5 Third States and External Tax Relations

Ana Paula Dourado[1] and Peter Wattel[2]

5.1 Overview

This chapter covers topics relating to the EU's external tax relations, especially (i) free movement of capital and payments to and from non-Member States (third States), (ii) tax implications of the special status of overseas countries and territories (OCTs) of Member States, (iii) tax implications of international agreements between the EU and non-Member States, especially the European Economic Area Agreement (EEAA) and EU-association agreements, (iv) (external) tax treaty making powers, and (v) 'exportation' to third States of EU tax good governance rules (the EU blacklist of non-cooperative tax jurisdictions).

5.2 Third State Capital Movement[3]

5.2.1 Introduction; Differences Between Intra-EU and Third State Capital Movement

Art. 63(1) TFEU prohibits all restrictions on the movement of capital between Member States *and* between Member States and third States. Paragraph 2 prohibits all restrictions on payments between Member States and between Member States and third countries. Third State capital movement is therefore in principle as free as intra-EU capital movement, but it is not *quite* as free.

First, the *erga omnes* scope of Art. 63 TFEU may be limited in case of concurrence of capital movement and establishment, or of concurrence of capital movement and service provision, as establishment and services provision have *not*

1. Professor of Tax Law, International and European Tax Law, University of Lisbon; General Editor, Intertax.
2. Professor of EU Tax Law, ACTL, University of Amsterdam; Advocate-General, Supreme Court of the Netherlands; State Councillor extraordinary, Netherlands Council of State. The authors would like to thank Daniël Smit for his review of this chapter.
3. See for in-depth analysis, Daniël Smit, 'Freedom of Investment between EU and non-EU Member States and its Impact on Corporate Income Tax Systems within the European Union,' CentER dissertations series, December 2011, University of Tilburg, the Netherlands.

been liberalized in third State relations and the concurrence with other movements than capital movement may result in the freedom of capital movement not being applicable to avoid that indirectly, establishment and service provision would in fact be liberalised in third State relations. See Section 5.2.4.

Second, Art. 64 TFEU contains a standstill or grandfather clause saving restrictions on four categories of capital movement. Member States may retain measures as regards third States which existed on 31 December 1993 and which restrict capital movement involving (i) direct investment (including real estate), (ii) establishment, (iii) provision of financial services and (iv) admission of securities to capital markets. Many restrictive tax measures as regards third States are thus still permitted. See Section 5.2.3.

Third, Art. 64(3) empowers the Council to approve restrictive measures (Union law measures) as regards third States (a 'step backwards'). These restrictive measures are not specifically or necessarily related to taxes and do not need to be justified, as long as the special procedure and unanimity are observed; Moreover, Art. 65(4) was added in the TFEU by the Treaty of Lisbon, effective as of 1 December 2009: under very strict conditions and unanimous agreement it allows new restrictive *tax* measures of a *Member State* (tax and national restrictions) as regards one or more third States. The preparatory work suggests that this provision was introduced to address the concerns of some Member States in respect of free movement of capital.[4] Probably, some Member States realized that unilateral total liberalization of capital movement with third States may be hazardous, especially in tax matters, as third States may not be inclined, *e.g.*, to extend tax benefits to EU residents if the EU has already unilaterally given away, in Art. 63 TFEU, its negotiation position. Despite these concerns, this new Member State friendly procedure has never been used yet. This may change after Brexit.

Fourth, Art. 66 allows temporary safeguarding measures in exceptional circumstances seriously impeding the functioning of the economic and monetary union. The impact on direct taxes is limited and this provision is therefore not discussed in more detail.

Last, the Court recognizes (see Section 5.2.2) that third State capital movement takes place in a 'different legal context' from intra-Union capital movement, as third States are not bound by EU rules such as, in particular, the duty to cooperate sincerely (Art. 4(3) TEU), the Directive on Administrative Cooperation (DAC; see Chapter 13) and the Recovery Assistance Directive (see Chapter 13). Hence, Member States justifications for restrictive tax measures, especially those aimed at effective fiscal supervision and recovery of tax, stand a better chance of being accepted in third State situations than in intra-EU situations.

4. Conference of the Representatives of the Governments of the Member States, Brussels, 29 April 2004, PRESID 16, CIG 73/04, Meeting of Focal Points (Dublin, 4 May 2004) working document, 121.

5.2.2 In Principle the Same Substance as Intra-EU, but: 'a Different Legal Context'

In principle, free movement of capital has the same meaning in a third State context as it has in an intra-EU-context, and the concept of a restriction is the same as it is in an intra-EU context. The *Bordessa* case[5] and the *Sanz de Lera* case[6] offered a unique chance to compare the scopes of the free capital movement intra-Union and extra-Union, as both cases concerned the exact same national currency restrictions, *Bordessa* in an intra-EU situation and *Sanz de Lera* in relation to a non-member State (Switzerland). The Court's analysis showed no differences of principle or approach. In both cases, the requirement of prior authorization for the export of currency was considered disproportional, but in both cases the requirement of prior declaration was considered proportional in relation to the justified goal of prevention of money-laundering, drugs trafficking and the financing of terrorism. The Member States have tried to convince the Court otherwise in *Skatteverket v A.*,[7] arguing (i) that unlike the liberalisation of intra-EU movement of capital, which is intended to complete the internal market, the extension of free movement of capital to third countries is linked to the completion of the economic and monetary union, (ii) that in relations with third countries, compliance with the prohibition in Art. (now) 63(1) TFEU would lead to unilateral liberalisation without the EU securing a guarantee of equivalent liberalisation by the third countries concerned and without, in the relations with those countries, harmonisation of, in particular, rules on direct taxation, (iii) that if free movement of capital were interpreted in an identical manner in relations with third countries and intra-EU relations, the latter would be deprived of the means of negotiating liberalisation with third countries, since such liberalisation would have already automatically and unilaterally opened up the EU market to those countries, and (iv) that free movement of capital in EU association agreements with third countries often have a more limited scope than that of Art. 63 EU, which would be meaningless if Art. 63 were as rigorously applicable in relations with third countries as in Union relations.[8] In vain, however; the Court answered:

> 31. (…), even if the liberalisation of the movement of capital with third countries may pursue objectives other than that of establishing the internal market, such as, in particular, that of ensuring the credibility of the single Community currency on world financial markets and maintaining financial centres with a world-wide dimension within the Member States, it is clear that, when the principle of free movement of capital was extended, (…), to movement of capital between third

5. Joined cases C-358/93 and C-416/93, *Bordessa*, EU:C:1995:54.
6. Joined cases C-163, 164 and 250/94, *Sanz de Lera*, EU:C:1995:451.
7. Case C-101/05, *Skatteverket v. A*, EU:C:2007:804.
8. Case C-101/05, *Skatteverket v. A*, EU:C:2007:804, points 29-30.

> countries and the Member States, the latter chose to enshrine that principle in that article and in the same terms for movements of capital taking place within the Community and those relating to relations with third countries.

So, if the Member States did not want to unilaterally liberalize third State capital movement, they should not have done so. But they did. Therefore, the Member States should use the grandfather clause (Art. 64 TFEU) to distinguish third State capital movement from intra-EU capital movement. Likewise, in the subsequent cases *Haribo* and *Salinen*,[9] the Court explicitly rejected the lack-of-reciprocity argument. However, the Court did not leave the Member States entirely in the cold. Taxation of third State capital movement is not always comparable to taxation of intra-EU capital movement, and wider justification for restrictions is possible in third State situations, because of the 'different legal context' of third State movement. As the Court considered in *Skatteverket v A*:[10]

> '36. (…) the extent to which the Member States are (…) authorised to apply certain restrictive measures on the movement of capital cannot be determined without taking account of the fact (…) that movement of capital to or from third countries takes place in a different legal context from that which occurs within the Community.
> 37. Accordingly, because of the degree of legal integration that exists between Member States (…), in particular by reason of the presence of Community legislation which seeks to ensure cooperation between national tax authorities, such as [the Directive on Administrative Cooperation; *authors*], the taxation by a Member State of economic activities having cross-border aspects which take place within the Community is not always comparable to that of economic activities involving relations between Member States and third countries (….). (…), it may also be that a Member State will be able to demonstrate that a restriction on the movement of capital to or from third countries is justified for a particular reason in circumstances where that reason would not constitute a valid justification for a restriction on capital movements between Member States (…).'

In *Haribo* and *Salinen*, this 'effective fiscal supervision'justification for restrictive measures was relied on by Austria to refuse a credit for corporation tax levied in third States with which Austria had not concluded a tax treaty providing for (sufficient) exchange of tax information to verify the amount of corporation tax levied in the third State:

9. Joined Cases C-436/08 and C-437/08, *Haribo and Österreichische Salinen*, EU:C:2011:61.
10. Case C-101/05, *Skatteverket v. A*, EU:C:2007:804.

> '129. The Austrian Government contends (...) that its tax regime is justified by the need to guarantee the effectiveness of fiscal supervision since the relevant double taxation conventions with non-member States do not guarantee the same level of exchange of information with the competent authorities of the States concerned as that provided for, by Directive 77/799, between the authorities of the Member States.
> 130. It is to be remembered that the framework established by Directive 77/799 for cooperation (...) does not exist between those authorities and the competent authorities of a non-member State where that State has not entered into any undertaking of mutual assistance (...).
> 131. It follows that, where legislation of a Member State makes the grant of a tax advantage dependent on satisfying conditions compliance with which can be verified only by obtaining information from the competent authorities of a nonmember State other than a State party to the EEA Agreement, it is in principle legitimate for the Member State to refuse to grant that advantage if – in particular, because that non-member State is not bound under an agreement to provide information – it proves impossible to obtain the requisite information from it (...).'

The Court accepted that where legislation of a Member State makes the grant of a tax advantage dependent on conditions, compliance with which can be verified only by obtaining information from a non-EU, non-EEA State, it is in principle legitimate for that Member State to refuse to grant that advantage if, in particular because the third State is not bound under an agreement to provide information, it proves impossible to obtain the requisite information from it. The (objective) absence or deficiency of exchange of tax information with the third State involved may therefore function as a safe harbor for Member States wishing to apply restrictive tax measures in respect of third State investors, even where the taxpayer would (subjectively) be fully transparent and cooperative. A similar decision was taken in *Rimbaud*,[11] in which France had made equal treatment of French real estate entities controlled by non-EU residents conditional on the existence of either sufficient exchange of tax information with the non-EU State concerned (in this case Liechtenstein) or a nondiscrimination provision in the tax treaty with that non-EU State. Although Liechtenstein is an EEA Member and Art. 40 of the EEA Agreement (see Section 5.4) provides for an equivalent right of establishment as Art. 49 TFEU, France could refuse an exemption from real estate tax because Liechtenstein – at that time – did not provide information as to the beneficial owners of the shares in the entity.[12]

11. Case C-72/09, *Établissements Rimbaud*, EU:C:2010:645.
12. See also Case C-521/07, *Commission v the Netherlands*, EU:C:2009:360, and, again, Case C-540/07, *Commission v Italy*, EU:C:2009:717.

