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International Taxation: Implementing Pillar Two in the European Union and Combatting the Tax Veto Through Enhanced Cooperation

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Foreword

On December 15, 2022, the Council of the EU unanimously adopted the Directive implementing Pillar Two in the EU. This paper was written prior to the surprise announcement and analyzed Hungary's use of the tax veto as the sole dissenter to the Directive. Although Pillar Two is now formally adopted this paper provides insights into the legislative process of the EU and the issues that arise from the unanimity requirement for tax legislation in the EU. There are possible methods, such as through Passerelle Clauses, to shift tax policy from unanimity to qualified majority voting, however, as discussed below is untenable and brings more challenges than solutions. This paper argues that absent an agreement from Hungary the rest of the EU member states should have pursued the enhanced cooperation procedure, which has never been used in a tax matter. This analysis is still relevant considering the adoption of Pillar Two for the future of tax policy in the EU as enhanced cooperation is a viable method to weaken the tax veto and push for greater compromise. The use of enhanced cooperation provides the best path forward for future tax disputes without the challenges shifting to qualified majority voting.

I. Introduction

The taxation of multinational businesses has created issues for governments and businesses across the globe. Businesses that operate in two or more countries can optimize their tax burden by shifting profits from high-tax jurisdictions to low-tax jurisdictions, which can adversely affect individual countries' tax revenues or allow businesses to invest more than they otherwise would.[1] Increased digitalization has only enhanced the international tax challenges by raising the question of how to properly assign income to the jurisdiction in which it was earned. Tech companies have

[1] Daniel Bunn, *Summary and Analysis of the OECD's Work Program for the BEPS 2.0,* TAX FOUNDATION (June 18, 2019), https://taxfoundation.org/oecd-work-program-beps-analysis/.

used base erosion and profit shifting measures for years across the European Union ("EU") to lower corporate tax rates to zero.[2] In some jurisdictions, the global community has come together across initiatives to address these concerns, and although there is a strong global consensus, the challenges to enacting the laws in each county's respective jurisdiction are ongoing.

In 2013, the Base Erosion and Profit Shifting ("BEPS") project was launched by the Organization for Economic Cooperation and Development ("OECD") to address the actions of multinational corporations that result in low tax rates.[3] In 2021, almost 140 countries in the OECD/G20 Inclusive Framework on BEPS came to a historic agreement on international tax reform and a plan for its implementation.[4] Many EU member states are a source for BEPS, while other larger governments oppose the use of BEPS, as they do not require the same economic stimulation given their robust economies and heightened engagement in corporate tax competition. Despite ongoing conflicts in the tax regime, all EU countries have agreed to the Inclusive Framework's BEPS 2.0 initiative.[5] The reform of international corporate tax rules consists of two pillars: Pillar One would cover the new system of allocating taxing rights over the multinationals to jurisdictions where profits are earned, with the key element being multilateral convention; Pillar Two contains rules aimed at reducing the opportunities for base erosion and profit-shifting so that the largest multinational companies (with revenues of at least €750) pay a 15% corporate minimum tax.[6]

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[2] *Id.*
[3] *Id.*
[4] OECD, *International Taxation,* WWW.OECD.ORG, https://www.oecd.org/g20/topics/international-taxation/ (last visited Dec. 18, 2022).
[5] OECD, *International Taxation,* WWW.OECD.ORG, https://www.oecd.org/g20/topics/international-taxation/ (last visited Dec. 18, 2022).
[6] OECD, *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*, WWW.OECD.ORG (Oct. 8, 2021), https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.htm.

The EU is in a strong position to become an international tax leader with the implementation of BEPS 2.0. The BEPS project requires a "first mover" and five EU member states (France, Germany, Italy, the Netherlands, and Spain) have indicated their intention to forge ahead on Pillar Two.[7] Thus, because the European Commission prefers a binding Directive that would oblige all 27 member states to adopt the same global minimum tax, the EU is best positioned to set the stage for other governments to follow suit in the adoption of BEPS. Hungary has been the sole dissenter on the proposed EU Directive, using the tax veto to block the implementation of Pillar Two uniformly across Europe.[8] EU's voting rules, which require uniformity in the implementation of tax policy, slow down efforts at harmonizing direct taxes and would better serve the internal market if they parted from the unanimity requirement.[9] However, with the current rules in place, the best way for the EU to implement BEPS is through a Directive.

This paper will analyze the EU's Pillar Two Directive in light of the tax veto and through the lens of enhanced cooperation, which would allow the EU to move forward with the Directive on Pillar Two without unanimous consent. This approach is a better alternative to awaiting the possibility that the tax legislation process could shift to qualified majority voting— a process that has yet to be used and could present more challenges than solutions in the tax arena.

First, this paper will discuss the history of the OECD and the implementation of BEPS initiatives throughout the years and leading up to the formation of the Inclusive Framework and Pillar Two. Next will follow an exploration of the procedures and challenges to the implementation of Pillar Two in the EU. Third, this paper will analyze the possible solutions for tax policy in the EU, followed by a discussion of the procedure for the use of enhanced cooperation, and the benefits

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[7] Robert Goulder, *Take the Tax Reform Plunge: Leave the EU Out of Pillar 2,* FORBES (Nov. 3, 2022), forbes.com/sites/taxnotes/2022/11/03/take-the-tax-reform-plunge-leave-the-eu-out-of-pillar-2/?sh=307ccf894d8a.
[8] *Id.*
[9] *Id.*

in its use across the landscape of international tax policy. Lastly, this paper will conclude by illustrating that enhanced cooperation can provide the best path forward to implement Pillar Two and serves as a basis to weaken the tax veto going forward.

