SPECIAL SECTION

Free Movement of Capital: The European Union Anti-Tax Avoidance Package and Brexit

Ana Paula Dourado*

In this article, the meaning and scope of free movement of capital under Article 63 of the Treaty on the Functioning of the European Union is (re) assessed, taking Brexit as an example. The scenario assumed herein is that Brexit will be extreme. Wtihin this scenario, the United Kingdom (UK) can be handled as the USA or Brazil, for example.

In the bilateral relationship between the UK and the European Union (EU) Member States, there will be no legal obligations for the UK deriving from either primary or secondary law, whereas the EU Member States are still forbidden to restrict capital movements from and to the UK.

The CFC Rule in the Anti Tax Avoidance Directive, the EU standard on exchange of information, EU Good Governance Clauses, and their application in the Brexit extreme scenario are also discussed.

1 Introduction

From a legal perspective, the exit of the United Kingdom from the European Union (EU) – the so-called Brexit – is a story that remains open for the time being. According to Article 50 of the Treaty on the European Union:

1. Any Member State may decide to withdraw from the Union in accordance with its own constitutional requirements.
2. A Member State which decides to withdraw shall notify the European Council of its intention. In the light of the guidelines provided by the European Council, the Union shall negotiate and conclude an agreement with that State, setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union. That agreement shall be negotiated in accordance with Article 218(3) of the Treaty on the Functioning of the European Union. It shall be concluded by the Council, acting by a qualified majority, after obtaining the consent of the European Parliament.
3. The Treaties shall cease to apply to the State in question from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification referred to in paragraph 2, unless the European Council, in agreement with the Member State concerned, unanimously decides to extend this period.

On the basis of paragraph 2 of this provision, all that one has at the moment, are hypothetical scenarios on which one can base some legal arguments and consequences as regards direct taxes.

Agreements to be concluded on the basis of Article 50(2) range from Brexit extreme to Brexit light. In the former scenario, the United Kingdom will exit the EU and neither become a member of the European Economic Area (EEA), nor conclude any special bilateral agreements with the EU providing for some benefits similar to those in the Treaty on the Functioning of the European Union (TFEU) and, possibly, benefits similar to those resulting from EU secondary law.

In a less extreme scenario, the United Kingdom will conclude an association agreement with the EU, with non-discrimination clauses the range of which can vary from free movement of goods to free movement of persons. That would be the case if the United Kingdom were to conclude an association agreement with the EU, similar to others, such as those concluded with Russia, Tunisia and Lebanon (see the *Secil* case).[1]

If the United Kingdom becomes a third state with no special agreement with the EU, it will be treated as what can be called 'the rest of the world'. It will benefit only from the free movement of capital and will likely have no legal obligations towards the EU.

In a Brexit light scenario, the United Kingdom will become a member of the EEA or obtain special treatment from the EU, for strategic reasons, as has happened between the EU and Switzerland (for example the

Notes

* Professor of the University of Lisbon, Member for the EU Platform on Tax Good Governance

1 C-464/14, *Secil Companhia Geral de Cimento S.A. v. Fazenda Pública.*

agreement on the free movement of persons, between the EU and Switzerland, of 21 June 1999[2]).

2 The brexit extreme scenario

The scenario assumed in this article is that Brexit will be extreme. Within this scenario, the United Kingdom can be regarded as in the same category with the United States and Brazil, for example. In the bilateral relationship between the United Kingdom and the EU Member States, there will be no legal obligations for the United Kingdom deriving from either primary or secondary EU law, whereas the EU Member States will still be forbidden to restrict capital movements from and to the United Kingdom.

The meaning and scope of free movement of capital is considered here, taking Brexit as an example.

3 Free movement of capital and third countries

The movement of capital was harmonized by Directive 88/361/EEC, which defined capital and provided for free movement of capital.[3] However, the scope of the Directive was limited to Member States of the then European Economic Community and their nationals. Article 56 of the European Community (EC) Treaty (current Article 63 of the TFEU) extended the scope of the free movement of capital to third countries.

Thus, since 1 January 1994, the date of entry into force of the EC Treaty, any restriction on the movement of capital between Member States, as well as between Member States and third countries, is prohibited. The beneficiaries of this prohibition are EU nationals and third-country nationals, individuals and corporations.

