CHAPTER XI: SUMMARY AND CONCLUSIONS

1 Summary and conclusions

1.1 The research question

Today’s global economy is characterized by a high degree of international economic integration. This is not only evidenced by the large global network of international economic integration agreements that exists, but also by daily practice in which transnational trade and investment are widespread. The main purpose of international economic integration is to promote international trade and investment by removing obstacles to international flows of goods, services, persons and capital which, for its part, contributes to economic growth and, consequently, to an increase in global welfare. One example of international economic integration, which constituted the very basis for this study, is the European Union. The European Union aims to create an internal market that is characterized by the abolition, as between Member States, of obstacles to the free movement of goods, persons, services and capital. Because of the fact that all 27 Member States apply their own corporate income tax systems, major distortions for international flows of persons, services and capital may arise. As a result, fair competition within the internal market may be distorted. Therefore, a large number of restrictions in the field of corporate income taxation have been abolished in the past within the Union, not only through Union legislation, but particularly through an extensive interpretation by the Court of Justice of the European Union (ECJ) of the provisions relating to the free movement of persons, services and capital in the field of corporate income taxation.

Practice shows that the Member States of the European Union maintain a diversified range of economic relations with non-EU Member States (or third countries). A large number of non-EU-based enterprises are carrying on business in the European Union. Conversely, numerous EU-based enterprises are also carrying on business outside the territory of the Union. Both within these inward and outward investment relationships, “economic openness” is key. Accordingly, trade and investment between Member States and non-Member States is nowadays similarly promoted by abolishing or reducing tax or other obstacles to international flows of goods, services and/or investment between the Member States and non-Member States. One may recall in this regard the large number of economic integration agreements which the Union has concluded over the past decades with countries all around the world, such as countries in Eastern Europe, the Euro-Mediterranean countries and the African, Caribbean and Pacific states and which, to a greater or lesser extent, provide for liberalization of trade and investment between the Union and the respective non-Member State. The Treaty on the Functioning of the European Union itself also provides for a substantial degree of economic
openness vis-à-vis third countries, particularly by means of the Treaty provisions relating to the free movement of capital. On the basis of these provisions capital movements between Member States and non-Member States may not be restricted.

It is this unique current legal relationship between the EU Member States individually and the Union as a whole vis-à-vis the rest of the world which this study has taken as a starting point. It has focused on freedom of investment between the Member States and non-Member States under EU law and its significance for Member States’ corporate income tax systems from the perspective of the transnational corporation. Essentially, this study has sought to examine to which extent the impact on Member States’ corporate income tax systems of the liberalization provisions included in the above instruments (“freedom of investment”) is similar, or should be similar, to the impact that the above-mentioned free movement provisions included in the Treaty have on Member States’ corporate income tax systems in an intra-Union context. This question appeared to be one of the most controversial issues in the recent development of EU law and has been heavily debated over the past years. This study has sought to provide for solid, balanced and usable answers.

The research question of this study was as follows.

With reference to six selected corporate income tax measures, and the significant impact of EU law thereon in an intra-Union context, this study has examined, with an emphasis on the market integration perspective, to which extent corporate income tax measures raised by Member States and distorting patterns of investment between Member States and non-Member States can be removed under the Treaty on the Functioning of the European Union and other relevant European economic integration arrangements concluded between the Member States and non-Member States.

Based on the idea of international tax neutrality, as defined, this study has subsequently evaluated the extent to which a Member State’s corporate income tax measures that distort third-country investment should be removed and demonstrates in which fashion this could be realized with reference to a number of corporate income tax measures.

The research question was answered not only on an abstract level. The practical impact of the conclusions of this study on Member States’ corporate income tax systems was also demonstrated. In this regard, the following six corporate income tax measures were selected: i) limitation on the deduction of interest expenses paid on inter-company or third-party loans; ii) withholding taxes on dividend, interest and royalty payments; iii) measures providing for relief for double taxation of income received from foreign investments; iv) CFC legislation; v) measures denying the deduction of foreign losses from the domestic taxable base; and vi) corporate income taxation of realized or deemed capital gains upon the transnational transfer of business assets. Below, the outcome of
the research question is presented.

