The External Tax Strategy of the EU in a Post-BEPS Environment

Editor: **Adolfo Martín Jiménez**

IBFD

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Why this book?

Recent developments in tax policy within the European Union and at the international level (i.e. BEPS Actions and the BEPS implementation process) have made it relevant to analyse how the European Union interacts in tax terms with other relevant international tax actors (i.e. the OECD and third countries). The European Union has tried to define its own standards of good tax governance, which are not completely equal to those of the OECD, and is trying to export those standards to third countries. Like its internal tax policy, the external policy is more inclined to protect Member States' tax bases and their competitive position than to promote single or free market values, which may contradict some of the free trade and fundamental goals the European Union sought to protect. In this field, recent developments in the case law of the Court of Justice of the European Union also need to be taken into account and may exert a very relevant influence on the formulation of the external tax policy, up to the point at which a change in direction may be needed.

Within this context, the book explores the configuration of the external tax policy of the European Union, including (i) what the differences or similarities are with international standards already defined at the international level; (ii) where there may be problems in terms of interaction with those standards or with EU law principles; and even (iii) whether the European Union is behaving in a protectionist manner in tax terms. It also offers input on areas in which the external tax policy of the European Union should be reconsidered, as well as on the specific situations of some of its main trading partners (e.g. the United Kingdom and the Brexit process or the United States in the context of its tax reform).

This publication seeks to stimulate debate among scholars, policymakers, practitioners and politicians from the European Union and third countries in a field that still needs further debate and a solid reconsideration of its foundations.

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Preface

On 15 and 16 September 2017, the 12th Annual Conference of the Group for Research on European and International Taxation (GREIT) was held in Jerez de la Frontera (Spain) at the Law School of the University of Cádiz. As is known, GREIT usually chooses topics that are still nascent and/or need further development from an academic, policy and practical perspective. On this occasion, the External Tax Strategy of the European Union in a Post-BEPS Environment was selected as the object of study. Undoubtedly, this is not a new topic, but it has been a controversial one, and is also a field of EU tax law that still needs further reflection and refinement, especially in view of how the case law of the Court of Justice of the European Union (ECJ) has evolved and the international tax developments in the last years. The object of the book is therefore modest; it will not solve all of the open questions of the external tax strategy of the European Union – an issue that is tremendously complex in the post-BEPS world – but will attempt to assess what needs to be reconsidered, the potential conflicts or aspects that deserve further attention, as well as new issues and challenges.

What follows in this book are the presentations of some of the speakers at the 12th GREIT Conference (plus some other chapters by other authors), although we also benefited from the input of all of the participants. The conference gathered and involved presentations by not only academics and practitioners, but also politicians and high-level civil servants who provided insights from a policy perspective (namely, the Spanish Minister of Foreign Affairs, the Spanish attaché at the Spanish Permanent Representation in Brussels, EU and OECD representatives).

A couple of clarifications are useful in this introduction. First, although the seminar referred to the "external tax strategy of the European Union", such a concept was given a broad interpretation, and therefore, some of the presentations concentrated on how the European Union interacts with international standards (OECD/G20) as defined in the BEPS (and post-BEPS) process, or the initiatives on transparency and exchange of information directly or indirectly connected with BEPS. It is ironic that a good part of the external tax policy of the European Union concentrates nowadays on preserving the Member States' corporate tax bases and promoting tax good governance standards that benefit mainly the Member States as such (rather than focusing on protecting or enhancing the EU internal market from that external perspective), but this move has also had the effect of reinforcing the position and competences of the European Union as an international tax

actor and vis-á-vis third countries. Therefore, paradoxically, this "policy direction" – more protective of the interests of the Member States – contributes to attributing new competences in tax matters to the European Union, or creates the need for further, better-targeted action at the EU level, internally as well as externally, at the expense of the tax competences of the Member States. Second, it has been the tradition of GREIT to not only explore tax issues as such, but to also try to connect tax and other fields of law so that tax law can benefit from – and be further aligned with – the evolution of EU law in general. This book is not an exception in this regard, and includes two specific and relevant contributions on general EU law in part 4.

On the tax content side, the book is divided into different parts. Part 1 is devoted to the European Union's external tax policy in the stricter sense. First, the general framework, history and role of the EU Commission in defining the external tax policy are exhaustively presented by a team of officers from the EU Commission (F. Bungaro, M. Federici and F. Roccatagliata). The two main components of that external tax policy in the strictest meaning, i.e. the EU tax haven list and the tax good governance clauses to be included in trade agreements, as promoted by the Commission, are further explored in the chapters of I. Lazarov (Vienna University) (chapter 2) and my own contribution (chapter 3). First, Lazarov thoroughly studies the EU tax haven blacklist and defensive measures that the Member States may adopt against the blacklisted countries through the lens of the fundamental freedoms of the Treaty on the Functioning of the European Union (TFEU) and the EU Charter of Fundamental Rights, concluding that the blacklisting process and its consequences for private parties should work in a less automatic form than most tax administrations would probably desire in order to avoid conflicts with primary EU law. Second, chapter 3 not only describes the origins and problems of the policy of the Commission and the Council of including tax good governance clauses in EU trade agreements with third countries and the scarce success it has had, but also adds a more general reflection on the convoluted relationship of EU trade treaties and direct taxes, and proposes a change in policy direction: rather than expanding the contents of trade treaties, it is time to think about more targeted "EU direct tax treaties" with third countries and a clearer separation of trade and income tax issues in different specific treaties.

