DEBATE

Is There A Need for A Directive on Pillar 2? A Few Normative Comments

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Poland's request to link the entry into force of the Pillar 2 Directive to an international agreement on Pillar 1 raises fundamental questions about the European constitutional structure. Beyond the mere legality of such a link, this contribution seeks to respond to some normative concerns related to the creation of such secondary legislation.

Keywords: Pillar 2 Directive, principle of autonomy, principle of primacy, European sovereignty, EU legal order, international tax agreement, treaty override, EU external relations, EU competence, subsidiarity, proportionality

1 Introduction

In her elaborate and thoughtful inquiry of arguments against linking the creation of a directive on Pillar 2 to the entry into force of an international agreement on Pillar 1 as requested by Poland, Professor Dourado makes a number of highly interesting points that I feel called upon to comment.

I shall preface these comments by expressing my full agreement with the legal analysis proposed in that article, although I am inclined to be somewhat less critical of the view that the Pillar 2 Directive would contribute to the goals of the EU, as I will elaborate below.

More broadly and beyond some minor remarks on certain arguments that I seek to raise in respect of the reasoning explored in that piece, I would like to address two closely related questions. First: What is the correct standard for assessing the 'need' as questioned by the article? Second: What concerns can reasonably be raised against the proposed link from a normative (as distinguished from a strictly legal) perspective?

In order to accord with the format of a comment in Professor Dourado's contribution, I will structure my remarks following the headlines of her analysis while aiming to explore those questions and expand on some additional themes in the conclusion to this brief comment.

2 Sovereignty – and autonomy?

The primary contention in Professor Dourado's article is that EU primary law does not stand against linking the entry into force of the proposed Pillar 2 Directive to the conclusion of a multilateral convention on Pillar 1. To refute the claim made by the French Finance Minister who somewhat generically referred to the undermining of 'European sovereignty', she explores the requirements of sovereignty, autonomy, primacy, and, finally, the more concrete primary law rules touching upon the subject matter at hand in Article 115, Article 3, paragraph 2 and 351 TFEU.

In light of the 'challenging' nature of the politician's reference to a 'European sovereignty', Professor Dourado superbly dissects the legal principles and notions underlying any claim of such a concept. While impressive in its clarity, one may wonder whether the incremental debunking of this 'sovereignty claim' from a strictly legal perspective risks missing the normative point intended to be put forward with the reference. In my view, that point is that EU rules should be agreed upon through the political process within the Union and ultimately put into binding force by the Union's institutions. This would ensure that they are independent – autonomous – of legal or political developments outside the legal framework that binds the Member States together in the 'New Legal Order'[1] created by the EU treaties.

Notes

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1 CJEU 5 Feb. 1963, case 26/62 Van Gend en Loos, EU:C:1963:1.

INTERTAX, Volume 50, Issue 6 & 7

As such, the main value at stake in the debate is not sovereignty (a somewhat uncertain and contestable attribute of the EU) or primacy but the autonomy of rule-making in the EU legal order. The 'constitutional' question raised by the Polish request is, consequently, whether it is compatible with the special nature of EU law to make the application of a set of its rules contingent on actions taken by Member States – within their own exclusive competence – in collaboration with third countries.

It is certainly possible for the EU to adopt rules that have some contingencies. In fact, most tax directives are contingent in their application on the rules that apply within Member States, which these can set autonomously in line with their exclusive competence: The most obvious example is the capital duty directive,[2] which regulates indirect taxation on raising capital insofar as Member States choose to maintain such a levy while making it clear that it would be preferable to completely abolish such taxes. Yet, the same level of contingency arguably exists for corporate tax directives. They do not require Member States to impose a corporate income tax but rather specify rules that must apply if a Member State *does* do so. As Professor Dourado correctly notes, the contingent adoption of a Pillar 2 Directive could similarly be seen as a mere conditional approval of the internationally agreed standard under the two-pillar regime. Doing so would arguably strengthen the EU and its Member States' position vis-à-vis third countries without weakening the autonomy of EU law.

Is there another problem of such a contingency? In my own view, this is an issue relating to the fundamental importance of legal certainty for Member States, taxpayers, and EU institutions in respect of the rules that apply within the Union. Yet, making the entry into force of an elaborate set of rules merely contingent on an external event does not fundamentally undermine certainty. In fact, it seems perfectly appropriate to create a set of rules that will apply in the event that some external – and thus both unpredictable and uninfluenceable – event will impact the taxation of MNEs established in the European Union. In fact, it increases certainty regarding the rules that will apply under circumstances that are themselves beyond the EU's control (both constitutionally and factually).