This prohibition is a unilateral obligation assumed by EC/EU Member States towards third states in the Maastricht Treaty (ex-Article 56), the origin of which can be justified by the introduction of the European and Monetary Union, strong promotion of the euro as an international currency and in the context of the worldwide globalization movement.[4] The Treaty does not define capital and, even though the 88/361/EEC Directive has been obsolete since 1 January 1994, it is settled case law that the meaning of capital is to be found in the Directive, more specifically in its Annex I.[5]

Directive 88/361/EEC does not contain a condensed definition of capital, but rather enumerates and defines it. The movement of capital is defined in a very broad sense. Capital covers any right concerning assets, such as portfolio investment across States; different types of direct investment and establishment, including transfers related to insurance contracts and the establishment of branches and subsidiaries; and inheritance. In general terms, any right concerning assets is capital for purposes of the TFEU, and the movement of capital is the transfer of any rights concerning assets.[6] This broad concept of capital and the movement of capital means that, in most cases, it will overlap with other fundamental freedoms in the Treaty, namely, freedoms related to establishment, services and workers.

Apparently, the consequences deriving from Article 63 of the TFEU for direct taxes were not taken into consideration when the EC Treaty was approved:[7] in direct tax cases, 'counterintuitively', the Court of Justice of the European Union (ECJ) grants a scope to the free movement of capital that is inversely proportional to the importance ('the size') of the investment[8] and in this way reduces the scope of Article 63 without admitting it.

In the Court's doctrine it is formally *acte clair* that Article 63 of the TFEU has the same object and scope independently of only Member States or a Member State and a third country being involved.[9] Article 63 therefore implies that corporate income taxes and income taxes on individuals, property taxes and any other direct taxes in the Member States, cannot be discriminatory towards the movement of capital.

Since 2006 (the *Van Hilten*[10] case), there have been many ECJ direct tax cases concerning the meaning and scope of the free movement of capital, although – in

Notes

2 OJ 30 Apr. 2002, L114/6; *see also* the Amending Protocol to the Agreement between the European Community and the Swiss Confederation providing for measures equivalent to those laid down in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments: OJ 19 Dec. 2015, L 333/12.

3 Before that, *Luisi and Carbone* defined capital as 'financial operations essentially concerned with the investment of the funds rather than remuneration for a service': ECJ 31 Jan. 1984, Joined Cases 286/82 and 26/83 (*Luisi and Carbone*), ECR (1984), 00377, para. 21.

4 Ana Paula Dourado, National Report Portugal, *The EU and Third Countries: Direct Taxation* 511–513 (Lang and Pistone eds., Wien: Linde Verlag 2007).

5 *See* Daniel S. Smit, *The Relationship Between the Free Movement of Capital and the other EC Treaty Freedoms in Third Country Relationships in the Fields of Direct Taxation: a Question of Exclusivity, Parallelism or Causality?*, 2 EC Tax Rev., 253 (2007); ECJ 19 Mar. 1999, case C-222/97, *Trummer and Mayer*, para. 21 (1999), I-01661; ECJ 23 Feb. 2006, C-513/03, *Van Hilten* para. 39 (2006), I-01957

6 Joined cases C-358/93 and C-416/93 *Bordessa* case 1995 I-361; Ana Paula Dourado, *Free Movement of Capital and Capital Income Taxation Within the EU*, EC Tax Rev. 179 (1994); Wolfgang Schoen, *Europaische Kapitallverkehersfreiheit und nationale Steuerrecht*, in *Gedaechtnisschrift fuer Brigitte Knobbe-Keuk*, 747 (Schoen ed., Verlag Dr. Otto Schmidt 1997).

7 A. Cordewener, G. W. Kofler, & C.P. Schindler, *Free Movement of Capital, Third Country Relationships and National tax Law: An Emerging Issue Before the ECJ*, 47 Eur. Taxn. 110–114 (Mar. 2007).

8 A. Cordewener, G. W. Kofler, & C.P. Schindler, *Free movement of capital and third countries: exploring the boundaries with Lasertec, A and B and Holboeck*, 47 Eur. Taxn. 374 (Aug./Sept. 2007).

9 ECJ 14 Dec. 1995, Joined Cases C-163/94 and C-165/94 and C-250/94, *Sanz de Lera et al.* (1995), I-04821, paras 24 et seq.; 41, 47; ECJ 23 Feb. 1996, Joined cases C-358/93 and C-416/93, *Criminal Proceedings Against Aldo Bordessa et al.* (1995), I-361, para. 24; ECJ 18 Dec. 2007, C-101/05, *A.* v. Skatteverket v. C (2007), I-11531, para. 21.