1.2 The benchmark of international tax neutrality and its relationship with the requirement of a "genuine economic link" under freedom of investment

In order to assess the results of this study, first the benchmark of international tax neutrality has been defined and its relationship with freedom of investment has been demonstrated. To this end, it has been established that the basic purpose of international economic integration between the Union and the rest of the world is to contribute to an optimal or efficient allocation of productive resources across countries through the operation of market forces. Consequently, productivity should be increased, which should result in an increase of global economic growth and welfare. It has been established that this rationale is also valid with regard to freedom of investment as an element in international economic integration between the Member States and non-Member States.

This implies that in a perfectly competitive market global economic efficiency is achieved by tax rules that do not distort the decisions that investors would have made in the absence of taxation. In other words, business decisions should be taken on the basis of economic rather than on the basis of tax considerations. Freedom of investment thus requires international tax neutrality. In its ultimate implications, international tax neutrality would require harmonization of corporate income tax systems worldwide, which is neither feasible nor advisable. In the absence of worldwide harmonization of corporate income tax systems, the question arises: how can international tax neutrality still be achieved as much as possible? According to the author, international tax neutrality can be best achieved if taxation does not adversely influence the relation between taxes and public goods to the disadvantage of transnational investment. Under this condition, fair competition between foreign and domestic enterprises which carry on the same genuine economic activities under the same market conditions and using the same public goods in that State to the same extent is promoted. In its ultimate implications, it boils down to a system based on source state taxation. That is to say, income should be taxed only in the state where that income has been generated. This is because the public facilities provided by that state contributed to the operation of the profit-making activities.

The concept of freedom of investment under EU law appears to perfectly match the above benchmark. It essentially is an economic concept and implies a genuine economic link with the territory of a Member State through the exercise of a genuine economic activity. The notion of economic activity under EU law is characterized by an activity, not being of a purely marginal or ancillary nature, which is usually carried out, on a continuing basis, by a private undertaking on a market with a business or commercial purpose, in particular the wish to maximize returns from capital invested. An economic activity can particularly, although not exclusively, be carried on through a fixed
establishment in another Member State for an indefinite period. Such a fixed establishment may find expression in the form of (the setting-up of) agencies, branches or subsidiaries. It furthermore involves a sufficient degree of independence and a sufficient degree of management and control within that Member State. In the case of companies, this implies that a company’s essential decisions concerning the general management of that company and the functions of its central administration are carried out in that Member State. In addition, the concept of branch under EU law implies a place of business which has the appearance of permanency, has a management and is materially equipped to negotiate business with third parties. Furthermore, a company can carry on a genuine economic activity directly. However, a company which, owning controlling shareholdings in another company, actually exercises that control by involving itself directly or indirectly in the management thereof must also be regarded as taking part in the economic activity carried on by the controlled undertaking. Such a shareholding may involve either a definite or effective influence in the management of that company and within its control and is governed by the definition of direct investment under the Treaty. This is opposed to portfolio investments which entail investments which are solely made with the intention of making a financial investment without any aim to influence the management and control of the undertaking or, in other words, which entail the mere passive exploitation of property. It follows that both direct investments and portfolio investments generally involve an economic activity carried on through a branch or subsidiary in another Member State.

It has been established that the above benchmark of international tax neutrality as made operational through the idea of genuine economic link can be usefully applied by Member States in the field of corporate income taxation if one is to accept that the legal reality of corporate structures consisting of different separate legal entities under which transnational corporations are traditionally operating should not unconditionally be followed when determining in which state income is generated. To this end, one needs to determine in which place the activities take place and which value one should attribute to them, based on the arm’s length standard. The notions of control over risk and financial capacity to assume the risk are two important, although not determinative, factors in this regard. These factors show a striking similarity to the idea of genuine economic link under freedom of investment. This is because this idea equally requires, inter alia, a sufficient degree of management and control and a sufficient degree of independence within the Member State concerned. Also, the place of corporate residence and the existence of a branch under EU law correspond with comparable concepts in the field of corporate income taxation. Hence, the idea of genuine economic link is not alien to the area of corporate income taxation. It could easily be implemented by using existing concepts.