With tax good governance and the promotion of its EU version ("EU tax good governance" standards) being crucial elements of the external tax policy, U. Gonzalez Frutos (OECD) explains, in part 2, chapter 4, how the concept of tax good governance has globalized and evolved in different international contexts ("a patchwork of organizations") and how the OECD

and the European Union seem to be competing in leading the efforts towards global tax good governance (including the establishment of standards for the taxation of the digitalized economy). He speaks about "competition" in the definition of standards between the OECD and the European Union, or even a "shift in leadership" (or an attempt at least) to place the European Union as the forerunner in this competition.

Also in part 2, R. Lyal (EU Commission), in chapter 5, very nicely explains (i) how the standards of transparency and exchange of information have evolved within the European Union (not only in response to international standards); (ii) what the differences with the OECD standards are; and (iii) whether these differences deserve the criticism they sometimes attract, or, on the contrary, whether most of them are well founded and a logical evolution in a context in which the European Union wants to be a path-breaker. State aid is also a peculiar element of EU tax good governance – at least in its broadest sense – that can have a very relevant impact on third countries. The effects of fiscal State aid in third-country situations are studied by P. Wattel in chapter 6, who first considers the State aid proceedings that affect US multinationals, focusing his reflections on the *Apple* case, and subsequently reviews different State aid clauses in agreements with third states to show that, even if they are similar to article 107 of the TFEU, they do not contain comparable levels of enforcement, which may influence their practical impact and effects (the issue is also developed and connects with chapter 3 on tax clauses in the EU trade treaties).

BEPS substantive actions (not issues of transparency and exchange of information) are also regarded as international and EU standards of tax good governance. The implementation of BEPS standards into EU and domestic legislation raises two main issues with regard to third countries. First, all Member States are signatories of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI), as well as many third states. However, EU law can have an impact on the MLI, and therefore also influence the relationship of individual Member States and third countries. P. Pistone (IBFD/Vienna University/University of Salerno) focuses on this topic and concentrates on the interaction between BEPS Actions 6 and 14 and the corresponding articles of the MLI with EU law to show that, although most of the problems of compatibility between the MLI and EU law can be solved at the interpretative level, there are cases in which real tensions and problems of incompatibility between them may arise.

Second, the European Union has also been at the forefront of the implementation of the BEPS standards and has developed its own version, namely

the "EU BEPS standards", mainly with the Anti-Tax Avoidance Directive (Directive 2016/1164, or ATAD I, as amended by Directive 2017/952, or ATAD II). The EU BEPS standards also raise intricate problems if the third-country dimension is taken into account. P. Arginelli (Catholic University of the Sacred Heart, Italy), in chapter 8, deals very insightfully with the third-country effects of ATAD I and II from three different perspectives: (i) tax policy coherence; (ii) compatibility with double tax conventions between Member States and third countries; and (iii) potential conflicts with the free movement of capital (mainly, in this latter case, regarding controlled foreign company (CFC) rules and the possibility left to the Member States not to apply the carve-out for substantive economic activities in third-country situations). In turn, in chapter 9, C. Brokelind (Lund University) discusses, in an enlightening form, the risks of collision between the ATAD and tax treaties with third countries, concluding that the Member States need to amend the latter (as well as their domestic laws) in order to make the ATAD provisions fully effective. She adds that this amendment should be coordinated to avoid further distortions, but that it is controversial as to whether the European Union has acquired the "external" competence to do this with regard to third countries.

Part 3 discusses the external tax strategy of the European Union from different perspectives: that of the European Union as a whole, and that of individual states. In chapter 10, W. Haslehner and P. Schwarz (University of Luxembourg) perceptively argue that, in its current state, the European Union can be legitimately regarded as engaging in harmful tax competition itself vis-à-vis third countries, and they explain, in a very interesting and thoughtful form, the reasons for this perception (which connects with chapter 3 in part 1, with a similar conclusion). At the same time, they also propose a more active engagement of the European Union in a positive definition of international tax policy that improves the attractiveness of the European Union.

From that look at how the outside world may perceive the European Union, F. Vanistendael (Emeritus, Catholic University of Leuven) shifts, in chapter 11, to an "intra-EU evaluation" of the tax policy of the European Union. Quite cleverly, he points out that if the European Union wants to be perceived as a block by third countries, it needs to behave as such – also internally – and recover interest in the internal market as a pre-condition to have an efficient policy vis-à-vis third countries. The interest in the internal market seems to have been overshadowed by other international projects that pursue other goals (that the EU has assumed), probably more in line with the Member States' agendas. As a result, Vanistendael discusses what

challenges the European Union faces in this regard, centred around two different lines: the internal market and the Economic and Monetary Union of the European Union.