In *Emerging Markets Series*,[13] the CJEU held that it is for the national court to decide whether or not there is equivalence between the EU legal framework and the international regulatory framework on mutual assistance. The case concerned a US investment fund requesting from the Polish tax authority the refund of a 15% corporation tax applied to dividends paid to it by Polish companies. Had the fund been resident in Poland, it would have been granted such refund. Its request was rejected on the ground that, as an investment fund established in the USA, it did not satisfy the exemption conditions set out in Art. 6(1)(10) of the Polish law on corporation tax. The Court considered this to be a restriction on the free movement of capital which was in principle prohibited by Art. 63 TFEU (points 42–43). On the need for effectiveness of fiscal supervision as a justification, it acknowledged the existence of a regulatory framework for exchange of information established between Poland and the USA under the applicable bilateral tax treaty as well as under Art. 4 of the OECD and the Council of Europe Convention, on mutual administrative assistance in tax matters (points 85–87). However, it did not rule itself on the question of whether that was sufficient to produce a comparable legal context as within the EU:

> "88 It is none the less for the referring court to examine whether the obligations under agreements, are in fact capable of enabling the Polish tax authorities to verify, where it may be necessary, the information provided by investment funds established in the United States of America on the conditions for their formation and operation, in order to determine that they operate within a regulatory framework equivalent to that of the European Union."

The recent *SECIL* case[14] confirms previous case law, adding that Member States may not rely on the need for effective fiscal supervision to categorically refuse equal treatment in third State relations if a legal framework for the exchange of information is present which enables the EU Member State involved to obtain the information necessary to check whether the conditions for the benefit claimed by the taxpayer are met. Such framework could be a bilateral tax treaty or a TIEA[15] concluded with the third State concerned, but possibly also an association agreement between the EU and the third State involved if that agreement provides for exchange of tax information. Similarly to *Emerging Markets*, in SECIL the CJEU asked the referring court to

> "examine whether the obligations arising under the Portugal–Tunisia Convention are such as to enable the Portuguese tax authorities to obtain from the Republic of Tunisia the information which would allow them to verify satisfaction of the

13. Case C-190/12, *Emerging Markets Series*, EU:C:2014:249.
14. Case C-464/14, *SECIL v Fazenda Pública*, EU:C:2016:896.
15. Tax Information Exchange Agreement.

> condition that the distributing company be subject to tax. If so, the restriction resulting from the refusal to grant full or partial deductions, provided for in Article 46(1) and (8), respectively, of the CIRC, cannot be justified by the need to ensure the effectiveness of fiscal supervision".[16]

In any event, there must be a real need for the information which is said to be unattainable: in *STEKO*,[17] the Court held the argument that effective fiscal supervision instruments were not available to be irrelevant because the value drop of the holdings in non-resident companies was caused by a bear stock market, which was publicly available information.

5.2.3 The Grandfather Clause (Article 64(1) TFEU)

Although the *erga omnes* applicability of free capital movement was a considered decision, it appeared undesirable to treat third State capital movement identical to intra-EU capital movement in every respect. Therefore, the 'standstill' clause of Art. 64 TFEU protects ('grandfathers') national restrictions on capital movement involving (i) direct investment, including real estate, (ii) establishment, (iii) provision of financial services and (iv) admission of securities to capital markets, provided these restrictions of free movement already 'existed' on 1 January 1994. This raises the question what 'existing' means. The Court has explained that even if a restrictive measure has been amended subsequent to 31 December 1993, it will still be considered as 'existing' on 31 December 1993 (and can thus be saved) if its basic idea ('underlying logic') and procedures remained unchanged or if the change only *reduced* restrictions to free movement. It held in *Test Claimants in the FII GLO I*:[18]

> '192. As the Court stated in *Konle*,[19] any national measure adopted after a date laid down in that way is not, by that fact alone, automatically excluded from the derogation laid down in the Community measure in question. If the provision is, in substance, identical to the previous legislation or is limited to reducing or eliminating an obstacle to the exercise of Community rights and freedoms in the earlier legislation, it will be covered by the derogation. By contrast, legislation based on an approach which is different from that of the previous law and establishes new procedures cannot be regarded as legislation existing at the date set down by the Community measure in question (see Konle, paragraphs 52 and 53).'

16. Case C-464/14, *SECIL v Fazenda Pública*, EU:C:2016:896, point 68.
17. Case C-377/07, *STEKO Industriemontage*, EU:C:2009:29, point 55.
18. Case C-446/04, *Test Claimants in the FII Group Litigation I*, EU:C:2006:774.
19. Case C-302/97, *Konle*, EU:C:1999:271.

Art. 64 has grandfathered, a.o., an Austrian measure denying the Austrian half rate applicable to domestic and EU dividends to residents receiving third State (Swiss) dividends.[20] It might also have saved a restrictive Portuguese measure which was already in force in 1993 (a denial of exemption of dividends received from subsidiaries in Tunisia and Lebanon), were it not for the fact that although Portugal itself had not changed its restrictive legislation, the EU-Tunisia and EU-Lebanon association agreements had come into force *after* 1993, which altered the 'underlying logic' of the applicable legal framework, as these agreements liberalised 'direct investment' between the EU and Tunisia and between the EU and Lebanon. As the Court held, in *SECIL*,[21] even if a Member State does not formally repeal its restrictive measure, it nevertheless waives its power under Art. 64(1) TFEU by concluding an international agreement such as an association agreement, which liberalizes, with direct effect, a category of capital mentioned in Art. 64(1) (in that case: 'direct investment'). Such a change in the legal framework amounts to the introduction of new legislation since it is based on a logic different from that of the existing legislation. Also, such liberalisation of capital movement would be meaningless if a Member State could continue to apply restrictive legislation which the association agreement precisely prohibits. Thus, the standstill clause of Art. 64 TFEU may be overruled by free movement of capital provisions in an association agreement. Portugal was saved, not by the grandfather clause, but (partly) by the fact that no effective legal framework for exchange of tax information with Tunisia and Lebanon was provided for, making it impossible for Portugal to check whether the Tunisian subsidiary was effectively subject to corporation tax in Tunisia (a condition for the exemption). The national Court still needed to check, however, whether Portugal could obtain the necessary information from Tunisia on the basis of the Portugal-Tunisia tax treaty (with Lebanon, no tax treaty had been concluded). If that was the case, then Portugal could not rely on the need for effective fiscal supervision to refuse the exemption.

Since the standstill-clause was originally not designed with the aim to protect existing restrictive tax measures (it primarily aimed at respecting existing reservations in the context of the OECD Code of Liberalisation of Capital Movements), its application in the field of direct taxation raises numerous and often rather complex questions. For example, in the pending Case C-135/17, *X GmbH v Finanzamt Stuttgart*, one of the questions referred is whether a measure is still substantially the same as on 31 December 1993 if, even though it has substantially been changed after 31 December 1993 and the new regime has formally been in force for a short time, the new regime has never in practice been applied because the law shortly after changed again into a regime which *is* substantially similar to the pre-1994 regime. We think we know the answer, given point 87 of *SECIL*:

20. Case C-157/05, *Winfried Holböck*, EU:C:2007:297.
21. Case C-464/14, *SECIL v Fazenda Pública*, EU:C:2016:896.

> "Article 64(1) TFEU does not cover provisions which, whilst in substance identical to legislation which existed on 31 December 1993, have reintroduced an obstacle to the free movement of capital which, following the repeal of the earlier legislation, no longer existed (…)."

In another pending case, C-685/16, *EV v Finanzamt Lippstadt*, one of the questions is whether the measure is still substantively the same as in 1993 if the participation threshold for tax deduction has been raised after 1993 from a 10% holding to a 15% holding.

It should be noted that by grandfathering capital movement which 'involves' establishment or (financial) services, Art. 64 TFEU acknowledges that Art. 63 also covers movements which would also be covered, in intra-EU cases, by other fundamental freedoms, especially the freedom of establishment and the free provision of services, otherwise it would be superfluous to grandfather them. Art. 64 thus explicitly recognizes overlap between Capital on the one hand and Establishment and Services on the other. This is important for the determination of the scope of free capital movement in third State relations (see Section 5.2.4).

As Art. 64 TFEU is a derogation from the main rule of free movement of capital and payments (Art. 63), it must be interpreted strictly, as all derogations from the goals of the EU, so that the practical effect of the main rule of Art. 63 is preserved.[22] This narrows the scope of the grandfather clause, but on the other hand, for Art. 64(1) to apply, it is not necessary that the restrictive national measure has the *aim* to restrict capital movement in respect of the four categories it enumerates. To be grandfathered, it is sufficient that the national measure has a restrictive *effect* on capital movement in one of the four categories mentioned. This was confirmed in *X v Staatssecretaris*,[23] concerning a Netherlands measure permitting an extended assessment period (12 years) in case of hidden foreign bank accounts as compared to the assessment period in domestic cases (5 years). Obviously, that measure did not seek to regulate any of the four categories of capital movement mentioned in Art. 64(1); it applied (also) to situations wholly alien to direct investment, establishment, the provision of financial services or the admission of securities to capital markets. However, that did not preclude applicability of the grandfather clause.

The Court held that the scope of Art. 64(1) TFEU does not depend on the specific purpose of a national restriction, but on its effect on the movements of capital referred to in that provision; if Art. 64(1) TFEU would apply only where the national legislation at issue relates solely to the movements of capital referred to in that article, that would undermine the practical effectiveness of that provision.

22. Case C-560/13, *Wagner-Raith*, EU:C:2015:347, point 43.
23. Case C-317/15, *X v Staatssecretaris*, EU:C:2017:119.

> "21 (…), the applicability of Article 64(1) TFEU depends, not on the purpose of the national legislation containing such restrictions, but on its effect. That provision applies to the extent to which that national legislation imposes a restriction on movements of capital involving direct investment, establishment, the provision of financial services or the admission of securities to capital markets. Accordingly, the fact that that legislation may also apply to other situations is not such as to preclude Article 64(1) TFEU from being applicable in the circumstances which it covers.
> 22 (…), that interpretation is confirmed by the Court's case-law. (…). It is clear from those judgments [*authors*: *SECIL*, C-464/14, EU:C:2016:896, paragraph 78, and *Orange European Smallcap Fund*, C-194/06, EU:C:2008:289, paragraph 102], (…), that the scope of Article 64(1) TFEU does not depend on the specific purpose of a national restriction, but on its effect on the movements of capital referred to in that provision.
> 24 (…) an interpretation according to which Article 64(1) TFEU applies only where the national legislation at issue relates solely to the movements of capital referred to in that article would undermine the practical effectiveness of that provision. As the Netherlands Government has noted (…), such an interpretation would have had the consequence of compelling all the Member States, in order to be able to apply the restrictions set out in Article 64(1) TFEU, to revise their national legislation and adapt it very precisely to the scope of that provision before the deadline of 1 January 1994."

Nevertheless, for the grandfather clause to apply, there should be a sufficient causal link between the capital movement concerned (in *X v Staatssecretaris*: the opening of a bank account in the third country) and the provision of financial services, but the Court was satisfied that the capital movements resulting from the opening of a securities account with a bank involve 'the provision of financial services' and that there is a causal link between those capital movements and the provision of financial services, given that the holder places his capital in a securities account in return for management services from the bank:

> "28 (…), in order to be capable of being covered by the derogation provided for in Article 64(1) TFEU, the national measure must relate to capital movements that have a sufficiently close link with the provision of financial services, which requires that there be a causal link between the movement of capital and the provision of financial services (…).
> 29 (…) the capital movements resulting from the opening of a securities account with a banking institution involve the provision of financial services. (…).
> 30 (…), there is a causal link between the capital movements concerned and the provision of financial services given that the holder places his capital in a securities account by reason of the fact that, in return, he benefits from the management

> services which he receives from the banking institution. Accordingly, in a situation such as that at issue in the main proceedings, there is a sufficiently close link between the capital movements and the provision of financial services."

