FII 2 and the applicable freedoms of movement in third country situations

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Abstract

In this article, the authors discuss the approach that the Court of Justice of the European Union (CJEU) adopts in deciding which of the European treaty freedoms apply to third country situations. On 13 November 2012 the CJEU delivered a landmark ruling on this matter in the Test Claimants in the FII Group Litigation case. The CJEU observed that if the tax legislation in question is of a general nature then the free movement of capital also applies where EU resident entities derive taxable proceeds from majority interests held in companies resident in third countries. In reaching this conclusion, the CJEU adopted an approach that seems to differentiate from that applied in earlier judgments. Moreover, the CJEU's findings clearly differ from the approach taken by the Dutch Supreme Court in various recent judgments. The Dutch Supreme Court considers external cross-border investments in majority shareholding interests as acts of establishment, which are not protected under EU law, because the freedom of establishment does not apply to third country situations. Assessing EU jurisprudence, the authors seek to answer the question which treaty freedom applies in cases involving the direct taxation of proceeds from cross-border third-country corporate shareholding interests; and where does the approach adopted by the CJEU differ from that of the Dutch Supreme Court? The authors further address some potential consequences that the CJEU case law on this matter could have on the future interpretation of the freedom of capital.

1 Introduction

On November 13, 2012, the Court of Justice of the European Union (CJEU) rendered its second judgment in the Test Claimants in the FII Group Litigation case ('*FII 2*').[3] In this judgment, the CJEU again ruled on the reference for a preliminary ruling on whether the former UK double taxation relief rules for inward bound dividends were contrary to EU law. The judgment is interesting in several respects. For example, the CJEU addresses whether the UK methods used for indirect credit and exemption are compatible with the treaty freedoms. However, this aspect is not touched upon in this article.

In this article, we discuss the approach adopted by the CJEU in deciding which of the European treaty freedoms apply to third country situations. Much has been written about this issue in the professional tax literature.[4] After the CJEU had rendered its first judgment in this case, it became apparent that several of the

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[3] CJEU case C-35/11 (*Test Claimants in the FII Group Litigation – FII 2*), V-N 2013/3.8. Cf. S.C.W. Douma, 'Vrij Kapitaalverkeer na FII(2)' ("The free movement of capital in the wake of FII(2)), NTFR 2012/2689.
[4] Some of the professional literature available on this subject: D.S. Smit, *Freedom of Investment between EU and Non-EU Member States and its Impact on Corporate Income Tax Systems within the European Union*, Tilburg: Tilburg University, 2011, Joachim Englisch, 'Taxation of Cross-Border Dividends and EC Fundamental Freedoms', 38 Intertax (2010, no. 4) 197, at 197-221, Axel Cordewener, 'Free movement of capital between EU Member States and Third Countries: How Far Has the Door Been Closed?', 18 EC Tax Review (2009, no. 6) 260, at 260-263, Maarten de Wilde and Renata Fontana, 'ECJ holds German legislation disallowing write down on participations acquired from non-residents compatible with free movement of capital (Glaxo Wellcome)', European Tax Service, BNA International Inc., October 2009, at 24-25, Sigrid Hemels, Joost Rompen, Patrick Smet, Isabelle De Waele, Steffan Adfeldt, Gottfried Breuninger, Markus Ernst, Viviane Carpentier, Siamak Mostafavi, 'Freedom of Establishment or Free movement of capital: Is There an Order of Priority? Conflicting Visions of National Courts and the ECJ', 19 EC Tax Review 19 (2010, no. 1), at 19-31, Ben J. Kiekebeld and Daniel S. Smit, 'Freedom of establishment and free movement of capital in Association and Partnership Agreements and direct taxation', 16 EC Tax Review 216 (2007, no. 5), at 216-230, Daniël S. Smit and Ben J. Kiekebeld, *EC Free Movement of Capital, Income Taxation and Third Countries: Four Selected Issues*, Kluwer Law International, Alphen aan den Rijn, 2008 (Smit/Kiekebeld 2008), Daniël S. 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

litigating parties held majority interests in companies resident in 'third countries'. [5] As the UK court considered CJEU case law on the applicable treaty freedoms in such cases unclear, it requested a preliminary ruling on this issue. Does the case at hand involve a restriction of the freedom of establishment, a restriction of the free movement of capital, or a restriction of both (at the same time)? In reaching its conclusion, the CJEU adopted an approach that seems to differentiate from that applied in earlier judgments.[6] Broadly speaking, the CJEU concluded that if the tax legislation in question is of a general nature then the free movement of capital also applies where EU resident entities derive taxable proceeds from majority interests held in companies resident in third countries. This approach clearly differs from the approach adopted by the Dutch Supreme Court in various recent judgments, which was also based on earlier CJEU case law. The Dutch Supreme Court considers external cross-border investments in majority shareholding interests as acts of establishment, which are not protected under EU law, because the freedom of establishment does not apply to third country situations.