10 ECJ 23 Feb. 2006, C-513/03.

respect of some topics – it is difficult to conclude that there is settled case law.[11]

For the purposes of assessing the consequences for direct taxes in the Brexit extreme scenario, the discussion below reviews the problem of the overlap between the free movement of capital and the free movement of workers, freedom of establishment and the free movement of services.

4 Overlap between free movement of capital and other fundamental freedoms

Although protection of the free movement of capital covers any legal transaction that is necessary to attain the transfer of those assets, and although the TFEU does not contain a hierarchy among the freedoms, the overlapping of the free movement of capital with the aforementioned fundamental freedoms in the Treaty, has created problems of interpretation.[12]

In fact, the free movement of workers, the freedom of establishment and the freedom to provide services benefit only nationals of a Member State. If the free movement of capital overlaps with the free movement of workers (in the case of inheritance and inheritance taxes, for example),[13] establishment (in the case of setting up a company, subsidiary or permanent establishment in a Member State)[14] and services (in the case of financial services or insurance contracts),[15] and if all of them apply simultaneously, nationals of third states would ultimately be protected under all fundamental freedoms at stake.[16]

The overlapping among freedoms and the fact that – except for movement of capital – all other freedoms benefit only nationals of EU Member States, has been an argument for the ECJ/Court of Justice of the European Union (CJEU) to limit the scope of the free movement of capital in direct tax cases. In most cases involving an overlap, the Court gives precedence to the freedom other than the free movement of capital. According to the Court, the free movement of capital is 'an indirect consequence of' the freedom to provide services. The facts show a 'predominant consideration' of establishment/services: 'The rules in dispute impede access to the […] market for companies established in non-member countries; they affect primarily the freedom to provide services' (*Bachmann*,[17] *Fidium Finanz*,[18] *Van Hilten*,[19] *Burda*[20]). The holding in the capital of a company established in another Member State 'which gives him definite influence over the company's decisions and allows him to determine its activities is exercising his right of establishment' (*Baars*).[21] The purpose of the legislation at issue (*FII*,[22] *Holboeck*[23]) and the analysis of the factual situation (*Burda*,[24] *KBC*[25]), as well as abuse of a freedom, have been subsequently developed as complementary, more refined arguments to resolve issue of overlap.

Curiously, this hierarchy has also been asserted by the Court in respect of (some) cases involving only Member States (e.g. *Bachmann*, *Baars* and *Burda*[26]), but not all of them (e.g. *Bouanich*[27]). But when the Court uses a tie-breaker criterion in an EU case, it has no consequences, as the scope of the fundamental freedoms is identical.

In direct tax cases involving investment and non-distribution of dividends, freedom of establishment has also been related to the pursuit of an activity on a stable and continuous basis in a Member State, whereas the free movement of capital does not require that activity (*Olsen*[28] and *Commission v. UK*[29]).

Notes

11 *See* for example, S. Hemels et al., *Freedom of Establishment or Free Movement of Capital: Is There an Order of Priority? Conflicting Visions of National Courts and the ECJ*, 1 EC Tax Rev. 19–27 (2010); and recent developments specifically on CFC rules, in A.P. Dourado, *The Role of CFC rules in the BEPS Project and in EU Law*, 3 BTR (2015)

12 A. Cordewener, G. W. Kofler, & C.P. Schindler, *supra* n. 7, at 371–374. A. Dourado, *National Report*, *supra* n. 4, at 508–514; S. Hemels et al., *supra* n. 11, at 19–27; Smit, *supra* n. 5, at 254–262.

13 ECJ 23 Feb. 2006, C-513/03, *Heirs of MEA van Hilten-van der Heijden v. Inspeteur van de Belastingdienst et al.* (2006), I-01957.

14 ECJ 13 Mar. 2007, C-524/04, *Test Claimants in the Thin Cap Group Litigation Orders v. Commissioners of Inland Revenue*, I-02107.

