

Editorial

Article 116 TFEU – The Nuclear Option for Qualified Majority Tax Harmonization?

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Taxation is one of the few policy areas left after the Lisbon Treaty where in principle, decision-making still requires unanimity in Council, and where the EU Parliament is little more than a spectator. In a Union of twenty-seven Member States – Brexit won't make much of a difference in this regard – this status quo frequently results in an impasse over tax reform proposals, and it tends to petrify existing EU tax legislation.¹ Moreover, the special legislative procedure which sidelines Parliament diminishes the democratic legitimacy of legislation in an area where democratic accountability should be paramount.

In an attempt to break legislative deadlocks, the Juncker Commission in January 2019 unveiled its 'roadmap for a progressive and targeted transition to qualified majority voting (QMV)' in EU taxation policy, and proposed using the 'passerelle clause' in Article 48 (7) Treaty on European Union (TEU) to this effect² However, the adoption of a decision to amend the EU Treaty under this procedure requires, in itself, unanimity in the European Council, and it very quickly emerged that this would not be a realistic option in the foreseeable future.³ Against this background, the new Commission President *von der Leyen* has now pledged to 'make full use of the clauses in the Treaties that allow proposals on taxation to be adopted by co-decision and qualified majority voting'⁴ to deliver on her ambitious tax policy agenda. As the Commission itself had previously acknowledged, the (almost) only existing Treaty

provision that might lend itself to this kind of revolutionary approach is Article 116 Treaty on the Functioning of the European Union (TFEU).⁵ But is Article 116 TFEU really the nuclear option for QMV in EU taxation law, occasionally invoked already in the past⁶ but never exercised so far? And if so, would it be wise for the EU Commission to draw this option now?

Art. 116 TFEU addresses situations where a difference between normative provisions in Member States is distorting the conditions of competition in the internal market and where the ensuing distortion 'needs to be eliminated'. Beyond the necessary internal market dimension, this competence clause is not limited in substantive scope and it therefore potentially also covers tax legislation.⁷ This notwithstanding, the criteria for legislation stipulated in Article 116 TFEU are stricter than those laid down in Article 113–115 TFEU in several regards. Unlike the latter provisions, Article 116 TFEU cannot be relied on to tackle distortions that do not stem from the pursuit of different regulatory approaches or taxation concepts by several Member States, but merely arise from the parallel application of essentially identical but uncoordinated national tax regimes. Moreover, the diverging national provisions must already be in force. The mere risk of a possible distortion due to projected legislation is dealt with separately in Article 117 TFEU,⁸ which does not provide a legal basis

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¹ For a detailed analysis of the above mentioned and other negative effects of the unanimity requirement, see the analysis provided in the Communication from the Commission, 15 Jan. 2019. Towards a more efficient and democratic decision making in EU tax policy, COM(2019) 8 final.

² See Communication from the Commission, *supra* n. 1; the above quote is from the corresponding Press Release, 15 Jan. 2019, IP/19/225.

³ At the ECOFIN meeting held a month after the Commission published its Communication, a 'considerable number' of Member States was opposed to any changes to the current voting rules in taxation, see Outcome of the ECOFIN Meeting, 3671st Council Meeting, 12 Feb. 2019, 6301/19, at 5–6.

⁴ Mission letter from President-elect *von der Leyen* to Commissioner-designate for Economy *Gentiloni*, at 6; see also *von der Leyen*, Political Guidelines for the Next European Commission 2019–2024, at 12.

⁵ See Communication from the Commission, *supra* n. 1, at 9. The other provision mentioned in this text is Art. 325(4) TFEU on the protection of the financial interests of the Union, which would in any event have a very limited scope of application, however; essentially, it could be relied on to enact targeted measures aimed at tackling VAT fraud. Certain other policy fields where QMV is standard procedure and where the new Commission seeks to have recourse to so-called corrective taxes in order to pursue its regulatory objectives, have explicit carve-outs for provisions that are primarily of a fiscal nature; see Art. 192(2)(a) TFEU (environmental policy), and Art. 194(3) TFEU (energy policy); Art. 173 (3) TFEU (industrial policy).

⁶ See e.g. *Collins/Hutchings*, ELR 1986, 191 (196); see also the response given by Commission President *Juncker* in a public hearing of the EP PANA Committee, <https://www.europarl.europa.eu/ep-live/en/committees/video?event=20170530-1500-COMMITTEE-PANA> (at 15:56).