In this article, we analyze the judgment rendered in the *FII 2* case. Which treaty freedom applies in cases involving the taxation of proceeds from cross-border third-country corporate shareholding interests and where does the approach adopted by the CJEU in the *FII 2* case differ from that of the Dutch Supreme Court? We also address some potential consequences the *FII 2* judgment could have on the future interpretation of the free movement of capital.

2 The path taken by the CJEU when deciding which treaty freedom applies

2.1 Qualification of type of movement relevant from a legal perspective, but the CJEU's approach has not always been clear

The question as to which freedom applies is particularly relevant for economic activities outside the territory of the European Union/European Economic Area (EU/EEA).[7] After all, the persons and territory covered by primary European Union law differs per type of movement involved. The free movement of people, goods and services only applies to citizens (or employees) of the Members States.[8] Moreover, these freedoms only apply to acts of establishment, movement of goods or services within the territory of the EU/EEA. This is different under the free movement of capital, which extends to third countries. The persons and territory falling under the free movement of capital is also universal.[9] Consequently, Member States are allowed to discourage

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causality?', 16 EC Tax Review 252 (2007, no. 6), at 252-267, Axel Cordewener, Georg W. Kofler and Clemens Philipp Schindler, 'Free Movement of Capital And Third Countries: Exploring The Outer Boundaries with Lasertec, A and B and Holböck', 47 European Taxation 371 (2007, no. 8-9), at 371-376, Axel Cordewener, Georg W. Kofler and Clemens Philipp Schindler, 'Free movement of capital, third country relationships and national tax law: an emerging issue before the ECJ', 47 European Taxation 107 (2007, no. 3), at 107-119, B.J. Kiekebeld, 'Kapitaalverkeer versus vestigingsverkeer: eindelijk echt duidelijk?', (*Free movement of capital versus freedom of establishment: clarity at last?*) NTFR-B 2013/11, D.S. Smit, 'Europese verdragsvrijheden and derde landen: invloed op de Nederlandse vennootschaps- en dividendbelasting' (*European treaty freedoms and third countries: their impact on Dutch corporate income tax and dividend withholding tax*), TFO 2012/122, S.J.C. Hemels and J.W. Rompen, 'Vestiging of kapitaalverkeer: welke vrijheid heeft prioriteit? (Freedom of *establishment or free movement of capital: which freedom takes precedence?*), WFR 2010/1058, M.G.H. van der Kroon, Het Baarscriterium krijgt invulling' (*The Baars criterion explained*), WFR 2010/229, B.J. Kiekebeld, 'Kapitaalverkeer versus vestigingsverkeer'(*Free movement of capital versus freedom of establishment*), NTFR-B 2009/47, A.A. Fase, 'Het rangordevraagstuk in derdelandenverhoudingen' (*The ranking issue in third country relationship*), WFR 2008/687, W.F.E.M.Egelie, 'Deelnemingen en de samenloop tussen art. 43 EG and art. 56 EG: hoe zit het nu?' (*Participations and the conflict between Article 43 EC and Article 56 EC: please explain?*), NTFR 2007/1374, WFR 2008/687, P.J.J.M. Peeters, 'Meerderheidsdeelnemingen: bestaat er een rangorde tussen art. 43 and 56 EG?' (*Majority interest participations: how do Article 43 and 56 EU rank?*) WFR 2007/777, as well as E. Nijkeuter, 'Samenloop van art. 43 EG en art. 56 EG' (*Conflict between Article 43 EC and Article 56 EC*), WFR 2006/249.

[5] CJEU case C-446/04 (*Test Claimants in the FII Group Litigation – FII 1*).

[6] CJEU case C-439/07 and C-499/07 (*KBC Bank*) and CJEU case C-311/08 (*SGI*).

[7] Broadly speaking, the EU/EEA territory is the territory of the EU/EEA Member States on the European continent. A problem arises, for example, in defining the overseas areas of the EU Member States. This matter e.g. also arises within the Kingdom of the Netherlands. Are the Caribbean island administrations of the Netherlands and the other territories making up the Kingdom of the Netherlands third countries? The Dutch Supreme Court has requested a preliminary ruling on this issue (see BNB 2012/197-298).

[8] Art. 54 TFEU.