II. OECD BEPS Initiatives

Since the financial crisis of 2008, significant efforts have been underway to create enhanced cooperation on international tax issues as countries enact domestic laws and international agreements to combat tax avoidance and evasion.[10] The OECD has led the charge using various initiatives to create a greater tax consensus and more effective policies.[11] In the 21st century economy, digitalization and globalization pose new international tax challenges by creating significant opportunities for tech companies to leverage opportunities for BEPS.[12] To counteract these BEPS practices, the OECD has sought to end the race to the bottom across counties by implementing a more equitable and sustainable tax structure.[13]

A BEPS action plan between the OECD and G20 countries was rooted in the need to address the tax avoidance practices of large multinational enterprises ("MNE").[14] The OECD/G20 Action Plan was developed in 2013 to increase symmetry in domestic laws and improve transparency between states.[15] The BEPS package was the first major transformation of international tax rules, as it successfully connected profit reporting to the jurisdiction in which

[10] OECD, *International Taxation,* WWW.OECD.ORG, https://www.oecd.org/g20/topics/international-taxation/ (last visited Dec. 18, 2022).
[11] OECD, *Mission and Impact,* WWW.OECD.ORG, https://www.oecd.org/tax/beps/about/#mission-impact (last visited Dec. 1, 2022).
[12] OECD, *Action 1,* WWW.OECD.ORG, https://www.oecd.org/tax/beps/beps-actions/action1/ (last visited Dec. 1, 2022).
[13] *Id.*
[14] Itai Grinberg, Breaking BEPS: The New International Tax Diplomacy, 104 GEO. L.J. 1137-1196 (2016).
[15] *Id.*

economic activity or value was created.[16] In an effort to continue the coordinated efforts of the BEPS package and increase global cooperation, the OECD/G20 Inclusive Framework on BEPS ("Inclusive Framework") was formed in 2016.[17] The goal of the Inclusive Framework is to ensure that interested countries can develop standards for BEPS on equal footing while also monitoring the progress of the original OECD/G20 BEPS initiative.[18] As of 2016, eighty-two countries met for the inaugural meeting of the Inclusive Framework—a number which has since grown to over 141countries.[19]

Although the BEPS 1.0 package made significant progress within the international tax system by limiting profit shifting, additional steps were required to fully accomplish the goals of BEPS 1.0 and adequately address the challenges raised by increased digitalization.[20] By October 2021, the Inclusive Framework approved the Two Pillar solution in harmony with the 141 Inclusive Framework Members to reform international taxation and ensure that MNEs pay their fair share of tax wherever they operate throughout the world.[21] The Inclusive Framework's Two Pillar solution has been coined BEPS 2.0, and its purpose is to build a consensus of tax policy and avoid the route of unilateral measures.[22] The OECD projects that the BEPS 2.0 proposals will raise the global corporate tax income by $150 billion, mostly through Pillar Two.[23] Pillar One outlines

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[16] Reuven S. Avi-Yonah and Young Ran Kim, Tax Harmony, The Promise and Pitfalls of the Global Minimum Tax, 43 MICH. J. INT'L L.J. 505 (2022).
[17] *Id.*
[18] OECD, *Developing Countries and the OECD/G20 Inclusive Framework on BEPS,* WWW.OECD.ORG https://www.oecd.org/tax/beps/developing-countries-and-the-oecd-g20-inclusive-framework-on-beps.pdf (last visited Dec. 18, 2022).
[19] *Id.*
[20] OECD, *International Taxation,* WWW.OECD.ORG, https://www.oecd.org/g20/topics/international-taxation/ (last visited Dec. 18, 2022).
[21] OECD, *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*, WWW.OECD.COM (Oct. 8, 2021), https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.htm.
[22] Ernst & Young, *OECD and country officials discuss BEPS 2.0 Pillars One and Two and other OECD tax wor*k, WWW.EY.COM (June 30, 2022), https://www.ey.com/en_gl/tax-alerts/oecd-and-country-officials-discuss-beps-2-0-pillars-one-and-two-and-other-oecd-tax-work.
[23] *Id.*

profit reallocation proposals to build consensus across countries to avoid double taxation, while Pillar Two creates a global minimum tax rate to ensure multinational corporations pay their fair share of tax wherever they operate.[24] The Inclusive Framework has targeted the implementation of BEPS 2.0 in each jurisdiction during the course of 2023. [25]

The Global Anti-Base Erosion Model Rules ("GloBE") were released in December 2021 and address how states should enact the Pillar Two in their respective jurisdictions.[26] The main provision of Pillar Two will subject MNEs with revenues of at least €750 million to a minimum tax of 15%.[27] Every jurisdiction in which a multinational company operates will be considered in determining whether the effective tax rate falls below 15%. If a jurisdictions effective tax rate falls below 15%, a top-up tax will be collected and paid ensuring an effective tax rate of 15% no matter what jurisdiction collects it.[28] The model rules provide guidance for implementation in each state's jurisdiction, but do not require the exact adoption as long as the policy implications remain aligned with the model rules.

Having garnered a large consensus for the Inclusive Framework and the model rules in place, each member of the Inclusive Framework is tasked with enacting Pillar Two in their proposed timeframe, in 2023. However, the implemention of Pillar Two into the tax law is much more difficult in practice, as individual countries and EU Member states will remain at a standstill until one or more governments take the plunge. In the EU specifically, the challenge of

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[24] OECD, *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*, WWW.OECD.ORG, https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.htm (last visited Dec. 18, 2020).
[25] *Id.*
[26] OECD, *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS,* WWW.OECD.ORG, https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two.htm (last visited Dec. 18, 2022).
[27] *Id.*
[28] Council Directive 2021/0433, art. 25-28, 2021 O.J. (L. 823) 46-50.

implementing Pillar Two illuminates the hurdles that arise with the requirement of unanimous consent in creating tax policies and whether alternative routes should be pursued for greater uniformity and efficiency.