⁷ See CJEU 13 Jan. 2005 – case C-174/02, *Streekgewest*, ECLI:EU:C:2005:10, para. 24; CFI 11 July 2014 – case T-151/11, *Telefónica de España*, ECLI:EU:T:2014:631, para. 98.

⁸ See also CJEU 15 July 1964 – case 6/64, *Costa/ENEL*, ECR 1964, 585 (at 595).

for EU legislation, however. In this sense, Article 116 (2) TFEU only permits repressive, not preventive, legislation.⁹

Apart from the above limitations, the potential of Article 116 TFEU to overcome the unanimity requirement and strengthen the role of Parliament in tax matters depends crucially on how narrowly or broadly the notion of ‘distortions of competition to be eliminated’ is construed. This has long been debated in scholarly literature, and the Court of Justice of the European Union (CJEU) has not yet had an opportunity to clarify the concept. The original provision in the Treaty of Rome was inspired by the 1956 *Spaak* Report,¹⁰ which distinguished between general and specific distortions.¹¹ The former affected the respective national industry of Member States as a whole, such as different levels of corporate taxation or of social security contributions. They were assumed to be compensated by adjustments in the effective exchange rate and, according to the Report, were therefore not, in themselves, a concern to be addressed by an approximation of legislation at the European level.¹² In line with the *Spaak* Report, the Commission therefore considered that the predecessor provision to Article 116 TFEU only applied to specific distortions.¹³ According to the Commission, a:

specific distortion occurs when: (a) an industry or part of an industry bears an additional burden – or enjoys an extra advantage – as compared with the average of the economy of the State to which it belongs; and when (b) no similar burden or advantage occurs in a similar industry or part of an industry in one or more of the other Member States.¹⁴

Moreover, and beyond the *Spaak* report, it was acknowledged that specific distortions can also result from facially neutral provisions which however have a disparate impact on different sectors of the national economy.¹⁵

However, some commentators have correctly pointed out that the reasoning of the *Spaak* Report is outdated, because general distortions, too, can no longer be compensated by exchange rate adjustments within the Euro zone, and only to a very limited extent in the Economic and Monetary Union (EMU) comprising the remaining

Member States.¹⁶ Furthermore, the wording of Article 116 TFEU is broad enough to also cover ‘general’ distortions of competition which arise only as between Member States, but not also within each Member State.¹⁷ It merely requires a ‘difference *between* the provisions ... in Member States’,¹⁸ not necessarily within one and the same Member State; the French version even speaks of national ‘disparities’. It is therefore well conceivable that due to the evolution towards ‘an ever closer union’ (Article 1 (2) TEU), the *effet util* of Union law now requires a more extensive interpretation of the Union competences under Article 116 TFEU than originally envisaged by the six founding Member States. General distortions arising from national regulatory or tax disparities that affect more than one sector of the economy, or even the national economy as a whole, should therefore also be regarded as covered.¹⁹

In either case, by analogy to the Court’s reasoning in the context of Article 114 TFEU, the alleged distortions of competition must be ‘appreciable’, i.e. the effect of the national disparities on the competition in the internal market must not be too ‘remote and indirect’.²⁰ In the light of the aforementioned case law, this criterion should also be subject to full judicial review. Beyond this *de minimis* threshold, (only) Article 116 TFEU requires that the distortion caused by the difference in the tax regimes of Member States must be sufficiently serious and significant to require prompt intervention at EU level.²¹ This can be derived from the special mention in Article 116 TFEU of a ‘resultant distortion [that] *needs to be eliminated*’. In most language versions, this additional requirement is made even more obvious by the linguistic distinction between the detrimental effect of the national normative disparities on the conditions of competition and the need to eliminate the ensuing distortion.²² However, the analysis of whether this increased threshold of urgency and relevance is surpassed involves complex assessments and evaluation of an economic and political nature, not the least of the

⁹ By contrast, Art. 114, 115 TFEU give broader competences to the EU legislature in this regard; see e.g. CJEU 12 Dec. 2006 – case C-380/03, Germany/Parliament and Council, ECLI:EU:C:2006:772, para. 38.

¹⁰ See e.g. Aubin, in *Festschrift für Otto Riese* 245, 251 et seq. (Aubin et al. eds 1964); Simon, in *Commentaire sur le Traité instituant la CEE* (Kovar et al. eds 1991), Art. 101, para. 4.