[9] Art. 63-66 TFEU. Please note that Article 63 TFEU deals with capital movements in an objective manner, aimed at the 'object' of the freedom. Article 49 TFEU (freedom of establishment) focuses on the person, i.e. the 'national', and is aimed at the 'subject' of the freedom. Cf. Smit/Kiekebeld 2008, loc. cit., paragraph 3.3.

economic activities beyond the external borders of the EU/EEA,[10] unless the legal transactions/movements qualify as capital movements. The EU/EEA Member States are not allowed to restrict or discriminate these capital movements, save for the application of the standstill provision.[11]

Despite the importance of precisely defining what qualifies as a movement of capital on the one hand, and what qualifies as an act of establishment, supply of goods or provision of services on the other hand, the approach adopted by the CJEU has not always been clear. This applies in particular to the distinction between capital movements and acts of establishment, and then primarily to the extent that it involves investments in a shareholding that allow the holder to exercise a decisive influence in the running of the company in which the interest is held.[12] In situations where the interest of the holder does not confer a decisive influence, the CJEU's approach seems to be consistent. In those cases, the investment and the accompanying investment proceeds are capital movements.[13]

2.2 Factual approach or object and purpose?

Until its judgment in the *FII 2* case, the case law of the CJEU did not always seem consistent in how it dealt with majority interests in third country situations. In some cases the CJEU qualified the movement based on the *facts and circumstances*, i.e. a factual approach. In other cases the CJEU based its conclusion on the *ratio of the assessed measure*, i.e. an object and purpose approach.[14]

The CJEU opted for the factual approach in various judgments,[15] where its conclusion on whether a capital movement or act of establishment was involved was based on the facts and circumstances. If the shareholder has a 'decisive influence' on the underlying business activities, then this is regarded as an act of establishment. This is also referred to as the 'Baars criterion'.[16] This approach leads to the conclusion in favor of the freedom of establishment. The Dutch Supreme Court has adopted this line of reasoning consistently in its judgments on these matters.[17] If the facts concern an act of establishment outside the external borders of the EU/EEA, then primary European Union law does not apply under this approach. In such cases, EU law is unavailable to resolve a substantially restrictive measure.

In various other judgments, the CJEU based its conclusion on whether a movement of capital or act of establishment was involved, on the subject matter of the tax measure at hand − and therein the uncertainty evolved.[18] In those cases, the CJEU looked at the aim and the spirit of the potentially restricting measure in order to qualify the capital movement. If the tax measure only applies to interests that allow the shareholder

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[10] This is in comparison to their intra-EU/EEA equivalents.

[11] Art. 64 TFEU. External cross-border capital movements fall under the free movement of capital, with the exception of restrictive and discriminatory measures in respect of 'direct investments' in place in the laws of the Member States as at December 31, 1993. Before this date, there was no provision in Community law that directly applied to capital movements involving third countries. Cf., e.g., Dutch Supreme Court case no. BNB 2005/224, in which the Dutch Supreme Court concluded that, in view of the *Bosal* case (CJEU case C-168/01), the deduction limitation for participation costs that is untenable under EU law, does not apply to costs incurred before January 1, 1994, relating to participations in entities resident outside the European Economic Community as it existed at that time. The Bosal judgment did affect the pre-1994 participations costs that involved entities resident within the Community, see e.g., Dutch Supreme Court case no. BNB 2005/224.

[12] In cases involving the distinction between a capital movement or the provision of a service, the CJEU seems to apply a causal test or 'weighing of interests approach': if the measure affects more than one freedom, then the freedom which is '*affected primarily*' applies, the other freedoms are then not taken into consideration if they are '*entirely secondary*'. C.f. CJEU cases C-204/90 (*Bachmann*), C-36/02 (*Omega Spielhallen*) and C-452/04 (*Fidium Finanz*). It is worth noting that Article 57 TFEU includes a preferential rule for the provision of services that stipulates that the other freedoms take precedence over the movement of services. The CJEU seems to be ignoring this provision.

[13] Cf. the *FII 1* case and the CJEU joined cases C-436/08, C-437/08 (*Haribo/Salinen*). CJEU case no. C-208/00 (*Überseering*).

[14] Cf. for example *Hemels et al*, loc.cit.loc. cit, at 31, *Englisch*, loc. cit., at 197-221, and *De Wilde/Fontana*, loc.cit.loc. cit, at 24-25.

[15] Cf. *Baars*, loc.cit., *Burda*, loc.cit. In *Burda*, the CJEU concluded that only the freedom of establishment applies to majority interests, as this effectively involves decisive control.

[16] Cf. the 'Baars criterium', Van der Kroon, loc.cit.

[17] Cf. Dutch Supreme Court BNB 2006/254, BNB 2009/23-24, BNB 2009/216, BNB 2009/239, BNB 2009/261, BNB 2010/291-292, BNB 2011/162, BNB 2012/102, BNB 2012/197-198 and Dutch Supreme Court, October 5, 2012, no. 11/02956.