Currently, the question is before the Court whether a discriminatory (German) withholding tax levied from a non-EU pension fund sufficiently links-up with the provision of financial services (by the pension fund) and thus may be grandfathered under Art. 64 TFEU.[24] An affirmative answer would impy that also third State portfolio (i.e. passive) investors may be caught by the standstill clause of Art. 64 TFEU and hence be denied the protection of Art. 63 TFEU.

To sum up, in each individual case, an analysis of the possible applicability of the grandfather clause is essential to determine the scope of protection of third State investors under the free movement of capital.

5.2.4 Mutual Exclusion or Overlap? How to Distinguish Capital Movement From Establishment and Service Provision

As the other Treaty Freedoms do not extend to third-State situations, it is essential to distinguish between capital operations on the one hand (liberalized) and all other operations, especially establishment of undertakings and service provision (not liberalized as regards third States, but to be negotiated within the World Trade Organization (WTO) rounds). That is not always easy,[25] as the TFEU does not contain any hierarchy of free movement rights, nor conflict rules the Court cares for. As for the most important distinction, between Capital and Establishment, the Court used to apply a 'definite influence' test (see Chapter 3.2.5(iii), especially the *Baars* case cited there), afterwards complemented by the purpose of the legislation (*Franked Investment Income GLO* I[26]) and recently by the market access test (*Franked Investment Income GLO II*[27]). It further observed, a.o. in *SEVIC*,[28] that establishment requires the pursuit of an activity on a stable and continuous basis, whereas capital movement does not require such indefinite presence.[29] As regards the distinction between Capital and Services, the Court has observed that capital

24. Pending Case C-641/17, *College Pension Plan of British Columbia*.
25. See: Ana Paula Dourado, 'The EU Free Movement of Capital and Third Countries: Recent Developments", 45 *Intertax* 3 (2017), pp. 40-60.
26. Case C-446/04, *Test Claimants in the FII Group Litigation I*, EU:C:2006:774.
27. Case C-35/11, *Test Claimants in the FII GLO 2*, EU:C:2012:707.
28. Case C-411/03, *SEVIC Systems*, EU:C:2005:762, point 18.
29. See Case C-112/14, *Commission v. UK*, EU:C:2014:2369, point 20. *See also SEVIC systems*, point 18. For elaboration, *see* W. Schön, *Europaische Kapitalverkehrsfreiheit und nationales Steuerrecht*, in *Gedächtnisschrift für Brigitte Knobbe-Keuk*, at 747 (W. Schön ed., Verlag Dr. Otto Schmidt 1997.

movement may be an indirect consequence of services (see, *e.g. Bachmann*[30] and *Fidium Finanz*[31]) and further rather vaguely considered, in *Wagner-Raith*,[32] that:

> "it is appropriate, first of all, to recall the demarcation between the Treaty provisions relating to the freedom to provide services and those governing the free movement of capital. The Court has already held that it is apparent from the wording of Article 56 TFEU and Article 63 TFEU, and the position which they occupy in two different chapters of Title IV of the Treaty, that, although closely linked, those provisions were designed to regulate different situations and they each have their own field of application (see, (…) Fidium Finanz, C-452/04, EU:C:2006:631, paragraph 28)."

The CJ's case law on the concurrence of Services, Establishment and Capital has long been somewhat enigmatical.[33] That mysteriousness is probably caused by the fact that the Court was worried that Services and Establishment, which have not been liberalized in third State context, would nevertheless apply through the back door by riding piggy-back on the free movement of capital.

Both the establishment of an undertaking and the provision of financial services (e.g. money lending) usually also entail capital movement, as obviously, money is needed to set up an establishment of an undertaking or to extend loans, but that capital movement is only incidental to the greater intention (the 'predominant consideration') of *establishment* or financial *service* provision. If that kind of ancillary capital movement were to be brought under the free movement protection, it would mean that indirectly, the freedoms of establishment and of services would in fact be unilaterally extended to third State relations. That was manifestly not the intention of the Treaty drafters, and it would produce undesirable and implausible results, such as, in particular, a serious weakening of the EU's negotiation position within the WTO rounds. Access of undertakings and service providers into the internal market would come free for third State parties, i.e. without reciprocal access to *their* markets for secondary establishment and service provision by EU undertakings. As the Court considered in the 2012 *FII GLO 2*:[34]

> "100. Since the Treaty does not extend freedom of establishment to third countries, it is important to ensure that the interpretation of Article 63(1) TFEU as regards relations with third countries does not enable economic

30. Case C-204/90, *Bachmann*, EU:C:1992:35.
31. Case C-452/04, *Fidium Finanz*, EU:C:2006:631.
32. Case C-560/13, *Wagner-Raith*, EU:C:2015:347, point 29-30.
33. See Case C-452/04, *Fidium Finanz*, EU:C:2006:631, Case C-492/04, *Lasertec*, EU:C:2007:273, Case C-157/05, *Holböck*, EU:C:2007:297, Case C-196/04, *Cadbury Schweppes*, EU:C:2006:544, Case C-524/04, *Test Claimants in the Thin Cap GLO*, EU:C:2007:161, Case C-101/05, *Skatteverket v. A*, EU:C:2007:804, Case C-298/05, *Columbus Container Services*, EU:C:2007:754.
34. Case C-35/11, *Test Claimants in the FII GLO 2*, EU:C:2012:707.

> operators who do not fall within the limits of the territorial scope of freedom of establishment to profit from that freedom. (…).”

Until this *FII GLO 2* case, the Court usually distinguished Capital from Establishment by using tie-breaker rules: *only* Establishment or *only* Capital would be considered; these would not overlap. The Court used the following tie-breakers to exclude one of the two possibly applicable freedoms: (i) the principal purpose of the national measure at issue (is it aimed at controlling interests or at portfolio investments? Is it aimed at service providers or at capital movement?), and (ii) the facts of the case (does the case *in fact* concern a controlling interest or a mere portfolio investment?).

The Court often precluded application of the free movement of capital in third State relations by holding that the main purpose of the national measure at issue was not related to (passive) capital investment, but to either Establishment or Service provision, which are both not liberalized in relation to third States.[35] In FII GLO 2, however, the Court's Grand Chamber changed direction and introduced a new criterion for determining whether free movement of capital applies in a third State situation, not visibly caring much anymore for an exclusive choice (*either* Establishment *or* Capital). It introduced the *market access criterion*. It held that if in third State relations both Establishment and Capital may be at issue, then the freedom of capital movement can in principle be relied on by the economic operator involved, *unless* the restrictive national rule at issue affects the conditions of access to the EU internal market for third State economic operators.

The'old' approach (principal purpose test) is represented by cases such as *Fidium Finanz*,[36] *Thin Cap*,[37] *Lasertec*,[38] *Skatteverket v. A and B*,[39] and *Holböck*:[40] in order to ascertain whether national legislation, in third State situations, must be judged under one or the other Treaty freedom, the purpose of the legislation at issue is decisive. National provisions aimed at holdings in companies giving the holder effective control of the company (allowing him to determine its activities), come under the freedom of establishment. By contrast, national measures targeting portfolio investors (not seeking definite influence) come under the freedom of capital. Where an establishment or a service provision also brings along capital movement, the Court in principle examined the national measure only under one single freedom if it appeared that, *e.g.*, the capital aspect of the operation was entirely subordinate to the establishment or service provision character of the operation.

35. *See also* Smit, *supra*, at 238-239.
36. Case C-452/04, *Fidium Finanz*, EU:C:2006:631.
37. Case C-524/04, *Test Claimants in the Thin Cap GLO*, EU:C:2007:161.
38. Case C-492/04, *Lasertec*, EU:C:2007:273.
39. Case C-102/05 (order), *Skatteverket v. A and B*, EU:C:2007:275.
40. Case C-157/05, *Holböck*, EU:C:2007:297.

Thus, in *Thin Cap* and *Lasertec* – both concerning refusal of deduction of interest payments to third States under national thin capitalization rules – the Court considered Establishment to be preponderant, which pushed out possible application of the rules on capital movement, because thin cap rules by their nature address *groups* of companies, *i.e.* controlling interests. In both cases, capital movement was considered entirely subordinate to Establishment: a possible restrictive effect of this type of legislation on the free movement of capital 'must be seen as an unavoidable consequence of the restriction on freedom of establishment.' The result was that for the taxpayers concerned there was no free movement right to rely on in third State relations: free establishment does not exist in third State relations, and the capital movement involved was too subordinate to Establishment to make the rules on free capital movement applicable. Likewise, in *Skatteverket v. A and B*, the Court considered a restrictive Swedish shareholder taxation measure in relation to a company with two Russian branches as mainly concerning Establishment and therefore not to be covered by the free movement of capital.

Where, however, the national measure is generic, potentially affecting both capital *and* establishment or both capital *and* services (not specifically aimed at effective control situations, nor at portfolio investment, nor at service provision), then the facts of the case are decisive: does the case at issue concern in fact a 'definite influence' situation, then only Establishment is at issue, even though also ancillary capital movement may be involved. Does the case in fact concern the provision of (financial) services, then the measure will only be tested under the freedom to provide services, much as though also ancillary capital movement may be involved. Does the case at issue in fact concern portfolio investment, having neither 'definite influence' nor (mainly) service provision as its principal aspect, then the free movement of capital applies.

The Court caused some confusion in *Holböck*, concerning an Austrian low income tax rate for dividends which was not available for third State (Swiss) sourced dividends. The measure applied to all sizes of shareholdings, therefore . The Court seemed to examine it under the free movement of capital even though Mr Holböck in fact owned two thirds of the shares in the Swiss company and therefore a controlling interest (which is Establishment), but we understand that case as merely saying that *even if* the freedom of capital would have applied (*quod non*, as Mr Holböck had definite influence), that would not have helped him, because the Austrian measure was grandfathered by Art. 64(1) TFEU as it already existed on 31 December 1993.

Until the 2010 *FII GLO 2* case, the Court's system of choosing between Establishment and Capital in third State situations thus appeared to be the following. It distinguished three types of national measures:

(i) legislation whose principal purpose relates to majority interests in companies, or at least to situations of definite influence in the management of the company, especially measures concerning groups of companies (fiscal examples: thin cap

legislation, CFC legislation, transfer pricing legislation, earnings stripping legislation, group loss relief rules, group taxation and consolidation rules, etc.);
(ii) legislation whose principal purpose relates to portfolio (passive) investment, even though situations of definite influence may sometimes also be affected but that is only coincidental (fiscal example: anti dividend stripping legislation[41]); and
(iii) generic legislation, whose principal purpose relates to all shareholders or participants, however small or big, in companies or firms, thus affecting any interest, whether portfolio or controlling (fiscal example: dividend withholding tax).

National measures type (i) were scrutinized in principle only under the right of establishment.[42] That means that in third State relations, the TFEU Freedoms do not apply. Thus, Member States' legislation on thin capitalization, CFCs, transfer pricing, earnings stripping, group loss relief, tax consolidation, etc. are generally safe from being struck down under the Treaty freedoms in third State cases: Establishment and Services do not extend to third State situations, and Capital is in general effectively switched off. This must have relieved the member States.