15 ECJ 3 Oct. 2006, C-452/04, *Fidium Finanz AG v. Bundesanstalt fuer Finanzdienstleistungsaufsicht* (2006), I-09521.

16 ECJ 13 Nov. 2012, C-35/11, *Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue*, para. 100.

17 ECJ 28 Jan. 1992, C-204/90, *Bachmann v. Belgian State* (1992), I-00249.

18 *Ibid.*, at fn. 14.

19 *Ibid.*, at fn. 12.

20 ECJ 26 June 2008, C-284/06, *Finanzamt Hamburg-Am Tierpark v. Burda GmbH* (2008), I-04571.

21 ECJ 13 Apr. 2000, C- 251/98, *C. Baars v. Inspecteur der Belastingdienst* (1998), I-02787.

22 ECJ 12 Dec. 2006, Case C-446/04, *Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue* (2006), I-11753.

23 ECJ 24 May 2007, C-157/05, *Holboeck v. Finanzamt Salzburg Land* (2007), I-04051.

24 *Ibid.*, at fn. 20.

25 ECJ 4 June 2009, Joined cases C-439/07 and C-499/07, *Belgische Staat v. KBC Bank NV et al.* (2009), I- 04409.

26 *Ibid.*, at fns 16, 20 and 19, respectively.

27 ECJ 19 Jan. 2006, C-265/04, *Margaret Bouanich v. Skatteverket* (2006), I-00923.

28 EFTA Court July 9, Joined cases E-3/13 and E-20/13, *Fred. Olsen and Others and Petter Olsen and Others v. the Norwegian State* (2014).

29 ECJ 13 Nov. 2014, C-112/14, *Commission v. UK*, EU: C: 2014: 2369, para. 20. See also, ECJ 13 Dec. 2005, C-411/03, *SEVIC Systems* (2005), I-10805, para. 18

Although the case law on the topic is erratic and unclear, there is a *de minimis* protection that the Court has never denied to movement of capital (it is *acte clair*). This protection relates to portfolio investments, as they do not fall under any other freedom.

From the internal market and European Monetary Union perspective, however, the purpose of extending the free movement of capital to third countries and nationals goes far beyond the protection of portfolio investments. Expanding EU multinationals worldwide and promoting the euro required a broad concept of capital, including direct investments, with 'definite influence' and services provided from EU companies to third countries.

The fact that Article 63 of the TFEU does not restrict protection to outbound movements (from a Member State to a third state), but covers inbound movements (from a third state to a Member State), at least as it has been always interpreted by the Court, reveals a strong belief in free movement at the worldwide level.

Finally, the grandfather clause in Article 64 of the TFEU demonstrates that the scope of Article 63 goes beyond portfolio investments. In fact, Article 64 introduces an exception to Article 63 of the TFEU, by excluding from its regime those restrictions which existed on 31 December 1993 under national or Union law, adopted in respect of the movement of capital to or from third countries involving direct investment – including in real estate – establishment, the provision of financial services and the admission of securities to capital markets. Article 64 is necessary only if Article 63 covers direct investment, establishment and services.[30]

CJEU case law that uses the overlapping of freedoms to restrict the scope of capital movement, is hardly compatible with Article 64. However, this issue was never directly addressed by the Court.

Taking the above discussion on the overlap between capital movements and other fundamental freedoms, in the Brexit extreme scenario, it remains to be seen how much investment from the United Kingdom in an EU Member State (and vice versa) can benefit from Article 63.

5 Investment, establishment, capital and brexit

One significant example, in the consideration here of the consequences of Brexit for the overlap between freedoms of establishment and capital, concerns inbound and outbound dividends resulting from 'definite influence' situations and direct investments ('involving long and lasting links'). The issue concerns whether participations with 'definite influence' from a national of an EU Member State in a company in the United Kingdom and vice versa, in a Brexit extreme scenario, is protected by the free movement of capital, or excluded because it falls exclusively under the freedom of establishment.

6 Portfolio investments

From an EU perspective, the free movement of capital will cover any portfolio investments in the United Kingdom and inbound dividends, as well as any UK portfolio investments in an EU Member State. This means that inbound dividends from the United Kingdom to an EU Member State, resulting from a portfolio investment, cannot be subject to a less favourable tax treatment than domestic dividends (vertical comparison). However, it is no longer clear whether they can be subject to less favourable tax treatment than that granted by a Member State to another Member State or an EEA State. So far, the Court has not accepted the so-called horizontal comparison and horizontal discrimination in respect of capital (see *D.* and *ACT GL0*[31]E), but it has accepted it recently in respect of workers[32]).