[18] Cf. CJEU cases C-182/08 (*Glaxo*), C-157/05 (*Holböck*) and *Haribo/Salinen*, loc.cit. In the *Holböck* and *Glaxo* cases, the CJEU assessed the majority interests under the free movement of capital, on the basis of the ratio of the disputed rule. Cf. *FII 2,* loc.cit., Observation 90.

to exercise a decisive influence on the underlying activities, then it is considered an act of establishment.[19] If the measure is aimed at taxing portfolio investment returns, or if it aims to combat abusive tax practices – the measure for instance seeks to counter the tax-induced sheltering of mobile intangible resources in controlled entities in low-taxing jurisdictions, then this is considered a capital movement.[20] The CJEU also adopted this approach in cases where the facts involve an investment in a majority interest.[21] It seems that this line of reasoning has also been followed by the French, German and UK tax courts.[22]

Complicating matters is the fact that the CJEU does not explain *why* it has adopted these apparent different approaches. The focus is on majority interests under general tax rules and thus on situations whereby the shareholder exercises a decisive influence, while it cannot be ascertained from the subject matter of the disputed tax rules whether these are targeted at direct investments, portfolio investments or the combating of tax abuse. In such cases, it is unclear how the movement should to be qualified from an EU law perspective, with the result being legal uncertainty about the scope of EU law in third country situations. It seems that the CJEU tried to clarify this issue in *FII 2* by merging its approaches into one single consistent approach.[23]

2.3 CJEU in FII 2: from an object and purpose, and factual perspective

In *FII 2*, the CJEU based its choice of applicable freedom on the object and purpose approach, only applying the factual approach where it apparently considered this necessary. Firstly, the CJEU ruled that under EU law tax measures whose subject matter is restricted to majority participations must be assessed as acts of establishment. This is exclusively governed by the freedom of establishment.[24] This could involve regimes dealing with groups of affiliated corporate entities, such as tax grouping regimes (e.g., group relief, tax consolidation) or thin capitalization rules. Secondly, the CJEU concluded that tax measures relating to portfolio investment interests, or measures relating to combating abuse must be assessed as capital movements or the combating thereof. Such situations are exclusively governed by the free movement of capital.[25] An example is the application of anti-abuse measures in respect of portfolio investments made through subsidiaries/companies in low-taxing jurisdictions, such as controlled foreign company regimes.[26] Another example is the application of regimes that seek to counter dividend stripping operations. Third, and finally – and this is important – the CJEU concluded that tax measures of general application must be assessed in light of the free movement of capital in third country situations.[27] This applies to both minority and majority interests, and irrespective of the active or passive nature of the investment. We consider this to be a remarkable conclusion. Let's look at how the CJEU arrived at it.

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[19] Cf. *FII 1*, loc.cit. CJEU case C-208/00 (*Űberseering*), Baars, loc.cit. and Burda, loc.cit. Cf. CJEU case C-387/11 (*Commission/Belgium*), Observation 34 and *FII 2*, loc.cit., Observation 91.

[20] Cf. *Haribo/Salinen*, loc.cit., *Glaxo*, loc.cit., *FII 2*, loc.cit., Observation 92, and *Cie/België*, loc.cit., Observation 34.

[21] Cf. *Glaxo*, loc.cit., and CJEU case C-31/11 (*Scheunemann*).

[22] Cf. respectively Cour Administrative d'Appel de Nancy, August 22, 2008, no. 07NC00783, *Bundesfinanzhof ('BFH')*, November 26, 2008, I R 7/08, Internationales Steuerrecht 7/2009, 244, *BFH* June 8, 2010, I B 199/09 and High Court of Justice, Chancery Division, Test Claimants in the FII Group Litigation v. IRC, November 27, 2008 (2009) STC 254 (Case No.: HC03C02223 and others, (2008) EWHC 2893 (Ch). Cf. Hemels et al., loc.cit., at 26-31.

[23] Cf. *FII 2,* loc.cit., Observation 88-104. In H&I 2013/3.1 Peter Wattel points out that the judgment was rendered by the Grand Chamber of the CJEU, consisting of a presiding judge, a deputy presiding judge and the presiding judges of the 'chambers of five'. This leads Wattel to the conclusion that the CJEU must have been aware that *FII 2* contradicts earlier case law.

[24] Cf. *FII 2,* loc.cit., Observation 91.

[25] Idem, Observation 92.

[26] However, it should be noted that if the free movement of capital applies, the standstill provision possibly does not, as it only applies to 'direct investments'. This seems to refer to the commercial definition of 'direct investments' i.e. as distinct from 'portfolio investments'. The CJEU also seems to make this distinction, for example, in CJEU cases C-282/04 and C-283/04 (*Cie/Nederland*), Observation 19, *Haribo/Salinen*, loc.cit. and CJEU case C-194/06 (*Orange Small Cap Fund*). Cf. e.g., also Dutch Supreme Court BNB 2012/102, in which the Dutch Supreme Court ruled, roughly translated: 'not for portfolio investment purposes? Therefore direct investment'. In line with this interpretation, the limitation of the standstill provision only applies to investments in shareholdings held as business assets. The standstill provision would then not apply to shareholdings held for investment purposes, leading to the traditional distinction – as typically recognized in income and capital gains taxation also – between portfolio investments and direct investment activities.

