, and their mandate is to represent the interests of their member states, including constituent businesses. A more active Parliament has led a less insular, more open European Commission that is listening to the voices of a broader range of stakeholders, including industry groups, smaller businesses and private citizens.

This may have complicated the legislative process and weakened the strength of the European Commission itself. However, these results may be outweighed by the benefits of a more accountable, credible and inclusive approach to making decisions that are in the public interest.

The roles and responsibilities of the various EU institutions are complex enough in and of themselves. When the shifts and changes over time are added, understanding the regulatory and business environment in the EU becomes even more challenging.

Appendix B: EU by the numbers

Table 1: Change in GDP per capita in purchasing power standards

	2006	2017	Relative change
EU 28	**100**	**100**	
Ireland	148	184	36
Romania	39	63	24
Lithuania	55	78	23
Poland	51	70	19
Malta	78	96	18
Latvia	53	67	14
Slovakia	63	77	14
Estonia	64	77	13
Czech Republic	79	89	10
Germany	116	123	7
Hungary	61	68	7
Bulgaria	37	40	3
Croatia	58	61	3
Austria	126	128	2

	2006	2017	Relative change
Euro area	**109**	**106**	**(3)**
Denmark	125	125	0
Slovenia	86	85	(1)
Belgium	119	117	(2)
Sweden	125	122	(3)
France	109	104	(5)
Portugal	83	77	(6)
Finland	115	109	(6)
Luxembourg	261	253	(8)
Netherlands	136	128	(8)
Spain	103	92	(11)
United Kingdom	116	105	(11)
Italy	108	96	(12)
Cyprus	101	84	(17)
Greece	96	67	(29)

Source: Eurostat
Note: Index is EU28 = 100

Table 2: Public debt as a percentage of GDP

	2006	2017	Highest	Year
EU-28	**60.1**	**81.6**	**86.5**	**2014**
Greece	103.6	178.6	180.8	2016
Italy	102.6	131.8	131.8	2017
Portugal	69.2	125.7	130.6	2014
Belgium	91.1	103.1	106.1	2015
Spain	38.9	98.3	100.4	2014
Cyprus	58.7	97.5	107.5	2014
France	64.6	97.0	97.0	2017
UK	40.8	87.7	87.7	2017
Austria	67.3	78.4	84.6	2015
Croatia	38.6	78.0	83.8	2015
Slovenia	26.0	73.9	82.6	2015
Hungary	64.5	73.6	80.5	2011
Ireland	23.6	68.0	119.6	2012
Germany	66.5	64.1	80.9	2010

	2006	2017	Highest	Year
Euro-area 19	**67.4**	**86.7**	**91.9**	**2014**
Finland	38.2	61.4	63.0	2016
Netherlands	44.7	56.7	68.0	2014
Slovakia	31.0	50.9	54.7	2013
Malta	64.5	50.8	70.1	2011
Poland	46.9	50.6	55.7	2013
Sweden	44.0	40.6	45.5	2014
Latvia	9.6	40.1	46.8	2010
Lithuania	17.2	39.7	42.6	2015
Romania	12.3	35.0	39.1	2014
Czech Republic	27.7	34.6	44.9	2013
Denmark	31.5	34.6	44.9	2012
Bulgaria	21.0	25.4	29.0	2016
Luxembourg	7.8	23.0	23.0	2017
Estonia	4.4	9.0	10.7	2014

Source: European Commission, Eurostat (2018)

Table 3: Unemployment rate — 2017

Greece	21.5
Spain	17.2
Italy	11.2
Croatia	11.1
Cyprus	11.1
France	9.4
Portugal	9.0
Latvia	8.7
Finland	8.6
Slovakia	8.1
Belgium	7.1
Lithuania	7.1
Ireland	6.7
Sweden	6.7

Slovenia	6.6
Bulgaria	6.2
Estonia	5.8
Denmark	5.7
Luxembourg	5.6
Austria	5.5
Netherlands	4.9
Poland	4.9
Romania	4.9
Malta	4.6
United Kingdom	4.4
Hungary	4.2
Germany	3.8
Czech Republic	2.9

Source: Index Mundi (2017)

Table 4: Foreign born percentage of population (2016)