Taking into account *Holboeck*,[33] *FII GL0 1*[34] and *FII GL0 2*,[35] inbound dividends from direct investment are also protected if the purpose of the Member State tax legislation is to cover both types of income. For example if domestic dividends are granted an exemption independently of the amount of participation, the exemption is to be extended to dividends coming from the United Kingdom, no matter what the amount of participation is. If the exemption is granted domestically (and in this way, economic double taxation eliminated), applying the credit method to dividends from the United Kingdom, may be discriminatory unless a switch-over clause were to be applicable and there was no exchange of information comparable to the mutual assistance Directive 2011/16/EU of 15 February 2011, as amended.[36]

In the *FII GL0 2* case – by coincidence, a UK case – decided prior to the Brexit referendum, the Court departed from the purpose of the UK legislation.

Notes

30 Pasquale Pistone, General Report, *The EU and Third Countries…*, *supra* n. 4, at 20–21.

31 ECJ 5 July 2005, C-373/03, *D. v. Inspecteur van de Belastingdienst* (2005), I-05821; ECJ 12 Dec. 2006, C-374/04, *Test Claimants in Class IV of the ACT Group Litigation v. Commissioners of Inland Revenue* (2006), I-11673

32 ECJ 24 Feb. 2015, *Sopora v. Staatsscretaris van Financiën* (2015). Eric Kemmeren, "Sopora: A Welcome Landmark Decision on Horizontal Comparison", 1 *EC Tax Rev.,* 179-182 (2015).

33 ECJ 24 May 2007, C-157/05, *supra* n. 23.

34 ECJ 12 Dec. 2006, C-446/04, *supra* n. 22.

35 The EU and Third Countries. Direct Taxation (Lang and Pistone eds., Wien: Linde Verlag 2007).

36 *See*: ECJ 10 Feb. 2011, Joined cases C-436/08 and C-437/08, *Haribo and Salinen v. Finanzamt Linz* (2011), I-00305.

National legislation applied not only to dividends received by a resident company on the basis of shareholding that conferred definite influence over the decisions of the company paying the dividends, but also to dividends on the basis of a shareholding not conferring that influence.[37] The Court furthermore considered that (inbound) dividends were not an issue concerning market access, and therefore even investments with definite influence were protected by the free movement of capital:

> Since the Treaty does not extend freedom of establishment to third countries, it is important to ensure that the interpretation of article 63(1) of the 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 a situation such as that at issue in the main proceedings. The legislation of the Member State in question does not 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 in 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.[38]

Thus, under the aforementioned circumstances, inbound dividends are covered by Article 63(1) of the TFEU.

In respect of outbound dividends, the situation is similar to the one described previously. Assume that in EU Member States, no withholding is applicable to domestic dividends, in respect of participations, independently of the holding amount. In such case, a Member State may not withhold taxes on dividends being paid to a UK holder, even if the latter has a 100% participation, following *Holboeck*, *FII GL0 1* and *FII GL0 2*. If, however, there is a bilateral treaty, according to which, the UK will grant a full tax credit and in this manner eliminate the discriminatory treatment by the EU Member State, the latter treatment may be justified[39].

Thus, as long as a UK company is set up in an EU Member State, and national legislation applies to both portfolio and definite influence situations, the taxation of dividends will be protected by the free movement of capital.

However, it is still difficult to say that this jurisprudence is *acte clair*, taking into account cases such as *Burda*[40] and *KBC*[41] where, besides the purpose test, the factual situation was taken into account. If there was definite influence in the concrete situation, freedom of establishment prevailed and free movement of capital did not apply. Even in the absence of a 'precedent rule' with *stare decisis* in EU law, the fact that *FII GL0 2* was decided after *Burda* and *KBC* and by the Grand Chamber is not irrelevant, and these are sound arguments for the *FII GL0 2* decision to prevail over *Burda* and *KBC*.

Unfortunately, when a case on the scope of the free movement of capital seems to settle the case law, a new decision follows that relies on different arguments and ultimately brings back uncertainty.