Notwithstanding the above, it has been recognized that taxpayer equity considerations may restrain the economic efficiency considerations which underlie the benchmark of
international tax neutrality in situations involving third-country investments where there are differences in the degree of legal integration between the respective Member State and the third country. This would notably be the case to the extent the interpretation and evaluation of freedom of investment under EU law would require Member States to tax income from third-country investments more favourably than comparable investments made within the Union. Inter-nations equity considerations as well may restrain economic efficiency considerations in the case of differences in the legal degree of integration between the respective Member State and third country. This would notably be the case where full adherence to the principle of freedom of investment as assessed in the light of the benchmark of international tax neutrality in situations involving third-country investments would otherwise result in an imbalanced allocation of taxation powers between these states.

1.3 The dividing line between Member States and third countries

Having defined the benchmark of international tax neutrality for purposes of this study, a fairly comprehensive overview has subsequently been presented of the relevant degree of legal integration in the field of corporate income taxation as it exists between the Member States and, to some extent, between Member States and third countries (or non-EU Member States). In accordance with FII, this overview allowed for a proper comparison to be drawn between the degree of legal integration in the field of corporate income taxation as it exists between Member States, on the one hand, and between Member States and third countries, on the other, which constitutes the core of this study. In addition, it formed the basis for a subsequent examination as to the extent to which corporate income tax measures that affect investments within the Union can be removed under EU law where such investments indirectly involve non-EU investors or non-EU investments.

To this end, first a preliminary question needed to be addressed: what are third countries as opposed to Member States for purposes of the Treaty freedoms? As the Treaty does not define what third countries are, on the basis of the case law of the ECJ an examination was made of how this concept is, or at least should be, interpreted with special reference to the Member States’ associated and dependent territories. No particular issues arise in this regard as concerns the States that are not mentioned in Article 52(1) TEU. It is safe to assume that only the States mentioned in Article 52(1) TEU are Member States and that all other states which are not mentioned in this provision qualify, by analogy, as third country. Thus, for instance, the United States, Russia, Switzerland must be regarded as third country under the above Treaty freedoms. The same holds true, for example, for Norway, Iceland and Liechtenstein, which are parties to the Agreement on the European Economic Area, and the microstates San Marino, Monaco, Andorra and Vatican City. Also, the question whether or not an investment is made by a national of a Member State under the freedom of establishment
or the free movement of services must be answered on the basis of Article 52(1) TEU read in conjunction with the domestic laws of the Member State concerned.

Matters are a bit more complicated as far as the position of the Member States’ associated and dependent territories are concerned. This is because generally the Treaty may apply only partially or even not at all to these territories, although such territories are formally part of a Member State. The case law of the ECJ is fragmented and not univocal in this regard. Nonetheless, the author believes that the following approach can be derived from the case law of the ECJ. When determining whether or not any associated or dependent territory should be regarded as a third country rather than a Member State, a distinction should be made between the scope *ratione personae* and the scope *ratione loci* of the free movement provision at issue.

With regard to the scope *ratione personae* of the freedom of establishment and the free movement of services under the Treaty (nationality is not relevant under the free movement of capital), the following conclusion is drawn. The question whether in situations involving an associated or dependent territory an investment takes place by one or more *national(s) of a Member State* or by one or more nationals of a third country under the freedom of establishment and the free movement of services should be answered solely on the basis of Article 52(1) TEU, read in conjunction with the domestic laws of the respective Member State.

With regard to the scope *ratione loci* of the freedom of establishment, the free movement of capital and the free movement of services, the following conclusion is drawn. To the extent the Treaty provisions apply to any associated and dependent territory under Article 52(1) TEU, read in conjunction with Article 355 TFEU, such a territory should be treated as part of a Member State. Accordingly, to the extent a territory is bound by the freedom of establishment, the free movement of capital and the free movement of services it should be treated as part of that Member State for purposes of determining the scope *ratione loci* of the given free movement provisions. Under these circumstances, the relationship between any Member State’s associated or dependent territory and its “mother” state is characterized as an internal situation to which the Treaty freedoms do not apply. On the other hand, to the extent the given free movement provisions do not apply to an associated and dependent territory under Article 355 TFEU, that territory should be treated as a third country for purposes of determining the scope *ratione loci* of the given free movement provisions. This also holds true as far as the position of any associated or dependent territory with its own mother State is concerned. These territories, which strictly speaking could be classified as “second countries” or, alternatively, territories with a status *sui generis*, must therefore be reclassified in each case as either a part of a Member State or as a third country, based on whether or not this territory is bound to apply the Treaty provision at hand. Having regard to the differences in the degree of legal integration that exists between the Member States and
the respective associated and dependent territories by virtue of Article 355 TFEU, this conclusion is also desirable.

