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The EU FTT – what is the effect of Estonia's exit?

At the ECOFIN meeting on 8 December, ten Member States issued a statement confirming they would proceed with the EU financial transaction tax (FTT). Estonia, which had previously been part of the FTT process, no longer wishes to be involved. This briefing considers the legal effect of Estonia leaving: is it merely that the FTT (if agreed) will no longer apply to Estonia? Or is it instead that the FTT process has now failed? And, if the latter, what is the legal effect if the participating Member States proceed regardless?

What is the background?

In January 2013, the Council of Ministers authorised France, Germany and nine other EU Member States to proceed with a wide-ranging EU financial transaction tax (FTT) on securities and derivative transactions under the "enhanced cooperation procedure". The Commission published a detailed proposal on 14 February 2013.

The enhanced cooperation procedure enables EU legislation to be enacted by nine or more participating Member States, without other Member States having a right of veto.

The original intention was for the FTT to be in force by January 2016; however the eleven Member States have found it difficult to reach agreement on fundamental questions around the basic scope of the tax, including the kinds of financial instruments that should be taxed, the FTT's jurisdictional reach, and exemptions for pension funds, the "real economy", and financial intermediaries.

At the 8 December ECOFIN meeting, ten of the eleven participating Member States issued a statement somewhat narrowing down the open issues, and stating that a decision on the remaining points would be made by the end of June 2016. However it is being reported that Estonia, which was initially one of the participating Member States, no longer wishes to proceed.

How does the enhanced cooperation procedure work?

The enhanced cooperation procedure was introduced in the Lisbon Treaty, and is now set out in Articles 326 to 334 of the Treaty on the Functioning of the European Union (TFEU).

There must be a minimum of nine participating Member States. Article 329 provides that those Member States wishing to establish enhanced cooperation between themselves send a request to the Commission, specifying the scope and objectives of the proposed measure. If the Commission assents, it then submits a formal proposal to the Council. The proposal is then required to obtain the consent of the European Parliament and then approval (by qualified majority) of all members of the Council.

Article 331 enables additional Member States to participate in an enhanced cooperation process, provided they notify their intention to the Council and the Commission. The Commission is required to confirm a new Member

State's participation within four months, provided that any conditions of participation have been satisfied and appropriate transitional measures (where required) have been put in place.

An enhanced cooperation proposal may be discussed by all members of the Council, but only the participating Member States can take part in the final vote. The vote will require unanimity amongst the participating Member States if it is the kind of measure which ordinarily requires unanimity (e.g. security or tax), and will otherwise require a qualified majority of the participating Member States.

Can a participant leave an enhanced cooperation process?

There is no procedure set out in the TFEU for a Member State participating in an enhanced cooperation process to cease to participate.

The point is of considerable importance. If it is not possible to cease to participate then the only possible outcomes of an enhanced cooperation procedure are that all the participants agree to introduce the measure (in which case it is binding on them) or that they are not all agreed (in which case the enhanced cooperation procedure comes to an end). In other words, Estonia must either participate in the FTT, or the enhanced cooperation process fails – Estonia cannot merely stand aside.

There was some discussion of the point in 2011, in the context of the proposal to introduce an EU unitary patent system by enhanced cooperation.

When the Council adopted the Decision authorising that enhanced cooperation process, it was advised by the Council Legal Service that any Member State that initially participated would be entitled to withdraw as long as no substantive act related to the enhanced cooperation had been adopted.

The House of Commons European Scrutiny Select Committee later considered the issue and concluded that "If the Treaties had meant to allow for withdrawal from an authorisation to proceed with enhanced cooperation, we think express provision would have been made for this". The Council Secretariat disagreed, and reiterated the view of the Council Legal Service, adding that "there is nothing elsewhere in the enhanced cooperation provisions of the Treaties that imports a sense of compulsion into the authorisation that is given under Article 329 TFEU".

What are the legal arguments?

This is a difficult area with very little in the way of judicial or other authority, as the enhanced cooperation procedure has been used only on two previous occasions.

Nevertheless, there are several reasons to doubt that it is possible for a participating Member State to leave an enhanced cooperation process:

- First, there are detailed provisions for Member States to become participants in the enhanced cooperation process; the absence of any provisions to cease to participate is therefore striking.
- Second, it is arguable that the nature of the enhanced cooperation process is to apply the usual EU rules to a sub-set of the EU, with voting rules and outcomes being applied with respect to that sub-set, but otherwise being unchanged. If that is correct, it may follow that a participating Member State may no more remove itself from the enhanced cooperation process than a Member State may remove itself from the usual legislative process.
- Third, the creation of the enhanced cooperation process requires approval of the Council and European Parliament. In doing so they may have regard to the number of participating Member States and the identity

of those participating (for example, their willingness to approve an FTT may have been different if it did not involve France and Germany). It therefore seems somewhat inconsistent if participants are able to withdraw, potentially altering the nature and effect of the proposed measure, without the approval of the Council and European Parliament.

- Fourth, the 2013 Council Decision authorising enhanced cooperation stated that the eleven Member States were "hereby authorised to establish enhanced cooperation between themselves in the area of establishment of a common system of financial transaction tax". It is not clear whether that authorisation would also cover an enhanced cooperation between ten of the eleven.

What are the consequences for the FTT if Estonia cannot withdraw?

If the correct analysis is that a participant cannot leave an enhanced cooperation process, but the ten Member States nevertheless continue to enact an FTT Directive without Estonia, then that Directive would be unlawful.

Two consequences could follow:

First, soon after the Directive is adopted, one of the EU institutions or an EU Member State could challenge its legality before the Court of Justice of the European Union.

Second, if the FTT enters into force without a challenge from an institution or Member State, then it would be open to challenge by any taxpayer that pays the FTT. Such challenges would initially be in the local courts of the taxing Member State, but ultimately would likely result in a CJEU hearing.

Any challenge by a Member State would likely reach the CJEU fairly quickly, very possibly with judgment delivered before the FTT enters into force. By contrast, any challenge by a taxpayer could take many years (we would say at least four), during which time many €10bns of FTT would be collected by the ten Member States. If the FTT were indeed found to be unlawful, then all of this tax would have to be refunded.

How can the participating FTT Member States avoid these difficulties?

We would expect the ten Member States to wish to avoid the possibility of a protracted dispute over the legality of the FTT, given the significant economic and political cost of the tax being collected and then found to be unlawful.

If they wish to put the point beyond doubt then it would be prudent for the ten Member States to seek a fresh authorisation from the Council and the European Parliament to proceed with a new enhanced cooperation process, without Estonia.

It is unclear why this approach is not being taken, given the large amounts of tax potentially at stake. We can speculate that, given the apparent disagreement amongst the ten as to how the FTT would work, there may be a concern that not all ten would be willing to recommit to the process. Indeed, if there are not at least nine willing to recommit then a new process could not be established.

The alternative is of course for diplomatic pressure to be put on Estonia to recommit to the FTT process.

What steps should market participants be taking now?

We remain of the view that it is premature to spend management time or incur legal costs planning for the introduction of the FTT when its future remains so uncertain.

Please speak to your usual Clifford Chance contact if you would like to discuss how we see the FTT progressing, or speak to one of the contacts listed overleaf.

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