III. Pillar Two in the European Union

The EU is at the forefront of the BEPS movement, and all of its member states are included in the Inclusive Framework. Germany and France consistently raise concerns with BEPS practices and have done so years prior to the implementation of BEPS 1.0.[29] The EU's involvement in BEPS has become highly publicized in the news, specifically regarding the discussion with member states surrounding Ireland's status as a major tax haven for MNE profit shifting measures.[30] The so-called "Celtic Tiger" economy has allowed MNEs to invest billions in Ireland in exchange for low corporate taxes.[31] Ireland currently has a corporate tax rate of 12.5% and a tax regime that helps global companies based there to avoid paying taxes in other jurisdictions where they make profits.[32] Although Hungary and Switzerland also have lower taxes, Ireland has become the hub of the tech industry, and boasts a flexible English-speaking work force.[33] Ireland hosts pharmaceutical giants such as Novartis and Pfizer, tech giants such as Apple, and other MNEs such as Ernst & Young and Accenture.[34] This is but one example of the cruciality behind the EU's implementation of Pillar Two through a European Commission Directive. Although implementing Pillar Two through a Directive may initially face challenges through unanimous consent, it

[29] Matt Thompson, *Five Countries Pledge to Enact Corp. Minimum Tax,* LAW360 (Sep. 9, 2022), https://www.law360.com/tax-authority/articles/1529069/five-countries-pledge-to-enact-corp-minimum-tax.
[30] *Id.*
[31] Liz Alderman, *Ireland's Days as a Tax Haven May Be Ending, but Not Without a Fight,* N.Y. TIMES (Oct. 7, 2021), https://www.nytimes.com/2021/07/08/business/ireland-minimum-corporate-tax.html.
[32] *Id.*
[33] *Id.*
[34] *Id.*

certainly provides the best path forward to create uniformity across the EU and ensures all member states enact similar laws that encompass the policies behind Pillar Two.

The European Commission sets the legislative agenda for the EU because it has the exclusive power to propose legislation, and thus has significant influence to shape and to promote the agenda for the EU.[35] Under Article 17(2) of the Treaty on the European Union ("TEU"), the Commission has exclusive power to propose legislation so long as there is no treaty to the contrary.[36] This power gives the Commission a great deal of autonomy in proposing and implementing initiatives.[37] The Commission may enact regulations or decisions that become binding automatically through the EU, while Directives must be incorporated into the national legislation of the individual member states as the member states see fit.[38] The Commission thereafter has the authority to monitor member states' enactment of the Directive and bring cases before the Court of Justice of the European Union ("CJEU") to ensure compliance.[39]

After Directives are proposed, the Council of the European Union ("Council") negotiates and adopts EU laws alongside the European Parliament ("Parliament").[40] The Council consists of representatives from the twenty-seven member states that meet in ten different configurations based on the policy area discussed.[41] Most EU legislation is passed as a "co-decision" with the European Parliament, however, in areas such as taxation, the Parliament is instead "consulted."[42] When "consulted," the Parliament may approve or reject proposals, although the Council has no

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[35] European Commission, *Applying EU Law,* EC.EUROPA.EU, https://ec.europa.eu/info/law/law-making-process/applying-eu-law_en#when-countries-fail-to-apply (last visited Dec. 1, 2022).
[36] *Id.*
[37] *Id.*
[38] *Id.*
[39] European Commission, *Taxation and Customs Union,* EC.EUROPA.EU, https://taxation-customs.ec.europa.eu/lisbon-treaty-and-tax-legislation-eu_en (last visited Dec. 1, 2022).
[40] Treaty on the Functioning of the European Union, art. 234, 2016, O.J. (C 202) 152.
[41] *Id.*
[42] Treaty on the Functioning of the European Union, art. 115, 2016, O.J. (C 202) 95.

legal obligation to follow the Parliament's opinion.[43] Tax policy requires unanimous consent from the Council for passage under Article 115 of the Treaty on the Functioning of the European Union ("TFEU"), which directly affects the establishment and functioning of the internal market.[44]

The EU has consistently had strong support for BEPS across member states and began its implementation of BEPS 2.0 shortly after the GloBE model rules were released. The European Commission proposed the "Council Directive on ensuring a global minimum level of taxation for multinational groups in the Union" ("Directive") in December 2021.[45] The Directive would provide a framework for Pillar Two's implementation in the EU in accordance with the GloBE rules agreed upon by the Inclusive Framework.[46] With all twenty-seven members of the EU included in the Inclusive Framework, the Directive, if passed, would provide a binding instrument to ensure uniformity in its implementation across EU member states.[47] The Directive would introduce a minimum level of taxation to 15% for multinationals with profits greater then €750 million that operate in the EU internal market.[48] The Directive closely mirrors the GloBE rules where Pillar Two consists of two main rules: the income inclusion rule ("IIR") and the undertaxed profit rule ("UTPR"). The IIR requires MNE residence countries to apply a "top-up" tax calculated based on the allocable share in every entity of the MNE where a subsidiary is taxed below the minimum and applies irrespective of whether the entity is located within the EU.[49] The IIR is a corrective measure to allow residence countries to tax the difference between the source taxation

[43] *Id.*
[44] Treaty on the Functioning of the European Union, art. 115, 2016, O.J. (C 202) 95.
[45] Council Directive 2021/0433, art. 1-4, 2021 O.J. (L 823) 19-26.
[46] PricewaterhouseCoopers, *EU Finance Ministers Fail Again to Reach Political Agreement on Proposed Pillar Two Directive,* WWW.PWC.COM (June 17, 2022), https://www.pwc.com/gx/en/tax/newsletters/tax-policy-bulletin/assets/pwc-eu-finance-ministers-fail-to-reach-agreement-on-p2-Directive.pdf.
[47] Ernst & Young, *European Commission proposes tax Directive for implementing BEPS 2.0 Pillar Two Model Rules in the EU,* WWW.EY.COM (Dec. 24, 2021), https://www.ey.com/en_lu/tax/european-commission-proposes-tax-Directive-for-implementing-beps.
[48] Council Directive 2021/0433, art. 25-28, 2021 O.J. (L 823) 46-50.
[49] *Id.*

and the 15% minimum, therefore incentivizing source jurisdictions to implement the 15% minimum tax.[50] If MNEs move to non-cooperating jurisdictions the effects will be neutralized if their residence jurisdictions has implemented the global minimum. To comply with the EU fundamental freedoms, the Directive will also apply to purely domestic groups within the EU that meet the €750 million threshold to avoid potential discrimination.[51]

The UTPR acts similarly, whereby source jurisdictions with a 15% minimum tax can deny a subsidiary's deduction to the parent or equivalent adjustment if a residence jurisdiction does not implement a minimum tax.[52] It is important to note, however, the UTPR will not apply for the first five years if the qualified MNE's tangible assets do not exceed €50 million and they operate in no more than five foreign countries.