In practical terms, the above conclusion means that the outermost regions, Gibraltar, the Åland Islands, Ceuta and Melilla have to be considered (part of) a Member State for purposes of applying the freedom of establishment, the free movement of capital and the free movement of services *ratione loci* since these territories are bound by the freedom of establishment and the free movement of capital under Article 355(1) and Article 355(3) TFEU, respectively. Conversely, the Overseas Countries and Territories, the Faeroe Islands, the United Kingdom sovereign base areas of Akrotiri and Dhekelia in Cyprus and the Channel Islands and the Isle of Man have to be considered third countries for purposes of applying the freedom of establishment, the free movement of capital and the free movement of services *ratione loci*.

1.4 Sketching the relevant degree of positive and negative integration between Member States in the field of corporate income taxation: a substantial degree of legal integration

Having established the dividing line between Member States and third countries for purposes of the Treaty freedoms, the focus was subsequently on the relevant degree of positive integration in the field of corporate income taxation under EU and international law, both between the Member States and to some extent between Member States and third countries. The core question here was: what is the relevant European and international legislation aiming at removing corporate income tax distortions within the Union and, to some extent, in the relations between Member States and third countries, including the Member States’ associated and dependent territories? It has been concluded that the degree of positive integration between Member States and third countries, including their associated and dependent territories, is less far-reaching if compared to the degree of positive integration as existing between Member States. This firstly holds true as concerns the relevant substantive rules, notably the Parent-Subsidiary Directive, the Interest & Royalty Directive, the Merger Directive and the EU

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1 France: French overseas departments and overseas regions (Guadeloupe, French Guiana, Martinique and Réunion), Saint-Martin and Saint-Barthélemy (it is anticipated that as from 1 January 2012, Saint Barthélemy will obtain the status of OCT); Portugal: Azores and Madeira; Spain: Canary Islands.

2 Denmark: Greenland; France: French overseas collectivities (Mayotte, Saint-Pierre and Miquelon, French Polynesia and Wallis and Futuna Islands), New Caledonia and dependencies and the French Southern Territories (including the Scattered Islands and Clipperton Islands); it is anticipated that as from 1 January 2012, Saint Barthélemy will obtain the status of OCT; The Netherlands: Aruba, Bonaire, Curaçao, Saba, Sint Eustatius and Sint Maarten; United Kingdom: Anguilla, British Antarctic Territory, British Indian Ocean Territory, British Virgin Islands, Cayman Islands, Falkland Islands, Montserrat, Pitcairn Islands, Saint-Helena, Ascension Island, Tristan da Cunha, South Georgia and the South Sandwich Islands and Turks and Caicos Islands.
Code of Conduct for Business Taxation. These pieces of legislation require the abolishment of withholding taxes on dividend, interest and royalty payments and a compulsory system of tax deferral in the case of mergers or divisions within a group of EU companies and the abolishment of harmful tax practices within the Union to an extent that is not seen in relations with third countries. As far as the relevant procedural rules are concerned, notably the Mutual Assistance Directive and the Recovery Directive, the degree of positive integration between Member States is also more comprehensive compared to the relations between Member States and third countries. The first instrument provides for exchange of information between Member States either upon request, automatically or spontaneously, whereas the internationally agreed standard between Member States and third countries governs exchange of information upon request only. Also, the new Mutual Assistance Directive will address the relations with third countries only to a limited extent. Still, a more comprehensive standard may be found in the various tax treaties that Member States may have concluded with third countries or in the Convention on Mutual Administrative Assistance in Tax Matters, which applies between Member States and a small number of third countries. The Recovery Directive provides for the assistance in the collection and recovery of taxes within the Union. Here too, no similar instrument applies between Member States and third countries, although the various tax treaties between Member States and third countries and the above Convention on Mutual Administrative Assistance in Tax Matters may provide for collection assistance as well. Next, a binding resolution procedure in certain cases of international double taxation applies between the Member States. This procedure does not apply to third countries and binding resolution procedures are currently found under the existing tax treaty network in only a few cases. Lastly, it has been established that the Council has recognized, at a policy level, the need to include in relevant agreements to be concluded with third countries by the Union and its Member States a specific provision on good governance in the tax area, referring to the principles of transparency, exchange of information and fair tax competition.