Brexit is one case in which the European Union is behaving as a block, but both the European Union and the United Kingdom are subject to World Trade Organization (WTO) law, which also has an enormous impact on the external tax policy of the European Union. S. Van Thiel (EU Delegation Vienna), in chapter 12, discusses the limits that WTO law imposes on the European Union and the United Kingdom in their respective tax and trade relations; however, he also remarks on the sheer tax and trade difficulties that UK traders may face – if no other agreement with the European Union is reached before Brexit is effective – when transitioning from being beneficiaries of EU freedoms and EU trade agreements to only having the (limited) capacity of invoking (not with direct effect) WTO law.

Finally, on tax topics, R. García Antón (Tilburg University) deals with the weaknesses of the US-EU relationship from a tax perspective. Being one of the main trading partners, the United States does not have a trade agreement with the European Union (apart from WTO law), which makes its relations with the European Union and its Member States somewhat different from those with other third countries with such an agreement. García Antón interestingly explains the main difficulties in achieving a level playing field between the two blocks (i.e. the United States and the European Union), as well as the Janus-faced policy that takes place in the European Union: while Member States compete to attract US foreign investment at the EU level, the legal EU framework does not seem to be the most favourable for US entrepreneurs. In the United States, there is also a protectionist spiral that tries to favour US companies and retaliate against the State aid investigations and the recent initiatives on digital service taxation. As García Antón claims, this policy should be revised, and an EU trade and tax agreement with the United States seems to be more urgent today than ever, although it is unlikely that such an agreement could be reached in the current political context.

As mentioned above, the tradition of GREIT is also to connect non-tax and tax issues. Therefore, last but not least, two topics were selected in this regard, and the respective chapters are included in part 4. First, in times of data protection, exchange of information and trade and tax agreements with third countries, it is of utmost importance to explore the effects of the EU Charter of Fundamental Rights in the formation of the EU external (tax) policy. In chapter 14, former President of the Spanish Constitutional Court

and former Advocate General of the ECJ, P. Crúz Villalón, shows us that the EU Charter has an almost unexplored external or third-country dimension. His thought-provoking chapter suggests that it is now time for (tax and non-tax) scholars to explore the effects of the EU Charter in the external EU policy. As he claims, data protection rights have a very relevant impact on the EU external policy, and this may not be the only case in which the EU Charter can have an external effect. It is probably high time for tax scholars to explore the effects of the EU Charter in tax and third-country situations (e.g. exchange of tax-relevant information, provisions in trade treaties and free movement of capital exceptions). His chapter also nicely connects with the contribution of Lazarov (chapter 2) and his claim of the effects of the EU Charter on the EU tax haven list and the defensive measures of the Member States.

Second, A. del Valle Galvez (University of Cádiz) was assigned the task of exploring recent developments in the external competences of the European Union. He selected migration and trade agreements as the areas he wanted to deal with. Both areas offer interesting insights to be taken into account in tax law. Despite uniform terminology, the migration and external border control policy offers tailor-made solutions that depend on the circumstances of the third country, as well as plurality and diversity in sources of law. There is no need to always use and apply uniform and standard instruments and tools vis-à-vis third countries since the particular situation, the reality and needs and interests of each third country should be taken into account. A diversity of solutions and sources of law could also be an option from an EU external tax policy perspective. In the field of trade, del Valle Galvez offers stimulating reflections on the impact of the most recent case law of the ECJ on the external trade policy of the European Union, which may also have repercussions in the external tax policy of the European Union and the tax clauses of trade agreements. On both issues, his chapter also connects with chapter 3 in part 1, where more targeted tax treaties that are better adapted to the reality of third countries and the need to separate direct tax issues from EU trade treaties are some of the main proposals.

Thanks to the efforts of the authors, this book is a "GREIT" contribution to the development of the external tax policy of the European Union. As mentioned, it may not solve all of the issues that still need further reflections and attention, but undoubtedly helps in identifying them, pointing out where the current problems are, suggesting solutions to many of these problems and pinpointing the new challenges that lie ahead in this field of EU tax law.

Last but not least, I am indebted and want to express my gratitude to the promoters of the GREIT group, C. Brokelind, A. Dourado, P. Pistone and D. Weber, for entrusting me with the task of organizing the conference and being enthusiastic about the topic. The conference was organized in the context of the activities of the EU Jean Monnet Chair that I held during the years 2014-2018, and was also made possible by the generous support of other sponsors, namely IBFD and the Spanish Institute for Fiscal Studies of the Spanish Ministry of Finance.

