soning, as it has also been applied in *Kerckhaert-Morres*, *Columbus Container Services* and *Truck Center*:

> 32. In a situation where both the Member State in which the dividends are paid and the Member State in which the shareholder resides are liable to tax those dividends, to consider that it is necessarily for the Member State of residence to prevent that double taxation *would amount to granting a priority with respect to the taxation of that type of income to the Member State in which the dividends are paid*. (emphasis added)

1541. In other words, the ECJ is not willing to choose between source state taxation or residence state taxation with regard to dividends, not even when such is the choice made by the OECD Member countries as is clear from the OECD Model Art. 23B.[1100] Consequently, Belgium is not obliged, under the free movement of capital, to alleviate the legal double taxation in the case at hand.

5.3.5. Free movement of capital and third countries

1542. A third major evolution in the income tax case law of the ECJ is the development of the free movement of capital with regard to non-Member States. Art. 56 EC Treaty [63 TFEU] prohibits both restrictions between Member States and restrictions between Member States and third countries. This provision may have far-reaching implications in the field of direct taxation as it could extend the full body of the Court's case law on the free movement of capital[1101] and, possibly, the right of establishment and the freedom to provide services to taxpayers that reside outside the Community.

1543. As has already been discussed above,[1102] a first question that is thereby raised is whether the free movement of capital should receive the same extensive and teleological interpretation with regard to third countries as it has received with regard to intra-Community situations. However, in the (very limited) general case law on the issue, the Court has never explicitly or implicitly indicated that it would interpret the free movement of capital differently in relation to third countries than in an intra-Community con-

1100. ECJ, 16 July 2009, *Jacques Damseaux v. État belge*, Case C-128/08, *not yet reported*, para. 33.
1101. C. Peters and J. Gooijer, "The Free Movement of Capital and Third Countries: Some Observations", 11 *Eur. Tax.* (2005) p. 475; K. Stähl, "Free movement of capital between Member States and third countries", *E.C.T.Rev.* (2004/2) p. 50.
1102. See supra at 5.2.3.2.

text. As will be seen in the present subsection, the Court has taken the same path in its case law on direct taxation.

1544. This raises a number of other issues. The so-called "grandfathering" clause of Art. 57(1) EC Treaty provides that the restrictions which existed on 31 December 1993 under national or Community law in respect of third-country free movement of capital and involving direct investment – including in real estate – establishment, the provision of financial services or the admission of securities to capital markets, can be maintained. In other words, national measures that restrict the free movement of capital with third countries will be upheld if (i) they were in force prior to 31 December 1993 and (ii) they relate to the above-mentioned transactions. The ECJ will therefore be confronted with defining the concepts of an "existing restriction" and of "direct investment".

1545. An even more interesting issue relates to the borderline between the scope of the free movement of capital on the one hand and that of the right of establishment and the freedom to provide services on the other. In the relation with the freedom to provide services, Elmer A-G had submitted in his opinion on the *Svensson and Gustavsson* case that any restriction on the free movement of capital was subordinated to the restriction that existed vis-à-vis the freedom to provide services. He suggested examining the case under the free movement of services only, implying that the application of both freedoms are mutually exclusive.[1103] The ECJ disagreed, however, and applied the rules governing services and those governing capital movements cumulatively and concluded that the national legislation was contrary to *both*.[1104]

1546. A similar problem arose with regard to the right of establishment since the EC Treaty equally does not in any way expand the scope thereof to third countries. In its case law that did not relate to third countries, the Court has drawn the line between "capital" and "establishment" on the basis of the ability of a shareholder to have a definite influence on the decisions of the company and to determine the activities thereof.[1105] In other words,

1103. A-G Elmer, Opinion of 17 May 1995, *Svensson and Gustavsson*, Case C-484/93, *E.C.R.* 1995, p. I-3955, paras. 8-11.
1104. ECJ, 14 November 1995, *Peter Svensson and Lena Gustavsson v. Ministre du Logement et de l'Urbanisme*, Case C-484/93, *E.C.R.* 1995, p. I-3955, paras. 8 and 11; see also supra at 5.3.3.7.
1105; ECJ, 13 April 2000, *C. Baars v. Inspecteur der Belastingen Particulieren/Ondernemingen Gorinchem*, Case C-251/98, *E.C.R.* 2000, p. I-2787, para. 22; ECJ, 21 November 2002, Case C-436/00, *X and Y v. Riksskatteverket*, C-436/00, *E.C.R.* 2002, p. I-10829, para. 37; ECJ, 12 September 2006, *Cadbury Schweppes plc, Cadbury Schweppes*

when the ties between shareholder and the company become close enough so that the former can exert a definite influence on the latter, the case is dealt with under the right of establishment. In cases such as *Konle*,[1106] *X AB and Y AB*,[1107] *Baars*,[1108] *Metallgesellschaft*,[1109] *X and Y*[1110] and *Bouanich*,[1111] however, the Court implied that the boundary between the two freedoms was little more than a matter of convenience: it was sufficient that a national measure ran contrary to the right of establishment in order to preclude it, without it being necessary to also examine it under the free movement of capital, or vice versa in the *Konle* case. There was no indication that the scopes of application of the free movement rights could be mutually exclusive.[1112] Moreover, Advocate-Generals Saggio, Alber, Tizzano and Kokott explicitly provided that two freedoms could be applicable simultaneously,[1113] without being contradicted on that point by the ECJ.

Overseas Ltd v. Commissioners of Inland Revenue, Case C-196/04, *E.C.R.* 2006, p. I-7995, para. 31.

1106. ECJ, 1 June 1999, *Konle*, C-302/97, *E.C.R.* 1999, p. I-3099, para. 55.

1107. ECJ, 18 November 1999, *X AB and Y AB v. Riksskatteverket*, Case C-200/98, *E.C.R.* 1999, p. I-8261, para. 30.

1108. ECJ, 13 April 2000, *C. Baars v. Inspecteur der Belastingen Particulieren/Ondernemingen Gorinchem*, Case C-251/98, *E.C.R.* 2000, p. I-2787, para. 42.

1109. ECJ, 8 March 2001, *Metallgesellschaft Ltd and Others, Hoechst AG v. Commissioners of Inland Revenue*, Joined Cases C-397/98 and C-410/98, *E.C.R.* 2001, p. I-1727, para. 75; see also supra para. 1061.

1110. ECJ, 21 November 2002, Case C-436/00, *X and Y v. Riksskatteverket*, C-436/00, *E.C.R.* 2002, p. I-10829, paras. 66-68.

1111. ECJ, 19 January 2006, *Margaretha Bouanich v. Skatteverket*, Case C-265/04, *E.C.R.* 2006, p. I-923, para. 57.

1112. C. Panayi, "The Fundamental Freedoms and Third Countries: Recent Perspectives", *Eur. Tax.* (2008) p. 573; Smit, "The relationship between the free movement of capital and the other EC Treaty freedoms in third country relationships in the field of direct taxation: a question of exclusivity, parallelism or causality?", op. cit., p. 252; Dahlberg, *Direct Taxation in Relation to the Freedom of Establishment and the Free Movement of Capital*, op. cit., p. 290; Mitroyanni, "Exploring the Scope of the Free Movement of Capital in Direct Taxation", op. cit., p. 5; Stähl, "Free movement of capital between Member States and third countries", op. cit., pp. 48-49; U. Haferkamp, *Die Kapitalverkehrsfreiheit im System der Grundfreiheiten des EG-Vertrags*, op. cit., pp. 193-194; Peters, "Capital movements and taxation in the EC", op. cit., p. 6; Schön, "Europaische Kapitalverkehrsfreiheit und nationales Steuerrecht", op. cit., p. 749.

1113. Saggio A-G, Opinion of 3 June 1999, *X AB and Y AB v. Riksskatteverket*, Case C-200/98, *E.C.R.* 1999, p. I-8261, para. 32 and Alber A-G, Opinion of 14 October 1999, *C. Baars v. Inspecteur der Belastingdienst Particulieren/Ondernemingen Gorinchem*, Case C-251/98, *E.C.R.* 2000, p. I-2787, paras. 48 and 50; Tizzano A-G, Opinion of 7 July 2005, *SEVIC Systems*, case C-411/03, *E.C.R.* 2005, p. I-10805, paras. 42 and 76; Kokott A-G, Opinion of 15 July 2005, *Margaretha Bouanich v. Skatteverket*, Case C-265/04, *E.C.R.* 2006, p. I-923, paras. 72-73.

