The UK Brexit Referendum: A Catalyst to Reform the European Union Institutional Architecture in Tax Matters?

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The results of the UK referendum in favour of leaving the European Union (EU) clearly put into question the European economic and political project as well as its institutional structure. This article argues that the Brexit may be a momentum to reform the institutional structure and procedural rules through which tax policy is made at the EU level.

The UK referendum is indeed unlikely to further slow down the EU harmonization process in tax matters, which has always followed a tortuous path. Instead, the Brexit may give momentum to reform major weaknesses of the EU institutional and decision-making process in tax matters, in particular the unanimity rule and the role of the European Parliament. Finally, with regard to taxation specifically, the establishment of an EU tax, providing the EU with sufficient genuine own resource, could also reinforce EU's legitimacy by countering the criticisms related to Member States' contribution to the European budget.

1 Brexit and EU's Institutional Framework in Taxation

There are three main reasons why the Brexit may be used as a catalyst in favour of European Union (EU)'s institutional reform in the field of tax law.

First, beyond the single arguments used in the referendum campaign (some of which very questionable from a legal and economical viewpoint), the fact that a majority of UK citizens have voted against the EU membership may be interpreted as a sign of lack of involvement in the decision-process that takes place in Brussels, Strasburg and the rotating EU capitals. This feeling may be present in the minds of other EU citizens and could be exploited by other Member States' politicians willing to follow the same path as the UK. To avoid the collapse of the EU as a whole, a reform of the EU institutions and decision-process towards more transparency and accountability is needed. This is certainly true in the area of taxation, where the link between citizens and political institutions is mostly felt.

Among the arguments in favour of the Brexit, many references have been made to the fact that the EU membership leads to a sort of 'regulation without representation', where unelected bureaucrats impose rules on the common people without any legitimation. Such an argument reminds of the old slogan 'no taxation without representation' used in several contexts to justify a greater autonomy, or even independence, whether by former colonies (taxation played a significant role in the American and Indian independence from the British Empire) or more recently at the regional level within the EU, as illustrated by constitutional reforms in various Member States, such as Spain, Belgium and the UK itself.[1] Tax laws and policies should indeed be adopted with high democratic and constitutional standards, such as for example the approval of tax legislations by an elected assembly.[2] Although the EU can certainly not (yet) be compared to a state, a high number of Member States' legislations – including tax laws – are now based on EU regulations and directives. Indirect taxes have indeed become more and more 'europeanized' and the EU budget is – partially financed – through taxes that have been harmonized at the EU level (around 20% of the EU budget is financed by customs duties and a percentage of the Value Added Tax {VAT} collected by Member States). However, those EU rules (including those on the

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1 E. Traversa, *Is It Still Room Left in EU Law for Tax Autonomy of Member States' Regional and Local Authorities?*, 20(1) EC Tax Rev. 4–15.

2 *See* Ana Paula Dourado, *No Taxation Without Representation in the European Union: Democracy, Patriotism and Taxes*, in *Principles of Law: Function, Status and Impact in EU Tax Law* 205–233 (Cécile Brokelind ed., IBFD 2014). *See also Procedural Rules in Tax Law in the Context of European Union and Domestic Law*, EUCOTAX Series on European Taxation 4 (Michael Lang, Pasquale Pistone, Josef Schuch & Claus Staringer eds., Kluwer Law International 2010): 'Member States in general base their authority to tax on specific tax laws, within the framework of constitutional requirements (…). Without exception in all countries that contributed to this book, the principle of legality is accepted in the sense that taxes may only be imposed if it is determined so by law'. *See* e.g. Art. 170 of the Belgian Constitution, Art. 34 of the French Constitution & Art. 104 of the Dutch Constitution.

financing of the EU budget) are adopted without the European Parliament playing a significant role (if at all). The increased involvement of the EU in tax matters combined with the dissatisfaction of EU citizens illustrated by the issue of the Brexit referendum could serve as a signal that the EU institutional process in taxation needs a democratic boost.

Second, the Brexit referendum leads to put into question the legitimacy of the unanimity requirement in tax matters. According to the EU treaties, the Council should act unanimously for the adoption of tax provisions (113, 115 and 192§2(a) TFEU). However, as the UK referendum demonstrates, this was not sufficient to strengthen the legitimacy of the legislative process. Even worse, this allowed some EU Member States, in particular the UK, to regularly oppose new proposals or changes in EU tax legislation, slowing down the harmonization process and impeding the EU to offer an adequate response to European tax issues of concern for the EU citizens, such as tax competition in the area of corporate and labour taxation or the taxation of financial institutions. From a transitional perspective, the unanimity requirement leads to the awkward situation that the UK until it does leave the EU officially will have the possibility to block or pass EU legislation in tax matters that it will never have to implement.

