Question 3

Third countries don't have full protection of the 4 fundamental freedoms in the treaty because they are not EU members.

However overseas territories of such EU Member States have a special relationship developed in Part 4 of the TFEU. Countries like BVI and Bermuda are granted special benefits for trading with the EU Member States for their social and economic development since they are essentially poor countries.

However there is some debate in the case law as to the relationship of these with the EU Member States, especially with regard to the free movement of capital.

In fact free movement of capital (FMoC) is the only freedom also applicable to third countries as per art 63.

This has a wide meaning – although not defined in the treaty but can be found in Directive 88/361/EC.

It includes inheritances, short and long term loans, portfolio shareholdings, holdings that give definite influence, i.e. control/determination of the subsidiary activities under Baar definition.

Its scope is wider than freedom of establishment which only targets cases of definite influence and therefore the third countries have a wider protection of EU law potentially under the FMoC.

Therefore FMoC and freedom of establishment sometimes are engaged at the same time, but freedoms are exclusive – see Gebhard.

It is settled case law from Second FII Glo that if the rules of a Member State are broadly drafted, i.e. target situation regardless the level of shareholding, and the case at issue involves a third country, the FMoC will always take priority over the freedom of establishment.

But what happens with third countries? Do they have the same protection under art 63?

External scenario

A paradigmatic case is Prunus. Prunus was a French co with an ultimate BVI shareholder.

There was an annual 3% wealth tax in France on immovable properties; however this could be avoided if there was a Double tax treaty with France containing and exchange of information clause.

Since BVI is a tax haven there was no such treaty. Therefore the BVI company had to pay the tax.

This was a case of a Member State dealing i.e. France with the overseas territory of another Member State, i.e. UK.

The CJEU simply held art 63 has unlimited territorial scope and therefore also overseas territories can benefit from it.

However art 64 contains a so called standstill provision. If a national rule restricting a freedom is already in place as at 31/12/1993, this is permitted, in case of third country scenario.

It is to note that the standstill operation only operates in cases of "definite influence". This was the case in Prunus.
However had there been a portfolio shareholding for example, the standstill provision could not operate – see Haribo & Salinen.

This was the case here, so Prunus couldn't win anyway.

<u>Internal scenario</u>

The CJEU delivered its judgments on X BV and TBG Ltd in 2014 at the same time. They both involved a payment of dividends from a Netherland company to its parent in the Netherlands Antilles. This gave rise to a WHT of 8.3%.

There was a restriction because there wasn't such a WHT between two Netherlands companies.

This is a transaction between a Member State and its overseas territory.

However unlike in Prunus, since it was an "internal" scenario, the CJEU didn't feel that art 63 was appropriate.

However the relationship between Member States and overseas territories has been further developed in the 2001 OCT decision of the Council. A decision is secondary law and is binding.

This OCT decision contained a clause giving a protection under the free movement of capital similar to art 63.

However while art 63 as explained above is broad in scope, the protection under the OCT decision is restricted to cases of "direct investments".

As explained in First FII Glo, these exclude portfolio shareholding and other similar instances.

However, in these two cases there was a 100% shareholding.

However the CJEU went on to comment that the overseas territories are tax heavens and for this reason a "tax carve-out" clause is introduces in the decision, to avoid excessive profit shifting to these tax heavens.

The rule is very general; it doesn't seem to worry if the transaction with the overseas territory is wholly artificial arrangement and therefore virtually allows every domestic anti-avoidance rule targeting such overseas territories/tax havens.

Therefore the 8.3% was perfectly acceptable in light of such risk and the claimants could not win in this instance either.

It is to note that there is little case law on the matter and therefore it is unsure whether X BV/TBG will be the final CJU position.

However in absence of clarity in the treaties and since CJEU judgments are supreme law, this is the current position for overseas territories.

Question 4

The investigations concerned are the recent preliminary examinations on tax rulings respectively on Ireland for the Starbucks multinational on profits attributions of branch activities, on Netherlands for the Apple on manufacturing activities and on Luxembourg on Fiat Finance on financial activities.

