EU Member States give final approval to proposed Pillar Two Directive

19 December 2022

In brief

On 15 December, the EU Council formally adopted the EU minimum tax Directive by written procedure. The written procedure ended with this unanimous agreement, notwithstanding the fact that Hungary abstained from the final vote, and Sweden made a written observation on a specific provision of the Directive. The Directive will enter into force on the day following its publication in the Official Journal of the European Union. Member States shall transpose the Directive into their domestic law by 31 December 2023. All Member States voted in favour of the accompanying Council Statement. This outcome follows a week of speculation on the deal after Poland reserved its support until yesterday's EU Council meeting.

The overall package passed at the EU Council meeting includes the EU minimum tax Directive, funding for Ukraine, a Council decision for the protection of the Union budget against breaches of the rule of law in Hungary (rule of law conditionality mechanism) and a further Council decision which approves the Commission's assessment of Hungary's recovery and resilience plan.

In detail

Securing the final deal

Our earlier tax policy alert of 13 December set out the background of the minimum tax proposal to date, including details of the decision of 12 December where the Committee of the Permanent Representatives of the Governments of the Member States to the European Union (COREPER) agreed in principle on the introduction of a global minimum taxation proposal. At that meeting, the COREPER advised the Council to adopt the draft Pillar Two Directive and the related Council statement. The COREPER mandated that a written procedure for formal adoption of the Directive would be appropriated and should be concluded later in the week. As noted above, the minimum tax Directive was being adopted as part of a package of measures.

The Hungarian representative dropped the Hungarian veto for the minimum tax Directive as part of the overall package on 12 December, which included the granting of financial aid to Hungary under the recovery and resilience fund. However, the Polish representative initiated a 'study reservation' on the Directive, to conduct further analysis over a number of days. This prevented the proposal from securing formal adoption. The study reservation was due to be completed by 14 December, but this deadline passed without a resolution. Ultimately, however, Poland agreed to support the proposal.

Observation: There were serious concerns that Poland would veto the proposal for a second time, on the basis that it has still not received its allocation of funds under the recovery and resilience fund. Poland previously withheld support earlier this year on the basis that it wanted assurances that the work on Pillar One would continue. These assurances were given and are now secured via Article 57 of the minimum tax Directive and in the Council Statement (see further below).

Hungarian abstention

All representatives voted in support of the Directive, apart from Hungary who abstained from the vote. Article 238(4) of the Treaty on the Functioning of the European Union (relating to the procedural rules around voting) provides that abstentions by members present in person or represented must not prevent the adoption by the Council of acts which require unanimity. Accordingly, the Directive can move forward without the explicit support from Hungary.

Swedish observation

Sweden made the following observation which is captured in an Annex to the agreement:

"Sweden is committed to the implementation of rules ensuring a global minimum level of taxation for multinational groups in the Union and have supported the proposed Directive when presented at previous Ecofin meetings. In order to accommodate the concerns of one Member State, a new Article 55a has been added to the Directive at a late stage. Sweden is prepared to accept the newly added Article since it is perceived necessary to reach a compromise on which there can be unanimity. However, Sweden wishes to make clear that the added language does not in any way prejudge our position of any proposal presented by the Commission based on the new Article 55a."

Article 55a was included in the compromise text of 21 June 2022, but has now been replaced by Article 57 of the latest compromise text of 25 November 2022. The relevant provision relates to the implementation of Pillar One, and it requires the Commission to monitor the implementation of Pillar One at OECD/G20 level and to submit a report to the EU Council by 30 June 2023 in this regard. If appropriate, the Commission will submit a legislative proposal to address the tax challenges that Pillar one seeks to address in the absence of the implementation of the Pillar One solution at a global level.

Observation: *The Swedish observation reserves a future decision on the Pillar One proposal until such time as that proposal is published. As the report on Pillar One implementation by the Commission must be delivered during the Swedish presidency, this may be intended to prevent Sweden from being committed either as a country, or as the presidency to any particular way of dealing with non-implementation (as is expected) of Pillar One.*

Adoption of the Directive might increase tensions with the US

On 14 December 2022, 32 Republican Senators and Representatives from the two tax-writing committees of the US Congress, wrote a letter to the US Secretary of the Treasury, Janet Yellen, about the need to stop other countries from asserting the UTPR on US companies. The letter states: "While some may believe that implementation by foreign countries of the model rules, including the UTPR, will lead the United States to follow suit, Congress's hand will not be forced. Nor will Congress sit idly by as U.S. companies and profits are taxed in a manner inconsistent with U.S. law and our bilateral tax treaties." The letter ends by inviting the Administration to find a bipartisan solution with Congress.

Observation: It is clear that the imposition of the UTPR on the domestic US income of US headquartered businesses in 2025 could provoke a serious reaction. Sooner or later a political solution will have to be found to this issue.

The takeaway

Now that the written procedure is secured, the European Union is the first block of countries that has formally adopted the Pillar Two minimum taxation rules. This will most likely encourage other countries to adopt and implement the rules in the coming weeks and months.

Let's talk

For a deeper discussion of how the EU Directive or OECD two-pillar approach might affect your business:

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