[27] Cf. *FII 2,* loc.cit., Observation 104.

The CJEU concluded that the free movement of capital applies to an external cross-border investment by a UK shareholder with a controlling interest.[28] This conclusion was reached by 'taking into account the facts of the case at hand'. The CJEU ruled that it is not possible to determine whether general tax measures, such as that of the disputed UK rules, as such mainly relate to acts of establishment or capital movements. The object and purpose approach, i.e. looking at the subject matter of the rules, is therefore not helpful. That is why the CJEU took the facts and circumstances into consideration in order to conclude how the movement should be qualified and to determine which freedom applied. The CJEU ruled that the UK rules fall under the treaty provisions concerning the freedom of establishment. However, the CJEU noted that the freedom of establishment does not apply, as the case in question concerned a controlling interest in a third country situation; the freedom of establishment does not apply to third country situations. The CJEU subsequently concluded that the rules must be assessed in light of the free movement of capital, irrespective of the size of the shareholding.[29]

Does this mean that the free movement of capital applies, *because* the freedom of establishment does not? We do not consider that this can be *a contrario* deduced from the CJEU's conclusions. Rather, it appears that the CJEU recognizes *alternatives* paths, whereby if it finds that one path (establishment) reaches a dead end, it will take the other path (capital).

It is worth noting that the CJEU explicitly rejects the opinions of the UK, German, French and Dutch governments. They argue that in the case of general tax measures, not only the intention of the tax legislation, but also the facts of the case at hand must be taken into account. We assume that they accordingly mean that the free movement of capital should not be applied in those cases involving on the facts an act of establishment.[30] When seen from that perspective, we consider it relevant to establish, for example, whether the shareholding interest at hand in reality involves a passively held shareholding investment (capital movement/portfolio investment), an actively held participation in a company which grant the shareholder no decisive influence (capital movement/direct investment) or an active direct investment in an underlying business activity through a controlling shareholding interest in a company (act of establishment/direct investment). However, the CJEU nevertheless rejects this view, as it leads to outcomes that it considers incompatible with the free movement of capital. In this respect, the CJEU points out that the treaty states that the free movement of capital also governs "*capital movements involving establishment or direct investment*".[31] The CJEU refers more specifically to investments that offer the shareholder the opportunity to actively participate in the activities of the company in which it holds an interest.

However, the CJEU did acknowledge the existence of a limitation;[32] one that we have not seen before in CJEU case law, and which we find intriguing yet somewhat difficult to understand. The limitation has two components: one aimed at 'economic operators', the other at 'conditions for market access'.

The CJEU notes the following in respect of the economic operators. According to the CJEU, the fact that the freedom of establishment does not apply to third country situations, means that it is important to ensure that the free movement of capital is not used by "(...) *economic operators who do not fall within the limits of the territorial scope of* [the] *freedom of establishment* (...)" for the sole purpose of being able to apply the freedoms. The CJEU seems to be formulating a type of anti-abuse approach in order to prevent EU law being applied to acts of establishment through the back door. Who are these economic operators? We think

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[28] Idem Observations 94-99.
[29] Idem Observation 99.
[30] Idem, Observation 101.
[31] *FII 2*, loc.cit., Observations 101-102, in which the CJEU refers to Article 64 (1) TFEU. The standstill provision of Article 64 refers to 'establishment'. This implies that the act of establishment is also included under the free movement of capital. After all, had that not been the case, the act of establishment would not have had to be included in the 'standstill' in order to use the free movement of capital to justify the restrictive measures in place since the end of 1993 for external cross-border acts of establishment, as the freedom of establishment does not apply to third country situations. Cf. Smit/Kiekebeld 2008, loc.cit., at 18.
[32] Cf. *FII 2,* loc.cit., Observation100.

they are legal entities with a 'European nationality'[33] that are, for tax purposes, resident outside the territories of the EU/EEA,[34] or that are resident in the EU/EEA, but whose indirect or direct[35] acts of establishment occur outside the EU/EEA[36]. These entities fall under the personal scope of the freedom of establishment because of their 'European passport', but do not fall under the territorial scope of this freedom, as they are in fact investing outside the EU/EEA territory[37-38]; it involves outbound investments in other words. This is also in line with the CJEU reference to legislation of a Member State that applies to 'a company of that Member State in a third country'. That is why we did not initially think of inbound investments. The CJEU's observations initially do not appear to refer to foreign law entities performing indirect or direct[39] acts of establishment within the territory of the EU/EEA, as they fall outside the personal scope of the freedom of establishment due to their 'non-European' passport, albeit inside the territorial scope of this freedom (because they are in fact investing within the territory of the EU/EEA). However, on the other hand this is not in line with the CJEU's reference to the legislation of a Member State that applies to 'a company from a third country in that Member State'.