Third, the Brexit calls into question the very legitimacy of the instrument of EU harmonization, in the absence of a real transfer of taxing competences to the EU. On the one hand, positive and negative integration in tax matters are exclusively driven by Internal market objectives, which tend to overshadow what should always remain the primary objective of tax policies, namely providing revenue to the state, as well as other objectives pursued by domestic tax legislators in Member States. On the other hand, harmonization as it stands now restricts Members States tax autonomy (including the sovereignty of national parliaments) without necessarily increasing the EU room for manoeuvre in tax policy as well as, on the spending side, without giving the EU enough budgetary margin to set up ambitious programs in economic and social policies. From this viewpoint, further harmonization may not be the solution and the EU should rather strive towards the creation of a genuine EU tax adopted by the EU parliament.

Based on these observations and questions, the UK's controversial relationship with the EU, and in particular the lately UK referendum in favour of the 'leave', could be an opportunity to reform EU's institutional and procedural rules and take new steps towards the development of a European fiscal Union. Such a reform could participate to a better involvement of EU citizens into the European project and reinforce EU's institutions' legitimacy. Three reforms should therefore be pursued: (1) to abandon the unanimity rule in tax matters, (2) to strengthen the role of the EU parliament in tax matters, and, finally (3) to clarify the link between EU taxes and the EU budget.

2 Reforming the unanimity rule in tax matters

UK's referendum in favour of Brexit puts into question the role of the unanimity rule in EU's decision making process and the need to replace it by a voting system based on (qualified) majority. Proposals to use a qualified majority voting in tax matters were already on the table earlier but were never included in EU treaties. For example, in 2003, following the intergovernmental conference on a constitutional treaty, the European Commission proposed to replace the unanimity rule by qualified majority voting in certain areas of taxation (such as for example, 'taxation in connection with the operation of the internal market', including 'modernising and simplifying existing legislation', 'combating tax fraud', etc.).[3]

In theory, unanimity should ensure that Member States are never forced into applying new EU tax legislation on which they did not give their explicit consent. Whether the unanimity rule effectively guarantees Member States' fiscal sovereignty is however doubtful.[4] In practice, negative tax harmonization – through the decisions of the Court of Justice of the EU, and to a certain extent of the European Commission – has had a clear impact on Member States' tax policies, which should always comply with general EU law, in particular the EU fundamental freedoms and EU state aid law.[5] This important role of the Court of Justice has often been linked to the lack of positive harmonization in tax matters. From that perspective, the unanimity rule could even have the opposite effect to the one intended: the lack of positive harmonization would lead to a higher level of negative harmonization, taking place without any explicit consent from the side of the Member States.[6] In the field of political science, some authors also insist on the higher efficiency and effectiveness of majority voting in

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3 European Commission, Communication 'A Constitution for the Union – Opinion of the Commission, pursuant to Article 48 of the Treaty on European Union, on the Conference of representatives of the Member States' governments convened to revise the Treaties', COM/2003/0548 final, Point I.7.

4 *See* Philipp Genschel, *How the European Union Constrains the State: Multilevel Governance of Taxation*, 50(3) Eur. J. Pol. Res. 293–314 (2011).

5 On the tools of negative EU tax harmonization, *Allocating Taxing Powers within the European Union*, Series: MPI Studies in Tax Law and Public Finance, vol. 2 (Isabelle Richelle, Wolfgang Schön & Edoardo Traversa eds., Springer 2013), *State Aid Law and Business Taxation*, Series: MPI Studies in Tax Law and Public Finance, vol. 6 (Isabelle Richelle, Wolfgang Schön & Edoardo Traversa eds., Springer 2016).

6 *Ibid.*

comparison to consensus.[7] The unanimity rule would favour the 'least ambitious parties' and lead to *statu quo* while political systems based on majority voting rules would encourage parties to reach compromises and innovative solutions.