1547. Some legal scholars refer to para. 26 of the aforementioned opinion of Advocate-General Alber in the *Baars* case to indicate the opposite position. Nevertheless, Alber A-G made very clear in paras. 30 and 48 of his opinion on the *Baars* case that the respective scopes of the free movement of capital and of the right of establishment were not mutually exclusive.[1114] The innovative feature of Alber's opinion is to be found in the fact that he searches for the Treaty freedom the importance of which is preponderant in the light of the national measure concerned. Once such a preponderant freedom can be found, the obstacles to the other freedom(s) that may also be caused by the national measure are of a subordinate nature and do not merit an independent examination under such other freedoms. It will become clear in the following discussion on the ECJ's jurisprudence that the Court has not forgotten this approach of Alber A-G.

1548. Following an extensive analysis of the preceding case law, Advocate-General Stix-Hackl equally comes to the conclusion in her opinion on the *Fidium Finanz* case (discussed hereinafter) that nothing in the case law of the ECJ would prevent the simultaneous application of the free movement of capital and the freedom to provide services.[1115] Moreover, why would Art. 57(1) EC Treaty grandfather restrictions regarding activities of direct investment (including in real estate), establishment and the provision of financial services in third country relations if those kinds of transactions could never fall within the scope of Art. 56 EC Treaty?[1116]

1549. A minority of legal scholars, on the other hand, have proposed that the scope of the free movement of capital and that of the right of establishment are mutually exclusive.[1117] Advocate-General Tesauro also expressed

1114. Alber A-G, Opinion of 14 October 1999, *C. Baars v. Inspecteur der Belastingdienst Particulieren/Ondernemingen Gorinchem*, Case C-251/98, *E.C.R.* 2000, p. I-2787, para. 30 reads: "The Court concluded that both the rules on the free movement of capital and those on the right of establishment were applicable. There is therefore a third rule governing the relationship between the two freedoms: 3. Where there is direct intervention affecting both the free movement of capital and the right of establishment, both fundamental freedoms apply, and the national measure must satisfy the requirements of both." And para. 48 reads: "I have already shown that a national measure may fall within the ambit of a number of fundamental freedoms. In the present case, therefore, the fact that freedom of establishment is in point does not preclude the simultaneous application of the rules on capital movements."

1115. Stix-Hackl A-G, Opinion of 16 March 2006, Fidium Finanz v. Bundesanstalt für Finanzdienstleistungsaufsicht, Case C-452/04, *E.C.R.* 2006, p. I-9521, para. 41 et seq.

1116. Cordewener, Kofler and Schindler, "Free Movement of Capital, Third Country Relationships and National Tax Law: An Emerging Issue before the ECJ", op. cit., p. 113.

1117. Ohler, *Die Fiskalische Integration in der Europäischen Gemeinschaft*, op. cit., pp. 142-143; Freitag, "Mitgliedstaatliche Beschränkungen des Kapitalverkehrs und Europäisches Gemeinschaftsrecht", op. cit., p. 190.

similar concerns in his opinion on the earlier *Safir* case[1118] on the cumulative application of the free movement of capital and the *freedom to provide services* as this might undermine the differing Treaty framework between these two freedoms:

> 16. Furthermore, indiscriminate application of the provisions of the Treaty governing services and capital might be further precluded by the fact that the scope of the prohibition laid down in Article 59, on the one hand, and that laid down in Article 73b of the Treaty, on the other, is different. While freedom to provide services is, of course, subject only to the exceptional restrictions permitted or envisaged by Article 56 (and, on the conditions reviewed below, to restrictions justified by overriding requirements), free movement of capital, on the other hand, is subject to the broader restriction laid down in Article 73d(a), which expressly permits the enactment of fiscal provisions which distinguish between taxpayers on grounds of residence (even though, under the 'classic' formula, they must not constitute a means of arbitrary discrimination or a disguised restriction). *This is a subtle difference in the ambit of the two provisions which makes it even more important for their respective scopes of application to be determined accurately.*
>
> 17. […] This should be done on the basis of the criteria laid down in the case-law existing prior to Svensson: *if the measure at issue directly restricts the transfer of capital, rendering it impossible or more difficult*, for example by subjecting it to mandatory authorisation or in any event by imposing currency restrictions, *Article 73b et seq. of the Treaty will apply*; if, conversely, *it only indirectly restricts movement of capital* and primarily constitutes a non-monetary restriction on the freedom to provide services, *then Article 59 et seq. of the Treaty will apply*.[1119] (emphasis added)

1550. The Court, however, deemed it unnecessary to examine the legislation at issue in *Safir* under the free movement of capital only because it had already established an infringement under the freedom to provide services.[1120]

1118. Tesauro A-G, Opinion of 23 September 1997, *Jessica Safir v. Skattemyndigheten i Dalarnas Län, formerly Skattemyndigheten i Kopparbergs Län* Case C-118/96, *E.C.R.* 1998, p. I-1897, paras. 15-17.

1119. Id., paras. 15-17 with reference to ECJ, 24 October 1978, *Société générale alsacienne de banque SA v. Walter Koestler*, Case 15/78, *E.C.R.* 1978, p. 1971; ECJ, 11 November 1981, *Criminal proceedings against Guerrino Casati*, Case 203/80, *E.C.R.* 1981, p. 2595; ECJ, 23 February 1995, *Criminal proceedings against Aldo Bordessa and others*, Joined Cases C-358/93 and C-416/93, *E.C.R.* 1995, p. I-361.

1120. ECJ, 28 April 1998, *Jessica Safir v. Skattemyndigheten i Dalarnas Län, formerly Skattemyndigheten i Kopparbergs Län* Case C-118/96, *E.C.R.* 1998, p. I-1897, para. 35; see also ECJ, 1 December 1998, *Ambry*, Case C-410/96, *E.C.R.* 1998, p. I-7875, para. 39; ECJ, 3 October 2002, *Rolf Dieter Danner*, Case C-136/00, *E.C.R.* 2002, para. 58; ECJ, 26 June 2003, *Försäkringsaktiebolaget Skandia (publ), Ola Ramstedt v. Riksskatteverket*, Case C-422/01, *E.C.R.* 2003, p. I-6817, para. 60.

5.3.5.1. *Fidium Finanz*

1551. The judgment in the non-tax *Fidium Finanz* case, however, took another direction different from that of Tesauro A-G in the *Safir* case.[1121] Fidium Finanz is a company incorporated under Swiss law, which has its registered office and central administration in Switzerland. Fidium Finanz offers small value unsecured loans to borrowers in Germany at high rates of interest. About 90% of its loans are granted to German residents. Fidium Finanz has no business establishment in Germany and its business is conducted entirely over the Internet. The German consumer authorities issued a prohibition against Fidium Finanz, which prevented it from using banks in Germany to make loans and collect repayments and interest. Fidium Finanz brought proceedings against the consumer credit authority, on the basis that the prohibition contravened Art. 56 EC. As such, *Fidium Finanz* is not a case on direct taxation, yet the analysis made by the ECJ on the applicability of the free movement of capital vis-à-vis the other freedoms is very relevant to the following income tax cases.

1552. A reference for a preliminary ruling was made both under the free movement of capital and under the freedom to provide services. Advocate-General Stix-Hackl had analysed the question on the basis of both freedom to provide services and free movement of capital.[1122] In other words, she did not consider the matter as being subsumed exclusively under freedom to provide services. Nevertheless, according to the Advocate-General, the German authorities were entitled to rely on the Art. 58(1)(b) EC Treaty grounds (public policy and public security) as justification for the restriction and for requiring a physical presence in Germany. The ECJ did not follow the Advocate-General's approach but reached the same conclusion.

1553. First, the ECJ provides that no order of priority between the free movement of capital and the freedom to provide services exists or can be inferred from the wording of Art. 51(2) EC Treaty. Hence, the Court admits that it is principally possible that in certain specific cases a restriction caused by a national measure may simultaneously hinder the exercise of both freedoms. Where a national measure relates to the freedom to provide services and the free movement of capital at the same time, it is necessary, first, to consider to what extent the exercise of those fundamental liberties is af-

1121. ECJ, 3 October 2006, *Fidium Finanz v. Bundesanstalt für Finanzdienstleistungsaufsicht*, Case C-452/04, *E.C.R.* 2006, p. I-9521.
1122. Stix-Hackl A-G, Opinion of 16 March 2006, *Fidium Finanz v. Bundesanstalt für Finanzdienstleistungsaufsicht*, Case C-452/04, *E.C.R.* 2006, p. I-9521.

fected and, second, whether, *in the circumstances of the main proceedings*, one of the freedoms prevails over the other.[1123]

1554. First, the Court finds that the business of a credit institution consisting of granting credit, constitutes a service within the meaning of Art. 49 EC Treaty under reference to the preceding *Svensson and Gustavsson*[1124] and *Parodi*[1125] cases and to Directive 2000/12/EC relating to the taking up and pursuit of the business of credit institutions.[1126] On the other hand, loans and credits granted by non-residents to residents also feature under Heading VIII of Annex I to Directive 88/36,[1127] which means that the transactions can also be considered as movements of capital. Hence, according to the ECJ, it follows that the activity of granting credit on a commercial basis concerns, in principle, both the freedom to provide services within the meaning of Art. 49 EC Treaty and the free movement of capital within the meaning of Art. 56 EC Treaty.