¹¹ See Rapport des Chefs de Délégation aux Ministres des Affaires Etrangères (‘Spaak Report’), at 60 et seq. (1956).

¹² See also R. Sprung, *Die Bestimmungen über die Beseitigung von Verzerrungen des Wettbewerbs im Vertrag über die EWG*, 20 Finanzarchiv 201–202 (1959/60).

¹³ See Commission, supplementary answer to the written question No 2226/80 by Mr Hemmo Muntingh, OJ 1983 C 257/1.

¹⁴ See Commission, *supra* n. 13. It should be noted that the English version of the Commission answer links conditions (a) and (b) with an ‘or’ and therefore seemingly treats them as alternatives; however, this is a translation error. All other language versions use the conjunction ‘and’ to indicate a cumulative requirement.

¹⁵ See Commission, *supra* n. 13.

¹⁶ See e.g. Quitzow, *State Measures Distorting Free Competition in the EC* 194 (2002); Hey, *Harmonisierung der Unternehmensbesteuerung in Europa* 83 (1997); Korte, in *EUV/AEUV* (Callies/Ruffert eds, 5th ed. 2016), Art. 116, para. 11.

¹⁷ See AG Darmon 17 Mar. 1992 – joined cases C-72/91 and C-73/91, *Slooman Neptun*, ECLI:EU:C:1992:130, para. 72; Schwartz, in *Festschrift für Walter Hallstein* 474 (at 493) (V. Caemmerer et al. eds 1966).

¹⁸ It should be mentioned that a few language versions, e.g. the German one, are less clear in this regard.

¹⁹ Likewise Zweigert, in *Festschrift für Hans Dölle* vol. 2, 401 (at 409) (V. Caemmerer et al. eds 1963); Hey, *supra* n. 16, at 83.

²⁰ See e.g. CJEU 5 Oct. 2000 – Case C-376/98, Germany/Parliament and Council, ECLI:EU:C:2000:544, paras 106–109.

²¹ Likewise Quitzow, *supra* n. 16, at 190 and 195; see also Korte, *supra* n. 16, para. 11; Classen, in *Europäisches Unionsrecht* (von der Groeben/Schwarze/Hatje eds, 7th ed. 2015), AEUV Art. 116, para. 21.

²² See e.g. the French version of Art. 116 TFEU: ‘[...] une disparité [...] fausse les conditions de concurrence sur le marché intérieur et provoque [...] une distorsion qui doit être éliminée’ (emphasis added).

overall regulatory and fiscal framework that affect the conditions of competition and the relative importance of the distortion within this framework. It must therefore be conceded that the Commission and the Council have broad discretion in this regard.²³

According to Article 116 TFEU, if a qualified distortion in need of elimination is found to exist, the Commission shall first consult ‘the Member States concerned’. If such consultation does not result in an agreement eliminating the distortion in question, the necessary directives shall be issued. Does this wording imply that only the Member States whose legislation or administrative regulation is responsible for the distortion can be the addressees of a QMV directive? Arguably, while this could be one possible outcome, no such restriction applies.²⁴ This can be inferred by way of contextual interpretation from Article 117 TFEU. Pursuant to Article 117 (2) TFEU, if a Member State that ‘causes’ the distortion by introducing or amending new provisions ignores eventual recommendations addressed to it by the Commission after the consultation procedure laid down in Article 117 (1) TFEU, other Member States shall not be required to amend their own provisions based on Article 116 TFEU. *Arguendo e contrario*, this sanction for non-compliance would be meaningless if the only possible addressee for a directive under Article 116 (2) TFEU were *always* only the Member State whose legislation caused the distortion.²⁵ A broad interpretation of Article 116 (2) TFEU is also confirmed by Article 117 (1) TFEU, whereby the Commission shall recommend to ‘the States concerned’ such measures as may be appropriate to avoid the distortion, even though the need for those measures arises from the projected legislation of ‘a Member State’. Since the Commission does not need to confine itself to recommend changes only to the Member State whose pending legislation could cause distortions, it should arguably also not be subject to any such confinements with respect to a proposal for a directive that would remove the distortions once they have actually materialized. The notable exception are the scenarios expressly covered by Article 117 (2) TFEU. Instead, the selection of the Member States to be consulted or to which the directive is addressed depends on the regulatory model (i.e. the tax regime) deemed appropriate by the Commission for levelling the normative differences between the Member States.