We do not understand this. Isn't it precisely this situation that falls inside the territorial scope of the freedom of establishment, but outside its personal scope? The only way we can reconcile these findings of the CJEU is to accept that the territorial scope of the freedom of establishment is governed by both the location of the investment and the location of the investor. Loosely formulated: the geographical location of its income-generating activities (situs/territoriality) or its residence for tax purposes (domicile). Only then, for example, will the American parent company with a primary act of establishment (transfer place of management/permanent establishment) or a secondary act of establishment (subsidiary) on the territory of a Member State of the European Union, fall outside the territorial scope of the freedom of establishment. But then, we do not understand the reasoning behind the *FII 2* judgment in the first place. Haven't we just identified both categories of external cross-border acts of establishment (inbound and outbound) and subsequently placed them under the limitation? If the CJEU apparently does not want to recognize external cross-border acts of establishment as falling under the free movement of capital, why does it then first qualify them as capital movements only then to cryptically exclude them by way of a newly developed limitation? Had the CJEU wanted to arrive at the conclusion of excluding the availability of invoking the freedom of capital regarding third-country majority shareholding investments, it could have also qualified the movement as an act of establishment to which the freedom of establishment applies exclusively. Then, the freedom of capital wouldn't have been available either. That is, since the third country movement in that interpretation would have been qualified as an act of establishment rather than a capital movement. That is, the approach as taken by the Dutch Supreme Court (see par. 3 hereunder). In short, we are left in the dark on this matter.[40]

[33] We are referring to legal entities controlled by the company laws of one of the EU/EEA Member States, whereby the residence of these entities for tax purposes is located outside the territory of the EU/EEA. For example, if the Member States in question apply the incorporation doctrine in their civil law.
[34] See the 'Programme général pour la suppression des restrictions à la liberté d'établissement' (General Program for the abolition of restrictions on the freedom of establishment), 18 décembre 1961, Journal Officiel des Communautés Européennes 2, 15 janvier 1962, Titre 1. . See also D.M. Weber, *Belastingontwijking en de EG-verdragsvrijheden* (Tax avoidance and EU treaty freedoms), FM no. 105, Kluwer, Deventer 2003, at 55.
[35] We are referring to business activities that are performed directly, i.e. through a permanent establishment in a third country, or are performed indirectly, i.e. through a controlled subsidiary resident in a third country.
[36] Cf. also CJEU case C-415/06 (*Stahlwerk*), FED 2008/56. This case involved a German GmbH that performed a business activity outside the territory of the EU through a participation held in a tax transparent German partnership through a permanent establishment. The GmbH wanted to credit a foreign loss against the domestic profits, thereby invoking the freedom of establishment. However, this was not permitted under German tax law. The CJEU ruled that the freedom of establishment did not apply in this case, as the loss-making business activities took place outside the territory of the EU.
[37] We consider that the territorial scope is, or should be, determined by the location of the investment: situs, territoriality. We also consider that, from an analytical perspective, the place of effective management also expresses the territoriality principle: situs.
[38] We also take into consideration entities under foreign law performing acts of establishment outside the territory of the EU/EEA. They are excluded from both the personal and territorial scope of the freedom of establishment (Article 54 TFEU in conjunction with Article 49 TFEU). This category may be less interesting now that their activities are performed outside the EU/EEA.
[39] We refer to business activities that are performed directly, i.e. through a permanent establishment in an EU/EEA Member State, or indirectly, i.e. through a controlled subsidiary resident in an EU/EEA Member State.
[40] Peter Wattel, loc.cit., regards this argument of the CJEU as a WTO argument. As seen from that perspective, this newly formulated limitation would mean that the unilateral extension of the free movement of capital toward third countries would not undermine the EU's negotiating position within the WTO.

As regards the second component, i.e. the conditions for market access, it almost looks as if the CJEU is anxious to point out that the newly formulated restriction does not apply in full. The CJEU ruled that the danger it identified – backdoor access to the freedoms – is not relevant to the case at hand. This is because the British economic double tax relief regime 'does not relate to the conditions for access to the market', but 'only involves a tax measure', i.e. the corporate tax treatment of inbound dividends. As we understand it, the CJEU basically observes that the case is not, for instance, about the issue of a license in order to carry on a business or suchlike within an EU Member State's jurisdiction – as was the case in *Fidium Finanz* –,[41] it is *just* about UK taxation. And, as a result of this, the limitation apparently does not apply here.