1555. In relation to the free movement of capital, the ECJ acknowledges that it is possible that by making financial services offered by companies established in third countries less accessible to German clients, the rules effectively make those clients less inclined to have recourse to those services and therefore reduce cross-border financial traffic relating to those services. However, the impact on the cross-border movement of capital was merely "an unavoidable consequence of the restriction on the freedom to provide services."

1556. To the ECJ, on the facts of the case, the predominant consideration was the freedom to provide services rather than the free movement of capital. Since the rules in dispute impede access to the German financial mar-

1123. With reference to ECJ, 24 March 1994, *Her Majesty's Customs and Excise v. Gerhart Schindler and Jörg Schindler*, Case C-275/92, *E.C.R.* 1994, p. I-1039, para. 22; ECJ, 22 January 2002, *Canal Satélite Digital SL v. Administracíon General del Estado*, Case C-390/99, *E.C.R.* 2002, I-607, para. 31; ECJ, 25 March 2004, *Herbert Karner Industrie-Auktionen GmbH v. Troostwijk GmbH*, Case C-71/02, *E.C.R.* 2004, p. I-3025, para. 46; ECJ, 14 October 2004, *Omega*, Case C-36/02, *E.C.R.* 2004, p. I-9609, para. 26; ECJ, 26 May 2005, *Criminal proceedings against Marcel Burmanjer, René Alexander Van Der Linden and Anthony De Jong*, Case C-20/03, *E.C.R.* 2005, p. I-4133, para. 35.
1124. See supra at 5.3.3.7.
1125. ECJ, 9 July 1997, *Société civile immobilière Parodi v. Banque H. Albert de Bary et Cie*, Case C-222/95, *E.C.R.* 1997, p. I-3899, para. 17.
1126. Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions, *O.J.* L 126, 26 May 2000, pp. 1-59.
1127. Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty, *O.J.* L178, 8 July 1988, pp. 5-18.

ket for companies established in non-member countries, they affect primarily the freedom to provide services. Given that the restrictive effects of those rules on the free movement of capital are merely an inevitable consequence of the restriction imposed on the provision of services, the ECJ did not find it necessary to consider whether the rules are compatible with Art. 56 EC Treaty.

1557. In other words, the ECJ analysed the national measure at issue with a view of finding the preponderant freedom. Once it had established that the German legislation primarily concerned the freedom to provide services, it no longer analysed the national measure under the free movement of capital. The preponderance of one Treaty freedom over another in the light of the national measure at issue is thus used to render the scope of the respective freedoms mutually exclusive. Mutual exclusivity of the scope of the respective Treaty freedoms is not proposed as a general principle but rather as a purported consequence of the "*circumstances of the main case*". The ECJ applied a similar reasoning in the *Cadbury Schweppes* case[1128] in order to limit the applicable Treaty provisions to the right of establishment.

5.3.5.2. *FII Group Litigation*

5.3.5.2.1. *Free movement of capital and third countries*

1558. The *FII Group Litigation* case is the first income tax case in which the Court is called to rule on the third-country scope of the free movement of capital.[1129] It is relevant for the present discussion to point out that the UK legislation at issue applied to shareholdings of 10% or more.

1559. The Court, apparently, does not find a free movement provision that is preponderant in the light of the UK measure at issue. Hence, it is not able to rely on its "mutually exclusive" approach as in the *Fidium Finanz* and the *Cadbury Schweppes* cases,[1130] and the Court provides the following:

1128. ECJ, 12 September 2006, *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*, Case C-196/04, *E.C.R.* 2006, p. I-7995, paras. 32 et seq.; see also supra at 5.3.4.21.

1129. ECJ, 12 December 2006, *Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue*, Case C-446/04, *E.C.R.* 2006, p. I-11753; The factual background and the other issues of the case are outlined supra under 5.3.4.24.

1130. Cordewener, Kofler and Schindler, "Free Movement of Capital, Third Country Relationships and National Tax Law: An Emerging Issue before the ECJ", op. cit., p. 113.

> 165. In so far as, according to the national court, that question also concerns companies established in non-member countries which, accordingly, do not fall within the scope of Article 43 EC on freedom of establishment, and for the reason set out in paragraph 38 of this judgment, the question arises *whether national measures* such as those at issue in the main proceedings *also contravene Article 56 EC* on the free movement of capital.
>
> 166. It must be pointed out in that regard *that the difference in treatment to which foreign-sourced dividends are subject* when they are received by a resident company which has elected to be taxed under the FID regime (see paragraphs 145 to 149 of this judgment) *has the effect of discouraging such a company from investing* its capital in a company established in another State and also has a restrictive effect on companies established in other States in that it constitutes an obstacle to their raising capital in the United Kingdom.
>
> 167. In order for such a difference in treatment to be compatible with the provisions of the Treaty on the free movement of capital, it must concern situations which are not objectively comparable or be justified by an overriding reason in the general interest. (emphasis added)

1560. It is remarkable that the ECJ continues to use exactly the same legal reasoning in third-country application of the free movement of capital as in its case law on intra-Community situations. Only two reservations are made in respect of a differing application of the third-country free movement of capital.

1561. First, since third countries are not bound by the Mutual Assistance Directive, it may be more difficult to determine the tax paid by companies established in a third country than in a purely Community context. The Court accepts this argument in theory but does not find it applicable in the case at hand. The argument of fiscal supervision was not accepted in the context of the right of establishment, so it is equally of no consequence for the analysis under the free movement of capital, whether intra-Community situations or third countries situations are concerned.

1562. Secondly, with reference to the opinion of Advocate-General Geelhoed,[1131] the Court accepts that a Member State may be able to demonstrate that a restriction on capital movements 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*. However, this again remained merely a theoretical possi-

1131. Geelhoed A-G, Opinion of 6 April 2006, *Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue*, Case C-446/04, *E.C.R.* 2006, p. I-11753, para. 121.

bility as the UK government did not invoke any such arguments.[1132] The Court concludes its answer to this part of the reference for a preliminary ruling by stating that the UK measure at issue[1133] is neither compatible with the right of establishment nor with the free movement of capital. No reservation whatsoever is made with regard to the third-country applicability of the free movement of capital.

5.3.5.2.2. *The "grandfathering" clause of Art. 57(1) EC Treaty: Direct investments*

1563. Having decided that the free movement of capital in relation to third countries is applicable to the UK taxation of foreign-sourced dividends and the modifications introduced thereto by the FID regime, the Court examines whether the grandfathering clause of Art. 57(1) EC Treaty may nevertheless authorize the restrictions caused by the UK measures. The carve-out of Art. 57(1) EC Treaty requires that the UK measures constitute restrictions on the movement of capital involving direct investment, establishment, the provision of financial services or the admission of securities to capital markets.

1564. The Court limits its investigation to the concept of "direct investment" and refers to the nomenclature of Art. 1 of Directive 88/361. According to that nomenclature, the concept of direct investments concerns investments of any kind undertaken by natural or legal persons and which serve *to establish or maintain lasting and direct links* between the persons providing the capital and the undertakings to which that capital is made available. According to the explanatory notes, the objective of establishing or maintaining lasting economic links presupposes that the shares held by the shareholder enable him to participate effectively in the management of that company or in its control. According to the ECJ, the carve-out of Art. 57(1) EC Treaty also extends to dividends derived from companies established in third countries *to the extent that holdings in such companies are acquired with a view to establishing or maintaining lasting and direct economic links* between the shareholder and the company concerned and which allow the shareholder to participate effectively in the management of the company or in its control. In other words, the Court does not pronounce itself on the UK legislation as a whole but provides that Art. 57(1) may only

1132. C. Panayi, "The Fundamental Freedoms and Third Countries: Recent Perspectives", *Eur. Tax.* (2008) pp. 579.
1133. Which is outlined supra at 5.3.4.24.4.

grandfather the UK legislation to the extent it covers holdings that establish or maintain lasting and direct economic links.

5.3.5.2.3. *The "grandfathering" clause of Art. 57(1) EC Treaty: Restrictions existing on 31 December 1993*

1565. This issue relates to the FID regime, which was introduced on 1 July 1994. The UK authorities argue that the carve-out of Art. 57(1) EC Treaty should also apply to the FID regime since that regime did not introduce any new restrictions vis-à-vis the existing measures but, conversely, merely abolished a number of the restrictive effects of the existing legislation.