Next, the side of the relevant degree of negative integration in the field of corporate income taxation under EU law and international tax law between Member States and the relevant degree of negative integration under international tax law between Member States and third countries has been highlighted. Essentially, the huge impact has been demonstrated that the state aid provisions and the liberalization requirement underlying the free movement provisions have on Member States’ corporate income tax systems in situations involving intra-Union investments. It furthermore has been demonstrated that the impact of the liberalization requirement following from other international instruments between the Member States and third countries – other than those based on EU law – on Member States’ corporate income tax systems in general, and the six central corporate income tax themes in particular, is far less-reaching. The following conclusions have been drawn.
Within the Union, corporate income tax distortions caused by differences between the corporate income tax laws of the different Member States can be removed to some extent under the Treaty state aid rules. This may in particular be the case where a Member State offers advantages to a selective group of companies by allowing them a lower level of corporate income taxation compared to the level of corporate income taxation that normally applies in that Member State to comparable companies. Provided that such an advantage constitutes illegal or incompatible state aid, the beneficiary of the aid is required to reimburse the aid received, including interest.

In addition, corporate income tax measures that tax income from transnational investments more heavily than income from comparable domestic investments within the Union may be scrutinized under the Treaty freedoms. In this regard, three essential steps must be taken each time. Firstly, it must be assessed whether a corporate taxpayer may, in terms of access, actually rely on the Treaty freedoms relating to freedom of investment. This implies, firstly, that the investment must involve an establishment, the provision of a (financial) services or a movement of capital. In addition, there must be a sufficient link, in terms of causality, between the contested corporate income tax measure and the Treaty freedom invoked. It is submitted that no causality exists if the restrictive effects on the transactions as defined under the relevant Treaty freedom are, from the angle of the contested corporate income tax measure, only coincidental. In such a case, the link between the contested corporate income tax measure and the Treaty freedom must be considered to be too indirect or too tenuous. It must then be assumed that the scope of the free movement provision invoked and, hence, the degree of legal economic integration, was not intended as to cover the tax measure at stake. Finally, a taxpayer may be denied access to the Treaty freedoms in situations of tax evasion where the conditions laid down by the relevant free movement provision are formally not observed.

Secondly, it must be determined that a restrictive corporate income tax measure actually constitutes a discriminatory restriction of the Treaty freedoms. From the case law of the ECJ it follows that discrimination can arise through the application of different rules to comparable situations or through the application of the same rule to different situations. The fact that the discriminatory effects of a contested corporate income tax measure could have been avoided is immaterial in this regard. In addition, the Treaty freedoms not only prohibit overt discrimination based on nationality, but also covert forms of discrimination which, by the application of other criteria of differentiation, nevertheless lead to the same effect. In this regard, the ECJ has repeatedly held that the use of the criterion of tax residence of a corporate taxpayer, the place of residence of a corporate taxpayer’s shareholders and the place where a corporate taxpayer has invested its capital may give rise to covert discrimination based on nationality. Furthermore, the test whether or not discrimination exists should, in principle, be restricted per country,
unless such would ignore, from the perspective of the objective of the contested tax measure, economic reality. Lastly, the discrimination test requires identification of a valid comparator. Tax liability constitutes a main criterion in order to establish comparability. In addition, comparability can be established or confirmed on the basis of the purpose of the tax legislation at issue and on the basis of a formal convention, such as a tax treaty, in which comparability is accepted by virtue of a specific non-discrimination clause. When determining the right comparator, differences that are not relevant should not be taken into account. And the question whether or not differences are relevant should be established on the basis of the underlying rationale of the contested corporate income tax measure.

Thirdly and lastly, it must be examined to which extent a restrictive corporate income tax measure can be justified. Up until now, the ECJ has accepted a number of reasons that can justify a restrictive corporate income tax measure, but this is often subject to strict requirements (territoriality, fiscal coherence, the need to safeguard the (balanced) allocation of taxation powers and the need to combat tax avoidance). A number of other justification grounds may be acceptable in the abstract, but could nevertheless be rejected on the basis of failure to meet the proportionality test where primary or secondary EU law provides for a more proportional legal framework applicable in the field of corporate income taxation (the need for effective fiscal supervision, the need for effective collection of tax and the need to counteract harmful tax competition). A number of other arguments have up until now never been accepted by the ECJ as a valid justification ground for a restrictive corporate income tax measure (the promotion of (national) research and development and competitiveness, the lack of compensatory taxation, lack and presence of harmonization, lack of reciprocity, loss of income and administrative difficulties). On the basis of this case law, it has been demonstrated that the Treaty freedoms have an impact, to a greater or lesser extent, on all six central corporate income tax themes within the Union.