The Directive provides the most efficient and clear path forward for the implementation of Pillar Two in the EU. If the Directive was unanimously approved by the Council, it would be binding on member states to implement the Directive into their respective tax laws in a manner that complies with the Directive.[53] This process would ensure uniformity in the application of Pillar Two, as well as compliance mechanisms for the Commission to place on resisting member states.[54] The Commission ensures member states properly apply EU law and uses its enforcement tool when member states do not incorporate a Directive by the deadline or misapply EU law into national law.[55] When member states fail to properly implement EU law, the Commission may begin infringement procedure against the state, and if it is unsettled, it can proceed to the Court of

[50] *Id.;* Reuven S. Avi-Yonah, Young Ran Kim, and Karen Smith, A New Framework for Digital Taxation, 63 HARV. INT'L L.J. 21 (2022).
[51] Council Directive 2021/0433, art. 25-28, 2021 O.J. (L 823) 46-50.
[52] European Commission, *Applying EU Law,* EC.EUROPA.EU, https://ec.europa.eu/info/law/law-making-process/applying-eu-law_en (last visited Dec. 1, 2022).
[53] European Commission, *Taxation and Customs Union,* EC.EUROPA.EU, https://taxation-customs.ec.europa.eu/lisbon-treaty-and-tax-legislation-eu_en (last visited Dec. 1, 2022).
[54] *Id.*
[55] Treaty on the Functioning of the European Union, art. 260, 2008, O.J. (C 115) 161.

Justice of the European Union.[56] Once applied across member states, the Directive would ensure a minimum level of taxation across the member states for large MNEs and put a floor on the race to the bottom between member states' tax competition. The Directive process would provide a consistent rollout of Pillar Two in the EU and create legal certainty for large MNEs with operations in the EU. Member states retain the option to unilaterally implement the GloBE rules, however, the Directive process ensures the greatest degree of uniformity and fairness across member states.[57]

The Directive requires unanimity from the Council based on Article 115 of the TFEU raising challenges to the implementation of Pillar Two in the EU.[58] Taxation is considered a sensitive policy area and is subject to unanimous voting.[59] There is much debate over whether unanimity should be required in the area of taxation given the political implications and leverage that can be used by a sole member state's use of the tax veto. Pillar Two's adoption in the EU has been met with Hungary as the sole dissenter in the Council to block the Directive.[60] Hungary as the sole member state to block the Directive has brought the question of the requirement of uniformity back into the forefront of discussion.

The EU moved rapidly to turn the Directive into law, yet the requirement of unanimity has allowed Hungary to block the progress of Pillar Two in the EU. The current situation with Hungary exemplifies why many see a need to shift away from the requirement of unanimity. Hungary previously voted for the Directive, yet reversed its position after the EU began cutting €4.1 billion in funding for Hungary due to concerns about the country's rule of law, corruption, and financial

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[56] *Id.*
[57] Reuven S. Avi-Yonah, Young Ran Kim, and Karen Smith, A New Framework for Digital Taxation, 63 HARV. INT'L L.J. 21 (2022).
[58] Treaty on the Functioning of the European Union, art. 115, 2016, O.J. (C 202) 95.
[59] *Id.*
[60] *EU Official Confident Hungary Will Lift Veto On Minimum Tax*, LAW360 (July 1, 2022), https://www.law360.com/tax-authority/articles/1508228/eu-official-confident-hungary-will-lift-veto-on-minimum-tax.

mismanagement.[61] While Hungary had previously raised concerns with the minimum tax rate of 15%, as they would be harmed by the minimum tax rate more than other member states due to the 12.5% corporate tax rate currently in place, Hungary ultimately agreed to move forward after minor concessions.[62] It was only after funding cuts that Hungary began to block the Directive from making it out of the Council with unanimous consent.

The Commission's proposals for tax policy are often met with conflicting reviews from larger economic powers such as France and Germany, as well as smaller member states such as Ireland that rely on tax incentives.[63] The requirement of unanimity has forced compromise in many areas, however, the delay in enacting Pillar Two through Hungary's blocking of the Directive for seemingly unrelated reasons raises the question whether unanimity is the right approach to promote the goals of the internal market. Given the importance of uniformity in the application and global support for BEPS 2.0, enhanced cooperation provides the best path forward. Alternatives, such as the use of Passerelle Clauses to shift tax policy to qualified majority voting, would be a futile and an unrealistic path forward.[64]

IV. Ineffective Tax Policy Solutions

The debate over whether tax policies should be decided with unanimous consent has been a discussion for years.[65] The tax veto was an important bargaining piece during the formation of

[61] *Id.*
[62] *EU Official Confident Hungary Will Lift Veto On Minimum Tax*, LAW360 (July 1, 2022), https://www.law360.com/tax-authority/articles/1508228/eu-official-confident-hungary-will-lift-veto-on-minimum-tax.
[63] *Poland, Estonia To Veto EU Minimum Tax, Diplomats Say*, LAW360 (Mar. 30, 2022), https://www.law360.com/tax-authority/articles/1479260/poland-estonia-to-veto-eu-minimum-tax-diplomats-say.
[64] Silvia Kotanidis, *Passerelle Clauses in the EU Treaties: Opportunities for More Flexible Supranational Decision-Making,* EUR. PARL, (Dec. 16, 2020) https://www.europarl.europa.eu/thinktank/en/document/EPRS.
[65] Dr. Nellie Munin, *The Lisbon Treaty and the CCTB (Common Corporate Tax Base): The Debate*, HEBREW UNIVERSITY INT'L LAW (Aug. 18, 2008), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1233982.

the EU, but recent struggles to gain unanimous consent have raised questions of whether the Passerelle clauses should be used to shift tax policy to qualified majority voting.[66]

The Passerelle Clauses provide a mechanism to shift from unanimity to qualified majority voting through treaty-based provisions that can be used to change the procedural decision-making processes. There two types of Passerelle Clauses: General and Specific Passerelle Clauses. General Passerelle Clauses under Article 48(7) of the TEU allow for the EU Council to change voting unanimity requirements to qualified majority voting.[67] General Passerelle clauses can only be applied to shift the special legislative procedure and the decision requires unanimity by the Council and consent from the Parliament. To shift from unanimity to qualified majority voting, there must first be a notification to all national parliaments of member states who have six months to make their opposition known.[68] If none of the national parliament's veto, the proposal moves on to the European parliament. The EU Parliament must consent to the use of Passerelle Clause by a majority. Finally, the proposal to use the clause reaches the Council where it requires a unanimous vote.[69] Specific Passerelle clauses are incorporated across different articles of the TFEU and allow use in specific areas such as social policies or environmental areas.