Prof. Dr Adolfo Martín Jiménez
Jerez, July 2018

Sample Content

The Compatibility of the EU Tax Haven "Blacklist" with the Fundamental Freedoms and the Charter

Ivan Lazarov*

2.1. Introduction

"There is a problem. Because for you to be right, the state would have to be wrong. Is that what you are saying?" This is part of the conversation in the opening scene of the famous TV series "Fargo" between a German Democratic Republic officer and an individual, detained for a crime he did not commit and whose address in the state's registers happens to coincide with that of the actual perpetrator. The state, however, can be wrong. Therefore, this chapter argues that any coercive measure against a private party should never be based on mere blacklisting that creates a non-rebuttable presumption of illegal behaviour, but rather on convincing evidence gathered by the state authorities and subject to evaluation on the merits of the case. Tax law should be no exception.

To reach this conclusion, the chapter will first describe the EU list of non-cooperative jurisdictions for tax purposes (the Blacklist),[1] show its interaction with domestic blacklists and, more, specifically look into the conditions for being put on the list and the consequent tax measures that stem therefrom. Second, the chapter will analyse whether the creation of such a blacklist and, more importantly, the countermeasures that it provides, can be reconciled with the free movement of capital under EU law. Finally, it will evaluate whether blacklisting is compatible with the standard for fundamental rights protection in the European Union in light of the rights to property and a fair trial.

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1. Council Conclusions of 5 December 2017 on the EU List of Non-Cooperative Jurisdictions for Tax Purposes, doc. no. 15429/17 (as amended).

2.2. List of non-cooperative jurisdictions for tax purposes

The purpose of this section will not be to perform another in-depth analysis of the technicalities surrounding the Blacklist. First of all, this has already been done by other authors.[2] Therefore, the author will concentrate only on the elements that are relevant for the purposes of this chapter, specifically (i) what the policy objectives behind the Blacklist are; (ii) what the grounds for listing a jurisdiction are and how these grounds correspond with the overall policy aim; (iii) which defensive measures are provided and how these measures can affect private parties; and (iv) what the interplay is between domestic blacklisting and the EU-wide Blacklist.

These issues must be read with the subsequent discussion regarding the free movement of capital and the protection of the fundamental rights in mind. By examining the effects of the possible defensive measures, one will be able to later on answer the question of whether there is a restriction of the fundamental freedoms and a limitation on the human rights. The policy goals and the grounds for inclusion on the list will illuminate the potential grounds for justifying the measures. Finally, to examine the extent of judicial review by the Court of Justice of the European Union (ECJ), one will need to look into the legal status of the Blacklist; is it a creature of EU law, or it should be looked at only through the prism of the national blacklisting measures?

2.2.1. The Blacklist as part of the EU external strategy in tax matters

Any inquiry into the Blacklist will be incomplete without paying due regard to the broader context in which it was adopted. This context manifested in the European Union through the European Commission's External Strategy for Effective Taxation.[3] The overall goal of that strategy seems to be twofold: it aims to prevent profit shifting out of the internal market while at the same time creating a clear and predictable business environment.[4] The

2. V. Kalloe, *EU Tax Haven Blacklist – Is the European Union Policing the Whole World?*, 58 Eur. Taxn. 2/3, p. 47 (2018), Journals IBFD; A.P. Dourado, *Editorial Comment – The EU Black List of Third-Country Jurisdictions*, 46 Intertax 3, p. 178 (2018).
3. European Commission, Communication from the Commission to the European Parliament and the Council, An External Strategy for Effective Taxation, COM(2016) 24 (28 Jan. 2016).
4. Id, at p. 2.

common EU blacklisting of third countries is a measure that is supposed to contribute to this general objective.

Therefore, already in 2016, the Commission urged for the creation of an EU blacklist to replace the divergent national measures with a clear and coherent approach.[5] This collective approach had to respect, in the Commission's view, the international obligations of the European Union. The author reminds that, besides the international commitments, any EU-wide measure should also respect EU law itself.

According to the External Strategy, once listed, a jurisdiction is supposed to face uniform countermeasures by the EU Member States, which should pursue a twofold aim: (i) to protect the tax base; and (ii) to create incentives for the listed third country to change its tax law.[6] However, when looking at the proposed tax countermeasures (e.g. withholding taxes and non-deductibility of costs), one can already see that they are aimed not so much against countries as such, but rather against private parties that are resident in their territory.[7] As one can see in section 2.2.3., these countermeasures were indeed proposed by the Council in the Blacklist.

2.2.2. Grounds to be put on the Blacklist

The grounds to list a jurisdiction on the EU-wide Blacklist can be grouped together into three main categories: (i) tax transparency; (ii) fair taxation; and (iii) the implementation of anti-BEPS measures.[8]

For the tax transparency requirement to be satisfied, a country should have adequate measures in place with respect to both automatic exchange of information and exchange of information on request within a dynamic timeframe. Regarding automatic exchange, the country should be committed to the Common Reporting Standards of the OECD and have the necessary arrangements for exchange with all EU Member States, either on a multilateral or a bilateral basis.[9] Concerning exchange on request, the country should have at least "largely compliant" status according to the OECD, and again, the necessary international commitments vis-à-vis all EU Member

5. Id., at p. 10.
6. Id., at pp. 11-12.
7. Id., at p. 12.
8. Council Conclusions, *supra* n. 1, at annex V.
9. Id., p. 24; and Kalloe, *supra* n. 2, at p. 52.