1566. With reference to the *Konle* case,[1134] the Court stated that a national measure adopted after a date such as provided in Art. 57(1) EC Treaty 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 preceding law and which establishes new procedures, cannot be regarded as legislation existing at the date set down by the Community measure in question.

1567. The Court accepts that the FID regime had indeed the purpose of limiting the restrictive effects if the UK taxation of foreign-sourced dividends. However, the Court has its doubts in relation to one aspect of the FID regime, notably with the fact that shareholders receiving a FID are not entitled to a tax credit. The ECJ leaves it to the referring national court to decide this issue. In any event, the fact that the FID regime is optional does not imply that it can automatically be considered as an existing regime within the meaning of Art. 57 EC Treaty.

5.3.5.3. *Thin Cap Group Litigation*

1568. Some of the group companies that had provided the loans in the Group Litigation Order were established in non-Member States.[1135] As a result, the first question concerned the applicable Community freedom.

1134. ECJ, 1 June 1999, *Konle*, C-302/97, *E.C.R.* 1999, p. I-3099, paras. 52 and 53.
1135. ECJ, 13 March 2007, *Test Claimants in the Thin Cap Group Litigation v. Commissioners of Inland Revenue*, Case C-524/04, *E.C.R.* 2007, p. I-2107.

1569. In accordance with its settled case law, the ECJ confirms that holdings in the capital of a company established in another Member State that gives a definite influence on the company's decisions and allowing them to determine its activities, come within the substantive scope of the provisions of the EC Treaty on freedom of establishment.[1136] The UK legislation initially applied a criterion of 75% ownership of the capital in the borrowing company. Later, the criterion was amended to direct or indirect "control". In other words, the UK legislation at issue concerns only situations in which the latter company enjoys a level of control over other companies belonging to the same group which allows it to influence the financing decisions of those other companies, in particular the decision as to whether those companies are to be financed by way of loan or equity capital.

1570. It is interesting to note that the Court, in para. 32, also considers the facts of the cases involved in the main proceedings and does not limit its investigation to the objective scope of the UK thin cap legislation. Hence, on the basis of both the objective scope of the UK legislation and of the facts of the cases at issue, the Court agrees with the Advocate-General[1137] and decides that the UK legislation was targeted only at relations within a group of companies and thus primarily affected the freedom of establishment.[1138] Even if that legislation had restrictive effects on the freedom of establishment and the free movement of capital, such effects must be seen as an unavoidable consequence of any restriction on freedom of establishment and do not justify an independent examination of that legislation in the light of Arts. 49 EC and 56 EC Treaty.[1139] In other words, the Court was again able

1136. With reference to ECJ, 13 April 2000, *C. Baars v. Inspecteur der Belastingen Particulieren/Ondernemingen Gorinchem*, Case C-251/98, *E.C.R.* 2000, p. I-2787, para. 22; ECJ, 21 November 2002, Case C-436/00, *X and Y v. Riksskatteverket*, C-436/00, *E.C.R.* 2002, p. I-10829, para. 37; ECJ, 12 September 2006, *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*, Case C-196/04, *E.C.R.* 2006, p. I-7995, para. 31.

1137. Geelhoed A-G, Opinion of 29 June 2006, *Test Claimants in the Thin Cap Group Litigation v. Commissioners of Inland Revenue*, Case C-524/04, *E.C.R.* 2007, p. I-2107, paras. 33-34.

1138. With reference to ECJ, 12 September 2006, *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*, Case C-196/04, *E.C.R.* 2006, p. I-7995, para. 32; ECJ, 12 December 2006, *Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue*, Case C-446/04, *E.C.R.* 2006, p. I-11753, para. 118.

1139. With reference to ECJ, 14 October 2004, *Omega*, Case C-36/02, *E.C.R.* 2004, p. I-9609, para. 27; ECJ, 12 September 2006, *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*, Case C-196/04, *E.C.R.* 2006, p. I-7995, para. 33; ECJ, 3 October 2006, *Fidium Finanz*, Case C-452/04, *E.C.R.* 2006, p. I-9521, paras. 48 and 49.

to discern a Treaty freedom that was preponderantly applicable so that it could exclude the free movement of capital from its examination.

1571. Lastly, another interesting issue addressed in the *Thin Cap Group Litigation* judgment, is whether the right of establishment also applies:

> (i) When the lending company is established in another Member State but where the common parent companies of the borrowing company and the lending company are resident in a non-member country;
>
> (ii) When the lending company is established in another Member State but where the loan is provided through a branch situated in a non-member country and the common parent companies of the borrowing company and the lending company are resident in a non-member country.

1572. The ECJ provided that it is not the residence of the lending company that will establish whether Community law is applicable but, since the right of establishment is at stake, rather the situation of the parent company which enjoys a level of control over each of the other companies concerned allowing it to influence the funding decisions of those companies. Insofar as that related company is not established in a Member State in the two situations mentioned above, Art. 43 EC Treaty is not applicable.

5.3.5.4. *Lasertec*

1573. The *Lasertec* case concerned the German thin cap rules, which were similar to the UK thin cap rules in the case discussed in the preceding section.[1140] However, the German thin cap rules had a broader scope, applying where a shareholder holds, directly or indirectly, over one quarter of the share or nominal capital of the subsidiary established in Germany *or* where the shareholder exercises, either independently or in collaboration with other shareholders, a controlling influence over the German company. The Swiss-based Lasertec AG held a participation of two thirds in its German-based subsidiary.

1574. The only question reviewed by the Court is on the basis of which Community freedom the German rules are to be analysed. It is not entirely clear from the judgment whether the Court has based its determination of the preponderant Treaty freedom on the scope of the national measure or, rather, on the facts of the case. The ECJ establishes that the German thin cap rules

1140. ECJ, Order of 10 May 2007, Case C-492/04, *Lasertec Gesellschaft für Stanzformen mbH v. Finanzamt Emmendingen*, *E.C.R.* 2007, p. I-3775.

apply when a definite influence is exerted on the subsidiary, irrespective of the precise threshold. However, a participation level of only 25%, which is also sufficient for the thin cap rules to apply, does not necessarily entail a definite influence on the subsidiary. In the *Baars* case, a shareholding of at least one third of the shares in a company was found to *not necessarily* affect the right of establishment,[1141] nor was the 10% holding requirement in the *FII Group Litigation* case sufficient to lead to the exclusive applicability of the right of establishment. It would appear that the Court was aware of this issue and, in order to dismiss any doubts as to the applicable freedom, decided to refer to the fact that in this particular case a participation of two thirds was held. This begs the question of whether the outcome of the case would have differed if Lasertec AG would only have held *one* third in its German subsidiary while the only other shareholder held *two* thirds. In that case, it could very well be argued that Lasertec AG had availed itself from the free movement of capital, rather than from the right of establishment, because it did not have a definite influence on the German subsidiary.

1575. The ECJ refers to the *Thin Cap Group Litigation* case by stating that even if the German measure had restrictive effects on the free movement of capital, such effects must be seen as an unavoidable consequence of any restriction on freedom of establishment and do not justify an independent examination of that legislation in the light of Art. 56 EC Treaty.

5.3.5.5. *A and B*

1576. The *A and B* case concerns Swedish legislation, introduced in the course of 1994, according to which dividend income from companies with few shareholders is converted into income from labour when the dividend income exceeds a certain threshold. This threshold is determined, inter alia, on the basis of a lump-sum return on the invested capital and of the wages paid out to the employees of the companies to the extent such wages are subject to Swedish social security contributions and wage taxes.[1142] The income thus recharacterized into labour income is then subjected to a higher tax rate. Following the accession of Sweden to the EU, *wages* paid out to employees employed in other Member States are also included in the calculation of the lump-sum return on the invested capital.

1141. See supra at 5.3.4.7.

1142. ECJ, Order of 10 May 2007, *Skatteverket v. A and B*, Case C-102/05, *E.C.R.* 2007, p. I-3871; see also B. Wiman, "Pending Cases Filed by Austrian Courts: The Skatteverket v. A, Skatteverket v. A and B, and Bouanich Cases", in *ECJ – Recent Developments in Direct Taxation*, M. Lang, J. Schuch and C. Staringer (eds.), Vienna: Linde Verlag, 2006, p. 302 et seq.

1577. A and B are individuals who each hold a share of 1.7% in X, a Swedish company with few shareholders. Company X is the parent company of company Y, another Swedish company, which in turn has a permanent establishment in Russia. The question rises before the Court whether the wages paid by the permanent establishment of Y in Russia are to be taken into account in the calculation of the above-mentioned threshold.