The preliminary review started in June and the Commission has released its comments that the tax rulings could potentially constitute State Aid if they have the "selectivity" feature.

The Commission has now started more in-depth investigation procedure on these three. A preliminary review started i think in October 2014 again on Luxembourg on the tax rulings for Amazon.

The tax rulings are advanced pricing agreements between a multinational and the states in which it operates. it can be unilateral, bilateral or multilateral.

The states agree in advance with the taxpayer on what transfer pricing methods should be applied to transactions between companies with a special relationship – under the OECD meaning it gives power to exert a definite influence on the activities of the other company.

The EU should be a free market with no obstacles. Such obstacles include the granting by Member States of special advantages to certain categories of companies. This is called State Aid. The legal basis is art 107 and 108 of the TFEU.

Art 107 is said to give the key elements of what constitutes state aid. These are further explained and developed in the 1998 Notice.

Art 108 provides the sole power to decide whether a measure is State Aid or not to the Commission and procedural rules are laid down in ad hoc Regulations.

Potentially every tax rule or tax regime, either newly introduced or existing, could be State Aid. This includes tax rulings on transfer pricing.

Let's analyse them in light of the features in art 107.

First of all, none is an aid as described in art 107(2) – aids always compatible or 107(3) – aids which can be compatible.

The rulings have no social character or are not aimed to assist less developed regions or economic activities of the EU.

Definition of aid

An aid in tax is the conferring of a tax advantage. This has a wide meaning: it can be a tax credit, a deduction exemption, depreciation, waiver or deferment of a debt.

Profit attribution in transfer pricing should follow the profit attribution rules in the OECD guidelines. Transfer pricing is relevant in cross-border scenario where companies with "special relationship" can decide where to shift profits e.g. by overpricing goods or giving very low value services, etc. This constitutes a base erosion of the tax base of one Member State in favour of the other, which is normally based in a lower tax jurisdiction.

The above mentioned countries used to have “harmful tax regimes” according to the definition of the 1997 code of conduct for business taxation.

These special regimes have all been terminated however these countries still don’t have strong economies and therefore tax competition for them is still a valid way to raise their revenues.

So what if they want to attract multinationals by granting them a favourable profit attribution regime to the activities of the multinational in that country?

- Granted through State resources
  This is not a transfer of funds but can be carried out by giving up taxing rights, e.g. giving tax holidays or the tax advantages given above. So this could be fulfilled if any of such advantages are granted.

- Distort competition
  If certain undertakings or sectors benefit of an aid, this will always have the effect to distort competition in the domestic market. As an effect of this, there will be broader distortion at the EU market level. So this element is generally always fulfilled.

- Favours certain undertakings or certain goods only
  This is the mostly discussed selectivity criteria. This is the core of the State Aid debate.

A measure is justified by the general scheme of the tax regime, e.g. progressive rates that meet re-distributive purposes, different depreciation and valuation methods, losses carry-over, measures to prevent double taxation or tax avoidance different taxation of non-profit making companies, measures to incentivise use of less energy and environment protection are all normally justified by such general scheme.

However there is no State Aid if the measure is granted across the board to all economic sectors, e.g. in Adria-Wien Pipeline, the tax rebate on energy were given only to certain undertakings. Although environmental and energy is an economic measure of public interest, the benefit was not granted across the board.

Also, it is possible that a measure is addressed to all sectors but effectively only a few can have access to it, e.g. only large companies or companies incorporated after a certain date. If this is the case, the measure will constitute state aid.

Also, the measure can be applied at the discretion of the Member State, e.g. in P OY a loss carry-over was granted with change of ownership of in derogation to the normal rules. This derogation was applied at the discretion of Finland if it was vital for the continuation of the business. But how could this be assessed?

The CJEU held that this could constitute State Aid if a clear identification of the beneficiaries is not made and remitted this to the national courts to establish.

Also, there is State Aid if the taxation of the undertakings benefitting of it don’t suffer a “normal tax burden”. This has to be identified and therefore a comparison has to be made between similar undertakings that suffer the normal tax burden and undertakings that benefit from the state aid.