It seems that the CJEU makes an analytical distinction here between measures aimed at market access – the port of entry – and measures aimed at taxing returns generated by economic activities that take place after the port of entry has been passed. If this 'escape' must be so interpreted – and for the time being we assume this to be the case – then it does not seem to apply to direct taxation. However, regardless, we consider this distinction somewhat tenuous. The distinction between a foreigner only being able to access a market subject to the granting of a license or permit and a foreigner being allowed to operate on the internal market but being more heavily taxed relative to domestic investors, in our view, analytically is a mere gradual one in the end.

In summary, the *FII 2* case has made clear that general tax measures in third country situations fall under the free movement of capital and can be substantively assessed in terms of their compatibility or incompatibility with this freedom, irrespective of the size of the shareholding interest, or the reason for investment.

3 Approach adopted by Dutch Supreme Court consistent, but not in line with CJEU

3.1 The Dutch Supreme Court applies a factual approach

In the recent past, the Dutch Supreme Court has had to deal with the qualification of external cross-border investments in majority shareholding interests under EU law on various occasions.[42] These judgments were rendered without first asking the CJEU for a preliminary ruling. That is, until recently.[43] The Supreme Court probably considered the CJEU's interpretation of EU law clear on this issue, i.e. an *acte éclairé*.[44]

In opting for the qualification given to cross-border movements under EU law and the accompanying applicable freedom, the Dutch Supreme Court consistently adopts the factual approach.[45] The Supreme Court bases its conclusion on whether a capital movement or an act of establishment is present, solely on the facts and circumstances of the case at hand. As a result, taxpayers that are restricted in earning benefits from majority shareholding interests in third countries are not protected by EU law, according to the Dutch Supreme Court. In its opinion, these scenarios fall outside from the scope of the treaty freedoms. In the case of majority interests, the taxpayer shareholder exercises a decisive influence on the activities performed by the company in which it holds an interest. The Dutch Supreme Court therefore considers such a scenario to in fact constitute an act of establishment, which supplants the capital movement and therefore the application of the free movement of capital. As the freedom of establishment does not apply to external cross-border acts of

[41] *Fidium Finanz AG*, loc.cit. For example, restrictions imposed on foreign investors. CJEU C-244/11 (*Commission/Greece*) for example concerned a scheme under which prior authorization is required for the acquisition of voting rights representing 20% or more of the share capital in certain companies (former state-owned companies). The CJEU ruled that an interest such as the one in the case at hand only qualifies as an act of establishment due to the 'definite' influence conferred by that interest on the company's affairs. It is noteworthy that the term 'economic operators' is used several times in the judgment when referring to the investors.

[42] See the references in footnote 17.

[43] Chronologically after Advocate-General Jääskinen's opinion, July 19, 2012, *FII 2*, loc.cit., the Dutch Supreme Court asked the CJEU whether the free movement of capital applies to a majority interest held by an Antillean shareholder in a Dutch company. Cf. Dutch Supreme Court BNB 2012/197-198.

[44] *Hemels et al*, loc.cit., at 29, consider this remarkable in view of the diverse approaches adopted by the various national tax courts of the EU Member States.

[45] Cf. *Baars*, loc.cit., *Burda*, loc.cit.

establishment, the available Dutch Supreme Court's case law up until today considers the treaty freedoms not applicable with regards to the taxation in the Netherlands of proceeds from third country majority shareholding interests. The Supreme Court is yet to substantively address the operation of the treaty freedoms in such cases.

3.2 What is the difference between the path followed by the Dutch Supreme Court and that followed by the CJEU? Exclusive versus alternative

In hindsight, the approach adopted by the Dutch Supreme Court seems to have been wrong. In cases involving shareholders with a decisive influence, the CJEU has concluded that the free movement of capital can be substantively applied. Both judicial bodies argue that a facts and circumstances approach must be adopted, as an object and purpose approach fails when applied to general tax measures.

What is the difference between the path followed by the Dutch Supreme Court and that followed by the CJEU? We believe that the difference lies in the *exclusiveness* of the path followed by the Dutch Supreme Court, whereas the CJEU seems to recognize two *alternative* paths. The Dutch Supreme Court considered, thereby referring to the decisive influence of the shareholder, that such a scenario – exclusively – involves an act of establishment. Therefore, the Supreme Court arrived at the conclusion that such a case is governed exclusively by the freedom of establishment. However, the CJEU considers that such a scenario also involves a capital movement to which the free movement of capital – alternatively – applies; therefore applying that freedom in third country majority shareholding situations as well, and, by reference to the treaty text, also if the case at hand in fact concerns an act of establishment. With regard to majority interests, general tax measures must also comply with the free movement of capital. The CJEU does express concern about abuse situations, although it does not seem to see any problems arising as regards taxation.