1578. The Court finds that the Swedish legislation primarily renders the opening of a permanent establishment in a third country less attractive and thus falls primarily within the scope of the right of establishment which does not extend to non-Member States. Again, the Court finds that any restrictions to the free movement of capital are an unavoidable consequence of the restriction on the freedom of establishment and do not justify an independent examination of that legislation in the light of Art. 56 EC Treaty.

1579. In any event, it seems peculiar that both the *Lasertec* and the *A and B* cases have been pronounced as orders of the Court instead of as judgments which, according to Art. 104, §3 of the Rules of Procedure, implies that the answer to a question submitted to the ECJ may be clearly deduced from its existing case law.

5.3.5.6. *Holböck*

1580. Mr Holböck is resident of Austria and the manager of CBS Conmeth Business Systems GmbH, the registered office of which is also established in Austria.[1143] The sole shareholder of that company is CBS Conmeth Business Systems AG ("the AG"), which has its registered office in Switzerland. Mr Holböck holds two thirds of the share capital in the Swiss company and received dividends therefrom during the period from 1992 to 1996. As income from capital, those dividends are taxable in Austria at the full income tax rate while dividends distributed by Austrian companies are subject to tax only at half of the average rate applying to the taxpayer. This legislation was in force prior to 31 December 1993 and remained in force until after Austria's accession to the European Union on 1 January 1995.

1143. ECJ, 24 May 2007, *Winfried L. Holböck v. Finanzamt Salzburg-Land*, Case C-157/05, *E.C.R.* 2007, p. I-4051; see also C. Staringer, "Pending Cases Filed by Austrian Courts: The Holböck Case", in Lang, Schuch and Staringer, id., p. 9 et seq.; C. Panayi, "The Fundamental Freedoms and Third Countries: Recent Perspectives", *Eur. Tax.* (2008) pp. 577-578.

1581. Mr Holböck refers to the *Lenz* case[1144] where the ECJ had decided that the unequal treatment caused by the same Austrian tax legislation amounted to a restriction on the free movement of capital for which there was no justification. Mr Holböck invoked Art. 56 EC Treaty since it also prohibits restrictions on the movement of capital between Member States and third countries.

1582. The ECJ finds that as to the question whether national legislation falls within the scope of one or another of the free movement provisions, it has been well-established case law that the *purpose* of the legislation concerned must be taken into consideration.[1145] The scope of the Austrian legislation was not limited to shareholdings that enable the holder to have a definite influence on a company's decisions and to determine its activities. The Court states that the Austrian legislation, which applies irrespective of the extent of the shareholding, may fall within the scope of both the freedom of establishment and the free movement of capital. In other words, the Court does not take account of the fact that Mr Holböck holds two thirds of the share capital in the Swiss company and it applies both freedoms simultaneously since the scope of the national legislation does not require a definite influence. The question then rises why in the *Lasertec* case only the right of establishment was considered as the applicable freedom although it was sufficient for the applicability of the relevant German thin cap rules that 25% of the capital of the subsidiary was held.

1583. In any event, the ECJ provides that neither of the two freedoms is able to preclude the application of the Austrian legislation. Evidently, the right of establishment does not extend to extra-Community situations. The Court then proceeds to establish that the Austrian measure is caught by the derogation laid down in Art. 57(1) EC Treaty, which grandfathers restrictions in existence on 31 December 1993 under national or Community law in respect of the movement of capital to or from non-member countries in-

1144. ECJ, 15 July 2004, *Anneliese Lenz v. Finanzlandesdirektion für Tirol*, Case C-315/02, *E.C.R.* 2004, p. I-7063; see also supra at 5.3.4.15.
1145. With reference to ECJ, 12 September 2006, *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*, Case C-196/04, *E.C.R.* 2006, p. I-7995, paras. 31 to 33; ECJ, 3 October 2006, *Fidium Finanz*, Case C-452/04, *E.C.R.* 2006, p. I-9521, paras. 34 and 44 to 49; ECJ, 12 December 2006, *Test Claimants in Class IV of the ACT Group Litigation v. Commissioners of Inland Revenue*, *E.C.R.* 2006, p. I-11673, paras. 37 and 38; ECJ, 12 December 2006, *Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue*, Case C-446/04, *E.C.R.* 2006, p. I-11753, para. 36; ECJ, 13 March 2007, *Test Claimants in the Thin Cap Group Litigation v. Commissioners of Inland Revenue*, Case C-524/04, *E.C.R.* 2007, p. I-2107, paras. 26 to 34.

volving direct investment (including in real estate), establishment, the provision of financial services or the admission of securities to capital markets.

1584. In defining the concept of "direct investment", the Court refers to the nomenclature of capital movements set out in Annex I to Council Directive 88/361/EEC. As a result, the concept of direct investments concerns:

> investments of any kind undertaken by natural or legal persons and which *serve to establish or maintain lasting and direct links* between the persons providing the capital and the undertakings to which that capital is made available in order to carry out an economic activity … As regards shareholdings in new or existing undertakings, as the explanatory notes confirm, the objective of establishing or maintaining lasting economic links presupposes that *the shares* held by the shareholder *enable him*, either pursuant to the provisions of the national laws relating to companies limited by shares or in some other way, *to participate effectively in the management of that company or in its control*.[1146] (emphasis added)

1585. Furthermore, the Court provides that Art. 57(1) EC Treaty not only extends to national measures which restrict investment or establishment but also to those measures which restrict payments of dividends deriving therefrom. It follows that a restriction on capital movements comes within the scope of Art. 57(1) EC Treaty to the extent it relates to holdings acquired with a view to establishing or maintaining lasting and direct economic links between the shareholder and the company concerned and which allow the shareholder to participate effectively in the management of the company or in its control. Hence, Mr Holböck's shareholding of two thirds of the share capital in the Swiss company falls within the scope of the grandfathering clause of Art. 57(1) EC Treaty.

1586. In this respect, it is remarkable that the level of the actual shareholding was of no importance in determining the applicable Treaty freedoms,[1147] which were exclusively determined by the scope of the national measure, whereas the actual shareholding did become determinative in assessing whether Art. 57(1) EC Treaty applied. It becomes apparent that the scope of Art. 57(1) EC Treaty is not limited to restrictions on *inbound* in-

1146. ECJ, 24 May 2007, *Winfried L. Holböck v. Finanzamt Salzburg-Land*, Case C-157/05, *E.C.R.* 2007, p. I-4051, paras. 34 and 35 with reference to ECJ, 12 December 2006, *Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue*, Case C-446/04, *E.C.R.* 2006, p. I-11753, para. 182; see also supra at 5.3.5.2.2.

1147. Although the actual shareholding was relevant in determining the applicable freedom in the *Lasertec* case, see supra at 5.3.5.4.

vestments[1148] since Mr Holböck had, as a Community citizen, taken a direct investment in a Swiss company. It further follows from the *Holböck* judgment[1149] that Art. 57(1) EC Treaty may also safeguard *general* measures that are not specifically focused on restricting capital movements to and from third countries,[1150] nor is it limited to national measures on banking and financial services.[1151]

1587. Lastly, the ECJ provides guidance on how rules for national legislation "existing" on 31 December 1993 within the meaning of Art. 57(1) EC Treaty should be interpreted.[1152] The fact that Austria joined the EU only on 1 January 1995 appears not to be of relevance.[1153] The Court repeats its findings in the *FII Group Litigation* judgment almost literally[1154] and concludes that the Austrian measure falls under the exception regime of Art. 57(1) EC Treaty. In conclusion, the Austrian tax measure is not precluded by the Treaty provisions on the free movement of capital.

