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Enhanced cooperation: EU Implementation of Pillar 2 without unanimity

Dennis Weber (Editor) (Amsterdam Centre for Tax Law (ACTL) of the University of Amsterdam; Loyens & Loeff) and Jorn Steenbergen (Loyens & Loeff) · Tuesday, June 7th, 2022

The current state of play in the negotiations for an EU Pillar 2 Directive is that all but one Member State are on board. Hence, there is one "dissenting" Member State left. As unanimity is needed within the Council to adopt an EU Directive on Pillar 2, it is currently not possible to implement Pillar 2 within the EU in a coordinated manner (i.e., by way of a regular Directive). However, 26 of the 27 Member States are in favor of a Directive to implement Pillar 2. It raises the question whether Pillar 2 could be implemented by these 26 Member States using EU legislation, while leaving out the one dissenting Member State.

An option that has sometimes been voiced is the instrument of "enhanced cooperation". Such an enhanced cooperation would allow the 26 participating Member States to implement Pillar 2 in a coordinated manner, without the need for approval of the last dissenting Member State.

The procedure of enhanced cooperation is far from clear-cut. In this blog, we will discuss the procedure of enhanced cooperation in general terms. We also discuss some potential arguments from non-participating Member States. Our conclusion is that there is not much that non-participating Member States can do but accept that participating Member States proceed without them.

The two-step process of enhanced cooperation

Article 20 of the Treaty on the European Union (**TEU**) contains the constitutional framework for enhanced cooperation. It provides that a minimum of nine Member States can by request decide to use the institutions of the EU to establish enhanced cooperation between themselves. Enhanced cooperation thus allows Member States to issue legally binding Directives amongst a smaller group of participating Member States. These Directives are not binding on non-participating Member States. Nonetheless, non-participating Member States are allowed to join the enhanced cooperation framework at any time, provided they meet the relevant requirements.

Enhanced cooperation is a two-step process. The first step is an authorization by the Council allowing enhanced cooperation between the relevant Member States. The substantive and procedural conditions relating to granting the authorization are laid down in Articles 20 TEU and Articles 326 TFEU to 334 TFEU. One of the most relevant substantive conditions that we discuss in this blog, is that enhanced cooperation can only be used as a last resort. Article 20(2) TEU

namely states that authorization for enhanced cooperation can granted after it has been established that “the objectives of such cooperation cannot be attained within a reasonable period by the Union as a whole”. Another relevant substantive condition is that enhanced cooperation “shall not undermine the internal market or economic, social and territorial cohesion”, “shall not constitute a barrier to or discrimination in trade between Member States, nor shall it distort competition between them” (Article 326 TFEU).

An authorization for enhanced cooperation is nothing more and nothing less than a decision by the Council “approving” of the enhanced cooperation. It approves that the participating Member States use the EU’s institutional framework for their cooperation. The second step of the process is that the enhanced cooperation is the actual use of the institutional framework to adopt legislative acts within the framework of enhanced cooperation. Insofar as relevant here, the implementation of enhanced cooperation also entails adopting Directives within the framework of enhanced cooperation. This implementation must be assessed separately from the authorization. Such an implementation must be based on an existing legal basis for non-exclusive competences of the EU. The legal basis for implementation of enhanced cooperation on Pillar 2 would likely be Article 115 TFEU. This legal basis provides that the Council decides by unanimity of votes on the adoption of Directives, after consulting the European Parliament. This same procedure would be followed for the implementation of enhanced cooperation, with one major difference. The major difference with a “regular” Directive is that a Directive under enhanced cooperation is only binding on participating Member States. To avoid non-participating Member States barricading enhanced cooperation, a “mini-Council” is established for the adoption of legislative acts within enhanced cooperation.[1] Non-participating Member States can take part in the deliberations of the mini-Council, but they cannot vote on the adoption of any acts. The implementation of enhanced cooperation on Pillar 2 would be voted on by the participating Member States only. The Directive within the framework of enhanced cooperation would then be binding only on the participating Member States (though non-participating Member States are allowed to join the cooperation at any time).

The authorization

We will now discuss two relevant substantive provisions of enhanced cooperation. The first is that enhanced cooperation can only be used as a last resort. The second is that enhanced cooperation may not lead to (inter alia) discriminations in trade and distortion of competition between Member States.

The authorization for enhanced cooperation can only be granted by the Council after it has been established that “the objectives of such cooperation cannot be attained within a reasonable period by the Union as a whole”. Based on CJEU case law, this concept seems to have a broad meaning. When referring to this requirement, the CJEU considered that “The impossibility referred to in [Article 20(2) TEU] (…) may be due to various causes, for example, a lack of interest on the part of one or more Member States or the inability of the Member States, who have all shown themselves interested in the adoption of an arrangement at Union level, to reach agreement on the content of that arrangement”. From that same case law, it follows that “The Court, in exercising its review of whether the condition (…) has been satisfied, should therefore ascertain whether the Council has carefully and impartially reviewed those aspects that are relevant to this point and whether adequate reasons have been given for the conclusion reached by the Council”.[2] It can be derived from this that the requirement would only not be met if there is a “manifest inappropriateness” in the Council’s assessment. Whether there is a deadlock in the negotiations is a

highly political question, and would therefore be especially for the assessment of the Council. For that reason, we consider the interference of the CJEU to be very limited.