4 Consequences for interpreting the free movement of capital in future: what purpose does the shareholding serve?

Since *FII 2*, it therefore appears that the free movement of capital can be used to assess the EU compatibility of general tax measures in third country situations, irrespective of the size of the shareholding. What could this imply for future developments in EU law?

We expect, in future, to see further progress on the application of the standstill provision and the justification grounds. The standstill provision applies to tax measures in place as at December 31, 1993, in respect of direct investments. As this provision does not apply to tax measures in respect of portfolio investments, we consider that it does not apply to majority interests in companies limited by shares held for portfolio investment purposes.[46] Furthermore, in contrast to movements within the EU, it is easier to justify restrictions and discrimination in third country situations, for example, on the basis of 'combating the (risk of) abuse', or 'the effectiveness of fiscal supervision' in situations where no mutual assistance rules are available to effectively enable tax audits to take place.[47]

With regard to majority interests in third country situations, time will tell to what extent one of the justification grounds (territoriality principle, combating abuse, and effectiveness of fiscal supervision) or the standstill provision can be used to approve unilaterally imposed disruptions to the internal market. As regards the standstill provision, we believe that the legal issue of whether the interest is held for portfolio investment purposes (no direct investment, no standstill), or for business purposes (direct investment, therefore standstill in respect of rules in place as at year-end 1993) will prove relevant. We suspect that this will increase the

[46] Cf. footnote 26.

[47] CJEU cases C-540/07 (*Commission/Italy*) C-101/05 (*Skatteverket v. A*), C-451/05 (*ELISA*), C-72/09 (*Rimbaud*) and *Haribo/Salinen*, loc.cit. However, this justification ground must be proportionate and suit the purposes of the regulation. Cf. Erwin Nijkeuter, 'Exchange of Information and the Free Movement of Capital between Member States and Third Countries',20 EC Tax Review 232 (2011, no. 5), at 232-241.

pressure to qualify the capital movement as a direct investment, also in situations concerning majority interests.

As a final comment we would like to note that, for the purposes of qualifying the movement under the standstill provision as a ‘direct investment’ pursuant to EU law, we consider the presence of a ‘decisive influence’ as a necessary, but insufficient, condition. Control is only a means to an end, for example the carrying on of a business. After all, the control is merely a tool to manage the underlying business activities. Although a 100% interest is a strong indication that a direct investment is present, that does not necessarily have to be the case. It is also possible to portfolio invest by way of a 100% shareholding. Controlled foreign company regimes actually try to counter the opportunities for deferring taxation in such cases. If the interest held is substantial, then it is perhaps less likely that it would be held for investment purposes. But we consider that the reason for the investment cannot be automatically deduced from the presence or absence of a decisive influence. It seems to us that the question that needs to be asked in future would need to concern the purpose of the investor. What purpose does the shareholding interest serve? The investor’s intention may subsequently be objectified, perhaps, through a functional and factual analysis of the position that the shareholding interest fulfills in the taxpayer’s property.[48]

5 Final remarks

The *FII 2* case has made clear that general tax measures, such as a general direct tax system for income and gains from shareholdings, fall under the free movement of capital in third country situations and can be substantively assessed on their compatibility or incompatibility with this freedom, irrespective of the size of the shareholding. The CJEU has formulated a limitation, though. Abuse of the free movement of capital must be avoided. However, the judgment does not make it clear where and when the CJEU exactly suspects such abuse. Nevertheless, the abuse is not present in the *FII 2* case and it seems that, in general, there is limited room in the area of direct taxation to identify such abuse of the freedom of capital. The *FII 2* case has also shown (with hindsight) that the approach adopted by the Dutch Supreme Court in the recent past, was wrong. This has led to a discussion in the Dutch tax law practice on the legal consequences of this in the Netherlands.[49] As regards how the free movement of capital will be interpreted in EU law in future, the *FII 2* case has shown us that cases involving majority interests in third country situations must be assessed on their merits under EU law. It seems that the broader justification grounds in third country situations and, of course, the standstill provision will be given more prominence. As regards the standstill provision, we believe that the shareholder’s reason for investing in a shareholding will prove to be relevant. Is the shareholding interest held as a portfolio investment (no standstill) or is it held for business purposes (possibly standstill)? Such a distinction could produce interesting case law. We will follow developments with interest.

[48] Cf. Maarten F. de Wilde, ‘A Step towards a Fair Corporate Taxation of Groups in the Emerging Global Market’, 39 Intertax 62 (2011), at 70-71.

[49] Cf. E. Nijkeuter and M.F. de Wilde, “Met de kennis van nu...” (*With the knowledge we now have...*) (Part II); On FII 2, case law and what may follow, WFR 2013/185.