There are multiple procedural roadblocks to use of Passerelle Clauses that require unanimity and therefore make the process an unlikely solution to major tax policy. The tax veto is a very important tool that smaller EU countries would like to hold on to despite the recent difficulties implementing tax policy.[70] The larger EU powers that are often aligned on tax policy may be more open given the qualified majority voting system's population weight. Under a

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[66] *Id.*
[67] Treaty on the European Union, art. 48, 2008, O.J. (C 115) 41.
[68] *Id.*
[69] *Id.*
[70] Dr. Nellie Munin, *The Lisbon Treaty and the CCTB (Common Corporate Tax Base): The Debate*, HEBREW UNIVERSITY INT'L LAW (Aug. 18, 2008), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1233982.

qualified majority voting system, tax policy could be decided with support of at least fifteen member states that must compromise at least 65% of the EU population.[71] Further, there is a blocking mechanism where at least four member states can block if their populations equal at least 35% of the EU.[72] Under qualified majority voting, enacting tax policy would be much smoother and in the current environment would provide and important way to implement EU tax policy in a uniform manner.

It is unlikely that smaller EU countries would allow for the shift to qualified majority voting, and the Passerelle Clauses are likely to remain unused. Even harder than gaining support for the Pillar Two Directive would be to gain the unanimous support at multiple stages of the process for a Passerelle proposal to pass; but with a heightened protection on tax, it is highly unlikely. Based on the population balancing, the larger EU countries will have significantly more voting power and could align to support policies that may be harmful to smaller EU countries that may fail to reach the 35% threshold to block.[73] Because of this predicament, it is highly unlikely that any smaller EU member state would support the use of Passerelle provisions, and much prefer to retain the tax veto.

Under the current concentration of support for the implementation of Pillar Two in the EU, if in theory qualified majority voting was in place for passing the directive, it would surely pass with without Hungary's support. The Passerelle Clauses have never been used and will likely remain dormant for the near and distant future.[74] Given the unlikeness of a shift to qualified

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[71] *Id.*

[72] Council of the European Union, *Voting System,* WWW.CONSILIUM.EUROPA.EU, https://www.consilium.europa.eu/en/council-eu/voting-system/qualified-majority/ (last visited Dec. 1, 2022).

[73] Silvia Kotanidis*, Passerelle Clauses in the EU Treaties: Opportunities for More Flexible Supranational Decision-Making,* EUR. PARL, (Dec. 16, 2020) https://www.europarl.europa.eu/thinktank/en/document/EPRS.

[74] Danish Mehboob, *EU lawmakers move to end unanimous voting on tax,* INT'L L. REV. (Sep. 26, 2002), https://www.internationaltaxreview.com/article/2aob8r1ytz3ojpn2nhngg/direct-tax/eu-lawmakers-move-to-end-unanimous-voting-on-tax.

majority voting for tax matters, enhanced cooperation remains the best solution against the unanimity requirement for tax policy.

V. ENHANCED COOPERATION IN THE EUROPEAN UNION

Enhanced cooperation provides a viable method for the EU to implement Pillar Two in a fast and effective manner. Although using enhanced cooperation will leave Hungary as the lone dissenter, the adoption of Pillar Two across the remaining member states would be a significant step forward in the implementation across Europe and would give Hungary the opportunity to join in implementation at any time. Enhanced cooperation has never been used for a tax matter; however, the procedure has been discussed as an option in previous years with respect to other tax initiatives.[75] Because there is just one lone dissenter, enhanced cooperation will likely be a viable option, and the procedural elements are likely met by the current state of the Directive. The twenty-six member states should participate in enhanced cooperation to implement Pillar Two and begin using enhanced cooperation as a viable method for tax policy where unanimous consent is not tenable.

The legal basis for enhanced cooperation is found in Article 20 of the TEU and establishes that enhanced cooperation must be initiated by at least nine member states and essentially allows a Directive to pass as if it was passed by the council in the traditional manner; however, the Directive is only binding on the member states that decide to move forward with enhanced

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[75] Loyens Loeff, *Enhanced cooperation: EU Implementation of Pillar 2 without unanimity,* WWW.LOYENSLOEFF.COM (Oct. 6, 2022), https://www.loyensloeff.com/insights/news--events/news/enhanced-cooperation-eu-implementation-of-pillar-2-without-unanimity/.

cooperation.[76] The Directive will not be binding on the member states that fail to join, but they may join at any time if they meet the requirements of the Directive.[77]

There are various procedural mechanisms for member states to move forward with enhanced cooperation. After at least nine member states decide to use enhanced cooperation and submit a request to the Commission, the Commission may or may not submit a request to Parliament.[78] If the Commission decides to pursue enhanced cooperation, it then goes to the Council to authorize enhanced cooperation. Authorization by the Council requires two main criteria: first, enhanced cooperation must be used as a last resort; second, enhanced cooperation must not lead to discrimination or distortions of trade.[79]

Enhanced cooperation can only be authorized as a last resort measure. The standard is as reflected in *The Kingdom of Spain & Italian Republic v. Council of the European Union* with seemingly broad meaning.[80] The standard for measuring the Council's assessment of whether the measure qualifies as a last resort if there was "manifest inappropriateness" in the Council's determination of last resort.[81] 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."[82] 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."[83]

[76] Treaty on the European Union, art. 20, 2016, O.J. (C 202) 27.
[77] Loyens Loeff, *Enhanced cooperation: EU Implementation of Pillar 2 without unanimity,* WWW.LOYENSLOEFF.COM (Oct. 6, 2022), https://www.loyensloeff.com/insights/news--events/news/enhanced-cooperation-eu-implementation-of-pillar-2-without-unanimity/.
[78] Treaty on the Functioning of the European Union, art. 328, 2016, O.J. (C 202) 189.
[79] Treaty on the Functioning of the European Union, art. 326, 2016, O.J. (C 202) 189.
[80] C-274/11, The Kingdom of Spain & Italian Republic v. Council of the European Union, 2013 E.C.R. I-0000.
[81] *Id.*
[82] *Id.*
[83] *Id.*

The current Directive likely meets the standard to qualify as a last resort under Article 20.[84] The Directive implementing Pillar Two has strong support, and many EU members have vocalized their frustrations with its failure to pass due to Hungary's dissenting vote.[85] It is highly likely under the circumstances the Council will find enhanced cooperation to be a last resort.