States must be in place.[10] Prima facie, it seems that this ground for listing can be considered to be along the lines of the need to ensure effective fiscal supervision justification for restrictions on the free movement of capital.

The fair taxation ground requires that a country does not apply harmful preferential tax measures under the EU Code of Conduct for Business Taxation[11] by facilitating, for example, the creation of offshore arrangements (in which no real economic activity is performed in the territory of the jurisdiction in question).[12] The Council recently gave some interpretative guidance concerning the key elements to be assessed in order to classify a preferential tax measure as harmful, under one of the most controversial criteria, namely when tax advantages are granted to entities without any real economic activity and substantial economic presence in the state in question.[13]

According to this guidance, the screening process should involve an assessment, first observing whether the regime might potentially apply to situations in which real economic activity is lacking. This will be the case if, for example, (i) there is no requirement for real economic activity in order to qualify for the benefit; (ii) there is an explicit requirement that business is performed offshore; or (iii) the measure applies to areas in which capital is highly mobile. Some activities are a priori considered suspicious, such as intra-group financial and holding activities.[14] If the analysis leads to the conclusion that the regime might apply to activities that are not real, a further test for substantial economic presence should be performed. This economic presence must be evaluated giving due regard to the staff, premises and physical capital that is being employed and the corresponding amount of operating expenditure in the jurisdiction. Based on that, the regime must make sure that only profits arising from real economic activity are granted the benefit. Prima facie, it seems that this ground for listing can be related to the anti-abuse justification under the case law of the ECJ.

10. Council Conclusions, *supra* n. 1, at p. 23.
11. Resolution of the Council and the Representatives of the Governments of the Member States, meeting within the Council of 1 December 1997 on a Code of Conduct for Business Taxation, OJ C 2 (1998).
12. Id., at p. 25.
13. General Secretariat of the Council, Guidance on the interpretation of the third criterion of the Code of Conduct for business taxation, doc. 9637/18, FISC 241, ECOFIN 555 (8 June 2018), annex I.
14. Such suspicion is hard to reconcile with the recent decision of the Court of Justice of the European Union (ECJ) in *Deister Holding*, in which it held that the management of assets constitutes genuine economic activity; *see* DE: ECJ, 20 Dec. 2017, Joined Cases C-504/16 and C-613/16, *Deister Holding and Juhler Holding*, para. 73, ECJ Case Law IBFD.

Finally, a ground for listing will be the non-implementation of the BEPS minimum standards, namely, the following Action Plans: 5 (Harmful Tax Practices); 6 (Anti-Abuse); 13 (Country-by-Country Reporting); and 14 (Improving Dispute Resolution).[15] An implicit requirement for membership in the OECD Inclusive Framework is contingent on this requirement.[16] Prima facie, the ground can be linked to both the anti-abuse and effective fiscal supervision justifications.

The grounds for being blacklisted raise the question of whether all Member States themselves comply with these requirements before imposing them on third countries.[17] In that respect, it is worth noting that, based on these listing grounds, France, for example, is in the process of amending its domestic blacklisting legislation, reaching the conclusion that if these criteria are to be applied, six jurisdictions within the European Union should be also on the list, namely Gibraltar, Hungary, Ireland, Luxembourg, Malta and the Netherlands.[18]

2.2.3. Defensive measures

If a third country is blacklisted based on the criteria described in section 2.2.2., there are two groups of defensive measures that can be applied. The first group is targeted at the country itself and is not tax-related. Currently, there are only few such measures. The first one concerns the European Fund for Sustainable Development, making a connection between the possibility of a jurisdiction to be a beneficiary of aid and compliance with the screening criteria.[19] In that respect, it must be noted that a country, such as Samoa (which had a status of a least-developed country as late as 2014),[20] is on the Blacklist. It is dubious how, by denying access to aid, one can expect that a country will improve its administrative capacity to the level needed for compliance with the screening criteria.[21] The second non-tax measure was recently issued by the Commission and aims to prevent

15. Council Conclusions, *supra* n. 1, at annex V, p. 25.
16. Kalloe, *supra* n. 2, at p. 53.
17. These issues were touched upon with respect to the fair taxation requirement in Dourado, *supra* n. 2, at p. 179.
18. *See* Report of the National Assembly No. 683, available at http://www.assemblee-nationale.fr/15/rapports/r0683.asp (accessed 29 Oct. 2018).
19. Council Conclusions, *supra* n. 1, at annex III, p. 18.
20. UN OHRLLS, *Samoa To Gain Developing Country Economic Status In January 2014*, available at http://unohrlls.org/news/samoa-to-gain-developing-country-economic-status-in-january-2014/ (accessed 29 Oct. 2018).
21. *See*, in the same sense, Dourado, *supra* n. 2, at p. 180.

involving non-compliant jurisdictions in projects that are financed by EU funds.[22]