It thus seems obvious that neither sovereignty nor autonomy constitute obstacles to linking the Pillar 2 Directive to the conclusion of a legally binding international agreement on Pillar 1. Where I would slightly differ from Professor Dourado's view is that I would reach the same conclusion under the circumstances she described as prohibiting such a link. For Professor Dourado, incompatibility arises when two conditions are met: If, first, the EU had exclusive competence to make rules falling under 'Pillar 2'; and, second, the directive, once adopted, would 'detach it[3] from the initial international reasons that justified a relationship between the two pillars'.[4] Yet, even if the EU had exclusive competence for the taxation of large multinational companies and decided to use that competence as it considers appropriate by creating rules that exceed what could be justified by the international agreement underpinning Pillar 2, it could still decide to make the exercise of that competence conditional on some external event such as the entry into force of a multilateral convention. It is merely that Article 3(2) TFEU would, in that case, require that the EU becomes a party to such an agreement rather than the Member States.

3 The Principle of Primacy

Regarding the interaction with the principle of primacy, again, one cannot but agree that the creation of a link between the entry into force of a Pillar 2 directive and a multilateral convention on Pillar 1 does nothing to undermine that core constitutional norm. At a stretch, it is possible to argue that making a piece of EU legislation contingent upon the existence of an international treaty implicates the principle of primacy by virtue of the fact that a directive had been 'put in place' in accordance with primary EU law. Yet, the contingency would certainly not violate primacy. In this event, no overriding effect of international law can be said to take place simply because the Pillar 2 Directive would not enter into force; the lack of a Pillar 1 treaty would thus not lead to any modification in the application of EU laws and certainly not to an ex-post override.

Beyond this detail, it also does not seem convincing to me to state that the dependency of EU legislation on an extraneous action (such as the conclusion of a treaty by Member States and third states) would result in that action 'prevailing' over EU law. Professor Dourado correctly notes that such a reading would distort the actual meaning of the principle of primacy.[5] Primacy, like sovereignty, includes the power of the entity endowed with that quality to delegate the exercise of its authority to other entities while maintaining the subsequent power to withdraw that delegation. Nothing would prevent the EU legislature from amending a directive linked to an international treaty when first adopted later to disconnect from the same treaty, leaving the primacy of EU law unaffected.

Notes

[2] Council Directive 2008/7/EC of 12 Feb. 2008 concerning indirect taxes on the raising of capital, OJ L 46, 21 Feb. 2008, at 11–22.

[3] It is not fully clear what 'it' is referring to here, but it would appear to be a reference to the rules that the directive would introduce.

[4] A P. Dourado, Is There a Need for a Directive on Pillar Two? 50(6&7) Intertax @@@(2022).

[5] *Ibid.*

4 A 'Need' under Article 115 TFEU

A rather different constitutional question is raised with respect to the concrete EU competence to legislate in the area. Is a Pillar 2 Directive 'needed' for the establishment or functioning of the internal market as required by Article 115 TFEU to justify the creation of secondary law in light of the principles of subsidiarity and proportionality? Professor Dourado accurately positions the proposed Pillar 2 Directive next to the ATAD, which has also drawn some criticism in this respect.[6] The threshold to fulfil the requirement of Article 115 TFEU for an effect on the internal market can justifiably be interpreted to be quite low given the high level of protection of Member States' competence that is built into the unanimity requirement and the political procedures in the treaty protocol (No 2) on the application of the principles of subsidiarity and proportionality. In light of these safeguards, any direct positive impact on the internal market from the approximation of rules implementing a new international standard may be considered sufficient. This is true especially when the rules so introduced do not inherently discourage cross-border investment; by contrast to the rules in the ATAD, which largely concerned cross-border tax planning and thus had an inevitable chilling effect on cross-border investments, Pillar 2 has a different (if related) target, namely tax competition.

Insofar as Pillar 2 aims at an approximate levelling of tax burdens across different investment locations, its ambition seems fundamentally compatible and in accordance with the objectives of the internal market, which has also variously been described as levelling a playing field across Member States. On the flipside, it could be argued that a likely high administrative and compliance burden for taxpayers is contrary to the internal market ideal; however, in this respect, the existence of a directive would not seem likely to increase the burden relative to the situation where Member States unilaterally implement Pillar 2.