Admittedly, the interpretation defended here can lead to situations where some Member States intentionally create the conditions for a Commission proposal under Article 116 (2) TFEU, by first introducing legislation unilaterally that they would actually prefer to see implemented in all Member States through EU legislation. But such a strategy can only work with the (at least tacit) approval of the Commission, which has the exclusive competence to initiate the proceedings laid down in Article 116 TFEU and which should be expected to act in the best interest of the Union. Moreover, Member States themselves have indicated that they are willing to accept this consequence, as demonstrated by their joint declaration concerning certain British opt-outs from the Area of freedom, security and justice.²⁶ As a caveat, where some ‘coalition of the willing’ Member States have harmonized their national tax legislation by way of enhanced cooperation as envisaged in Article 20 TEU, the ensuing disparities with respect to the tax systems of the non-participating Member States cannot justify an extension of the partially harmonized system to the latter Member States by way of Article 116 TFEU. This would presuppose serious distortions of competition as a consequence of the enhanced cooperation. However, such effects would be unlawful under Article 326 TFEU and should be addressed by an action of annulment as the more proportionate and adequate remedy. Only if individual Member States should then decide to keep their distortive national taxes despite the annulment of the underlying Union legislation would there be room for the application of Article 116 TFEU.

Finally, directives adopted under the Article 116 (2) TFEU procedure must comply with the general proportionality requirement enshrined in Article 5 (4) TEU, which is furthermore emphasized once more in the provision itself (‘necessary directives’). This also requires careful consideration whether instead of full harmonization, a mere approximation of the divergent national legislation is sufficient in order to reduce any remaining differences to a level that no longer results in serious distortions of competition. This notwithstanding, the Union legislator may pursue its own policy preferences within those limits. Moreover, if the conditions for a directive based on Article 116 (2) TFEU are met, the corresponding Union legislation must automatically be assumed to abide by the principle of subsidiarity as prescribed in Article 5 (3) TEU: One of the criteria is precisely that despite prior consultation, Member States have not been able to reach an agreement eliminating the distortion.

What does the above imply for the role that Article 116 TFEU could potentially play in advancing the fiscal policy agenda of the Commission?

²³ Likewise Zweigert, *supra* n. 19, at 409; Schröder, in *EUV/AEUV* (Streinz ed., 3rd ed. 2018), AEUV Art. 116, para. 9; Khan/Eisenhut, in *European Union Treaties* (Geiger et al. eds 2015), Art. 116 TFEU, para. 5.

²⁴ Likewise Simon, in Kovar et al., *supra* n. 10; Classen, *supra* n. 21, para. 31; Korte, *supra* n. 16, para. 15. For a different opinion, see Schröder, *supra* n. 23, para. 12.

²⁵ This could be different if one were to endorse – *quod non* – an analogous application of Art. 117 (2) TFEU whenever a Member State did not consult with the Commission prior to enacting its distortive legislation; unclear Lenaerts & Van Nuffel, *European Union Law* (3rd ed. 2011), paras 9–116, fn. 593.

²⁶ Cf. Declaration No. 26 annexed to the Lisbon Treaty.

Based on a narrow interpretation of the concept of distortion, in the sense of an industry-specific advantage or disadvantage caused by national tax legislation, it would indeed be a very limited role. Article 116 TFEU could then only be relied on to ensure a Union-wide implementation of new taxes or tax burdens that initially only some Member States have introduced at a national level and whose scope is limited to specific sectors of the economy.²⁷ Potential candidates could be a Union-wide flight ticket tax, as a possible element of a ‘green’ tax policy shift, or a harmonized financial transaction tax, should the ongoing attempts to introduce it by way of enhanced cooperation fail. By contrast, industry-specific tax *benefits* will normally constitute selective fiscal State aid and must thus primarily be addressed according to the procedures laid down in Article 108 TFEU. If considered incompatible with the internal market, they will have to be abolished and eventual distortions are thereby removed.²⁸ Alternatively, if the fiscal aid scheme is deemed compatible with the internal market in accordance with Article 107 (2), (3) TFEU, the ‘more economic approach’ relied on by the Commission for this assessment is meant to ensure that the measure does not have disproportionately negative effects on competition and trade within the internal market.²⁹ This should normally bar the Commission from subsequently claiming that an approved fiscal aid scheme nevertheless seriously distorts competition if applied unilaterally and therefore requires urgent action under Article 116 TFEU. But also with respect to the harmonization of additional ‘ring-fenced’ tax *burdens*, it is always necessary to carefully test all the conditions laid down in Article 116 TFEU. As regards the proliferation of digital services taxes in some but not all Member States in particular, it is hard to conceive how a tax that is generally levied in the market or user jurisdiction and intended to be borne by the taxpayers themselves would seriously, and not merely indirectly and remotely, distort competition within the internal market. This has meanwhile been conceded by the Commission itself.³⁰