However, more interesting for the purposes of this chapter are the tax measures that are targeted at taxpayers that are resident in a jurisdiction on the Blacklist, or are resident in the European Union but have business relations with an entity from such a jurisdiction. Besides the more straightforward, increased monitoring and audit risk measures, the Council also suggests that the Member States apply, inter alia, the following additional measures: (i) non-deductibility of costs; (ii) controlled foreign company (CFC) rules; (iii) withholding taxes; and (iv) a reversed burden of proof.[23] In practice, some of the proposed measures are already implemented. For instance, France levies 75% withholding tax on branch profits, dividends, interest, royalties and services paid to companies resident in a non-cooperative jurisdiction.[24] Similar measures related to a higher withholding tax burden are applied in Latvia.[25] Belgium denies the deductibility of payments made to tax havens, interestingly subject to limitations stemming from the free movement of capital under EU law and the non-discrimination obligation under double tax treaties (DTTs).[26] Finland applies a CFC rule to blacklisted countries.[27]

Prima facie, the tax measures seem to be potentially problematic, both from the perspective of the free movement of capital and from the perspective of taxpayers' rights, if applied with respect to all taxpayers from a specific jurisdiction merely based on a blunt instrument such as the Blacklist.

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22. European Commission, Communication from the Commission on new requirements against tax avoidance in EU legislation governing in particular financing and investment operations, C(2018) 1756 final (21 Mar. 2018).
23. The other measures that are suggested are the limitation-of-participation exemption, a switch-over rule, special documentation requirements and mandatory disclosure by tax intermediaries of tax schemes; *see* Council Conclusions, *supra* n. 1, at annex III, p. 19.
24. *France - Tax Compliance Table* sec. A.4., Quick Reference Tables IBFD (accessed 29 Oct. 2018).
25. Z.G. Kronbergs, *Latvia - Corporate Taxation* sec. 7.3.3.3., Country Analyses IBFD (accessed 29 Oct. 2018).
26. G. Cruysmans, *Belgium - Corporate Taxation* sec. 1.4.1., Country Analyses IBFD (29 October 2018). For an example in which domestic courts found a conflict between blacklisting and double tax treaty (DTT) obligations, *see*, e.g. M. Mojana, *The Italian Rule on the Deductibility of Costs Incurred in Blacklisted Countries in Light of Italian Tax Treaties: Does a Conflict Exist?*, 54 Eur. Taxn. 6, pp. 274-278 (2014), Journals IBFD.
27. K. Hiltunen, *Finland - Corporate Taxation* sec. 10.4., Country Analyses IBFD (accessed 29 October 2019).

2.2.4. Domestic and EU-wide blacklists

Finally, one needs to inquire as to the legal characteristics of the Council Conclusions, i.e. the legal instruments used to adopt the Blacklist. Council Conclusions are soft-law instruments, since they are not binding upon the Member States. Conclusions might set objectives for the Member States, but non-compliance can have only political consequences. This is of paramount importance for the subsequent analysis, as all measures adopted by the Member States on the basis of the Blacklist remain actions of the Member States and are subject, therefore, to comprehensive primary EU law scrutiny.

If the Blacklist were adopted as a binding legal instrument, a Member State challenged for the compliance of its implementation measures with the fundamental freedoms or taxpayers' rights could have argued that the Council has a wide margin of discretion when setting the policy in acts of secondary law, and therefore, the Court could intervene only in cases of manifest non-compliance with primary law.[28] No such defence would be permissible in the case at hand, and thus, the domestic measures would face just as much primary EU law scrutiny as any other domestic measure.

Secondly, if a Member State is challenged regarding fundamental rights compliance with the European Convention on Human Rights (ECHR) before the European Court of Human Rights in Strasbourg (ECtHR), such Member State will have no recourse to the *Bosphorus* defence. In the case of *Bosphorus*, the ECtHR accepted that if a Member State is doing nothing more than implementing legal obligations flowing from its membership in the European Union, there is a rebuttable presumption that it is acting in compliance with the ECHR (as EU law is considered to provide equivalent protection).[29] The presumption can be rebutted only if a manifest deficiency

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28. *See*, for example, DE: ECJ, 14 Dec. 2004, Case C-434/02, *Arnold André*, para. 46; DE: ECJ, 12 Dec. 2006, Case C-380/03, *Tobacco Advertising II*, para. 39; and UK: ECJ, 8 June 2010, Case C-58/08, *Vodafone Ltd, Telefónica O2 Europe plc, T-Mobile International AG, Orange Personal Communications Services Ltd v. Secretary of State for Business, Enterprise and Regulatory Reform*, para. 53. It should be noted that it is dubious whether the Court accepts the wide-margin-of-discretion argument in the area of fundamental rights; *see*, for instance, IE: ECJ, Joined Cases C-293/12 and C-594/12, 8 Apr. 2014, *Digital Rights Ireland and Others*, in which no recourse to this point was made in relation to Charter compliance of secondary law (*see* the Charter of Fundamental Rights of the European Union, OJ C 326/91 (26 Oct. 2012), EU Law IBFD).