5.3.5.7. *Stahlwerk Ergste Westig* (SEW)

1588. Stahlwerk Ergste Westig ("SEW") is a German resident company that held a 100% shareholding in two US partnerships that were characterized as permanent establishments of the German company.[1155] These two

1148. As was suggested, on the basis of a literal reading of Art. 57(1) EC Treaty, by D.S. Smit, "Capital movements and third countries: the significance of the standstill-clause ex-Article 57(1) of the EC Treaty in the field of direct taxation", *E.C.T.Rev*. (2006) p. 208.
1149. See ECJ, 24 May 2007, *Winfried L. Holböck v. Finanzamt Salzburg-Land*, Case C-157/05, *E.C.R.* 2007, p. I-4051, para. 36.
1150. A strong case was made for the contrary position, requiring specificity towards third countries, by Smit, "Capital movements and third countries: the significance of the standstill-clause ex-Article 57(1) of the EC Treaty in the field of direct taxation", op. cit., pp. 210-212; see also Peters and Gooijer, "The Free Movement of Capital and Third Countries: Some Observations", op. cit., p. 479; Weber, "Het Bosal Holding-arrest: analyse, kritiek en gevolgen", op. cit., p. 1865.
1151. As suggested by Peters and Gooijer, id., p. 477; S. Mohamed, *European Community Law on the Free Movement of Capital and the EMU*, Stockholm: Kluwer Law International, 1999, p. 217.
1152. With reference to ECJ, 1 June 1999, *Konle*, C-302/97, *E.C.R.* 1999, p. I-3099, para. 27.
1153. C. Panayi, "The Fundamental Freedoms and Third Countries: Recent Perspectives", *Eur. Tax.* (2008) pp. 577-578.
1154. ECJ, 12 December 2006, *Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue*, Case C-446/04, *E.C.R.* 2006, p. I-11753, para. 192; see also supra at 5.3.5.2.3.
1155. ECJ, 6 November 2007, *Stahlwerk Ergste Westig GmbH v. Finanzamt Düsseldorf-Mettmann*, C-415/06, *E.C.R.* 2007, p. I-151; see also Ch. Wimpissinger, "Cross-border transfer of losses, the ECJ does not agree with Advocate General Sharpston", *E.C.T.Rev.* (2009) pp. 174-175.

permanent establishments incurred a significant amount of losses that were deducted by SEW from its income taxable in Germany. The German tax authorities refused such deduction since the income of permanent establishments are tax exempt on the basis of Arts. 7 and 23 of the Germany–US DTC. SEW claims that the disallowance of the loss deductions is contrary to the free movement of capital as applied in relation to third countries.

1589. Similarly to the *A and B* case, the Court provides that the purpose of the tax measure at issue should be taken into consideration.[1156] Since the German company can exercise a definite influence over the decisions of its US establishments and can determine its activities, the case falls exclusively within the substantive scope of the right of establishment.[1157] Again, the Court finds that even if the German measure at issue has restrictive effects on the free movement of capital, such effects should be considered as an unavoidable consequence of the possible restriction on the freedom of establishment and do not justify an independent examination of that legislation in the light of Art. 56 EC Treaty.[1158]

1590. Consequently, since the free movement of capital is not applicable and the right of establishment does not extend to third countries, the Court does not find any infringement of Community law.

5.3.5.8. *Skatteverket v. A*

1591. Under Swedish tax law, dividends paid to a natural person resident in Sweden and distributed by a limited liability company are normally sub-

1156. With reference to ECJ, 12 September 2006, *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*, Case C-196/04, *E.C.R.* 2006, p. I-7995, paras. 31-33; ECJ, 3 October 2006, Fidium Finanz, Case C-452/04, *E.C.R.* 2006, p. I-9521, paras. 34 and 44-49; ECJ, 12 December 2006, *Test Claimants in Class IV of the ACT Group Litigation v. Commissioners of Inland Revenue*, *E.C.R.* 2006, p. I-11673, paras. 37 and 38; ECJ, 12 December 2006, *Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue*, Case C-446/04, *E.C.R.* 2006, p. I-11753, para. 36; ECJ, 13 March 2007, *Test Claimants in the Thin Cap Group Litigation v. Commissioners of Inland Revenue,* Case C-524/04, *E.C.R.* 2007, p. I-2107, paras. 26-34.
1157. With reference to ECJ, 13 April 2000, *C. Baars v. Inspecteur der Belastingen Particulieren/Ondernemingen Gorinchem*, Case C-251/98, *E.C.R.* 2000, p. I - 2787, para. 22; ECJ, 12 September 2006, *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*, Case C-196/04, *E.C.R.* 2006, p. I-7995, para. 31; ECJ, 13 March 2007, *Test Claimants in the Thin Cap Group Litigation v. Commissioners of Inland Revenue*, Case C-524/04, *E.C.R.* 2007, p. I-2107, para. 27.
1158. See also C. Panayi, "The Fundamental Freedoms and Third Countries: Recent Perspectives", *Eur. Tax.* (2008) p. 577.

ject to income tax in that Member State.[1159] However, dividends distributed by a Swedish limited liability company (parent company) in the form of shares in a subsidiary (hereinafter "share dividends") are not included in taxable income when a number of conditions are met. That exemption for share dividends was repealed in 1994, yet reintroduced in Swedish tax law in 1995. Furthermore, as of 2001, the exemption for share dividends was extended to situations where the distribution of shares is carried out by a foreign company which is established in a state within the European Economic Area ("EEA") or in a state with which Sweden has concluded a double tax convention that contains a provision on the exchange of information.

1592. Mr A owns shares in company X, which has its registered office in Switzerland and is considering distributing the shares which it holds in one of its subsidiaries. The level of A's shareholding in company X is apparently unknown. The double tax convention between Sweden and Switzerland does not contain a provision for the exchange of information comparable to that of Art. 26 of the OECD Model Convention. Art. 27 of the applicable double tax convention merely provides for an amicable procedure between the competent authorities of the contracting states with a view to avoid taxation that is not in accordance with the provisions of the convention and to resolve any difficulties or doubts arising as to the interpretation or application of the convention. Thus, the question is raised whether the free movement of capital precludes the Swedish measure that denies the tax exemption to share dividends distributed by companies established in third countries with which no exchange of information procedure has been agreed upon.

1593. The merit of the *A* judgment is that, for the first time, the Court addresses the fundamental considerations that have been made against extending its case law on the free movement of capital in intra-Community situations to situations relating to third countries. First, the Court discusses the direct effect of the free movement of capital in relations between Member States and third countries. The Court provides that, as a matter of principle, the exceptions to the free movement of capital in relation to third countries laid down in Arts. 57(1) and 57(2) EC Treaty cannot preclude Art. 56(1) EC Treaty from conferring rights on individuals which they can rely on before the courts.[1160]

1159. ECJ, 18 December 2007, *Skatteverket v. A*, Case C-101/05, *E.C.R.* 2007, p. I-11531; see P. Pistone, "Ups and Downs in the Case Law of the European Court of Justice and the Swinging Pendulum of Direct Taxation" *Intertax* (2008), pp. 149-151.
1160. With reference to ECJ, 14 December 1995, *Criminal proceedings against Lucas Emilio Sanz de Lera and others*, Joined Cases C-163/94, C-165/94 and C-250/94, *E.C.R.* 1995, p. I-4821, para. 47.

1594. Secondly, with regard to the concept of "restriction" in extra-Community situations, the Court follows the opinion of Advocate-General Bot[1161] and points out that the Member States chose to enshrine that principle in the same article and in the same terms for movements of capital taking place within the Community and those relating to movement to and from third countries. Furthermore, the Court acknowledges that movement of capital with third countries may pursue objectives other than that of establishing the internal market. But precisely for that reason the Member States considered it necessary to include safeguard clauses and derogations in Arts. 57(1), 57(2), 59, 60(1) and 60(2) EC Treaty that apply specifically to the movement of capital to or from third countries. The ECJ immediately reassures the Member States that in determining the extent to which they can apply certain restrictive measures on the movement of capital, account has to be taken 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. Hence, as the Court had already stated in the *FII Group Litigation* case,[1162] it may 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. On the basis thereof, the ECJ dismisses the argument of some Member States that, by extending the prohibition of restrictions on movement of capital to relations between Member States and third countries without reservations, the Community would unilaterally open up its market to third countries while being put in a weak negotiation position to achieve such liberalization on the part of those countries.

1595. Once it is accepted that the intra-Community concept of "restriction" can also be applied in the case at hand, the Court quickly finds that the Swedish measure effectively entails a restriction on the movement of capital between Member States and third countries.

1596. As the Court is unsure whether the dividends, which company X is contemplating to distribute to A, relate to direct investments within the meaning of Art. 57(1) EC Treaty, the Court examines whether the Swedish legislation may fall within the exception provided for in that article as a restriction which existed on 31 December 1993. The words "restrictions which

1161. Bot A-G, Opinion of 11 September 2007, *Skatteverket v. A, Case*, C-101/05, *E.C.R.* 2007, p. I-11531 paras. 74-83.
1162. See ECJ, 12 December 2006, *Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue*, Case C-446/04, *E.C.R.* 2006, p. I-11753, paras. 170-171.

exist on 31 December 1993" presuppose that the measure in question formed part of the legal order of the Member State concerned *continuously* since that date. If that was not the case, a Member State could, at any time, reintroduce restrictions on the movement of capital to or from third countries which existed as part of the national legal order on 31 December 1993 but had not been maintained. The Swedish provisions on the *exemption* of share dividends were repealed in 1994, then reintroduced in 1995 and extended in 2001 to dividends paid by companies established in an EEA Member State or in another state with which Sweden has concluded a convention providing for the exchange of information. However, the ECJ points out that the fact remains that the exemption has never been granted for share dividends paid by companies established in a third country outside the EEA that has not concluded such a convention with Sweden. Hence, the Swedish measure must be regarded as a restriction that existed on 31 December 1993 within the meaning of Art. 57(1) EC Treaty. Interestingly, the Court concludes that since it is not clear whether *the dividends in question in the main proceedings* relate to direct investments, it is necessary to examine whether national legislation such as that in issue in the main proceedings may be justified by an overriding requirement of general interest. Just as in *Holböck*, the Court is not so much concerned with the *scope* or the *purpose* of the legislation at issue as it is with the actual facts of the case in determining whether Art. 57(1) is applicable.