Compared to the impact that the non-discrimination requirement enshrined in the Treaty freedoms has on Member States’ corporate income tax systems, the impact of the non-discrimination requirements included in the most relevant international legal integration instruments applicable between Member States and third countries is much more limited. Essentially, these instruments are, taken together, only concerned with overt discrimination on the basis of nationality and furthermore subject the contracting states to an obligation of national treatment for inward investments through subsidiaries and branches and for the provision of inward loans and licences. Other forms of discrimination, notably discriminatory treatment of income from outward investments, are not covered in these instruments. Accordingly, the impact of the non-discrimination clauses included in these instruments on the six central corporate income tax themes is much more limited.
1.5 **Freedom of investment between Member States and non-Member States in the field of corporate income taxation: on balance a less substantial degree of legal integration**

1.5.1 **Access to freedom of investment: the benchmarks of “definite influence” and “genuine economic link” as the existing and desirable gateways**

On the basis of the above sketched overview of the relevant legal integration between Member States and, to some extent, between Member States and third countries in the field of corporate income taxation, the main question of the study was subsequently addressed. To this end, it has first been examined and assessed whether and to which extent the interpretation of the question of access to freedom of investment between Member States and third countries should diverge in comparison to the question of access to the Treaty freedoms in an intra-Union context in the field of corporate income taxation. In this regard, the free movement provisions relating to freedom of investment included in the Treaty, the EEA Agreement, the various APC Agreements and the Agreement between the Community and Switzerland on the free movement of persons have been discussed. The position of the Member States’ associated and dependent territories was discussed as a separate matter as well.

It has been established that the interpretation of the concepts of establishment, capital and services under the above international arrangements should not diverge in comparison to intra-Union situations. This means that freedom of investment between Member States and third countries is essentially an economic concept. Apart from certain cases involving mere capital transactions, it implies a genuine economic link through the exercise of a genuine economic activity in the territory of a third country (in situations involving outward investments) or with the territory of a Member State (in situations involving inward investments). In the author’s view, the existence of a genuine economic link therefore is, or at least should be, the gateway to freedom of investment.

Notwithstanding the above, one can, on balance, conclude that in terms of access, the degree of liberalization vis-à-vis third countries, including Member States’ associated and dependent territories, varies substantially according to the free movement provision and the international arrangement invoked. Consequently, third-country investments can be denied access to freedom of investment more easily compared to investors that seek access to the Treaty freedoms within the Union. Broadly speaking, one can conclude the following in this regard. As concerns access to the Treaty freedoms, one can essentially establish that large third-country investments receive a relatively low protection whereas small third-country investments receive a relatively high protection under the Treaty freedoms, particularly the free movement of capital under Article 63(1) TFEU. This is mainly due to the fact that the ECJ tends to interpret Article 63(1) TFEU,
for unspecified reasons, in a rather strict fashion by easily giving priority to the freedom of establishment where third-country investments involve, as a factual matter, a definite influence, thus excluding from its scope the majority of restrictive corporate income tax measures applicable to the transnational corporation. Under the APC Agreements, it is precisely the other way around: large third-country investments are relatively more protected, particularly under the freedom of establishment included in a number of these Agreements, than small third-country investments. An exception applies to the EEA Agreement. Here, the scope of the free movement provisions is, in terms of access, similar to the scope of the Treaty freedoms as they apply between the Member States.