National measures type (ii) were judged in principle only in the light of the freedom of capital.[43] This means that in third State situations, the economic operator involved can rely on the free movement of capital and that if the national measure distinguishes between domestic situations and third State situations, it may be incompatible with that freedom in the same manner as it would be in intra-EU cross-border situations. As observed, however, in third State situations more possibilities exist for the Member States to justify a restrictive rule, especially under the grandfather clause of Art. 64(1) TFEU and under the 'different legal context'-escape (the need for effective fiscal supervision).

A remarkable consequence of this was that portfolio investment into or from third States (indeed: capital movement) was better protected than majority investment into or from third States (as that is Establishment, which is not protected in third State relations). This rather odd result[44] may have been one of the reasons why the Court has changed direction as regards type (iii) measures in the *FII GLO 2* case, making it possible that also majority interests in third State companies are protected by the free movement of capital, provided the restrictive national measure (e.g. taxation of third

41. Case C-182/08, *Glaxo Wellcome*, EU:C:2009:559.
42. See, a.o. Case C-464/14, *SECIL v Fazenda Pública*, EU:C:2016:896, point 32, and Case C-35/11, *FII GLO 2*, point 91, EU:C:2012:707.
43. *See*, a.o. Case C-464/14, *SECIL v Fazenda Pública*, EU:C:2016:896, point 33, Case C-35/11, *FII GLO 2*, point 92, Case C-190/12, *Emerging Markets*, EU:C:2014:249, point 29, and Case C-628/15, *The Trustees of BT Pension Scheme* EU:C:2017:687, points 30-31.
44. Which may have been intended by the Member States: big third State parties minded to take over EU industry would not be protected, whereas the more welcome small third State portfolio investors would be protected.

State group dividends or group royalties) is not a measure on market access. See below.

An example of a type (ii) national measure was the German anti-dividend stripping legislation at issue in the *Glaxo Wellcome* case[45] (concerning an *intra*-EU case of concurrence between Capital and Establishment). The German measure sought to prevent tax avoidance by foreign shareholders through short-lived transfer of their shares in German companies into German hands, shortly before a dividend payment, to indirectly enjoy the German imputation credit through a higher sale price, although that credit was only intended for shareholders subject to tax in Germany. The ECJ applied only the freedom of capital provisions, despite the fact that the case at issue concerned a group restructuring, and the shares transferred represented full control in a German subsidiary:

> '49. It is (…) common ground that the application of that legislation does not depend on the size of the holdings acquired from the non-resident shareholder and is not limited to situations in which the shareholder can exercise definite influence on the decisions of the company concerned and determine its activities.
> 50 In addition, since the purpose of the legislation at issue in the main proceedings is to prevent non-resident shareholders from obtaining an undue tax advantage directly through the sale of shares with the sole objective of obtaining that advantage, and not with the objective of exercising the freedom of establishment or as a result of exercising that freedom, it must be held that the free movement of capital aspect of that legislation prevails over that of the freedom of establishment.
> (…)
> 52. It follows that the legislation at issue in the main proceedings must be examined exclusively in the light of the free movement of capital.'

National measures type (iii) (generic measures), indiscriminately affect both Establishment and Capital situations. Which of the two freedoms then applies, was, until the 2012 *FII GLO 2* Case, determined by the facts of the case, to be established by the national court, as the ECJ does not establish facts in preliminary proceedings.[46] If the facts would show definite influence on the company policy (a controlling interest), then only Establishment would be at issue and the rules on capital movement would be switched off (meaning that in third State situations, no freedom at all applies). If the facts of the case would show mere portfolio investment, then only the freedom of capital movement would apply. For intra-EU situations this analysis was confirmed by *Burda*[47] (concerning a 50% holding) and *Aberdeen Property*[48] (concerning a 100% holding). For third State situations it was confirmed

45. Case C-182/08, *Glaxo Wellcome*, EU:C:2009:559 .
46. Except maybe in the unclear Case C-157/05, *Holböck*, EU:C:2007:297.
47. Case C-284/06, *Burda*, EU:C:2008:36.
48. Case C-303/07, *Aberdeen property Fininvest Alpha Oy*, EU:C:2009:377.

in the joined cases *KBC Bank and BRB NV*.[49] As *KBC Bank and BRB NV* concerned third State dividends, there can be no doubt that the Court's findings apply to third State situations (see point 71 quoted below). The Court decided *KBC Bank and BRB NV* by Order, implying that it saw nothing out of the ordinary, but rather an *acte clair*, probably because it felt it had already explained its system of choosing between Establishment and Capital – as explained above – in *Burda* and *Aberdeen*, albeit for intra-EU situations. *KBC Bank and BRB NV* concerned the Belgian participation exemption for subsidiary dividends, which applied to both small holdings and controlling interests. The issue was whether a dividend from a non-Member State (Switzerland) should also be exempt. The Court held:

> '68. (…) in order to determine whether national legislation falls within the scope of one or other of the freedoms of movement, it is clear from what is now well established case-law that the purpose of the legislation concerned must be taken into consideration (…).
> 69. (…) national legislation, the application of which does not depend on the extent of the holding which the company receiving the dividend has in the company paying it, may fall within the purview both of Article 43 EC on freedom of establishment and of Article 56 EC on the free movement of capital (….).
> 70. However, to the extent to which the holdings in question confer on their owner a definite influence over the decisions of the companies concerned and allow it to determine their activities, it is the provisions of the Treaty relating to freedom of establishment which apply (….).
> 71. Consequently, it is for the referring court to determine, in the light of the purpose of the national legislation and the facts of the case before it, whether Article (now 63 TFEU; *authors*) may be invoked. If so, it is for that court to determine whether that article precludes the different treatment of dividends from subsidiaries established in a non-member State compared to dividends from subsidiaries with their seat in Belgium.'

Thus, the facts of the case (definite influence or portfolio investment?) determined whether Capital was preponderant and pushed away Establishment, or *vice versa*, and it was for the referring national court to make that assessment of facts.

As observed, in *FII GLO 2*,[50] however, the Court's Grand Chamber changed direction. It introduced a *market access criterion* for determining whether free movement of capital applies in a third State situation in which a type (iii) national measure is at issue, not visibly caring much anymore for an exclusive choice (*either* Establishment *or* Capital). It considered that if in third State relations both Establishment and Capital may be at issue (type (iii) measures), then the freedom

49. Joined cases C-439/07 en C-499/07, *België v KBC Bank NV* and *BRB NV v België*, EU:C:2009:339.
50. Case C-35/11, *Test Claimants in the FII GLO 2*, EU:C:2012:707.

of capital movement can in principle be relied on by the economic operator involved, *unless* the restrictive national rule at issue affects the conditions of access to the EU internal market for third State economic operators or *vice versa*. Since direct tax measures typically apply *after* accessing a market, one may wonder whether the market access criterion makes a difference in the field of direct taxation. This does not imply that the Court ignores Member States' concerns as regards unilateral capital liberalization vis-à-vis third States. These concerns, however, will have to be addressed on a case-by-case basis by reliance on the standstill clause (Art. 64 TFEU) or on the lack-of-administrative-cooperation justification, rather than through the 'old' either/or-approach applied in the Court's pre-*FII GLO 2* case law.

The Court's 2012 turn in *FII GLO 2* changed the assessment of national measures type (iii) (generic measures). The Court realized that the grandfather clause of Art. 64(1) TFEU refers to 'establishment', which logically implies that capital movement to and from third States may *coincide* with Establishment.[51] It also implies that the grandfather clause – which saves existing national measures restricting 'movement of capital to or from third countries involving *direct investment* (…), *establishment* (…) (and) the provision of financial *services* (…)" – would be meaningless if free movement of capital would already be switched off by the mere *fact* that the holding in a third State company in effect represents 'definite influence' in that company and with that, represents 'establishment'. It would be impossible to conceive a situation in which capital movement would 'involve establishment'. By grandfathering capital movement which involves Establishment or Services, Art. 64 TFEU acknowledges that Art. 63 also covers movements related to other fundamental freedoms, such as establishment and services, otherwise it would be superfluous to grandfather them.

Therefore, and possibly also because of (i) the odd result of the previous case law (portfolio investment was better protected than majority investment), and (ii) the consideration that making the application of the Treaty Freedoms dependent on assessments of fact by national Courts may not be very helpful to uniform application of the Treaty Freedoms, the Court held, in *FII GLO 2*, that the fact that the economic operator holds a controlling interest (and with that, an 'establishment'), does not in itself switch off the freedom of capital movement. Also an EU majority shareholder in a third State company may rely on the free movement of capital, provided (a) the restrictive national measure he opposes to is not exclusively aimed at situations of 'decisive influence' (*i.e.* is not a type (i) measure), and provided (b) the national measure does not relate to the conditions for access to the third State market or to the market in the Member State involved (market access). The Court considered, derogating from its judgment in *KBC Bank and BRB NV*, that if the national rules discriminately taxing third State dividends does not apply exclusively to 'decisive influence'-situations, the EU shareholder may rely on Art. 63 to call into

51. The Court may already have realized that in Case C-157/05, *Holböck*, EU:C:2007:297.

question the legality of such rules, *irrespective* of the size of its shareholding in the third State company paying the dividends. However, if the impugned national rules regulate market access, then the shareholder cannot rely on the free movement of capital to invalidate them:

> "100 Since the Treaty does not extend freedom of establishment to third countries, it is important to ensure that the interpretation of Article 63(1) TFEU as regards relations with third countries does not enable economic operators who do not fall within the limits of the territorial scope of freedom of establishment to profit from that freedom. Such a risk does not exist in (…) the main proceedings. The legislation of the Member State in question does not relate to the conditions for access of a company from that Member State to the market in a third country or of a company from a third country to the market in that Member State. It concerns only the tax treatment of dividends which derive from investments which their recipient has made in a company established in a third country.

The Court explicitly repealed its previous findings that in case of generic restrictive measures (addressing all participations in undertakings irrespective of size or influence) the facts of the case would be decisive for the applicability of Art. 63 TFEU. Upon a closer look, it made only the purpose of the national measure decisive:

> "101 (…) the line of argument (…) that the freedom applicable to the tax treatment of dividends originating in third countries depends not only on the purpose of the national legislation at issue (…) but also on the particular circumstances of the case in those proceedings would produce effects incompatible with Article 64(1) TFEU.
>
> 102 It is apparent from that provision that Article 63 TFEU on the free movement of capital covers, in principle, capital movements involving establishment or direct investment. The latter terms relate to a form of participation in an undertaking through the holding of shares which confers the possibility of effectively participating in its management and control (…)."
>
> 103 (…).
>
> 104 (…), European Union law must be interpreted as meaning that a company that is resident in a Member State and has a shareholding in a company resident in a third country giving it definite influence over the decisions of the latter company and enabling it to determine its activities may rely upon Article 63 TFEU in order to call into question the consistency with that provision of legislation of that Member State which relates to the tax treatment of dividends originating in the third country and does not apply exclusively to situations in which the parent company exercises decisive influence over the company paying the dividends."

Thus, even if *in fact* the case concerns a controlling interest in a third State company (and with that, 'establishment'), that does not preclude the EU shareholder in that third State company to rely on the free movement of capital, except when (a) the restrictive national measure is a type (i) measure (*aimed* at controlling interests) or (b) it is a measure affecting the conditions for access of EU economic operators to third State markets or of third State economic operators to member State markets. In both cases, the purpose of the national measure is decisive, not the question whether the shareholder happens to hold a controlling interest or a very small interest. The latter type of measures (on market access) are to be negotiated in WTO rounds: the EU is not unilaterally going to give up its internal market access restrictions for establishment and service provision by third State economic operators if these third States are not going to open up *their* markets for establishment and service provision by EU economic operators. Rules on (the taxation of) dividends, however, do not regulate conditions for market access, whether or not the dividend recipient has a controlling interest.