7 Pursuit of an Economic Activity and Financial Investments

In the *Olse*n case (an European Free Trade Area (EFTA) Court case)[42] and in the *Commission v. UK case* (CJEU case),[43] the EFTA court and the ECJ, respectively, considered that financial investments, such as the setting up of a trust, or holding of more than 10% of shares in a foreign company, respectively, fell under the free movement of capital. It was not an issue covered by the freedom of establishment, because there was no 'participation in the economic life of the country effectively',[44] it was an issue of attracting capital. Thus, in both *Olsen* and *Commission v. UK*, the free movement of capital was extended to the detriment of the freedom of establishment, and is applicable independently of (1) the purpose of the legislation and (2) there being a portfolio shareholding or a definite influence situation.

If financial investments are covered by the free movement of capital, independently of the level of participation, inbound and outbound investments from the United Kingdom into an EU Member State, and from an EU Member State in the United Kingdom, cannot be subject to discriminatory tax treatment.

8 Anti-abuse Provisions and Brexit

Fundamental freedoms, including the free movement of capital, can be circumvented. In *Glaxo*[45] the Court

Notes

37 ECJ 13 Nov. 2012, C-35/11, *supra* n. 16, para. 91.

38 ECJ 13 Nov. 2012, C-35/11, *supra* n. 16, para. 100.

39 *See* ECJ 3 June 2010, C-487/08, *Comm. v. Spain, 2010 I-04843, paras. 57-62*

40 ECJ 26 June 2008, C-284/06, *supra* n. 20.

41 ECJ 4 June 2009, Joined cases C-439/07 and C-499/07, *supra* n. 25.

42 EFTA Court 9 July 2014, Joined cases E-3/13 and E-20/13, *supra* n. 28.

43 ECJ 13 Nov. 2014, C-112/14, *supra* n. 29, at para. 20.

44 EFTA Court July 9, Joined cases E-3/13 and E-20/13, *supra* n. 28, para. 95.

45 ECJ 17 Sept. 2009, C-182/08, *Glaxo Wellcome GmbH & Co. KG v. Finanzamt Muenchen I* (2009), I-08591, espec. paras 46 and 51.

considered that it was an issue concerning the free movement of capital and not the freedom of establishment, as there was no real activity exercised by the company set up in the United Kingdom by a German parent company (using the same concept for establishment as the one used in the *Olsen* case).

Abuse of a freedom can therefore imply reclassification. If the exercise of a fundamental freedom is considered to be capital, third states will benefit from it, i.e. from the prohibition of restrictions. The artificial exercise of a fundamental freedom has led to the application of national anti-abuse provisions. If they are national anti-abuse provisions, they cannot be discriminatory (or restrictive).

However, discriminatory or restrictive anti-abuse provisions can be justified, as long as they are not disproportionate. Thus, for example, Controlled Foreign Companies (CFC) rules and thin capitalization rules have been held to be discriminatory by the CJEU and the EFTA Court. Discrimination can be justified if proportionate. And this proportionality requires that the presumption of abuse be rebuttable. However, national anti-abuse rules targeted at cross-border situations were traditionally aimed at aggressive tax planning by multinationals – and therefore with the freedom of establishment (their purpose was to address abuse in definite influence situations). The Court decided so in *Cadbury Schweppes*[46] and *Thin Cap GL0.*[47]

Thus, on the basis of the above-mentioned case law, a Member State may apply CFC and thin capitalization rules to a third country, including the United Kingdom in a Brexit extreme scenario, as the United Kingdom will no longer be protected by the freedom of establishment.

Contrary to the *Cadbury Schweppes* case, in the *Olsen* and *Commission v. UK* case CFC rules applied to financial investments were considered incompatible with the free movement of capital. These cases were decided after the Base Erosion And Profit Shifting (BEPS) project was initiated, and after the Action Plan and EC Recommendations against aggressive tax planning were issued. Therefore, the G20/Organisation for Economic Co-operation and Development (OECD)/EU fight against aggressive tax planning and avoidance influenced neither the EFTA court nor the CJEU.

If *Olsen* and *Commission v. UK* are confirmed by the CJEU, an EU Member State may not apply CFC rules or any other anti-abuse rules to a third country, including the United Kingdom, with irrebuttable presumptions.