1597. All intervening Member States invoked the need to guarantee the effectiveness of fiscal supervision as a justification ground for the restrictive nature of the Swedish measure. The Swedish tax authorities did not have recourse to any mutual assistance between competent authorities, as provided for by Directive 77/799, since a non-Member State is concerned. Neither does the double tax convention contain a measure providing for an exchange of information comparable to that in Art. 26 of the OECD Model Convention. Even if the taxpayer has the information necessary to demonstrate that the requirements of the exemption regime are satisfied, the tax authorities remain unable to assess the value of the evidence provided.

1598. The ECJ recalls its case law in which it held that the limited nature of the exchange of information provided for by Directive 77/799 is not a sufficient reason for the tax authorities to justify a flat-out refusal to grant a tax advantage. Tax authorities are able to request from the taxpayer the evidence that they consider necessary to effect a correct tax assessment and, where appropriate, refuse the exemption applied for if that evidence is not

supplied.[1163] Hence, in an intra-Community context, the Court has held that the taxpayer should not be precluded *a priori* from providing relevant documentary evidence enabling the tax authorities of the Member State imposing the tax to ascertain, clearly and precisely, that he is not attempting to avoid or evade the payment of taxes.[1164] Furthermore, the taxpayer submitted that insofar as the exemption related to dividends paid by a company that is quoted on the stock exchange, certain information could also be obtained by inspecting the data which such a company was legally required to publish.

1599. However, according to the ECJ, such case law relating to intra-Community situations cannot be transposed in its entirety to movements of capital between Member States and third countries. The Court gives two reasons why such movements take place in a different legal context from that of the preceding cases on intra-Community restrictions:

> In the first place, relations between the Member States take place against a common legal background, characterised by the existence of Community legislation, such as Directive 77/799, which laid down reciprocal obligations of mutual assistance. Even if, in the fields governed by that directive, the obligation to provide assistance is not unlimited, *the fact remains that that directive established a framework for cooperation* between the competent authorities of the Member States which does not exist between those authorities and the competent authorities of a third country where the latter has given no undertaking of mutual assistance.
>
> In second place, … the *Community harmonisation measures on company accounts* which apply in the Member States allow the taxpayer to produce reliable and verifiable evidence on the structure or activities of a company established in another Member State, whereas the taxpayer is not ensured of such an opportunity in the case of a company established in a third country which is not required to apply those Community measures.[1165] (emphasis added)

1600. Hence, the ECJ concludes that where the legislation of a Member State makes the grant of a tax advantage dependent on satisfying requirements, compliance with which can be verified only by obtaining informa-

1163. With reference to ECJ, 28 January 1992, *Hans-Martin Bachmann v. Belgian State*, Case C-204/90, *E.C.R.* 1992, p. I-249, para. 20; ECJ, 30 January 2007, *Commission v. Denmark*, Case C-150/04, *E.C.R.* 2007, p. I-1163, para. 54; ECJ, 11 October 2007, ELISA, Case C-451/05, *E.C.R.* 2007, p. I-8251, paras. 94 and 95.
1164. With reference to ECJ, 8 July 1999, *Baxter and others*, C-254/97, *E.C.R.* 1999, p. I-4809, paras. 19 and 20; ECJ, 10 March 2005, Case C-39/04, *Laboratoires Fournier SA t. Direction des vérifications nationales et internationales*, *E.C.R.* 2005, p. I-2057, para. 25; ECJ, 11 October 2007, ELISA, Case C-451/05, *E.C.R.* 2007, p. I-8251, para. 96.
1165. ECJ, 18 December 2007, *Skatteverket v. A*, Case C-101/05, *E.C.R.* 2007, p. I-11531, paras. 61-62.

tion from the competent authorities of a third country, it is legitimate for that Member State to refuse to grant that advantage if it proves impossible to obtain such information from that country. The ECJ leaves it to referring court to decide whether compliance with the conditions for the share dividend exemption can only be verified by obtaining information from the competent authorities of Switzerland.

5.3.5.9. *Orange European Smallcap Fund*

1601. The first third country issue brought up in the *Orange European Smallcap Fund* case[1166] (hereinafter "OESF") is the fact that Dutch legislation reduced the tax credit for foreign withholding taxes granted to investment companies proportional to the shares held by non-resident shareholders or entities established outside of the Netherlands, including shareholders or entities established outside the Community.

1602. The ECJ repeats the principles with regard to the third country applicability of the free movement of capital it established in the *FII* and *Skatteverket v. A* cases discussed above. Encouraged by the ruling in those cases that a restriction on capital movements to or from third countries could be 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, the Dutch government invoked a justification ground that had never been accepted in intra-Community situations. It argued in particular that the need to avoid a reduction in tax revenue[1167] must be capable of being relied upon as justification for a restriction on the movement of capital to or from third countries. Although the Court is highly conditional in its response, it does not altogether rule out the acceptability of such justification ground as it has done many times over with regard to intra-Community situations. Conversely, the ECJ avoids having to rule on the issue by pointing out that the reduction of the tax credit concession in proportion to the interest in the investment company held by shareholders resident or established in third countries has the effect of reducing the total amount of profit available for distribution for all shareholders of that company, *including those established within the Community*. What follows is a rather Jesuitical consideration of the ECJ:

> 95. Consequently, *on the assumption that such a ground may be relied upon as justification for a restriction on the movement of capital to or from third countries*, such a justification cannot be taken into consideration in the present case,

1166. See supra at 5.3.4.36.
1167. See infra at 5.3.6.2.

> inasmuch as that reduction affects all shareholders of the collective investment enterprise concerned without distinction, whether resident or established in the Member States or in third countries. (emphasis added)

1603. Clearly, the ECJ did not want to exclude altogether that a reduction in tax revenue as a justification ground for a restriction on the movement of capital with regard to third countries might be acceptable. The Court merely points out that the consequence of the Dutch measure in question goes beyond compensating a loss of tax revenue with regard to third country residents, but also affects intra-Community situations. For that reason, the decision of the ECJ in relation to intra-Community situations[1168] equally applies to situations in which shareholders of an investment company are resident or established in third countries.

1604. A second issue raised in *OESF* concerns the meaning of the "direct investment"' concept of Art. 57(1) EC Treaty, particularly whether it covers the holding of a participation in a company that does not put the holder in a position to exercise a decisive influence over the management or control of that company. The ECJ again refers to the nomenclature annexed to Directive 88/361/EEC on the implementation of Art. 67 EC Treaty. It follows therefrom that direct investments relate to investments of any kind undertaken by natural or legal persons and which serve *to establish or to maintain lasting and direct links* between the persons providing the capital and the undertakings to which that capital is made available in order to carry out an economic activity.[1169] However, the ECJ now gives some more guidance by providing that the objective of establishing or maintaining lasting economic links presupposes that the shares held by the shareholder enable him, either pursuant to the provisions of the national laws relating to companies limited by shares or in some other way, *to participate effectively in the management of that company or in its control*.

1605. Thus, it appears that whereas establishment requires that the shareholder can exercise a definite influence on the company and determine its activities, direct investment only requires that lasting and direct links are established or maintained which allow the shareholder to *participate* effectively in the management or control of that company.

1168. See supra at 5.3.4.36.3.

1169. ECJ, 12 December 2006, *Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue*, Case C-446/04, *E.C.R.* 2006, p. I-11753, paras. 179-181; ECJ, 18 December 2007, *Skatteverket v. A*, Case C-101/05, *E.C.R.* 2007, p. I-11531, para. 16; ECJ, 23 October 2007, *Commission v. Germany*, Case C-112/05, *E.C.R.* 2007, p. I-8995, para. 18.

1606. Thirdly, the referring Dutch court wanted to know whether the answer to the first third country issue also applied to situations where the dividend was distributed by a company established in a third country. The ECJ replied that as soon as the Netherlands decided to grant investment companies established on its territory a tax credit for withholding taxes levied abroad and to exercise its taxing competence over all dividends distributed by such enterprises to their shareholders, whether resident or established in that Member State or in others, or in third countries, it had to extend the benefit of that concession to investment companies the shareholders of which include shareholders who are not resident or are not established in the Netherlands. The Court states that the same considerations as made above[1170] are relevant and that the free movement of capital also precludes the Dutch legislation as it applies to dividends received from third countries.