As observed, it is difficult to think of direct tax measures which affect the conditions of establishment of undertakings or the market access of service providers. For all practical purposes, therefore, one may conclude that unless the national tax measure at issue is a type (i) rule (*aimed* at controlling interests), the free movement of capital applies in third State situations. In any event, dividend taxation seems to be covered by the free movement of capital in third State situations, unless the impugned national tax rule applies *exclusively* to group situations ('definite influence'). Only in that case, Establishment pushes aside Capital. It would seem that in general, tax measures which are not aimed at intra-group relations ('definite influence'), are not regulating market access either, so that virtually all generic tax measures seem to be covered by the free movement of capital in third State situations.

The Court's new approach was confirmed in *SECIL*,[52] in which a Portuguese company could rely on Art. 63 TFEU as regards dividends received from subsidiaries in Lebanon and Tunisia even though it held an influential (28,64%) and a controlling (98,72%) interest, respectively, in these subsidiaries, because the restrictive Portuguese measure (discriminatory refusal of exemption of the dividends) was not intended to apply exclusively to situations in which the recipient company has a decisive influence in the distributing company.

Therefore, and to sum up, the above classification of national measures into three categories had to be rewritten after *FII GLO 2*, as follows (the first two categories did not change):

(i) legislation whose principal purpose relates to situations of definite influence on a company's decisions, determining its activities, especially measures concerning

52. Case C-464/14, *SECIL v Fazenda Pública*, EU:C:2016:896.

groups of companies concern Establishment and are therefore outside the scope of the free movement of capital in third State relations;

(ii) legislation whose principal purpose relates to portfolio (passive) investment, even though situations of definite influence may sometimes also be affected, falls under the free movement of capital;

(iii) generic legislation, whose principal purpose relates to all participants in an undertaking, whether or not capable of exerting definite influence, are also covered by the free movement of capital, unless that legislation regulates access to the internal market or to the market of third States, in which case no Treaty freedom can be relied on.

5.2.5 No Intra-EU Cherry-Picking From Tax Treaties With Third States, nor *Vice Versa*

In *Riskin and Timmermans*,[53] the Court reiterated, this time in a third State situation, its findings in an intra-EU situation in *D. v Inspecteur*[54] (see section 16.3.4): Member States are not required to extend the benefits they extend in a tax treaty with (Member or third) State A to State A residents also to residents of (Member or third) State B, as tax treaties are a package deal negotiation result dependent, a.o., on the unharmonised national laws of the two treaty partners involved and they apply, therefore, by their nature only to residents of the Contracting States. A resident of Belgium cannot, therefore, cherry-pick from tax treaties Belgium has concluded with third States in order to have a Polish source tax credited against his Belgian income tax which is not creditable under the Belgian-Polish tax treaty.

5.3 Member States' Overseas, Associated and Dependent Territories: Member State, Third State, 'Second' State?[55]

A still rather murky area of free (capital) movement rights is their application to Member States' overseas, associated and dependent territories, such as the Portuguese Azores and Madeira, the Finnish Åland Islands, the French overseas DOM, ROM and COM,[56] the Danish Faeroe Islands and Greenland, the Caribbean part of

53. Case C 176/15, *Riskin and Timmermans*, EU:C:2016:488.
54. Case C-376/03, *D. v Inspecteur*, EU:C:2005:424.
55. See, a.o. Dimitry Kochenov, 'Substantive and Procedural Issues in the Application of European Law in the Overseas Possessions of European Union Member States,' 17 *Michigan State Journal of International Law* 2 (2008-2009), p. 195-289; Daniël S. Smit, 'The Position of the EU Member States' Associated and Dependent Territories under the Freedom of Establishment, the Free Movement of Capital and Secondary EU Law in the Field of Company Taxation,' 39 *Intertax* 2 (2011), p. 40-60; and Daniël Smit, 'Freedom of Investment between EU and non-EU Member States and its Impact on Corporate Income Tax Systems within the European Union,' Dissertation, December 2011, University of Tilburg, the Netherlands.
56. *Départements d'Outre-mer*, *Régions d'Outre-mer* and *Collectivités d'Outre-mer*.

the Netherlands[57] and its *status aparte* islands of Aruba, Curaçao and St. Maarten, the Spanish Canary Islands, Gibraltar, the Channel Islands, and British Overseas territories such as the Virgin, Cayman and Falkland Islands. The applicability of the Treaty Freedoms, or at least of the free capital movement, depends on whether and to what extent the TFEU applies to these territories (see Arts. 52 TEU, 355 TFEU, Annex II to the TFEU, Part Four (Arts. 198-204) of the TFEU, and the Council's Decision on the association of Overseas Countries and territories (OCT),[58] based on that Part Four of the TFEU).

Depending on a Member State's Constitution, its overseas territories may be an integral part of that Member State, or OCTs (Overseas Countries and Territories) in some form of constitutional or administrative dependency. In the former case, they can either be fully subject to EU Law or to a special regime on the basis of Art. 349(2) TFEU. In the latter case, they can be associated territories on the basis of Art. 198 and Annex II TFEU and subject to a special regime provided for by the OCT Association Decision[59] of the Council. There are also European territories for whose external relations a Member State is responsible within the meaning of Art. 355(3) TFEU, e.g. Gibraltar.[60]

Art. 349(2) TFEU empowers the Council to decide on the conditions of application of the EU treaties and specific regimes, including common policies, to peripheral (remote and insular) EU regions, i.e., to Guadeloupe, French Guiana, Martinique, Réunion, Saint-Barthélemy, Saint-Martin (French DOM; départements d'outre-mer), the Azores, Madeira (Portuguese autonomous regions) and the Canary Islands (Spanish autonomous regions), provided these conditions are not incompatible with the EU treaties.[61] These regions are constitutionally an integral part of 'their' Member States. All EU free movement rights apply to movements between these overseas parts of one Member States and *other* Member States.[62] Unless otherwise specified by the Council and to the extent compatible with the TFEU, free movement of capital then also applies to facts involving those member State regions and third countries

57. The islands of Bonaire, St. Eustatius and Saba.
58. (Seventh) Council Decision of 27 November 2001 on the association of the overseas countries and territories with the European Community, 2001/822/EC, O.J. 2001, L 314, p. 1.
59. Council Decision 2013/755/EU of 25 November 2013 on the association of the overseas countries and territories with the European Union (Eighth 'Overseas Association Decision'), O.J. L 344 of 19 December 2013, p. 1–118.
60. Although the EU free movement rights apply *in* Gibraltar, they do not apply between Gibraltar and the UK, as from a free movement point of view, that is an internal situation within one single member State. See Case C-591/15, *The Gibraltar Betting and Gaming Association Limited*, EU:C:2017:449, and Case C-192/16, *Stephen Fischer et al*, ECLI:EU:C:2017:762.
61. See, e.g., Joined cases C-363/93, 407/93, 408/93, 409/93, 410/93, and 411/93, René Lancry, EU:C:1994:315, point 32.
62. See, e.g., Case C- 163/90, Legros a.o., EU:C:1992:326, and Joined Cases C-363/93, 407/93, 408/93, 409/93, 410/93, and 411/93, René Lancry, EU:C:1994:315.

Depending on the circumstances, Member States' overseas territories may therefore be (i) (parts of) Member States to which the TFEU applies, possibly with certain exceptions and limitations, (ii) third countries, possibly with certain exceptions, or (iii) *sui generis* status countries (aptly called 'second countries'), governed by specific status and association rules. If they are to be regarded as third countries, the question arises whether they are also third countries in relation to their own 'motherland' (in that case, the free capital movement rules apply) or merely an internal situation within one sovereign State (in which case the free movement rules do not apply to operations between that region and its motherland, but only to operations between that region and *other* Member States).

The case law of the CJEU in this area suggests that this question must be answered case-by-case, on the basis of a substance over form approach.[63] From that case law, one may draw the general conclusion that to the extent an associated or dependent territory is bound to apply the free movement of capital vis-à-vis EU Member States, pursuant to Art. 52(1) *juncto* Art. 355 TFEU, such a territory should be treated as (part of) a Member State for purposes of Art. 63 TFEU from the perspective of the Member States. On the other hand, to the extent an associated or dependent territory is not bound by these provisions, to apply the free movement of capital vis-à-vis the Member States, such a territory should be treated as a third State for the application of Art. 63 TFEU from the perspective of the Member States. This means that Gibraltar, the Åland Islands, Ceuta and Melilla and the outermost regions[64] are to be considered as (part of) a Member State also for the application of the Anti-Tax Avoidance Directive (ATAD; see Chapter 12). Conversely, the Overseas Countries and Territories,[65] the Faeroe Islands, the United Kingdom sovereign base areas of Akrotiri and Dhekelia in Cyprus and the Channel Islands and the Isle of Man would have to be considered third countries for purposes of Art. 63 TFEU.

However, the situation of the OCTs under Art. 63 TFEU is more complicated. Art. 198 TFEU provides the legal basis for the Member States to agree to associate, with the Union, the non-European countries and territories which have special relations with Denmark, France, the Netherlands and the United Kingdom. These territories are the OCTs listed in Annex II of the TFEU: Greenland, New Caledonia and Dependencies, French Polynesia, French Southern and Antarctic Territories,

63. See, for elaboration, D.S. Smit, 'The position of the EU Member States' associated and dependent territories under the freedom of establishment, the free movement of capital and secondary EU law in the field of company taxation', *Intertax* 2 (2011), p. 40-61.

64. France: French overseas departments and overseas regions (Guadeloupe, French Guiana, Martinique and Réunion) and Saint-Martin; Portugal: Azores and Madeira; Spain: Canary Islands.

65. Denmark: Greenland; France: French overseas collectivities (Mayotte, Saint-Pierre and Miquilon, French Polynesia and Wallis and Futuna Islands), New Caledonia and dependencies, the French Southern Territories (including the Scattered Islands and Clipperton Islands) and Saint Barthélemy; The Netherlands: Aruba, Bonaire, Curaçao, Saba, Sint Eustatius and Sint Maarten; United Kingdom: Anguilla, British Antarctic Territory, British Indian Ocean Territory, British Virgin Islands, Cayman Islands, Falkland Islands, Montserrat, Pitcairn Islands, Saint-Helena, Ascension Island, Tristan da Cunha, South Georgia and the South Sandwich Islands and Turks and Caicos Islands.

