EUROPEAN COMMISSION UNVEILS PLAN TO ELIMINATE UNANIMOUS CONSENT REQUIREMENT FOR TAX LEGISLATION

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Proposal would facilitate adoption of new tax policies in the European Union

On January 15, 2019, the European Commission (the "Commission") released its proposal to gradually remove the ability of European Union ("EU") member states to veto EU-wide tax legislation. The "right of legislative initiative" rests with the Commission, which proposes laws usually co-decided by the member states in the Council of the EU and the European Parliament. However, the power to tax is a prerogative of the EU member states, with the EU having only limited competences and the European Parliament playing only a consultative role in this process. Tax-related legislation at the EU level therefore still requires unanimity of member states and remains a rare exception in the decision- making process of the EU, where unanimity has been replaced throughout the years by a more efficient qualified majority voting ("QMV"). The Commission argues that the unanimity requirement has often delayed or blocked negotiations on certain tax proposals intended to ensure that corporate taxpayers are paying their fair share and to avoid base erosion, including the Financial Transaction Tax ("FTT"), the Common Consolidated Corporate Tax Base ("CCCTB"), and, more recently, the EU digital services tax ("DST").

The proposal, set out in the Commission's communication "Towards a more efficient and democratic decision making in EU tax policy," outlines a step-by-step introduction of QMV in tax files. This voting method, already used for around 80% of EU legislation, would enable 16 of the 28 member states, representing at least 65% of the total EU population, to pass tax legislation. Although QMV also foresees the possibility to create blocking minorities, in some instances dissenting EU member states could see the approval of EU tax measures they would not support.

Paradoxically, for the Commission's effort to succeed without changing the EU founding treaties, the unanimous consent of the EU member states is required to approve the elimination of the unanimity requirement on tax matters. The first objections to what could constitute the end of tax competition among EU countries, as well as a huge shift of powers and sovereignty to the EU level, have already started to surface.

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The Commission argues that the fragmentation of tax rules along the national borders increases compliance costs for businesses, which must comply with multiple and uncoordinated tax regimes, lowering the attractiveness of the EU single market as an investment destination. The Commission also underlines the need to reinforce the competitiveness of the EU tax system amid external pressures, including U.S. tax reform. While it is acknowledged that tax competition is not a bad thing per se, the communication warns about the possibly heavy toll of shifting the tax burden to labor or consumers.

It is still unclear how many member states are likely to share the Commission's enthusiasm over the QMV. The initiative could limit their competitive advantage to attract businesses because the likely result of a move to QMV would be that the larger member states with generally higher rates would push for closer convergence of tax within the bloc. From a business perspective, this could on one hand lead to a faster adoption of controversial measures, such as the DST. On the other hand, tax measures harmonizing rules across the EU could in the long run simplify compliance and decrease businesses' administrative burden.

We have seen previous attempts to scrap the veto on tax matters during the difficult conferences and negotiations that lead to past EU treaty changes, which failed to materialize due to fear of loss of member states' sovereignty. However, as a clever way out of the debate between those who wanted to protect unanimity and those who wanted a stronger and more effective EU in all policy areas, a special mechanism called the "passerelle" clauses was enshrined in the treaties. The Commission now proposes to activate the passerelle clauses for the first time. There is a general passerelle clause set out in the Treaty on European Union ("TEU") that would allow a "passage" (hence the name) from one system to another. Therefore, the adoption of any measures currently subject to unanimity could be accomplished by QMV, either with a consultation or co-decision of the European Parliament. A more specific passerelle clause was also introduced under the Treaty on the Functioning of the European Union ("TFEU") to be eventually used for measures in the environmental field. As the Commission explains, national sovereignty would remain intact, as the "activation" of both clauses requires the unanimous support of the member states in order to be used.

The Commission proposes a four-step process in this important evolution, making it a progressive change, with the most contentious taxation questions to be addressed by 2025:

- The first step would leave member states' taxing right untouched and provide for QMV only with respect to actions designed to fight tax fraud and avoidance, including administrative cooperation and anti-base erosion and profit shifting ("BEPS") measures;
- In the second step, measures of a fiscal nature related to climate change, public health, or transport would see their voting simplified;
- The third step would concern the value-added tax ("VAT") and excise duties; and
- The fourth and final step would propose broadening the QMV to wider single-market issues, such as the CCCTB or digital taxation.

The Commission has invited the EU heads of states and governments to endorse its plan and decide on the use of the general passerelle clause to implement the first and second steps as soon as possible. National leaders would have to seek the consent of their parliaments as well as the European Parliament's agreement. National legislators would have six months to express their objections, which are likely to materialize as already signaled by some member states. EU leaders are further invited to consider the third and fourth step by 2025. It is strongly advisable for businesses to follow the process closely, starting with the initial political reactions and discussions we are going to witness in the coming months.

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