This is necessary, as shown for example in the British Aggregates case. It is not something that the Commission is obliged to do but for the CJEU this is the best course of action.

Therefore noting that the Commission and the CJEU may have different view on what constitutes State Aid – see the Gibraltar tax regime below and British Aggregates – and the CJEU may be called upon on an opinion (not binding) on the legality of State Aid; the Commission should bear this in mind.

As explained above, the outcome of the preliminary research of the Commission is that the tax rulings "may" be state aid if they meet the "selectivity" criteria. More thorough analysis is being carried out and the Commission should bear the above in mind.

The Commission and the Code of Conduct Group are giving a close look at all the EU patent box regimes, the first from a State Aid point of view and the second from a "genuine activity" test point of view on whether such benefits are granted to companies that are really conducting an active economic and commercial activity.

Similarly there has been much debate on the Gibraltar tax regimes. The matter went to the CJEU for an opinion.

The CJEU ruled contrary to the Commission saying that:

- there is no material selectivity in there being a harmful tax regime. This is not sufficient. Thus is also explained in the Notice. Other elements should be analysed.

- there is also no regional selectivity in that the Gibraltar tax regime is more beneficial than the UK tax regimes. It was held that after also the Azores case, the UK and Gibraltar systems are separate, can't be looked at one.

It is also to note that exchange of information on cross-border tax rulings will be introduced in the new Administration Cooperation Directive as envisaged by the Commission in the March 2015 Tax Transparency Package.

This shows how the tax rulings are high on the Commission agenda and changes to the 1998 Notice are envisaged to include new areas, e.g. could it be transfer pricing rulings? And explain existing areas such as modernised rules on research and development and innovation and review the Block Exemption Regulation.

Question 5

Direct tax is competence of the Member States, not of the EU.

Nonetheless, Member States have to act in conformity with the objectives of the Union and refrain from taking any action that could jeopardize the attainment of such objectives – as per art 4(3) of TEU.

Therefore although the EU has no sovereignty over tax matters, the above article is a catch-all.

It is the legal basis to prohibit Member States from creating legislation which restricts the four fundamental freedom.

This, in addition to art 18 TFEU that prohibits discrimination based on nationality, has created a large CJEU jurisprudence on when a Member State doesn't fulfil the EU law.

Member States can be brought in front of the CJEU by the Commission for an alleged infringement (art 258 TFEU), or the national courts can request the CJEU an interpretation of EU law relevant to the case subject of the judicial proceedings (art 267 TFEU).

In both cases the judgement is binding and is left to the national court in the Member State to take corrective actions, if necessary.

A restriction in tax matters occurs when a taxpayer exercising a freedom, e.g. moving residence, investing abroad, having a PE in another country, is compares with another taxpayer, in the same country, that doesn't exercise the freedom i.e. is acting in a domestic scenario.

Both the Host State and the State of Origin can infringe a freedom – see Marks & Spencer and Cadbury. If the two taxpayers are comparable and the Member State is treating the taxpayer exercising the freedom in a discriminatory manner, the CJEU will prohibit such behaviour.

However Member States can use overriding justifications in the name of public interest. The most successful are tax avoidance, balanced allocation of taxing rights and fiscal supervision. I will illustrate below.

A rare justification is fiscal cohesion – see Bachmann on pension contributions.

Protection of the revenue will never be successful, i.e. Verkoijen was taxing the inbound dividends while domestic dividends were not taxed – just because the profits would completely escape taxation in Netherlands, at subsidiary level and parent level. This is always rejected.

According to Gebhard, in order to be justified, a national rule must:

- not be applied in a discriminatory manner; if it is, then it must
- be suitable to the objective of the rule e.g. tax avoidance, fiscal supervision, etc.
- not go beyond what is necessary to attain such objective.

This is also called the principle of proportionality and is a general principle of EU law. The latter condition will be interpreted strictly by the CJEU.

Each justification would need discussion to be explained in the light of the principle of proportionality; however a paradigmatic summary is Cadbury Schweppes.

The focus here was on prevention of tax avoidance as justification, although Member States can put forward (and will) more than one justification.