However, a more extensive interpretation of Article 116 TFEU, including also ‘general’ but serious tax disparities in its scope of application, would provide the Commission with significant leverage in the pursuit of some of its core taxation projects. It could provide fresh dynamics for negotiating a Common Corporate Tax Base (CCTB) in Council,³¹ it could facilitate the harmonization of carbon taxes,³² and it could be relied on to

tighten CFC legislation beyond the compromise found with Anti-Tax Avoidance Directive (ATAD) I, or to introduce an international minimum tax on business profits if some Member States should press ahead towards it.³³ Still, Article 116 TFEU would not be a panacea. It cannot be relied on for pushing reform in petrified areas of (full) harmonization where differences in the tax regimes of Member States are no longer permitted. This creates the paradox that qualified majority voting (QVM) is more accessible in tax policy fields where Member States have retained their sovereignty, rather than ceding it to the Union. With respect to certain other reform projects, a recourse to Article 116 TFEU is arguably barred due to the fact that the current disparities constitute barriers for cross-border trade but hardly also ‘appreciable’ distortions of competition. This concerns, e.g. differences regarding the level of tax transparency, or different procedural requirements such as different VAT return forms.³⁴

Finally, it should be acknowledged that there is also a political dimension to invoking Article 116 TFEU. Since the provision is still plagued by legal uncertainty, an overruled minority of Member States can be expected to challenge its use in the European courts. Moreover, even a qualified majority of Member States may often be hard to gather behind a Commission proposal, as can currently be observed with respect to the proposals concerning public Country-by-Country Reporting (CbCR) or the definitive VAT regime. If the Commission really intended to make ‘full use’ of Article 116 TFEU where necessary, it would therefore be well-advised to begin doing so with a reform project where chances of sufficient political support and legal success are high, and the economic risk of an eventual annulment is limited. Against this backdrop, a Union-wide flight ticket tax could be a good trial balloon.

On balance, Article 116 TFEU does indeed constitute the nuclear option for qualified majority tax reform in Europe, albeit certainly not for the full range of projects that are on the ambitious tax policy agenda of the new Commission. However, as with any type of nuclear option, its use needs to be carefully pondered, both legally and politically.

²⁷ See also AG Geelhoed 18 Sept. 2003 – Case C-308/01, *Gil Insurance*, ECLI:EU:C:2003:481, paras 64–65.

²⁸ See *Sprung*, *supra* n. 12, at 211.

²⁹ See Nicolaidis, in *The Modernisation of State Aid for Economic and Social Development* 63–74 (Nascimbene/Di Pascale eds 2018).

³⁰ See the answer given by Commissioner Moscovici on behalf of the European Commission, 27 June 2019, ENE-001797/2019.

³¹ It has been argued that the co-existence of different national corporation tax systems is unlikely to cause serious distortions that require urgent legislative action, see *Hey*, *supra* n. 16, at 84. In my view, however, this is at least debatable, and Commission and Council should enjoy broad discretion in making this assessment.

³² Several Member States have unilaterally introduced an additional carbon tax alongside the harmonized energy taxes, or plan to do so in the near future. It could be argued, however, that no disparities exist – and thus Art. 116 TFEU is not applicable – with respect to industry sectors where *all* Member States have refrained from imposing carbon taxes as a consequence of EU harmonization. This concerns, in particular, the aviation sector, due to CJEU 10 June 1999 – case C-346/97, *Braathens*, ECLI:EU:C:1999:291.

³³ So far, this is the case only with respect to deduction barriers operated by Germany, France and the Netherlands for certain outbound royalty or interest payments.

³⁴ Article 116 TFEU could therefore hardly be used to revive the failed Commission initiative to standardize the VAT return, see Commission Proposal COM(2013) 721, 23 Oct. 2013.