29. IE: ECtHR Grand Chamber, 30 June 2005, Application no. 45036/98, *Bosphorus Hava Yollari Turizm Ve Ticaret Anonim Şirketi v. Ireland*. The findings of this case were upheld in more recent decisions; *see* AT: ECtHR, 18 June 2013, Application no. 3890/11, *Povse v. Austria*; and LV: ECtHR Grand Chamber, 25 Feb. 2014, Application no. 17502/07, *Avotins v. Latvia*.

of fundamental rights protection is found. Therefore, by adopting a soft-law instrument that creates no legal obligations, the Council lowered the threshold for successful fundamental rights claims by taxpayers from the manifest deficiency under *Bosphorus* to the "standard" deficiency required under the Convention.

Finally, it is clear that Member States remain free to have their own blacklists alongside the EU-wide Blacklist.[30] It is unclear, therefore, how the Blacklist contributes to the twofold policy agenda set by the Commission in its External Strategy that was discussed in section 2.2.1.; even if the Blacklist might contribute to the objective of the prevention of profit shifting, it does not create a clear and predictable business environment within the European Union.

Having said that, the chapter will move on to examine the primary EU law boundaries of the Member States' actions upon the inclusion of a jurisdiction on the list. The author argues that the existing limitations are rather substantive, making some of the suggested anti-BEPS measures illegal to implement if they are merely based on the blacklisting of a jurisdiction. As rightfully pointed out by the Council in its conclusions, the implementation of defensive measures shall be done in accordance with Member States' obligations under EU and international law.[31]

2.3. Compatibility of the Blacklist with the free movement of capital

Naturally, as the Blacklist includes third countries, the only applicable fundamental freedom can be the free movement of capital. It will be easier to test the defensive measures' compatibility with the free movement of capital by using the rather extreme French provision, which imposes 75% withholding tax on dividends distributed to companies located in non-cooperative jurisdictions. Let us imagine that a parent company, resident in a non-cooperative jurisdiction, has a subsidiary in France that is 100% owned, and the subsidiary is distributing dividends that are subject to 75% withholding

30. Dourado, *supra* n. 2, at p. 180. Such domestic blacklists exist, for example, in Latvia (Low-Tax and Tax-Free States and Territories Regulations 655 of 2017), Italy (art. 11(4)(c) of Legislative Decree 239/1996, as amended by Legislative Decree 147/2015 of the Ministry of Economy and Finance), Greece (Circular 1024 of 12 February 2018 by the Public Revenue Authority) and Belgium (article 179 of the Royal Decree to the Income Tax Code (RD-ITC)).
31. Council Conclusions *supra* n. 1, at Recital 17.

tax. Is such withholding tax compatible with the free movement of capital? First, one needs to ask whether such distribution falls within the scope of the freedom. Second, the question arises as to whether the measure constitutes a restriction on the capital movement between France and the blacklisted third country. If yes, one thirdly needs to inquire whether the goals of the Blacklist can potentially justify the restriction. Finally, the proportionality test needs to be applied.

2.3.1. Scope

The scope of the free movement of capital is of vital importance in a third-country scenario, as this is the only freedom that can apply. In that respect, the Court of Justice of the European Union (ECJ) has already held that a dividend payment falls within the scope of capital movement and that, for a more general frame of reference, the nomenclature set out in the already repealed Directive 88/361/EEC[32] is still relevant.[33] Therefore, not only the straightforward example of dividends, but also other defensive measures, can potentially fall within the scope of the freedom.

In that respect, it is worth mentioning the distinction that the ECJ is making – based on the aim of national legislation – between (i) pure capital movement, which is covered by the freedom in third-country situations; and (ii) contingent capital movement, which is merely the unavoidable consequence of exercising one of the other freedoms, and therefore remains outside the scope of EU law in third-country scenarios. The latter case will concern situations in which the rule at hand governs the conditions for access to the market,[34] for example, when a domestic measure restricts certain financial services of a third country.[35] In other words, it will all depend on the measure in question and whether it targets the activity as such, or the auxiliary elements surrounding it.[36] In principle, the suggested defensive

32. Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty, pp. 5-18, OJ L 178 (8 July 1988), EU Law IBFD.
33. SE: ECJ, 18 Dec. 2007, Case C-101/05, *Skatteverket v. A*; and UK: ECJ, 14 Sept. 2017, Case C-628/15, *The Trustees of the BT Pension Scheme v. Commissioners for Her Majesty's Revenue and Customs*, ECJ Case Law IBFD.
34. PT: ECJ, 24 Nov. 2016, Case C-464/14, *SECIL – Companhia Geral de Cal e Cimento SA v. Fazenda Pública*, para. 43, ECJ Case Law IBFD. For the evolution of the case law that led to *SECIL*, *see* A.P. Dourado, *The EU Free Movement of Capital and Third Countries: Recent Developments*, 45 Intertax 3, pp. 196-200 (2017).
35. DE: ECJ, 3 Oct. 2006, Case C-452/04, *Fidium Finanz AG v. Bundesanstalt für Finanzdienstleistungsaufsicht*, para. 34, ECJ Case Law IBFD.
36. A similar differentiation is made by W. Schön, *Free Movement of Capital and Freedom of Establishment*, European Business Organization Law Review 17, pp. 229-260 (2016).

tax measures do not restrict access to the market as such. Therefore, they are capable of potentially falling within the scope of the free movement of capital. Few borderline cases need some further examination.