The second requirement is that enhanced cooperation shall not "undermine the internal market or economic, social and territorial cohesion", "constitute a barrier to or discrimination in trade between Member States" or "distort competition between them" (Article 326 TFEU). The enhanced cooperation for Pillar 2 could be assessed in light of the distortion of competition. Relevant here is that the Pillar 2 rules have an inherent extraterritorial effect in its application. This means that Pillar 2 leads to the (re-)taxation of foreign profits that are allocated to a different jurisdiction. The enhanced cooperation on Pillar 2 would have this extraterritorial effect, not only on profits of participating Member States but also on profits from non-participating Member States. The non-participating Member States could try and argue that this extraterritorial effect leads to a discrimination in trade or distortion of competition, as they are not part of the enhanced cooperation.

Unsurprisingly, it seems that the CJEU is also lenient on whether there is a distortion of competition. The CJEU seems to limit its review on Article 326 TFEU to careful and impartial examination of the relevant aspects and the provision of adequate reasons for the Council's conclusion. Similarly, the Advocate General considered that the CJEU's assessment in this respect is limited to whether the measure is "manifestly inappropriate having regard to the objective which the competent institution is seeking to pursue".[3] It follows from other CJEU case law that the inappropriateness depends on "whether objectives pursued by the measure chosen are such as to justify even substantial negative economic consequences for certain operators".[4] Therefore, it is essentially for the Council to assess whether the objective pursued by Pillar 2 justifies (possible) substantial negative economic consequences. The objective of Pillar 2 is to provide a minimum taxation for the largest multinationals by stopping (or rather curbing) global tax competition. It is impossible to exclude profits from non-participating Member States from the scope of the Pillar 2 rules. Such application (or any other more favorable treatment with respect to non-participating Member States) would bring the risk that non-participating Member States become a safe haven from the Pillar 2 rules. In our view, the objective of Pillar 2 justifies the negative economic consequences. Enhanced cooperation on Pillar 2 would therefore not likely be "manifestly inappropriate" in light of Article 326 TFEU.

With that, we do not consider it likely that non-participating Member States can successfully oppose the authorization for enhanced cooperation.

The implementation

Once authorization has been granted, participating Member States can use the TFEU to implement Pillar 2 among themselves. The implementation of Pillar 2 under enhanced cooperation would be a full-fledged Directive, with all standards of the TFEU applying in the same manner. The implementation would be based on Article 115 TFEU.

All regular requirements for a Directive under the TFEU must be followed. Furthermore, Article 326(1) TFEU explicitly specifies that the enhanced cooperation may not infringe primary EU law. Similar to regular Directives must the implementation of enhanced cooperation be in line with (inter alia) the fundamental freedoms. Nonetheless does the CJEU in this assessment apply a much milder standard for Directives than that it does for national measures. Specifically for taxation matters, it follows from the case *RPO* that "when the EU legislature adopts a tax measure, it is

called upon to make political, economic and social choices, and to rank divergent interests or to undertake complex assessments. Consequently, it should, in that context, be accorded a broad discretion, so that judicial review of compliance with the conditions set out in the previous paragraph of this judgment must be limited to review as to manifest error".[5] In our view, the same would apply for the implementation of enhanced cooperation. EU legislature in enhanced cooperation (i.e., the mini-Council) would have a broad margin of discretion in the implementation of Pillar 2, more or less in line with the case *RPO*. The question would here also be whether the Council has made a manifest error (i.e., whether the decision is manifestly inappropriate). Conceptually, we do not consider it likely that the Council would have made a manifest error on whether the implementation of Pillar 2 is contrary to primary EU law.

Lastly, we note that the implementation of enhanced cooperation on Pillar 2 would be based on Article 115 TFEU, but must *also* be in line with the authorization. Without the authorization, there would be no legal basis to use Article 115 TFEU for the implementation of Pillar 2 (in the absence of consent from all Member States). The implementation itself must therefore comply with its authorization, including that it may not lead to a distortion of competition (Article 326 TFEU). That is logical, because if the implementation was not required to be in line with its authorization, then the authorization for enhanced cooperation would effectively be a *carte blanche* on participating Member States. Considering the limited assessment by the CJEU, it does not seem that Article 326 TFEU would provide extra judicial review on the implementation of enhanced cooperation, compared to a regular Directive.

Concluding remarks

This blog provides an overview of enhanced cooperation on Pillar 2. Although the instrument of enhanced cooperation is not clear-cut, we have tried to set out whether enhanced cooperation on Pillar 2 would be allowed. It seems that enhanced cooperation provides the EU legislature with a broad margin of discretion. Consequently, it seems that an enhanced cooperation on Pillar 2 would only be contrary to primary EU law if it can be argued that the Council has made a manifest error in the authorization of the enhanced cooperation, or if it can be argued that the mini-Council has made a manifest error in the implementation of that enhanced cooperation. Though there may be some arguments that non-participating Member States could voice, it is in our view not likely that this would lead to successfully opposing the enhanced cooperation on Pillar 2.

[1] Article 20(3) TEU and Article 330 TFEU. The creative term of mini-Council has been coined in literature before. See A. Schrauwen, Chapter 1 – Sources of EU Law for Integration in Taxation in Traditional and Alternative Routes to European Tax Integration: Primary Law, Secondary Law, Soft Law, Coordination, Comitology and their Relationship (D. (Dennis) Weber ed., IBFD 2010), Books IBFD, par. 1.5.

[2] ECJ 16 April 2013, Joined Cases C-274/11 and C-295/11, Spain v. Council and Italy v. Council, ECLI:EU:C:2013:240, para. 54.

[3] Opinion of Advocate General Bot, 11 December 2012, Joined Cases C-274/11 and C-295/11, Spain v. Council and Italy v. Council, ECLI:EU:C:2012:782, para. 116.

[4] ECJ 9 June 2010, C-58/08, *Vodafone and Others*, para. 53.

[5] CJEU 7 March 2017, C-390/15, *RPO*, ECLI:EU:C:2017:174, para. 54 and cited case law. .

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