Hungary's actions have shown that passing the Directive is likely an impossibility. As noted earlier, there are various failed negations with Hungary, as well as a lack of willingness to compromise on the part of Hungary's finance minister.[86] Further, Hungary's sole dissent is likely based on other political factors, such as the withholding of aid to Hungary, given the various reservations the EU has given the internal political climate of Hungary. Instead, Hungary states it cannot support the Directive due to the war in Ukraine and inflationary concerns.[87] It therefore appears Hungary is blocking the Directive with a showing of bad intent, paired with an unwillingness to compromise after agreeing to the terms of Pillar Two previously. The actions of Hungary in blocking the Directive would qualify under the case law as "lack of interest by one-member state" and rise to the level of impossibility.[88]

The Directive is supported by twenty-six member states, leaving only Hungary out.[89] The member states that support the Directive show an eagerness to implement Pillar Two. Given the eagerness to implement Pillar Two, it is highly likely the twenty-six member states will be aligned

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[84] Treaty on the European Union, art. 20, 2016, O.J. (C 202) 27.
[85] Matt Thompson, *Five Countries Pledge to Enact Corp. Minimum Tax,* LAW360 (Sep. 9, 2022), https://www.law360.com/tax-authority/articles/1529069/five-countries-pledge-to-enact-corp-minimum-tax.
[86] *Id.*
[87] Ernst & Young, *OECD and country officials discuss BEPS 2.0 Pillars One and Two and other OECD tax work,* WWW.EY.COM (June 30, 2022), https://www.ey.com/en_gl/tax-alerts/oecd-and-country-officials-discuss-beps-2-0-pillars-one-and-two-and-other-oecd-tax-work.
[88] Loyens Loeff, *Enhanced cooperation: EU Implementation of Pillar 2 without unanimity,* WWW.LOYENSLOEFF.COM, (Oct. 6, 2022) https://www.loyensloeff.com/insights/news--events/news/enhanced-cooperation-eu-implementation-of-pillar-2-without-unanimity/.
[89] Todd Buell, *EU Still Seeking Unanimity on Pillar 2, Official Says*, LAW360 (Oct. 25, 2022), https://www.law360.com/tax-authority/articles/1543113/eu-still-seeking-unanimity-on-pillar-2-official-says.

on enhanced cooperation in an effort to meet the 2023 deadline to implement Pillar Two across the EU. Given the strong alignment across all but one member state, it would also qualify as a last resort. The overwhelming consensus would demonstrate an "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."[90] The Council would find that enhanced cooperation would be a last resort measure and permit authorization.

Even if the enhanced cooperation qualifies as a last resort for Council authorization it must also 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."[91] The CJEU's review is limited to whether the Council manifestly made an error of assessment. The court must establish whether enhanced cooperation in a certain area is manifestly inappropriate because it would "undermine the internal market and also economic, social and territorial cohesion, would constitute a barrier to and discrimination in trade between Member States and would distort competition."[92] In the CJEU, Spain and Italy challenged the authorization of enhanced cooperation on the Unitary Patent Directive.[93] One challenge was based on a breach of Article 326, in which various measures in the Unitary Patent Directive, such as the use of language arrangements, would give rise to discrimination and secure important advantages for participating member states over nonparticipating member states.[94] The CJEU found the Council's authorization was not manifestly inappropriate even though English, German, and French were the only languages used, as there was no evidence that "cooperation would undermine the internal

[90] C-274/11, The Kingdom of Spain & Italian Republic v. Council of the European Union, 2013 E.C.R. I-0000.
[91] Treaty on the Functioning of the European Union, art. 326, 2016, O.J. (C 202) 189.
[92] C-274/11, The Kingdom of Spain & Italian Republic v. Council of the European Union, 2013 E.C.R. I-0000.
[93] *Id.*
[94] Treaty on the Functioning of the European Union, art. 326, 2016, O.J. (C 202) 189.

market and also economic, social and territorial cohesion, would constitute a barrier to and discrimination in trade between Member States and would distort competition."[95] The court gives significant deference to the legislature despite potential impacts from the use of enhanced cooperation, and thus it is not manifestly inappropriate for Council authorization.[96]

The Council's authorization of the use of enhanced cooperation for the implementation of Pillar Two is unlikely to be considered manifestly inappropriate by the CJEU. The most likely challenge to authorization is that the use of enhanced cooperation would cause a distortion of competition because of the extraterritorial effect of Pillar Two applied to MNE income that is undertaxed in a jurisdiction allowing the home jurisdiction to apply a top-up tax.[97] Non-participating member states may argue the extraterritorial tax would distort competition.

The CJEU is unlikely to find the use of enhanced cooperation would distort competition. The Courts assessment is limited to whether the measure is "manifestly inappropriate having regard to the objective which the competent institution is seeking to pursue".[98] Inappropriateness is determined on "whether objectives pursued by the measure chosen are such as to justify even substantial negative economic consequences for certain operators".[99] Under this standard, significant deference is given to the Council to determine whether the objective of Pillar Two justifies substantial negative economic consequences. The objective of Pillar Two implement a minimum level of taxation for large MNEs. Given the extraterritorial effect of Pillar Two there are possible negative consequences in non-participating member states. The Council balancing any

[95] C-274/11, The Kingdom of Spain & Italian Republic v. Council of the European Union, 2013 E.C.R. I-0000.
[96] *Id.*
[97] Council Directive 2021/0433, art. 25-28, 2021 O.J. (L 823) 46-50.
[98] C-274/11, The Kingdom of Spain & Italian Republic v. Council of the European Union, 2013 E.C.R. I-0000.
[99] *Id.*

possible negative effects will likely find the measures positives outweigh the negatives and the CJEU will likely agree given the significant amount of deference given to the Council.