First, one might argue that a tax can be set at such a high level that it de facto has prohibitive market access effects.[37] The ECJ held already, in 1968, with respect to the free movement of goods, that an internal, indirect tax can be deemed a measure equivalent to the quantitative restriction under article 34 of the Treaty on the Functioning of the European Union (TFEU), and not as internal taxation under article 110 of the TFEU, if it is set at such a high level that it has the effect of restricting access to the market.[38] Yet, if such an argument is accepted under the free movement of capital, a national measure will be able to escape EU-law scrutiny in third-country situations simply by being too restrictive. The logic of the Court under the free movement of goods is not transferrable to the movement of capital, as under the latter freedom, both border and internal measures are governed by one and the same provision, i.e. article 63 of the TFEU. The author therefore considers that even a 75% withholding tax (as that applied in France) against blacklisted jurisdictions falls within the ambit of the free movement of capital.

Second, the issue of whether a CFC rule, such as the one in Finland, can be tested against the free movement of capital, remains debatable. It is usually accepted that, after the clarification in *Cadbury Schweppes*, domestic CFC rules fall under the freedom of establishment in light of the fact that, by definition, a CFC would require a situation of definitive influence.[39] If definitive influence, in light of the object of national legislation, remains the central criterion to differentiate between establishment and capital, indeed, a typical CFC rule will fall outside the scope of the freedoms when a third country is involved.[40] However, should the Court drift towards a market access analysis, a CFC can very well fall within the ambit of the free move-

37. *See*, in a similar sense, Dourado, *supra* n. 34, at p. 199 (2017).
38. DE: ECJ, 4 Apr. 1968, Case C-31/67, *Stier v. Hauptzollamt Hamburg-Ericus*; DK: ECJ, 11 Dec. 1990, Case C-47/88, *Commission of the European Communities v. Kingdom of Denmark*, para. 12, ECJ Case Law IBFD; and DK: ECJ, 17 June 2003, Case C-383/01, *De Danske Bilimportører v. Skatteministeriet, Told– og Skattestyrelsen*, para. 40, ECJ Case Law IBFD.
39. UK: ECJ, 12 Sept. 2006, Case C-196/04, *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*, para. 32, ECJ Case Law IBFD. In that sense, *see also* Dourado, *supra* n. 34, at p. 194.
40. Nevertheless, if the participation threshold that triggers the controlled foreign company (CFC) rule is low enough, the free movement of capital may apply. *See* DE: ECJ, Opinion of AG Mengozzi, 5 June 2018, Case C-135/17, *X*, paras. 16-20.

ment of capital; it does not restrict access to the market, but merely seeks to impose a restriction on the proceeds of such access.[41]

Finally, the question remains as to whether the free movement of capital can be applied not only to defensive measures related to dividends, but also to different types of services, e.g. interest, royalties or other professional services. Here, again, one needs to look at the object of the defensive measures, with the crucial question being what the regulatory goal of these measures is; is it to restrict the activity as such, or is it to merely target the tax consequences thereof, aiming to preserve the domestic tax base by imposing restrictive measures on the auxiliary capital movements? According to the author, all defensive measures drift towards the second category, and are therefore covered by the free movement of capital. The Member States are very well in the position to impose market access barriers based on the Blacklist. An example of one such barrier is the already discussed restriction imposed by the Commission of EU funds by private parties from blacklisted jurisdictions.[42] In the same vein, Member States may prohibit certain transactions with countries on the Blacklist.

2.3.2. Restriction

Knowing that the defensive measures have the potential to fall within the scope of EU law, one should then turn to examine if their application can create a restriction on the free movement of capital between EU Member States and blacklisted third countries. It seems rather uncontroversial that by applying higher withholding tax, disallowing deductions, imposing a CFC rule that is otherwise not applicable or reversing the burden of proof, a Member State makes it less attractive for a company to operate in a blacklisted jurisdiction. Such treatment is both vertically (vis-à-vis staying purely domestic) and horizontally (vis-à-vis another third country that is not on the Blacklist) discriminatory.[43] Therefore, the defensive measures constitute a restriction on the free movement of capital.

41. In support of the idea that CFC measures fall under the free movement of capital, *see also* Schön, *supra* n. 36, at p. 257.

42. European Commission, Communication from the Commission on new requirements against tax avoidance in EU legislation governing in particular financing and investment operations, C(2018) 1756 final (21 Mar. 2018).

43. A good example of both modes of discrimination with respect to a CFC rule is provided in *Cadbury Schweppes*, *supra* n. 39, at paras. 44-45.

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