	Born in other EU	Born in Non-EU	Total
Luxembourg	33.8	11.4	45.2
Cyprus	13.7	7.4	20.4
Ireland	11.6	5.3	16.9
Austria	8.2	9.9	18.2
Romania	8.0	1.0	1.8
Belgium	7.7	8.7	16.3
Sweden	5.4	11.6	17.0
Germany	5.3	8.0	13.3
United Kingdom	5.0	8.3	13.3
Malta	4.8	5.8	10.6
Spain	4.2	8.5	12.7
Denmark	3.8	7.4	11.2
Netherlands	3.3	8.8	12.1
France	3.3	8.5	11.8
Hungary	3.3	1.9	5.1
Slovenia	3.2	8.4	11.7
Greece	3.2	8.1	11.3
Italy	3.0	6.7	9.7
Slovakia	2.8	0.6	3.3
Portugal	2.2	6.2	8.4
Finland	2.2	3.8	6.0
Croatia	1.6	11.4	13.1
Czech Republic	1.6	2.5	4.1
Estonia	1.5	13.3	14.7
Latvia	1.4	11.7	13.1
Lithuania	0.7	3.8	4.5
Bulgaria	0.7	1.2	1.9
Poland	0.6	1.1	1.6

Appendix C:

Impact by tax area/subject

Scenario	1. Carrying on	2. Nothing but the single market	3. Those who want to do more, do	4. Doing less more efficiently	5. Doing much more together
Tax issue					
Duties					
Customs	No change — already harmonized	No change — already harmonized	No change — already harmonized	No change — already harmonized	No change — already harmonized
Excise	No change	Possible harmonization of rates	Possibly more harmonization	No change	Harmonization of rates and possibly penalties
VAT					
Procedure	No change but ongoing discussion on breadth of destination principle	Possible adoption of definitive destination principle for all business to business (B2B) and business-to-consumer (B2C) transactions	No change but ongoing discussion on breadth of destination principle	Potential adoption of definitive destination principle for all B2B and B2C transactions	Adoption of definitive destination principle for all B2B and B2C transactions
Rates	No change	Possible harmonization of exemptions	Change unlikely	Potential harmonization of exemptions	Harmonization of rates[7] and exemptions
Personal taxes					
Income tax	No change	No change	No change	No change	No change unless there is significant change to the treaty
Employment taxes	No change	No change	No change	No change	No change unless there is significant change to the treaty
Wealth/ property taxes	No change	No change	No change	No change	No change unless there is significant change to the treaty
Corporation tax					
Base — Common corporate tax base	Unlikely in near future	Unlikely	Likely within restricted group	Unlikely	Likely (first step to CCCTB)
Base — CCCTB	Unlikely in near future	Unlikely	Likely within restricted group	Unlikely	Likely

[7] Note that even if statutory rates were harmonized or imposed at a minimum rate, it is likely that some countries would continue to levy regional, city or trade taxes at differing rates

Scenario	1. Carrying on	2. Nothing but the single market	3. Those who want to do more, do	4. Doing less more efficiently	5. Doing much more together
Rates	Remain under member state control	Remain under member state control	Some countries may coordinate rates	Remain under member state control	Harmonization quite possible in medium term
Significant digital presence PE?	Will depend on OECD/international agreement	Follow OECD	Likely within restricted group	Will depend on OECD/international agreement	Yes
Digital services tax?	Possibly (absent a unified approach, some unilateral action by member state is likely)	Unlikely (absent a unified approach, some unilateral action by member state is likely)	Likely within restricted group	Possibly (absent a unified approach, some unilateral action by member state is likely)	Yes
Focus on avoidance	Continue as is	New initiatives unlikely	Continue as is at EU level	Possibly	Yes
EU code of conduct	Continue to address harmful regimes	Continue to address harmful regimes	Continue as is at EU level, restricted group may roll back certain regimes	Continue as is	May become hard law, not soft law
Tax incentives	Allowed on national basis according to EU rules	Allowed on national basis according to EU rules	Restricted group may coordinate incentives	Allowed on national basis according to EU rules	Coordinated on EU basis
Public country-by-country reporting	Possibly	Unlikely	Likely within restricted group	Possibly	Yes
Other					
Exchange of rulings	Continue as is	Continue as is	Continue as is	Continue as is	Continue as is
State Aid	Continue as is	Reduced activity	Continue as is	Possibly reduced activity	Possible increased use
EU blacklist and impact on third countries	Continue as is	Reduced activity	Continue as is	Possibly reduced activity	Increased use
Mandatory disclosure rules	Possibly strengthened depending on effectiveness	Continue as is	Possibly strengthen depending on effectiveess	Continues as is unless clearly not working	Continue or expand
Financial transaction tax	Unlikely	Unlikely	Possibly within a restricted group	Unlikely	Possibly
Tax competition between countries	Will continue with rates and focused incentives	Will continue with rates and focused incentives	Will continue generally but a restricted group may coordinate tax regimes	Will continue with rates and focused incentives	Largely eliminated
Compliance burden on companies	Largely the same; different rules remain in all member states	Largely the same but less EU intervention in future; different rules remain in all member states	May increase as a two-speed EU emerges	Largely the same; different rules remain in all member states but potentially fuller VAT harmonization	Significant short term change/ disruption but leading to greatly reduced difference in member states

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