Wallis and Futuna Islands, Mayotte, Saint Pierre and Miquelon, and Saint-Barthélemy, Netherlands Antilles (Aruba, Bonaire, Curaçao, Saba, Sint Eustatius, Sint Maarten), Anguilla, Cayman Islands, Falkland Islands, South Georgia and the South Sandwich Islands, Montserrat, Pitcairn, Saint Helena and Dependencies, British Antarctic Territory, British Indian Ocean Territory, Turks and Caicos Islands, British Virgin Islands, and Bermuda. These OCTs are not part of the territory to which the TFEU applies, and are therefore not part of the internal market, but they are subject to the special association regime contained in the Council OCT Association Decision. The purpose of their association is to promote their economic and social development and to establish close economic relations between them and the Union as a whole. The *Leplat* case[66] shows that, failing express reference to them, the general provisions of the TFEU, including the treaty freedoms, do not apply to the OCTs listed in Annex II. The OCT Association Decision itself also contains free movement rights, however, but these are much more frugal and narrowly framed than the EU free movement rights. For instance, Art. 59 of the most recent Council OCT Association Decision provides in respect of free movement of capital as follows:

> "1. No restrictions shall be imposed on any payments in freely convertible currency on the current account of balance of payments between residents of the Union and of the OCTs.
> 2. With regard to transactions on the capital account of balance of payments, the Member States and the OCTs authorities shall impose no restrictions on the free movement of capital for direct investments in companies formed in accordance with the laws of the host Member State, country or territory and shall ensure that the assets formed by such investment and any profit stemming therefrom can be realised and repatriated.
> 3. The Union and the OCTs shall be entitled to take the measures referred to in Articles 64, 65, 66, 75 and 215 TFEU in accordance with the conditions laid down therein mutatis mutandis.
> 4. The OCTs authorities, the Member State concerned or the Union shall inform one another immediately of any such measures and submit a timetable for their elimination as soon as possible."

Whatever this means, it is clearly less liberal than Art. 63 TFEU, but the Court thinks otherwise (see the *X and TBG* case below and the *SECIL* case discussed in Section 5.2.2).

The fourth recital of the (2013) OCT Association Decision rather aptly catches the murky status of Member States' OCTs: they are neither Member State nor third State:

66. Case 260/90, *Leplat*, ECLI:EU:C:1992:66.

> "(4) The TFEU and its secondary legislation do not automatically apply to the OCTs, with the exception of a number of provisions which explicitly provide for the contrary. Although not third countries, the OCTs do not form part of the single market and must comply with the obligations imposed on third countries in respect of trade, particularly rules of origin, health and plant health standards and safeguard measures."

Two recent cases seem to more or less clear up in which cases the free movement of capital applies between (i) the OCT of one Member State and another Member State, and (ii) between the OCT and its own 'motherland.'

In the first place the rather confusing *Prunus* case,[67] which concerned an exemption from French real estate tax for companies. Two companies indirectly owning French real estate and established in the British Virgin Islands were not exempt, however, because neither a sufficient exchange of information clause nor a nondiscrimination clause applicable to the Virgin Islands was included in the tax treaty between France and the UK. The first question was whether these companies could rely on the free movement of capital, *i.e.* whether the Virgin Islands were a third country vis-à-vis France. Surprisingly, the Court did not apply the *specialis* (the free movement provisions in the OCT Association Decision), but rather laconically held that the *generalis* (Art. 63 TFEU) was applicable:

> '20 Article 63 TFEU prohibits 'all restrictions on the movement of capital between Member States and between Member States and third countries'. In view of the unlimited territorial scope of that provision, it must be regarded as necessarily applying to movements of capital to and from OCTs.'

Thus, between a member State and the OCT of *another* member State, the free movement of capital applied as if those OCTs were third countries. We believe the Court applied Art. 63 TFEU instead of the (much) narrower free movement provision in the dedicated OCT Associations Decision, because otherwise the paradoxical result would have been that capital movement between France and, *e.g.* Panama or Bhutan would have been better protected than capital movement between the EU and its OCTs.

This judgment did not shed light on the question of whether Art. 63 TFEU also applies to movements of capital between a Member State and its *own* OCT, *i.e.* to capital movements *within* one and the same public international law entity, *e.g.* between the British Virgin Islands and the UK, or between Curaçao and the Netherlands. That question was raised in *X and TBG Ltd*,[68] concerning a discriminatory Netherlands 8.3% withholding tax on dividends paid to Curaçao

67. Case C-384/09, *Prunus*, EU:C:2011:276.
68. Joined cases C-24/12 en C-27/12, *X and TBG Ltd*, EU:C:2014:1385.

which would not have been levied if they had been paid within the Netherlands. The Court took an approach different from the one in *Prunus*. Instead of applying Art. 63 TFEU and ignoring the OCT Association Decision, it this time did the opposite:

> "45 The existence of [the Association Decision; *authors*] results in the general provisions of the EC Treaty (…) not referred to in Part Four of that treaty, not being applicable to OCTs in the absence of an express reference (…).
> 46 As regards Part Four of the Treaty, it should be noted that, although it contains some provisions concerning the free movement of goods, (…), and the free movement of workers, (…), as well as the freedom of establishment, (…), by contrast it does not contain any provision relating to the free movement of capital.
> 47 As regards the OCT Decision, (…), it states, in Article 47(1) [now 59, cited above; *authors*], what restrictions on payment and on movements of capital are prohibited between the European Union and OCTs.
> 48 By referring to (…), Article 47(1) [now 59; *authors*] of the OCT Decision has a particularly wide scope, close to the scope of Article 56 EC [now 63 TFEU; *authors*] in the relations between Member States and third countries (…).
> 49 Consequently, by prohibiting, inter alia, restrictions on the acquisition of shares in companies and the repatriation of profits stemming therefrom, Article 47(1)(b) [now 59] of the OCT Decision prohibits, among others, restrictions on the payment of dividends between the European Union and OCTs, along the lines of the prohibition of such measures set out in Article 56 EC [now 63 TFEU; *authors*] as regards, inter alia, relations between Member States and third countries."

We surmise the Court wanted to reach the same result as in *Prunus* (equal protection of free movement between the EU and its OCTs and between the EU and third States), however this time not by equating OCTs to third States, as in *Prunus*. Indeed, that would sit uneasily with the preamble to the OCT Association Decision, which explicitly states that the OCTs are *not* third States. Instead, the Court interpreted Art. (now) 59 of the OCT Association Decision as wide as possible, preferably as having the same width as Art. (now) 63 TFEU; see points 48 and 49 quoted above, in which the Court speaks of 'a particularly wide scope, close to the scope' of Art. (now) 63 TFEU and states that Art. (now) 59 of the OCT Decision prohibits restrictions 'along the lines' of the prohibition in Art. (now) 63 TFEU.

We conclude that the Court has come 'close to' interpreting Art. 59 of the OCT Association Decision as having the *same* substance as Art. 63 TFEU. That would be a welcome simplification and clarification of the capital movement status of the OCTs: capital movement to and from the OCTs will be treated in principle as comparable to the treatment of third State capital movement, i.e. 'along the lines' of Art. 63 TFEU.

There are also European territories for whose external relations a Member State is responsible, within the meaning of Art. 355 (3) TFEU. According to that provision, the provisions of the EU Treaties shall apply to such European territories. That is

the case of Gibraltar. The Court's case law shows that the freedom to provide services and the freedom of establishment and capital apply to Gibraltar.[69] That did not help *the Gibraltar Betting and Gaming Association Ltd*,[70] however, as the Court also held that it results from the Constitutional position of Gibraltar and from Art. 355(3) TFEU that transactions between service providers in Gibraltar and customers in the UK are to be considered as taking place within one single Member State. In such an internal situation, the EU free movement rights do not apply. In *Stephen Fischer et al*,[71] it reached the same conclusion in respect of the freedom of establishment and free movement of capital: those freedoms "do not apply to a situation which is confined in all respects within a single Member State".[72]

5.4 The European Economic Area Agreement (EEAA)

The Agreement on the European Economic Area (EEAA) entered into force on 1 January 1994. It brings together in a single market, referred to as the 'Internal Market', the EU Member States and three of the EFTA[73] States: Iceland, Liechtenstein and Norway. EFTA-Member Switzerland did not accede to the EEAA but concluded its own agreements with the EU. The EEAA guarantees equal rights and obligations within the Internal Market for citizens and economic operators in the EEA. It provides for the application of the EU fundamental freedoms – the free movement of goods, services, persons and capital – throughout the 31 EEA States. When a State becomes a member of the European Union, it shall also apply to become party to the EEAA (Art. 128), thus also leading to an enlargement of the EEA.

The EEAA also covers cooperation in research and development, education, social policy, the environment, consumer protection, tourism and culture, collectively known as "flanking and horizontal" policies. When a country becomes a member of the European Union, it shall also apply to become party to the EEAA (Art. 128), thus also leading to an enlargement of the EEA.

EEA partners accept almost the entire EU *acquis communautaire*. In the words of Court, the EEAA establishes "in the most complete way possible, the free movement of goods, persons, services and capital, so as to extend the internal market established in the Union to States which are parties to that agreement."[74] In principle, all of the CJEU case law on the EU free movement rights is therefore also relevant for

69. Even though, under Article 29 of the 1972 Act of Accession, in conjunction with Annex I, Section I, point 4, thereto, Gibraltar does not form part of the EU customs territory. See Case C-591/15, The Gibraltar Betting and Gaming Association Ltd, EU:C:2017:449, point 29, and Case C-192/16, *Stephen Fischer et al*, EU:C:2017:762, points 6-8.
70. Case C-591/15, *The Gibraltar Betting and Gaming Association Limited*, EU:C:2017:449.
71. Case C-192/16, *Stephen Fischer et al*, EU:C:2017:762.
72. See also Case C-293/02, *Jersey Produce Marketing Organisation*, EU: C: 2005:664.
73. European Free Trade Association.
74. Case C-464/14, *SECIL v Fazenda Pública*, point 125, EU:C:2016:896.

movement between EU Member States and the other EEA-Members, as well as between the three non-EU EEA-States. The EFTA-part of the EEA has its own Court, the EFTA Court, which concords with the CJEU: the free movement rights in the EEAA are interpreted by the CJEU and the EFTA Court in the same manner as the CJEU interprets the free movement rights in the TFEU. The EFTA EEA-Member States also have their own 'Commission': the EFTA Surveillance authority. One important difference is, however, that the EU Directives, such as DAC and ATAD, do not apply in the relations between EU Member States and the three other EEA-Members, nor between the three non-EU EEA-States. To that extent, there is less legal integration with the three EFTA/EEA-Members, which may be relevant when assessing whether a tax measure restricting free movement to or from an EFTAis justified, as the *Rimbaud*[75] case discussed in Section 5.2.2 showed in respect of Liechtenstein.

In respect of capital, Art. 40 EEAA provides for the same free movement of capital as within the EU, but contrary to Art. 63 TFEU, it does not extend free movement of capital to non-contracting parties (non-EEA countries); third State (non-EEA) capital free movement therefore only applies for EU Member States, not for the three other EEA Member States.

In Case C-521/07, *Commission v Netherlands*,[76] Netherlands dividends paid to another Netherlands company or to a company of another EU Member State were exempted from dividend withholding tax if the parent company held at least 5% of the capital, whereas dividends paid to a company established in Iceland or Norway were exempted only if the latter held at least 10% (Icelandic parent company) or 25% (Norwegian parent company) of the capital of the Netherlands company. The Court recalled that one of the principal aims of the EEA Agreement is to extend the EU internal market to the three EFTA States joining the EEA, and that the fundamental freedoms in the EEA Agreement, which are identical in substance to those of the Treaty, are to be interpreted uniformly within the Member States (point 32). It concluded that the Dutch regime constituted a restriction on the free movement of capital which is, in principle, prohibited by Art. 40 of the EEA Agreement (point 39).

The Netherlands pointed out that the mutual assistance Directive in force between the Member States did not apply to Iceland and Norway and that there was no binding rule enabling it to obtain information to verify whether the conditions laid down in domestic legislation were fulfilled. The Court, however, considered that vderification of the conditions for the exemption to apply did not require exchange of information.