5.3.5.10. *STEKO*

1607. The issue of third country applicability is not comprehensively dealt with in the *STEKO* decision.[1171] It was not clear from the questions of the referring national court whether the shareholdings at stake were shareholdings in companies established within or outside the EU. The German authorities invoked that the need to ensure the effectiveness of fiscal supervision would be an adequate justification ground for refusing the tax deductibility of the depreciation of participations in companies established outside the EU.

1608. The ECJ simply holds that such a justification ground is of no relevance where the depreciation in the value of holdings in non-resident companies is the result of a fall in the stock market, which had been established in the facts of the case. Consequently, the final ruling of the Court finds the German measure contrary to the free movement of capital without making any further qualification with regard to participations in companies established outside the EU.

5.3.5.11. *KBC Bank*

1609. The *KBC Bank* and *BRB* joined cases[1172] concern the compatibility of the Belgian dividend received deduction (hereinafter "DRD") regime

1170. See also supra at 5.3.4.36.3.
1171. See supra at 5.3.4.42. – no written opinion of the Advocate-General was issued.
1172. ECJ, Order of 4 June 2009, *Belgium v. KBC Bank NV and Beleggen, Risicokapitaal, Beheer NV*, Joined Cases C-439/07 and C-499/07, *not yet published*; see also

with Art. 4 of the Parent-Subsidiary Directive, with the right of establishment and free movement of capital. In an earlier *Cobelfret* decision, the ECJ had concluded that the DRD regime, with respect to intra-Community dividends, is precluded by the Parent-Subsidiary Directive. In the *KBC Bank* case, the same material issue was put before the ECJ but now in relation to dividends distributed by companies established in non-EC countries.

1610. In its implementation of the Parent-Subsidiary Directive, Belgian tax legislation first includes qualifying dividends received in the taxable profits of a Belgian parent company and, subsequently, grants the Belgian parent company a dividend received deduction ("DRD") of 95% of the qualifying dividends. However, the DRD is limited to the net operating profits, meaning that any "excess" DRD cannot be used and does not increase the tax losses of the Belgian parent company. In other words, the net operating losses of a Belgian parent company are set off against income from dividends received and the dividend received deduction subsequently granted may only reduce the taxable income to zero. Thus, any excess DRD cannot be used nor can it be carried forward or carried back. The overall effect of the limitation of DRD is that the net operating losses of the parent company cannot be offset against future taxable profits.

1611. KBC Bank received dividends from non-EC resident companies, which gave rise to "excess" or unusable DRD because of an insufficiently positive tax base. The request for a preliminary ruling therefore included the question whether Belgium was obliged under the free movement of capital to remedy the "excess" DRD incurred on non-EC sourced dividends.

1612. The ECJ first repeats its findings of the *Cobelfret* case, i.e. that Belgium failed to implement the Parent-Subsidiary Directive correctly with respect to intra-EU dividends because it does not effectively refrain from taxing dividend income in all situations.

1613. Surprisingly, however, the ECJ decided in its *KBC Bank* order that if dividends from third countries are treated less favourably than Belgian dividends, it is up to the national courts to determine whether the free movement of capital is applicable and whether such freedom precludes a difference in the treatment of the dividend distributions. The ECJ then gives a summary of its traditional position on the free movement of capital with regard to third countries as guidance for the national courts. First, the ECJ

P. Bielen, "Aftrekbeperking DBI-overschotten strijdig met de Moeder-dochterrichtlijn", 359 *T.F.R.* (2009) pp. 327-329; P. Bielen, "Hof van Justitie hakt Europese knoop inzake DBI-overschotten niet volledig door", 367 *T.F.R.* (2009) pp. 746-751.

provides that, in order to determine the applicable free movement right, account has to be taken of the scope of the national measure at issue. If the scope of the national measure at issue does not depend on the size of the participation, both the right of establishment and the free movement of goods may be applicable.[1173] However, if the actual participation in the case at hand confers on the shareholder definite influence over the company's decisions and allows the shareholder to determine the company's activities, the right of establishment takes precedence.[1174]

1614. Secondly, the ECJ reminds the national courts that account has to be taken 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. More in particular, because of the existence of Directive 77/799,[1175] taxing economic activity within the Community may not always be comparable to economic activities carried out between Member States and third countries.[1176]

1615. Thirdly, it cannot be excluded that a Member State can invoke a justification ground for a restriction of the free movement of capital with respect to non-EC countries under circumstances where the same justification ground would not be acceptable to justify a restriction on the free movement of capital between Member States.[1177]

1616. The ECJ concludes that it is up to the national judge to decide whether, taking account of the scope of the national measure and the actual facts of the case, the free movement of capital is applicable and whether such national measure is precluded by the free movement of capital.

1173. With reference to ECJ, 12 December 2006, *Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue*, Case C-446/04, *E.C.R.* 2006, p. I-11753, para. 36; ECJ, 26 June 2008, *Finanzamt Hamburg-Am Tierpark v. Burda GmbH*, Case C-284/06, *E.C.R.* 2008, p. I-4571, para. 71.

1174. ECJ, 12 December 2006, *Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue*, Case C-446/04, *E.C.R.* 2006, p. I-11753, para. 81.

1175. Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation, *O.J.* L 336, 27 December 1977, pp. 15-20.

1176. With reference to ECJ, 12 December 2006, *Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue*, Case C-446/04, *E.C.R.* 2006, p. I-11753, para. 170; ECJ, Order of 23 April 2008, *Test Claimants in the CFC and Dividend GLO v. Commissioners of Inland Revenue*, C-201/05, *E.C.R.* 2008, p. I-2875, para. 92.

1177. With reference to ECJ, 18 December 2007, *Skatteverket v. A*, Case C-101/05, *E.C.R.* 2007, p. I-11531, paras. 36 and 37; ECJ, Order of 23 April 2008, *Test Claimants in the CFC and Dividend GLO v. Commissioners of Inland Revenue*, C-201/05, *E.C.R.* 2008, p. I-2875, para. 93.

5.3.5.12. Conclusion

1617. It was obvious that the free movement of capital when applied to third countries would become somewhat of a predicament for the ECJ. In the case law discussed above, the Court took the principal position that the personal and substantive scope of the free movement of capital is identical, irrespective of whether it is applied in an intra-Community or in an extra-Community context. From the perspective of the internal reference points in its "direct effect" doctrine, there were good reasons for the Court to take the opposite position, i.e. that the free movement of capital in relation to third countries does not have direct effect. The implications for the establishment of the internal market are murky at best and their purpose has never been spelled out by the Council on the occasion of the drafting of the Maastricht Treaty.

1618. Nevertheless, the Court chose to grant direct effect to these provisions. Once this fundamental hurdle was taken, the next question was whether the Court would allow for the potential expansion of the territorial scope of the other Treaty freedoms when the free movement of capital was concurrently applicable. In other words, would some instances of establishment or of the provision of services in extra-Community situations also be protected by Community law, through the proverbial "back door" of the free movement of capital?

1619. The ECJ has provided a very cautious answer to the latter question. The Court has chosen to avoid the issue of the third country extension of the free movement of capital in the *Fidium Finanz*, *Lasertec* and *A and B* cases by looking for a *preponderant* Treaty freedom in the light of the national measure at issue[1178] and by thus segregating the scope of the free movement of capital from the scope of the other freedoms. This comes as a new and surprising, if ultimately understandable, development.[1179] The Court has had to ignore the purpose of Art. 57(1) EC Treaty which, by grandfathering re-

1178. Which has also been confirmed in later cases where the third country issue was not at stake, such as ECJ, 18 July 2007, *Oy AA*, Case C-231/05, *E.C.R.* 2007, p. I-6373, para. 24; ECJ, 18 June 2009, Aberdeen Property Fininvest Alpha Oy, Case C-303/07, *not yet reported*, para. 35.

1179. Cordewener, Kofler and Schindler, "Free Movement of Capital and Third Countries: Exploring the Outer Boundaries with Lasertec, A and B and Holböck", op. cit., p. 372; Smit, "The relationship between the free movement of capital and the other EC Treaty freedoms in third country relationships in the field of direct taxation: a question of exclusivity, parallelism or causality?", op. cit., p. 252; Dahlberg, *Direct Taxation in Relation to the Freedom of Establishment and the Free Movement of Capital*, op. cit., p. 290; Mitroyanni, "Exploring the Scope of the Free Movement of Capital in Direct Taxation", op. cit., p. 5; Stähl, "Free movement of capital between Member States and third countries", op. cit., pp. 48-49; Haferkamp, *Die Kapitalverkehrsfreiheit im System der Grund-*