With regard to judicial review of compliance with those conditions, the Court has accepted that in the exercise of the powers conferred on it, the Community legislature must be allowed a broad discretion in areas in which its action involves political, economic, and social choices, and in which it is called upon to undertake complex assessments and evaluations.[100] Thus, the criterion to be applied is not whether a measure adopted in such an area was the only or the best possible measure, since its legality can be affected only if the measure is manifestly inappropriate with regard to the objective the competent institution is seeking to pursue.[101]

If the Council authorized the use of enhanced cooperation to implement Pillar Two, it is likely to pass any possible challenges in the CJEU. Enhanced cooperation has yet to be used in a tax matter and has only been used four times prior.[102] Enhanced cooperation remains a viable path forward for Pillar Two's implementation in the EU if Hungary continues to veto the Directive.

Given the overwhelming majority of support for Pillar Two in the EU, using enhanced cooperation now would be an important step in the proof of concept of enhanced cooperation in tax matters. Previous enhanced successful enhanced cooperation procedures had participation from much more than the required nine.[103] The use of enhanced cooperation provides the best balance between national tax sovereignty by allowing the unanimity requirement for tax policy to remain in place but also allowing for the harmonization of tax policy across participating member states.

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[100] C-189/01, Jippes and Others, 2001 E.C.R. I-5689; C-558/07, S.P.C.M. and Others, 2009 E.C.R. I-0000.
[101] *Id.*
[102] European Parliament, *The Implementation of Enhanced Cooperation in the European Union,* THINK TANK (Oct. 1, 2018), https://www.europarl.europa.eu/thinktank/en/document/IPOL_STU(2018)604987. In the past, enhanced cooperation has been used for Divorce and Legal Separation, European Patent with Unitary Effect, Property Regimes Rules for International Couples, and the European Public Prosecutor's Office.
[103] Anzhela Cédelle, *Enhanced Cooperation: A Way Forward for Tax Harmonisation in the EU?,* OXFORD CNTR. FOR BUS. TAX. (Oct. 1, 2015), https://oxfordtax.sbs.ox.ac.uk/wp-15/33-anzhela-cedelle-enhanced-cooperation-a-way-forward-for-tax-harmonisation-in-the-eu.

VI. Implementing Pillar Two Through Enhanced Cooperation

Enhanced cooperation is not the perfect solution, but it remains the strongest viable option for the implementation of Pillar Two in the EU. While a Directive provides the best framework for complete uniformity and enforcement across member states, the utilization of enhanced cooperation provides almost identical benefits in the current situation with Hungary as the sole dissenter.[104] Enhanced cooperation will have largely the same uniformity effects and will allow Hungary to join the other member states at any point, rather than a continued negotiation with Hungary which has shown a consistent unwillingness to reach an agreement.

Given the importance of uniformity in the implementation of Pillar Two, looking back to the Digital Services Tax provides important insights into the risks posed if enhanced cooperation is not pursued and countries are left to unilaterally implement Pillar Two.[105] Further, if the EU countries do not simultaneously implement Pillar Two, opportunities exist to exacerbate the race to the bottom, having the contrary effect of the goals of Pillar Two with the risk of non-conforming member states of lowering the corporate tax rate in countries that want to incentivize tax competition.[106]

The experience of the Digital Services Tax ("DST") in the EU provides important insights into the potential problems that can arise if member states enact Pillar Two unilaterally. In 2018, the Commission proposed a Council Directive for "laying down rules relating to the corporate taxation of a significant digital presence," in an effort to tax digital business based on economic

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[104] Loyens Loeff, *Enhanced cooperation: EU Implementation of Pillar 2 without unanimity,* WWW.LOYENSLOEFF.COM, (Oct. 6, 2022) https://www.loyensloeff.com/insights/news--events/news/enhanced-cooperation-eu-implementation-of-pillar-2-without-unanimity/.

[105] DW, *US reaches agreement to end european digital taxes*, WWW.DW.COM (Oct. 22, 2021), https://www.dw.com/en/us-reaches-agreement-to-end-european-digital-services-taxes/a-59584827.

[106] Michael P. Devereux, and John Vella, and Heydon Wardell-Burrus, *Pillar 2: Rule Order, Incentives, and Tax Competition,* OXFORD CNTR. FOR BUS. TAX. (Jan. 14, 2022), https://oxfordtax.sbs.ox.ac.uk/pillar-2-rule-order-incentives-and-tax-competition.

presence.[107] The key provisions of the DST Directive would target specific digital services businesses where a 3% rate of gross revenue in the areas of online advertising, digital intermediation services, and the sale of collected data generated by user activities.[108] The DST would also only apply to companies that met revenue thresholds of €750 million and EU revenue over €50 million.[109] The DST was intended to be a short-term solution until international consensus could be reached on digital services taxes.[110]

The Directive was met with a lack of consensus across member states, and there were significant internal political pressures that led to the Directive's failure.[111] Member states began to unilaterally implement DSTs with varying rates and provisions. Most of the member states followed the proposed Directive and applied DSTs to the three areas noted earlier; however, there were variations across member states with regards to domestic revenue thresholds and tax rates.[112] There are significant differences in the unilaterally implemented DST with tax rates starting at 1.5% up to 7.5% across the EU as well as varying thresholds.[113] For example, Austria applies a 5% tax rate on advertising revenue on companies with €25 million in domestic revenue, while Italy applies a 3% tax rate on companies with a €5.5 million domestic revenue threshold.[114] While the DST is considered an interim measure, the differing structure across the EU highlights the prospect of a lack of uniformly unilateral implementation can have across Europe rather than implementation through Directive.