Commission v Italy (C-540/07),[77] concerned an Italian 95% exemption of profits distributed to recipient companies resident in Italy. In contrast, tax of 27% was withheld from profits distributed to taxpayers not resident in Italy. The rate of tax

75. Case C-72/09, *Établissements Rimbaud*, EU:C:2010:645.
76. Case C-521/07, *Commission v Netherlands*, EU:C:2009:360.
77. Case C-540/07, *Commission v. Italy*, EU:C:2009:717.

withheld was reduced to 12.5% for profits paid to holders of savings shares. In respect of recipient companies in EEA States, the Court held the fundamental freedoms in the EEAA, including Art. 40 on free movement of capital to be identical in substance to and having the same scope as those of the TFEU and to be interpreted accordingly.

It can be concluded, that the free movement rights contained in the EEAA are interpreted by the CJEU and the EFTA Court in the same manner as the free movement rights in the TFEU. However, the lack of effective fiscal supervision (exchange of information at a level comparable to that between EU Member States) in the relation with a non-EU EEA Member State has been accepted by the CJEU as a justification for discriminatory or restrictive tax measures, even where these would not be accepted within the EU.

5.5 External Tax Relations

5.5.1 External Tax Treaty-Making Powers

As explained in Chapter 2, Union competence is based on the principle of conferral: the Union has only the competences conferred on it by the treaties (Art. 5 TEU). The Union's competence in tax matters is shared with the Member States, except as regards the customs union, which is an exclusive Union competence (Art. 3(1)(a) TFEU). Indirect taxation other than customs duties and direct taxation are an 'internal market' matter (Art. 4(2)(a) TFEU) and therefore a shared competence with preemption: as soon as and to the extent in which the Union has exercised its competence to regulate a tax matter, the Member States have to that extent lost their individual competences to regulate that tax matter.

The Treaties confer not only internal powers on the Union, but obviously also external powers, such as those regarding the common commercial policy (Arts. 206 and 207, an *exclusive* external power), cooperation with third countries, development coordination, and humanitarian aid (Arts. 208-214), international agreements (Arts. 216-219), environment (Art. 191(4)), exchange-rate systems for the Euro (Art. 219), Research and development (Art. 186), and the common foreign and security policy (Art. 24 TEU); for the latter, a specific set of rules and procedures is provided. In areas of external competence, the TFEU also provides for treaty-making power, making the Union competent to negotiate and conclude treaties with third States and international organizations, also if internally the Union may not have as yet exercised any regulatory competence.

Except where the Union's external competence is exclusive (such as in the field of common commercial policy), the Member States also remain competent to conclude treaties with third States, but because of the precedence of Union law over national law, external action of the Union limits the area left for the Member States. As it appears from Arts. 3(2) and 216 TFEU, the Union is not only competent to conclude

treaties with third States where the TFEU explicitly so provides (primary power), but also 'where the conclusion of an agreement is necessary in order to achieve, within the framework of the Union's policies, one of the objectives referred to in the Treaties' (implied power), where its conclusion is necessary to enable the Union to exercise its internal competence, where the conclusion of an agreement is provided for in a legally binding Union act (self-conferral of treaty-making power), or where the conclusion of the agreement is likely to affect common rules or alter their scope.[78] The preemption rule and the 'implied powers' rule in the TFEU are based on case law of the European Court, notably the *AETR* case,[79] and on several opinions on external treaty making-powers issued by the Court.[80]

These rules thus entail, a.o., that whenever EU law confers internal powers on the Union in order to achieve an objective, the Union is also competent to conclude international agreements necessary to achieve that objective, even in the absence of a specific Treaty provision conferring such competence, as well as that where the exercise by the Union of internal powers to achieve the aims of Treaties lead to adoption of common rules, the Member States no longer have the power to conclude their own agreements with third States on the subject matter covered by the common rules if such agreements with third States could jeopardize the full effectiveness of the common rules. A good example in tax matters may be the negotiation by the Union of the agreements with Switzerland, Liechtenstein, Andorra, Monaco, and San Marino as regards the exchange of information and/or withholding of source tax on savings interest, as the intra-EU Directive on Administrative Cooperation (DAC; see Chapter 13) cannot be effective without such external agreements.

The question thus arises whether the fact that the Union adopted common rules, such as the Parent-Subsidiary Directive (see Chapter 6), the Merger Directive (see Chapter 7), the Interest and Royalty Directive (see Chapter 10), the Directives on administrative cooperation (DAC; see Chapter 13) and the Anti-Tax Avoidance Directive (ATAD; see Chapter 12), implies that the Union also has external powers to negotiate and conclude tax treaties with third States as regards these issues.[81] It is evident that a possible competence of the Union in this respect can only be shared, not exclusive, as the Treaties do not confer any powers as regards tax treaties, not even as regards intra-EU harmonization of national tax laws, except in so far as necessary for the functioning of the *internal* market. Furthermore, tax treaties have a much wider scope than the EU direct tax directives mentioned, and these directives

78. T C Hartley, *The Foundations of European Union Law, An Introduction to the Constitutional and Administrative Law of the European Union*, 7th ed., 2010, pp. 186-187.
79. Case 22/70, *Commission v. Council* , EU:C:1971:32.
80. Opinions 2/91, EU:C:1993:106, 2/92, EU:C:1995:83 and 1/94, EU:C:1994:384.
81. See Hubert Hamaekers: 'Corporate Tax Policy and the Competence of the European Community: An EC Tax Convention with Non-Member States?', 1990 *European Taxation* 358; Dirk van Unnik and Maarten Boudesteijn: 'The New US-Dutch Tax Treaty and the Treaty of Rome', *EC Tax Review* 1993/2, p. 107-110; and Paul Farmer: 'EC Law and Direct Taxation – Some Thoughts on Recent Issues', 1 *The EC Tax Journal 2* (1995-1996).

apply only to intra-EU situations. The *Open Skies* cases[82] illustrate that in fields which are primarily the responsibility of the Member States, such as aviation rights or direct taxation, the Union's competence to conclude treaties with third States is at the most a shared competence with preemption.

Therefore, the Union in our view has at least shared external powers in respect of the areas covered by the direct tax directives and the administrative cooperation directives, *i.e.* on the tax treatment of cross-border intragroup dividends and interest and royalties, the (automatic) exchange of tax information, and the application of measures against tax base erosion and profit shifting (BEPS) and exit taxes on companies, as well as on the tax treatment of cross-border mergers, and maybe even in fields of direct taxation where the Union itself has not yet exercised any regulatory powers, but where external use of powers is necessary for the functioning of the internal market (see Art. 4(2)(a)). The Member States are no doubt still competent to conclude individual tax treaties with third States, even if these treaties contain provisions at variance with the intra-EU system, provided this variance does not frustrate in any way the useful intra-EU effect of the EU tax directives. It is difficult to see how they could: we cannot think of a situation in which, *e.g.*, the tax treatment of dividend flows between the Czech Republic and China would frustrate the full effect of the Parent-Subsidiary Directive rules as regards a group dividend payment between the Czech Republic and Portugal. It is equally difficult to see how tax treaty-based mutual assistance in the assessment or recovery of tax claims between a Member State and a third State could jeopardize effective mutual assistance between that Member State and another Member State on the basis of the Mutual Assistance Directives.

There are, however, two direct-tax fields in which the EU may be on the way of preempting the external competence of the Member States. These are: (i) the tax treatment of mergers and company seat transfers in external situations involving a European Company (SE) or a European Cooperative Society (SCE), and (ii) the fight against BEPS and for tax transparency, especially common anti-hybrid mismatch rules in relation to third States ('ATAD II'; see Chapter 12) and tax good governance rules such as the common blacklist of non-cooperative third States (see 5.5.3. The useful effect of the common EU rules on the taxation of mergers and seat transfers of SE's and SCE's are likely to be affected if every separate Member State would be free to negotiate with third States any tax treatment it pleases for an SE/SCE merger/transfer in an external cross-border situation.

In the ATAD II Directive (see Chapter 12) the EU has embarked upon a common external policy as regards hybrid mismatches, which in our view implies external competence to the extent necessary to make that common policy work. Also, tax good governance clauses in tax treaties requiring exchange of information, or requiring the

82. Cases C-446-469/98, C-471-472/98, C-475-476/98 (*Commission v. UK, Denmark, Sweden, Finland, Belgium, Luxembourg, Austria and Germany*, respectively), EU:C:2002:624 – 631.

adoption of the EU BEPS standards by the external tax treaty partner, or requiring a minimum level of taxation, may be expected to become exclusive competence of the Union. However, bilateral tax treaties negotiated according to the international (OECD) standard of exchange of information and OECD BEPS will probably remain under (shared) Member State competence.

5.5.2 LOB-Provisions in Tax Treaties with Third States;[83] Derivative Benefits

In their mutual relations, Member States may not conclude (tax) treaties containing provisions which violate EU law. Such provisions must be set aside, whether these treaties were concluded before or after 1958 (or the date of EU-accession of the Member State involved).[84]

As regards treaties between a Member State and a third State, concluded before 1958 or before the EU-accession of the Member State involved, Art. 351 TFEU provides that they will be respected. However, where these treaties are incompatible with EU law, the Member State involved shall do its utmost to renegotiate the treaty in order to align its provisions with EU law, if necessary backed by a 'common attitude' of all EU Member States vis-à-vis the third State involved.

Many bilateral tax treaties with third States postdate the entry into force of (or the accession to) the predecessors of the TFEU, the EEC Treaty and the EC Treaty. It is clear that a Member State concluding a tax treaty with a third State which is incompatible with EU law fails to fulfill its EU obligations, but the consequences are less clear. Obviously, the Member State involved must undertake to eliminate the incompatibility. It is also clear, however, that in principle it is not the concern of the third State involved that its bilateral treaty partner possibly neglected its obligations under EU law, except in the unlikely case where Art. 46 of the Vienna Convention on the Law of Treaties would apply. That article provides that a contracting State is not held to observe the treaty if the other contracting State must have been aware of the fact that it was not competent to conclude the treaty because of a fundamental rule of national law.

83. See on this issue, a.o., Braedon Clark: 'The Limitation on Benefits Clause Under an Open Sky' *European Taxation* January 2003, p. 22-26; Adam Craig: 'Open Your Eyes: What the "Open Skies" Cases Could Mean for the US Tax Treaties with the EU Member States', *European Taxation*, February 2003, p. 63-74; Eric Osterweil, 'Are LOB Provisions in Double Tax Conventions Contrary to EC Treaty Freedoms?', 18 *EC Tax Review* 5 (2009), p. 241; Tom O'Shea, 'Limitation on Benefit (LoB) Clauses and the EU,' *International Tax Report*, November 2008, p. 2; Pasquale Pistone, 'Test Claimants in Class IV of the ACT Group Litigation: Limitation-on-Benefits Clauses Are Clearly Different from Most-Favoured-Nations Clauses,' 4 *British Tax Review* 2007, p. 144; and José Calejo Guerra, 'Limitation on Benefits Clauses and EU Law,' *European Taxation* February/March 2011, p. 85.
84. See, *e.g.*, Case 235/87, *Annunziata Mateucci*, EU:C:1988:460 and Case 286/86 (*Gérard Deserbais*), EU:C:1988:434.