The UK company set up two subsidiaries in Ireland, which was a special international centre at the time with very low corporation tax.

The UK CFC rules apportioned the profits of the two subsidiaries directly to the UK company. There was obviously a discriminatory treatment since the UK co was taxed on the profits of other companies! It wouldn't have happened if it had two UK subsidiaries.

It is settled case law from older cases such as De Lasteyrie and Lanhorst that an anti-avoidance measure is only proportional if it targets "wholly artificial arrangements".

In De Lasteyrie, an exit tax was payable immediately on moving of tax residence, without considering the underlying intentions for the move. Presumption of tax avoidance was inferred immediately without any consideration.

Tis was also commented in Cadbury: there is no presumption of tax avoidance if a EU citizen wants to exercise one of the freedoms. It is within its rights.

In Lankhorst, a transfer pricing case, an interest was disallowed and the payment of interest was re-characterised as dividends for the simple reason the lender was a non-resident company. Therefore targeting entire categories of taxpayers, which also happen to be EU citizens, i.e. either individuals or companies, is considered not proportional – see also Leur-Bloem.

General criteria can't be applied and the national measure should allow the tax payer to give a motive defence.

The national measure is proportional if it tries to be on case by case basis.

Returning to Cadbury, how can you measure whether there is a wholly artificial arrangement or not?

The CJEU set up an important principle here that there must objective factors that can be assessed.

Since the freedom of establishment is called upon in a CFC case where there is definite influence (see Baars definition), you need to assess whether there is the pursuit of an economic activity through a fixed establishment on a stable and continuous basis.

In case of CFC this is for example the presence of staff, premises and equipment in the CFC state.

This can be extended also to transfer pricing rules for example, where the arm's length price is an objectively verifiable element.

It is to note that it is the national rule that has to give the instruments to the taxpayer to prove the genuine nature of any intention to engage a cross-border transaction.

Therefore, following this judgment the UK CFC rules have now been changed, and so have the other EU Member States' CFC rules.

With regard to the proportionality applied to other justifications, it is useful to keep in mind this overview: in the Rimbaud case, the 3% French wealth tax could only be avoided by the company owning the immovable property if there was a double tax treaty with an exchange of information and non-discrimination clause. Here the company was based in Liechtenstein. There was neither such treaty with France nor a Directive on Mutual Assistance could be used, since Liechtenstein is outside EU and Directives only operate between Member States.

In such case the tax was applied and the CJEU held it was proportional.

Member States have the right to verify information before granting a tax advantage. With regard to balanced allocation of taxing rights, this is a very common justification in cross-border loss relief and exit case.

In National Grid Indus, the taxation of “deemed” gains of a resident on assets owned at the time of migration was considered “partly” proportional if considering that the “leaving” Member State had taxing rights on those gains until the change of residence, i.e. balanced allocation of taxing rights with a temporal content.

It is arguable though that a gain should be taxed at the realisation and immediate taxation creates cash-flow problems compared to another person that doesn’t migrate.

Therefore immediate taxation was considered not proportional but a deferment was not going beyond what is necessary to attain e.g. taxation of the gain on the asset up to the point of migration.

Question 6

Abuse of law is a concept that doesn't exist in the EU treaties. It can also not really be inferred in any of the EU treaty articles.

However some secondary law, e.g. Recommendations, Communications and Directives, may mention it.

Essentially though, the concept has been developed by the CJEU in various judgments and therefore can be considered a concept of EU law.

For example in the Halifax case the CJEU elaborated a specific principle of abuse of law. Halifax was a bank – so exempt business – and it wanted to build a bank. To do so it used two subsidiaries, one made a loan to the other which was engaged to make the construction works. The second company in turn engaged a third party building contractor. A large amount of VAT was recovered on the building costs in this way.

The matter was brought in front of the CJEU by the UK national court on whether the input VAT refund had to be denied, as sustained by HMRC. The CJEU ruled that those were taxable supplies made by taxable persons and therefore VAT had been correctly charged.