5 Third Country Relations

The relationship between the Pillar 2 Directive and tax treaties concluded between Member States and third countries is an interesting topic that would require more detailed exploration than is available in this space. To the extent that a clash between the application of the IIR, UTPR, STTR, and such treaties would occur, Member States would indeed be obligated to renegotiate their treaties. This is independent of whether Article 351 TFEU protects those treaties from the direct effect of EU law as is the case for pre-accession treaties. Indeed, all newer treaties will also have to be changed – irrespective of the directive's direct effect – to ensure that a Member State's obligations under international law are brought in accordance with those under EU law.

6 Concluding Remarks

I would like to conclude with remarks on two aspects going slightly beyond the detailed analysis made by Professor Dourado. I feel called upon to comment on one positive aspect of adopting a Pillar 2 Directive that she acknowledged in her introduction, specifically, the fact that the rules would be subject to a uniform interpretation by the court of justice.

While it is easy to understand that uniform interpretation – just as uniform rules – across the EU can generally be seen to be advantageous to taxpayers in light of increased certainty, it seems questionable whether the engagement of the CJEU with the difficult balance to be struck in the context of Pillar 2 would genuinely turn out to be beneficial in the long run. First, as with other OECD-inspired initiatives such as the exchange of information directive(s) and the ATAD, the CJEU would inevitably be required to refer to documents drawn up by the OECD and thereby importing international standards into EU law. International dispute resolution mechanisms would seem better placed to integrate such international practice (as well as international case law), especially since the same rules are going to be interpreted by panels outside the EU context. Second, the main substantive concern arising from the implementation of the Pillar 2 rules from the taxpayer's perspective lies in the potential for double taxation[7] – an issue for which the CJEU does not have the most consistent track record. As the avoidance of double taxation is neither the primary objective of the proposed directive nor – in the CJEU's view – required by primary law, it would seem unlikely that relief in this respect would be forthcoming from the CJEU. At the same time, insofar as double taxation might arise that could be said to contradict with bilateral treaties,[8] access to a MAP and arbitration, and – among EU Member States – the TDRD should be a possibility that might be a beneficial complement (if not a complete substitute) to the CJEU's involvement in interpretation with respect to the objective of uniform interpretation.

Notes

[6] *See* e.g. G. Bizioli, Taking EU Fundamental Freedoms Seriously: Does the Anti-Tax Avoidance Directive Take Precedence over the Single Market? 26(3) EC Tax Review 167 (2017); W. Haslehner, in *A Guide to the Anti-Tax Avoidance Directive* 32–65 (38–44) (Haslehner et al eds, Edward Elgar 2020) with further references.

[7] The potentially bigger but not 'substantive' concern for taxpayers is the high compliance cost which would not be addressed by the directive in the absence of a clear simplification option within its scope.

[8] Which depends notably on the nature of the IIR and UTPR and whether they are covered by the saving clause of Art. 1(3) OECD MC. *See* A. P. Dourado, *The EC Proposal of Directive on a Minimum Level of Taxation in Light of Pillar Two: Some Preliminary Comments*, 50(3) Intertax 200 (2022).

Professor Dourado explicitly refrained from commenting on the appropriateness of linking the Pillar 2 Directive to the creation of an international agreement on Pillar 1. As an inherently political question, I would also prefer not to take a final position on this question. It is certainly a reasonable view to consider the two pillars as 'agreed' by the Inclusive Framework as a package deal for which the implementation of one part could legitimately be made contingent on the follow-through with the other. This is even more true in light of the frequently observed fact that EU tax legislation, once adopted, is notoriously difficult to change, let alone undo. Thus, if certain Member States see the greater benefit in the Pillar 1 (in the form of added revenue qua destination jurisdiction) and would accept Pillar 2 rather as a necessary price (paid by reduced flexibility to compete on CIT rates) to achieve such a benefit, an explicit legal contingency seems to be the only credible way to achieve the intended compromise.

The suggestion of linking the Pillar 2 Directive to 'the entry into force of Pillar 2 in a minimum number of states'[9] appears equally sound, albeit with two small qualifications. First, it is not likely that Pillar 2 rules will generally be implemented in form of a multilateral treaty – nor would it seem necessary given the mechanism of unilateral top-up taxes merely coordinated by an internationally accepted standard. Second, insofar as Pillar 2 is not considered as part of a global compromise on taxing right allocation – i.e., to be linked to Pillar 1 – but simply as an attempt to combat a perceived race to the bottom of corporate income taxes, there would be sufficient political reason to independently adopt such minimum taxation at the EU level in order to prevent the race to the bottom in Europe.

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[9] Dourado, *supra* n. 4.