The proposal to replace the unanimity rule by a qualified majority voting in tax matters could finally be justified in the new context of the Organisation for Economic Co-operation and Development (OECD) action plan against Base Erosion and Profit Shifting (BEPS). One of the objectives of the BEPS project is indeed to counter harmful tax competition, which could be considerably reduced in the EU if the Member States would adopt common rules with regard to the structure of corporate income taxes, which – despite the encouraging signal given by the recent adoption of the Anti-Tax Avoidance Directive[8], is unlikely to happen if unanimity is required. The announced new EU commission proposal in favour of the introduction of a Common Consolidated Corporate Tax Base will certainly serve as a test to check the willingness of Member States to go further on this path.[9]

Against such proposals, one may argue that alternatives already exist for Member States that wish to pursue deeper integration in tax matters. An example is the Commission's proposal in favour of the establishment of a financial transaction tax (FTT) that would involve eleven Member States through enhanced cooperation.[10] Authors – but also non-participating countries – nevertheless rapidly (and rightly) pointed out the legal and practical risks of adopting harmonizing measures through such a procedure.[11] It is no surprise that a non-participating Member State (even less surprising, the UK) has asked the Court of Justice to rule on potential EU law violations by the Council decision allowing Member States to use the enhanced cooperation procedure for establishing a FTT.[12] Given that the Council decision only allowed Member States to adopt a FTT based on the enhanced cooperation procedure, the Court of Justice rejected UK's claims on the basis that the Council decision did not contained any of the substantives rules contested by the UK. Yet, the arguments put forward by the UK – as well as by various scholars shed scepticism as to the fact that the procedure of enhanced cooperation may provide an effective alternative to Member States that wish to deepen European integration in tax matters.

Other – rather theoretical – alternatives are the 'general passerelle clause' (Article 48 §7, al. 1 TEU), which allows a switch from unanimity to a qualified majority vote and the provision on the elimination of market distortion (Article 116 TFEU).[13] With regard to the 'general passerelle clause', the important procedural guarantees surrounding its use (including the need to first reach a consensus at the level of the Council) makes it less likely to be considered as a true alternative (48, § 7, al. 3 & 4 TEU).

The same can be said of Article 116 of the TFEU given that this provision has – so far – never been used by the Commission to foster fiscal harmonization in order to counter the lack of unanimity between Member States. However, the lack of previous use of that potential legal basis for tax harmonization appears to reflect a rather broad consensus that unanimity is required in taxation matters, at least until a modification of Article 114 TFEU, which excludes fiscal provisions from the ordinary legislative procedure, i.e. co-decision between the Council and the Parliament.

3 The role of the EU parliament in tax matters

As already explained, the unanimity rule is not a guarantee for the legitimacy of tax policies at the EU level. A better guarantee would be to reinforce the role of the European Parliament in tax matters, as well as reinforcing the legitimacy of the EU Parliament as such (for example with the use of a 'EU-wide' electoral constituency). The arguments put forward by the supporters of the Brexit could be used as a catalyst for a stronger involvement of the European Parliament in EU tax policy. UK citizens' distrust in EU's institutions could be a sign that the EU needs to be further reformed and that the role of the EU

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7 *See* Jon Hovi & Detlef F. Sprinz, *The Limits of the Law of the Least Ambitious Program*, 6(3) Global Envtl. Pol. 28–41 (2006).*See* p. 38: 'In other words, the effect of the unanimity rule in the European Union is not so much that it favors the least ambitious program, as that it introduces a strong conservative element'; Luke Kemp, *Framework for the Future: The Possibility of Majority Voting Within the United Nations Framework Convention on Climate Change (UNFCCC)* (2014) 1 FFU-Report, 3–7, http://edocs.fu-berlin.de/docs/servlets/MCRFileNodeServlet/FUDOCS_derivate_000000003244/Kemp_Framework_for_the_Future.pdf 14 October 2016.

8 Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, OJ L 193, 19 July 2016

9 European Commission, Communication from the Commission to the European Parliament and the Council, A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action, Brussels, 17 June 2015, COM(2015) 302 final.

10 European Commission, Proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax, Brussels, 14 Feb. 2013, COM(2013) 71 final.

11 Joachim Englisch, John Vella & Anzhela Yevgenyeva, *The Financial Transaction Tax Proposal Under the Enhanced Cooperation Procedure: Legal and Practical Considerations*, 2 Brit. Tax Rev. 223–259 (2013).

12 CJEU, *United Kingdom of Great Britain and Northern Ireland v. Council of the European Unio*n, C-209/13 (30 Apr. 2014).

13 *See* e.g. Peter J. Wattel, *Chapter 7: Some Fringe Areas of EU State Aid Law in Direct Tax Matters*, in *EU Income Tax Law: Issues for the Years Ahead* 148–149 (Denis Weber & Guglielmo Maisto eds., IBFD 2013); Christiana HJI Panayi, *European Union Corporate Tax Law* 4 (CUP 2013).

Parliament – as the prime democratic institution – should be further consolidated.