The problem arises most poignantly in connection with anti-treaty shopping clauses in bilateral tax treaties concluded with third States, especially those concluded with the US and Japan, but also the 2017 OECD Multilateral Convention against BEPS (MLI)[85] contains an LOB-provision.[86] Member States' tax treaties with these third States typically contain lengthy and impenetrable 'limitation on benefits' (LOB) provisions.[87] In order to qualify for the tax treaty benefits, especially the reduction of withholding taxes on dividends, interest and royalties, a taxpayer must be a resident of one of the contracting States. To ensure that only genuine residents benefit, rather than 'conduit' structures of which the ultimate beneficiaries are residents of neither contracting State – to exclude treaty shopping – LOB provisions contain various residence tests, such as the ownership and base erosion test, the publicly traded stock test, the active trade or business test and the headquarters test. Where an EU parent company receives dividends or interest from its US or Japanese subsidiary, failure of these tests in principle results in denial of the treaty reduction of US or Japanese withholding tax. If the tax treaty benefits are denied on the grounds that the shareholders of the EU parent company are resident in another Member State than the parent company itself, we are looking at a discrimination within the meaning of the ECJ's case law on free movement: domestic parent companies with EU shareholders are treated less favourably than domestic parent companies with domestic shareholders, which offends free capital movement, the right of establishment and the principle of loyal cooperation.

The (non-tax) *Gottardo* case[88] shows that the free movement of persons precludes Member States from limiting the benefits of a bilateral treaty they conclude with a third State to their own nationals exclusively. The case concerned Mrs Gottardo, of Italian origin, but through her marriage of French nationality, who had worked in Italy, Switzerland and France, paying social security contributions in all three States, and later applying for an Italian pension. However, she did not reach the requisite number of employment years if her Swiss employment period was not taken into account. The Italian-Swiss treaty provided for such inclusion, but only for nationals. The Court held that the free movement of workers required Italy to include the Swiss employment period irrespective of Mrs Gottardo's nationality, as long as it was an EU nationality.

85. BEPS Multilateral Instrument: the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, signed in Paris on 7 June 2017.
86. However, only 12 signatories have chosen to supplement the principle purpose test (PPT) for identifying abuse with a simplified Limitation on Benefits provision: Argentina, Armenia, Bulgaria, Chile, Colombia, India, Indonesia, Mexico, Russia, Senegal, Slovak Republic and Uruguay.
87. On the limitation on benefits clauses in the MLC, and the reasons on its limited adoption by the signatory States, see, B. Kuzniacki, The Limitation on the Benefits (LOB) Provision in BEPS Action 6/MLI: Ineffective Overreaction of Mind-Numbing Complexity (Part I), 46 Intertax 1, 2018, pp. 68-79.
88. Case C-55/00, *Gottardo*, EU:C:2002:16.

In the *Open Skies* cases,[89] the Court disqualified a similar nationality clause in the bilateral aviation agreements of eight Member States with the US, granting both contracting States the right to disallow the treaty benefits to airline carriers which were not substantively owned or controlled by nationals of the contracting States (but by nationals of other EU States, EEA States or third States).

Member States renegotiating their tax treaties with the US, Japan and other third States therefore usually try to include at least a 'derivative benefits' clause,[90] providing that companies also qualify as 'good' residents if they are controlled by persons resident in an EU (or EEA) State who would have been eligible for the same treaty benefits if they had derived the third State income themselves directly, *i.e.* if there is a tax treaty in force between the third State concerned and the EU or EEA State of residence of the controlling person(s) which provides for the same benefits.

After the *Open Skies* judgments, Member States agreeing to a restrictive LOB provision in a tax treaty with a third State may violate their EU law obligations. What are the consequences? A Member State cannot, in its relation with a third State, rely on EU law in order to withdraw from its tax treaty consent. It is not in a position to stop the third State involved from applying the tax treaty as agreed. Tax levied in breach of EU law should be refunded 'as a matter of principle' (see section 3.5.2.2), but it is not the Member State which levied the tax, and it is not the third State which is in breach of EU law. Thus, the only legal route to remedy seems to be a damages claim for State tort under the *Francovich* case law (see section 3.5.4). However, *Open Skies* and *Gottardo* may not be clear enough in their implications for LOB-clauses in tax treaties with Third States to speak of a 'manifest breach' of EU law. Moreover, the causal link between the alleged damages and the tax treaty negotiation result seems doubtful. If the EU Member State concerned had not agreed to the LOB clause insisted upon by the third State, no tax treaty, or at least no reduction of source taxation might have been concluded at all. Insisting on a third State waiver of LOB clauses would have jeopardized the very treaty negotiation result. This means that there is a justification for – reluctantly – consenting to the LOB provision, and that the Member State's tax treaty negotiation result is proportional in relation to the mandatory requirement of public interest that comprehensive tax treaties are concluded by EU Member States with, *e.g.*, the US and Japan which mutually reduce restrictive source taxation. Such treaties are manifestly more important for the internal market than avoiding possible but rather remote unequal treatment of EU nonresidents at the cost of not having a tax treaty or no reduction of source taxation at all.

Moreover, LOB-clause may possibly be seen as presumptive anti-abuse rules, which may, despite being in principle disproportionate for in principle excluding nonresident grandparents irrespective of actual abuse, be justified if sufficiently

89. Cases C-466-469/98, C-471-472/98 and C-475-476/98 (*Commission v. UK, Denmark, Sweden, Finland, Belgium, Luxembourg, Austria and Germany*, respectively), EU:C:2002:624 – 631.

90. In their tax treaties with the US, the following EU Members have included such a test: Belgium, Bulgaria, Denmark, Finland, Germany, Ireland, Luxembourg, the Netherlands, Sweden and the UK.

targeted against abuse and/or if they allow rebuttal, by the taxpayer, of the presumption of abuse through the LOB-tests and possibly a safety net provision calling for mutual agreement (see section 15.5). We observe however, that the Court did not accept a German anti-abuse measure which denied the dividend withholding tax exemption of Art. 5 of the Parent-Subsidiary Directive to EU parent companies where *their* shareholders would not have been eligible for the exemption, had they received the dividend directly.[91]

We have not put forward the *Class IV ACT* case[92] as authority for Member States to justify LOB clauses in their tax treaties with third States because we believe that case addresses another issue. It concerned the Member State *applying* LOB-provisions rather than the Member State whose residents suffered from them. The Court was asked whether the UK could apply an LOB provision in its tax treaty with the Netherlands excluding residents of the Netherlands from an imputation credit if they were controlled by other persons than residents of the Netherlands, even though the UK, in other tax treaties with other Member States like Italy, had extended the same imputation credit *without* applying a similar LOB. The Court allowed it, to the surprise of some. In our view, this acceptance has little significance for LOB-provisions in tax treaties with third States, as there is an important difference between *Class IV ACT* and *Open Skies:* the latter case involved Member States discriminating against *nonresidents* as compared to *residents* (which violates the freedoms of establishment and of capital movement), whereas the former concerned a Member State (the UK) distinguishing between *two nonresidents* from different Member States (the Netherlands and Italy) with mutually different tax systems and different tax treaty negotiation stakes.[93] As in *D. v Inspecteur*,[94] the Court considered these two nonresidents not to be in the same position. That does not relate to the comparability of *residents* and *nonresidents*, which is at issue in case of LOB-provisions in tax treaties with third States. We believe, therefore, that *Class IV ACT* does not revoke *Open Skies*, and that notwithstanding *Class IV ACT*, Member States need to justify the inclusion of LOB provisions in their tax treaties with third States which distinguish between resident companies with nonresident EU shareholders and resident companies with resident shareholders. We also believe, however, that they are able to justify them, provided they undertook to have a derivative benefits test ('equivalent beneficiaries') and a safety net provision included for the benefit of EU grandparents.

91. Joined Cases C 504/16 and C 613/16, *Deister Holding AG and Juhler Holding A/S*, EU:C:2017:1009. See also Case C-6/16, *Eqiom SAS/Enka former Holcim France SAS*, EU:C:2017:641.
92. Case C-374/04, *Test Claimants in Class IV of the ACT Group Litigation v. Commissioners of Inland Revenue*, EU:C:2006:773.
93. One important difference between Italy and the Netherlands was that Italy, like the UK, applied both a credit system and an imputation system, whereas the Netherlands applied neither, but rather an exemption system and a classical system of dividend taxation.
94. Case C-376/03, *D. v Inspecteur*, EU:C:2005:424.

5.5.3 The EU Blacklist of Non-cooperative Third States

On 5 December 2017, the Council approved[95] an EU blacklist of non-cooperative jurisdictions in respect of tax transparency, fair taxation and implementation of anti-BEPS measures. Seventeen jurisdictions have been listed: American Samoa, Bahrain, Barbados, Grenada, Guam, Korea (Rep.), Macao, Marshall Islands, Mongolia, Namibia, Palau, Panama, Saint Lucia, Samoa, Trinidad and Tobago, Tunisia, and the United Arab Emirates. Apparently, the operation is rather effective, as newsmedia report that Panama, South Korea, the United Arab Emirates, Barbados, Grenada, Macao, Mongolia and Tunisia have offered to change their laws and may be delisted shortly.

Another 47 jurisdictions (the 'grey' list), are expected to upgrade their 'tax good governance principles' sufficiently so as not to be blacklisted. These 47 have publicly committed to implement automatic exchange of information, to conclude a relevant network of agreements covering EU Member States, to implement minimum anti-BEPS standards, to abolish harmful tax regimes and tax regimes facilitating offshore structures that attract profits without real economic activity and/or to become a member of the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes.

The blacklisting process consisted of three steps and was based on a scoreboard, screening and listing. The EU Code of Conduct Group (see Chapter 23) and the Member States applied three risk indicators to 160 third countries (these risk indicators were also used to select the 160 jurisdictions to be screened): (i) transparency and exchange of information, (ii) preferential tax regimes and (iii) absence of corporate income tax or a zero or nearly zero tax rate.

The Council adopted defensive measures against the blacklisted jurisdictions, both non-tax countermeasures (related to the European Fund for Sustainable Development) and tax countermeasures (reinforced monitoring of certain transactions, increased audit risks for taxpayers investing or using structures or arrangements involving the black-listed jurisdictions, and several anti-BEPS measures). Reinforced monitoring and increased audit efforts are mandatory; application of the anti-BEPS measures is optional.

Shortly after approval of the afore-mentioned blacklist, on 23 January, eight jurisdictions were delisted, following commitments made by them to remedy EU concerns. They were separately listed as a new category subject to close monitoring. Those jurisdictions are: Barbados, Grenada, the Republic of Korea, Macao SAR,

95. Council of the European Union – Council conclusions on the EU list of non-cooperative jurisdictions for tax purposes, 5 December, 2017, No. 15429/17, FISC 345 ECOFIN 1088, available at: http://www.consilium.europa.eu/media/31945/st15429en17.pdf (last visited on 16 Jan. 2018).

Mongolia, Panama, Tunisia and the United Arab Emirates.[96] On 13 March 2018, the Council removed Bahrain, the Marshall Islands and Saint Lucia from the list and added the Bahamas, Saint Kitts and Nevis and the US Virgin Islands. Given these precedents, some other jurisdictions may be delisted and others listed. In order to be taken seriously, amendments to the list approved should not take place or enter into force in the course of a tax year.

96. See: http://www2.consilium.europa.eu/en/press/press-releases/2018/01/23/taxation-eight-jurisdictions-removed-from-eu-list/ (accessed on 23 Feb. 2018).