9 The Anti-Tax Avoidance Directive and Brexit

However, the new Anti-Tax Avoidance Directive (ATAD) allows irrebuttable presumptions in respect of CFC rules towards third country situations (excluding EEA States). According to Article 7(2) of the Directive:

> Where an entity or permanent establishment is treated as a controlled foreign company under paragraph 1, the Member State of the taxpayer shall include in the tax base:
>
> (a) the non-distributed income of the entity or the income of the permanent establishment which is derived from the following categories:
>
> (i) interest or any other income generated by financial assets;
> (ii) royalties or any other income generated from intellectual property;
> (iii) dividends and income from the disposal of shares;
> (iv) income from financial leasing;
> (v) income from insurance, banking and other financial activities;
> (vi) income from invoicing companies that earn sales and services income from goods and services purchased from and sold to associated enterprises, and add no or little economic value;
>
> Point (a) shall not apply where the controlled foreign company carries on a substantive economic activity supported by staff, equipment, assets and premises, as evidenced by relevant facts and circumstances.
> Where the controlled foreign company is resident or situated in a third country that is not party to the EEA Agreement, Member States may decide to refrain from applying the second subparagraph of point (a).

The enumerated categories of income correspond to passive income, with no economic activity, and therefore no 'establishment', as described in the *Olsen* case.

In contrast, by granting the possibility to the Member States of eliminating the test on the 'substantive economic activity' when third countries come into play, and by referring to premises, staff and equipment[48] the ATAD relies on the *Cadbury-Schweppes* jurisprudence, according to which CFC rules fall under the freedom of establishment.

It remains to be seen how will the CJEU will assess national CFC rules, transposing Article 7 of the ATAD,

Notes

46 ECJ 12 Sept. 2006, C-196/04, *Cadbury-Schweppes v. Commissioners of Inland Revenue* (2006), I-07995, paras 41–46.

47 ECJ C-524/04, 13 Mar. 2007, fn. 14., para. 36.

48 ECJ 12 Sept. 2006, C-196/04, *supra* n. 46, at para. 67.

and applying to third countries on the basis of irrebuttable presumptions. It also remains to be seen whether it will confirm the *Cadbury-Schweppes* or *Olsen* doctrines. If it confirms the former doctrine, Member States may apply CFC rules with an irrebuttable presumption of abuse to the United Kingdom, in the Brexit extreme scenario. If it confirms the *Olsen* doctrine, Member States will have to allow evidence that a substantive economic activity exists, and cannot treat the United Kingdom, in the Brexit extreme scenario, differently from other Member States.

It also remains to be seen whether this is an issue regarding the compatibility of the Directive with the Treaty, or an issue of the compatibility of Member State legislation in transposing the Directive with the TFEU.

Taking into account that the ATAD has *de minimis* rules, and that the CFC rules in the Directive distinguish between EU Member States and third countries, the transposition of those rules is the transposition of the Directive. However, there is an option (b) granted to Member States, using again the *Cadbury-Schweppes* language, and this option does not distinguish between CFC rules applied to Member States and CFC rules applied to third countries other than EEA States:

> (b) the non-distributed income of the entity or permanent establishment arising from non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage.

For the purposes of point (b), an arrangement or a series thereof shall be regarded as non-genuine to the extent that the entity or permanent establishment would not own the assets or would not have undertaken the risks which generate all, or part of, its income if it were not controlled by a company where the significant people functions, which are relevant to those assets and risks, are carried out and are instrumental in generating the controlled company's income.[49]

It would be problematic to conclude that national legislation transposing option (a), is incompatible with the free movement of capital. It is more likely that the Directive itself will be considered incompatible with the Treaty.

10 Exchange of information

Considering that an EU Member State restriction to a UK inbound or outbound situation falls under the free movement of capital, it can still be justified if the United Kingdom, as a third country, were not to comply with the exchange of information standard, i.e. if the exchange of information between the EU Member State and the United Kingdom were not to occur in equivalent terms to that under the Mutual Assistance Directive.

In respect of exchange of information upon request, the United Kingdom complies with the international standard in the OECD Model Convention, and the Directive follows that standard. However, the new global standard as enacted by the Organisation for Economic Co-operation and Development (OECD) relates to automatic exchange of information on financial accounts. Automatic exchange of information in the EU Mutual Assistance Directive goes beyond automatic exchange of information on financial accounts and covers every type of income from 2017 onwards.

So far, the comparison carried out by the CJEU between exchange of information from a third country to an EU Member State, and exchange of information under the Mutual Assistance Directive, refers to the exchange of information upon request.[50] It is not certain whether the CJEU will refer to the new global standard in order to assess whether a restriction on free movement of capital is justified, and whether it will go beyond the afore-mentioned automatic exchange of information on financial accounts.