[107] Council Directive 2018/0072, art. 1-4, 2018 O.J. (L 147) 3-5.
[108] *Id.*
[109] *Id.*
[110] *Id.*
[111] Marie Lamensch, *Digital Services Tax: A Critical Analysis and Comparison with the VAT System*, BRUSSELS SCHOOL OF GOVERNANCE (Feb. 12, 2019), https://brussels-school.be/publications/journal-articles/digital-services-tax-critical-analysis-and-comparison-vat-system.
[112] Daniel Bunn, *What European Countries Are Doing About Digital Services Taxes,* TAX FOUNDATION (Aug. 9, 2022), https://taxfoundation.org/digital-tax-europe-2022/.
[113] *Id.*
[114] *Id.*

The implementation of Pillar Two in the EU unilaterally would create similar risks of a lack of uniformity. While the GloBE model rules provide a uniform structure, there still remains an uncertainty over whether uncertainties could remain if unilateral implementation is used. Contrary to a Directive, unilateral implementation does not bring the same enforcement mechanisms that the Commission has at its disposal. While the Directive is held up by Hungary's use of the tax veto, enhanced cooperation provides the second-best option. Using enhanced cooperation, participating member states have the same Commission oversight over their implementation as in the traditional Directive process.[115] Given the risks behind lack of uniformity, the twenty-six member states that currently support the Pillar Two Directive should move forward with enhanced cooperation, giving MNEs greater clarity and signaling the EU's commitment to Pillar Two to other countries.

If the EU does not adopt Pillar Two at the same time or with the same timeline, the possibility of tax competition between member states may raise issues contrary to the ultimate goals of Pillar Two. If some counties, through the EU, implement Pillar Two unilaterally, it may put pressure on other countries to not enact Pillar Two and reduce corporate tax liabilities imposed on MNEs.[116] This effect would run contrary to the goals of Pillar Two by placing a floor of 15% on corporate tax.[117]

If only a few member states implement Pillar Two, opportunities exist for other member states—mostly smaller economic powers—to lower tax rates even to 0%.[118] Given the shifts in the

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[115] Loyens Loeff, *Enhanced cooperation: EU Implementation of Pillar 2 without unanimity,* WWW.LOYENSLOEFF.COM, (Oct. 6, 2022) https://www.loyensloeff.com/insights/news--events/news/enhanced-cooperation-eu-implementation-of-pillar-2-without-unanimity/.
[116] Michael P. Devereux, and John Vella, and Heydon Wardell-Burrus, *Pillar 2: Rule Order, Incentives, and Tax Competition,* OXFORD CNTR. FOR BUS. TAX. (Jan.14, 2022), https://oxfordtax.sbs.ox.ac.uk/pillar-2-rule-order-incentives-and-tax-competition.
[117] *Id.*
[118] *Id.*

political landscape across the EU, if Pillar Two does not receive at least a majority of implementation, the prospect of this becomes a greater possibility. Already thereis a recent shift in countries, like Italy, with the election of a new prime minister that has raised concerns that Italy may not participate in Pillar Two given the prime minister's close ties to Hungary.[119] If only a few member states implement Pillar Two unilaterally, it will increase the incentive for competition on corporate tax by non-participating states.

In countries with MNEs boasting effective tax rates below the 15% minimum, the MNEs will be subject to a top-up tax in their home jurisdiction that has implemented Pillar Two.[120] Because of this top-up rate applied by the home jurisdiction, states may lower their corporate tax rate even further to account for the top-up tax application so that MNEs may have the same tax return as before Pillar Two was implemented.[121] Qualified Domestic Minimum Top-up Tax ("QDMTT") can be implemented by source countries to tax excess profits without implementing Pillar Two and preventing other countries from applying a top-up tax. No Pillar Two countries can remain at the same competitive advantage by lowering their corporate tax rate and applying the QDMTT to excess profits, all while still providing a lesser tax burden then a 15% minimum tax rate.[122]

For the reasons noted above, if Hungary continued to exercise the tax veto, enhanced cooperation should be used to get the twenty-six-member states to implement Pillar Two as quickly as possible. As more time passes, political shifts, the threat of unilateral implementation, and the inherent risk of a lack of uniformity continues to threaten the viability of Pillar Two in the EU. Learning from the previous mistakes made with the DST, it has become clear that unilateral

[119] *Id.*
[120] *Id.*
[121] *Id.*
[122] *Id.*

implementation can lead to mixed results in the implementation of Pillar Two by national legislatures. Enhanced cooperation with only one nonparticipating member state will allow the implementation in all but one member state and have the same uniformity and enforcement by the Commission's traditional Directive. Further, if there are only a few countries that are able to quickly implement Pillar Two, there are risks that political or economic changes can cause certain member states to reevaluate their position and decide against Pillar Two. If this happens, it can exacerbate tax competition and "a race to the bottom" Pillar Two seeks to remedy.[123] Instead countries can apply a QDMTT to excess profits and lower corporate tax rates to remain competitive even with Pillar Two's implementation is other states. Uniformity and consensus are the most significant factors in the viability and implementation of Pillar Two in the EU, and currently, the best path forward is through enhanced cooperation.

VII. Conclusion

The international community has shown significant support and consensus for BEPS 2.0 and Pillar Two, and thus it is imperative that the EU—as the world's largest economy— begin the implementation across its member states. The key to the proper functioning of the BEPS 2.0 system is consensus and uniformity of implementation in each jurisdiction. A strong BEPS system will create a more equitable tax system by tying tax to the income earned in each jurisdiction, ensuring a minimum tax is applied across all jurisdictions, and putting a floor on the race to the bottom of corporate tax rates.

Given the importance of uniformity in its implementation, EU member states should pursue enhanced cooperation to implement Pillar Two throughout the EU. It is clear that other measures, such as using the Passerelle Clauses, are untenable in the current political environment and will

[123] *Id.*

remain unused for the foreseeable future. For now, the tax veto will remain in place and the EU's best option moving forward would be enhanced cooperation. With only one dissenter, the process of enhanced cooperation will have enough support to initiate the process, and the circumstances would permit the Council to authorize the proposal. The legal basis permits enhanced cooperation, and the CJEU is highly unlikely to find otherwise given the significant discretion afforded to the legislature.