However, paraphrasing the Centros case (a company law case): EU economic operations that rely on EU law to put themselves out of the reach of the law of a Member State, will not receive EU law protection.

Therefore the following definition of abuse of law was developed in Halifax:

- the tax advantage is contrary to EU law (in the specific case, the VAT directive)
- it is apparent form a number of "objective circumstances" that the main reason of the transaction is to obtain a tax advantage.

Such principle can also be derived by Emsland-Starke, an agricultural policy case: abuse of law occurs where, despite the "formal" observance of the EU law, its objectives have not been attained.

Therefore it could be said that in Halifax the requirements and conditions set by the VAT Directive to have the right of input VAT deduction were technically satisfied and observed – also the CJEU recognised so as explained above – but the "objective circumstances" led to decide that the VAT directive was misused just to obtain a tax advantage.

HMRC v Weald Lesing

Here the taxpayer was an insurance business – VAT exempt again – and wanted to lease assets to connected insurance companies.

To avoid a lot of irrecoverable VAT on the rents it wanted to charge low rents but under UK law, transaction between third parties must be at arm's length.

Therefore requested a third unconnected party to charge the low rents so that a less amount of VAT became actually irrecoverable.

The Halifax principle of "objective factors" was applied here too:

- the main activity of the third unconnected party was not that of leasing assets
- the contractual terms of the rents were not such that a third unconnected party in real market conditions would enter into them.

In fact it could be said that there was a separate arrangement between Weald Leasing and this third party so that the arm's length terms were tainted. Therefore the right to deduct input tax was denied.

It is to note how the meaning of abuse of law in VAT is different from the meaning in direct tax as assumed in Cadbury.

The CJEU in Cadbury also added a subjective element in the overall assessment of the abuse, which is the intention to avoid tax. You don't find this in the VAT cases.

<u>EON Asset Management</u>

In this case a company leased a company car to its director. The VAT charged on invoices could not be recovered by the director, since it was proved that it was actually kept for his personal use.

Therefore the CJEU is very strict on what constitutes abuse.

<u>Paul Newey trading as Ocean Finance</u>

Here the taxpayer was a loan broker. He wanted to recover VAT on advertising costs but he was an exempt business. So he set up a Jersey co which acquired the rights to use his trading name, "Ocean Finance". The company therefore receive the advertising costs and was carrying out the business – which at this point was technically no longer VAT exempt – receiving services from Paul Newey for the loan brokerage. The VAT in the advertising costs could be recovered.

Here the CJEU considered the Jersey company a look-through.

A look-through is also a conduit arrangement in that it lack of economic reality and therefore becomes "transparent" for fiscal purposes.

Translating this in a VAT scenario, the VATable person was still Paul Newey.

Although contractual arrangements could concur to establish whether there was an economic relationship, these were not alone sufficient to demonstrate that the Jersey company was pursuing an economic and commercial activity on its own.

Here the CJEU in its judgment approached to the doctrine in Cadbury Schweppes for example, that there is tax avoidance when the taxpayer sets up a wholly artificial arrangement that is not 'genuine' (i.e. it is not established to pursue an economic activity with an adequate use of premises, equipment, staff. It was simply a "sham" transaction).

It is to note that it can now be said, with the Cadbury Schweppes, Kofoed and Foggia judgments, that the abuse of law concept can be clearly transposed in direct tax too.

In the 2012 3M Italia case the CJEU clearly said that the Halifax principle can be used in direct tax matters. Note that abuse of law is clearly different from "benefiting of disparities". This is equally true in both direct tax matters and in VAT matters.

In the RBS Deutschland case, the German company was buying assets in UK which then leased to UK lessees.

For Germany this was provision of goods in UK and therefore VAT should have been charged in the UK, not in Germany.

For UK this was provision of services and therefore the place of supply was Germany, not the UK, with the overall result that there was no liability to VAT in any of the countries.

Disparities depend from the differences in EU Member States’ tax system. There is not abuse of law here and such arrangements are permitted by the CJEU.

Also, in the Halifax case the CJEU clearly states that taxpayers are permitted to benefit from the differences in the tax systems.