11 Good governance clauses

Presumably, one of the big advantages of Brexit to the United Kingdom is to escape state aid rules (Article 107 of the TFEU) and, in this manner, introduce targeted (i.e. selective) tax benefits in order to attract strategic investment. However, the EU External Strategy for Effective Taxation may influence the relationship with the United Kingdom in a Brexit extreme scenario.

In 2012, the Commission issued a Recommendation to the Parliament and Council regarding measures intended to encourage third countries to apply minimum standards of good governance in tax matters.[51] The Recommendation encouraged Member States to use transparency, information exchange and fair tax competition as the three criteria for assessing the tax regimes of third countries and, where necessary, to apply common counter-measures.[52]

On 28 January 2016, a Commission document on the external strategy was approved. This document defines fair tax competition as follows:

> means that a third country should not operate harmful tax measures in the area of business taxation. Tax measures which provide for a significantly lower effective level of taxation, including zero taxation, than those levels which generally apply in the third country in question are to be

Notes

49 *See Ibid.*, at para. 51, referring to 'wholly artificial arrangements'.

50 *See*, ECJ 10 Apr. 2014, C-190/12, *Emerging Markets Series of DFA v. Dyektor Izbyskarbowejw Bydgoszczy*, paras 71 et seq.

51 COM (2012) 8805, 6 Dec. 2012.

52 Brussels, 28 Jan. 2016 COM(2016) 24 final, *Communication from the Commission to the European Parliament and the Council on an External Strategy for Effective Taxation*, 3.

regarded as potentially harmful. Such a significantly lower level of taxation may operate by virtue of the nominal tax rate, the tax base or any other relevant factor.[53]

The Commission recommends as good governance clauses, that State aid provisions be included in bilateral agreements. In this manner, transparency on subsidies can be increased, the most harmful types of subsidies prohibited and consultations on harmful subsidies can be provided. This methodology would create more fair competition between Member States and third countries in the area of business taxation.[54]

If fair tax competition and good governance clauses are not respected by third countries,

Member States should decide on common countermeasures. Some but not all of the national provisions that constitute sanctions or defensive measures applicable to non-cooperative jurisdictions in national lists will be overtaken by the minimum standards in the aforementioned ATAD. That will be the case of CFC rules.

The document on the External Strategy recommends that the defensive measures linked to the common EU list should be a 'complementary top-up to the defensive measures in the Directive'.[55]

It also recommends that defensive measures include withholding taxes and non-deductibility of costs for transactions done through listed jurisdictions. This would make it much less attractive for EU companies to invest or do business in these jurisdictions, as the administrative burden and risk of double taxation would be higher.[56]

Although these tax good governance clauses are controversial and protectionist, if adopted, they would also apply to the UK in a BREXIT extreme scenario.

12 BEPS AND THE UNITED KINGDOM: CONCLUDING REMARKS

Although the United Kingdom, in the Brexit extreme scenario, will not have any obligations resulting from EU law, it can be more or less cooperative in respect of the BEPS project.

It may also interpret the OECD recommendations in a manner that does not lead to worldwide coordination, but can instead have a regional, i.e. a commonwealth, impact (see the example of the diverted profits tax, adopted by the United Kingdom and to be adopted by Australia).[57]

If transposition of the BEPS actions by the United Kingdom and the commonwealth is more attractive to multinationals than transposition of the BEPS Actions in the EU, tax competition between regional blocs could occur.

However, the fact that the United Kingdom, in a Brexit extreme scenario, would not benefit from the freedom of establishment, can be a significant disadvantage, as the United Kingdom would lose 'access to the EU market'. The aforementioned conclusions on non-discrimination of inbound and outbound dividends presuppose that EU and UK companies have access to each other's markets.

Notes

[53] Brussels, 28 Jan. 2016 COM(2016) 24 final, *ANNEXES 1 to 2 ANNEXES to the Communication from the Commission to the European Parliament and the Council on an External Strategy for Effective Taxation*, 3.

[54] *Supra* n. 52, at 7.

[55] *Ibid.*, at 11.

[56] *Ibid.*, at 3, 11–12.

[57] Heather Self, *The UK's New Diverted Profits Tax: Compliance with EU Law*, 43(4) Intertax 333 (2015).