Although the position of the European Parliament has been reinforced with the entry into force of the TFEU, its role is still very limited in tax matters. Indeed, in contrast to many other legal fields subject to the ordinary legislative procedure, which equally involves both the European Parliament and the Council in the decision process (289 and 294 TFEU), taxation is subject to a special legislative procedure (as laid down in Articles 113 115 and 192§2(a) TFEU), which recognizes a predominant role to the Council (289 and §2 TFEU). Under the special legislative procedure, the Parliament has usually only a limited consultative role. Yet, the European Parliament has recently shown an increased interest in tax matters (for example, through the setting up of the TAXE and TAXE 2 Committees), and could play in the future a much bigger role in the design of EU tax policy.

4 The link between taxation and the european budget at the EU level

Another institutional reform that could be initiated following the results of the UK's referendum concerns the European budget. As for now, the EU budget is financed by three main types of EU's own resources: the traditional own resources (mainly customs duties and sugar levies), the resources derived from VAT collections (0.3% of the VAT collected by Member States) and a percentage of Member States Gross National Income (GNI).[14] The most important source of EU's own resources comes from a percentage of Member States' GNI, which leads to easy criticisms by Eurosceptic political parties that consider the EU to weigh down too heavily on Member States' own budget.

The adoption of a European-wide tax could permit to limit the participation of Member States in the European budget by providing the EU with an independent source of revenue.[15] As such, no new taxes need to be established. For example, the EU common VAT system – which has already been broadly harmonized –would need only relatively few changes in its structure to become an EU tax, without a revenue-sharing mechanism between the EU and its Member States. Such reform could play an important role in strengthening the EU as a political union, allowing for a stronger link between taxing and spending at the EU level and permitting the EU to set up pan-European economic stimulation programs and solidarity mechanisms as well as financing common initiatives in the area, for example, of defence and foreign policy.[16] The economic crisis has weakened the coherence of the EU as a whole and has highlighted the need to organize fiscal transfers between EU Member States, even more between the Members of the Eurozone, given the inevitable relationship between monetary and tax policies.[17] The Brexit could be the occasion to make real the proposals of reforms for a 'genuine Economic and Monetary Union' that were formulated some years ago as a response to financial crisis.[18] For these reason, Brexit may be the right time to analyse the root causes of EU's legitimacy problem and to propose creative and disruptive solutions.

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[14] *See* Art. 311 TFEU; Council decision of 26 May 2014 on the system of own resources of the European Union (2014/335/EU, Euratom), OJEU L 168/105, 7 June 2014.

[15] Such proposition has been made before. *See* e.g. European Parliament, Working Document on improving the functioning of the European Union building on the potential of the Lisbon Treaty, 30 Oct. 2015, para. 42. *See also* The High-level group on own resources established in 2014 by Monti (http://ec.europa.eu/budget/mff/hlgor/index_en.cfm 14 October 2016); Alfredo De Feo & Brigid Laffan, *EU Own Resources: Momentum for a Reform?* (European University Institute 2016), http://ec.europa.eu/budget/mff/hlgor/library/selected-readings/01-DOC-COMM-EUORMomentumForReform-EUIDeFeoLaffan-Feb2016.pdf 14 October 2016; Margit Schratzenstaller, Alexaxnder Krenek, Danuše Nerudová, Marian Dobranschi, *EU Taxes as Genuine Own Resource to Finance the EU Budget – Pros, Cons and Sustainability-Oriented Criteria to Evaluate Potential Tax Candidates* (2016), http://ec.europa.eu/budget/mff/Library/hlgor/selected-readings/40-DOC-COMM-EuTaxes-Schratzenstalle.pdf 14 October 2016; Sabine Heidenbauer & Ramona Piscopo, *Report on the Conference: EU-Taxes*, 11 Intertax 653–661 (2007).

[16] *See* Michael L. Ross, *Does Taxation Lead to Representation*, 34 B.J. Pol. S. 229–249 (2004).

[17] On the meaning of the economic crisis for EU's tax policy, *see* Frans Vanistendael, *Revisiting Taxation in the Wake of the Crisis: Between National Tax Sovereignty and Tax Harmonisation*, 4(3) Madariaga Paper 16 (2011) ('The financial crisis has demonstrated in a painful way the absence of adequate instruments to conduct an effective fiscal and budgetary policy to meet the challenges of the crisis'); Frans Vanistendael, *The Crisis: A Window of Necessity for EU Taxation*, 9 Eur. Taxn. 394–401 (2010). The need for fiscal transfers was also tackled in a report of UK's European Union Committee (*see* 'Genuine Economic and Monetary Union and the implications for the UK', 8th Report of Session 2013–2014). On the relationship between monetary and tax policies, *see* Gabriel Ardant, *Histoires financières. De l'Antiquité à nos jours* (Gallimard 1976).

[18] *See* Herman Van Rompuy et al., *Towards a Genuine Economic and Monetary Union*, Report, 5 Dec. 2012.