It follows that the relationship between the free movement provisions of which freedom of investment consists (establishment, capital and financial services) is essential when determining the scope, in terms of access, of freedom of investment in situations involving third-country investments. In the author’s view, this question of concurrence between the free movement provisions is, or at least should be, addressed as a question of causality. Accordingly, the basic criterion should only be whether or not there is, in terms of causality, a sufficient link between the contested corporate income tax measure, on the one hand, and the free movement provision being invoked, on the other. In the author’s opinion, it would follow from the ECJ’s case law that causality should be denied only if this link is too indirect or too tenuous. This is the case if the restrictive effects on the transactions as defined under the free movement provision at issue are, from the viewpoint of the contested corporate income tax measure at issue, only coincidental. Nevertheless, although the ECJ rightly presents its decisions as a matter of causality, taking the purpose and effects of the contested tax measure into account, in the majority of cases it has basically decided the matter – wrongly – as a matter of exclusivity. From an international tax neutrality perspective, this approach must be regretted. By attaching decisive significance to the rather formal benchmark of definite influence, the ECJ fully ignores the essential nature of freedom of investment involving the exercise of a genuine economic activity – not being of a marginal or ancillary nature – within the territory of a Member State through a fixed establishment which involves a sufficient degree of independence and a sufficient degree of management and control within the Member State concerned. Whether or not this economic activity is carried out through an investment involving definite influence should not, in the author’s view, be material, especially since the benchmark of definite influence only differs from the idea of direct investment (which qualifies as capital) in terms of intensity of the required influence, but not in substance since in both cases the requirement of a genuine economic link applies. From this perspective, it is hard to justify the fact that investments are excluded from the scope of the free movement of capital to the extent they involve definite influence. In the author’s view, the restrictive approach taken by the ECJ blatantly sets aside the clear wording of the free movement provisions concerned. In addition, it ignores the fact that from a mere economic point of view, international patterns of investment may be affected or restricted by corporate income
tax measures, as was demonstrated in this study. The ECJ’s approach is consequently detrimental to the benchmark of international tax neutrality and runs counter to the degree of legal integration Member States apparently intended to establish under the Treaty in their relations with third countries. One cannot but speculate why the ECJ chose to apply such a strict approach in this matter, an approach which clearly contradicts the wording and background of Article 63(1) TFEU. Perhaps the ECJ was concerned about the fact that a more liberal approach would de facto widen the scope of the freedom of establishment to third countries without reciprocity being required. However, this argument, if it were true, is not very convincing. The reason is that the Member States already met this concern by including a specific standstill clause under Article 64(1) TFEU. This is because reciprocity considerations were a significant motive for the insertion of this clause. All in all, one gets the impression that the ECJ simply did not have the courage to apply the erga omnes liberalization consistently in the field of corporate income taxation and to grant generous access to Article 63(1) TFEU to majority investors as well while denying the benefits on a case-by-case basis in the context of the standstill clause and the justification grounds. Instead, it has introduced a rigid all-or-nothing approach which does not foster economic efficiency between the Member States and third countries.

1.5.2 Discrimination and justification grounds under freedom of investment: more leeway for Member States to distinguish between intra-Union and third country investments

Next, the focus was on the impact of freedom of investment on Member States’ corporate income tax systems in terms of discrimination and justification grounds. More in particular, it has been examined and assessed whether and to which extent the interpretation, in a third-country context, of the concept of discrimination and justification grounds should diverge compared to the interpretation given to these concepts in an intra-Union context. On balance, it has been concluded that the concept of discrimination underlying the free movement of capital under Article 63(1) TFEU, as this provision applies between Member States and third countries, Article 40 EEA and the various APC Agreements does not diverge from the interpretation given to this concept in the context of the Treaty freedoms as they apply between Member States. On the other hand, the concept of discrimination underlying the freedom of establishment included in the various Agreements is much more limited. Only the interpretation of the non-discrimination requirement underlying the freedom of establishment included in the EEA Agreement does not diverge from the interpretation given to the same concept in an intra-Union context. As far as the right of establishment in the APC Agreements is concerned, it has been concluded that this right is essentially only concerned with national treatment of branches or subsidiaries set up in a Member State by companies established in the respective APC country in a way comparable to Articles 24(3), (4) and (5) of the OECD Model Tax Convention. Other forms of differential tax treatment based on the place of residence of the taxpayer are not caught. In addition, restrictive corporate
income tax measures applied by Member States to outward third-country investments are not affected either. Finally, it has been established that only under a very limited number of APC Agreements, and in a limited number of situations, are Member States not allowed to treat the provision of (financial) services between Member States and the respective third countries less favourably than the provision of comparable (financial) services within the Union. One can therefore conclude that, broadly speaking, relatively small third-country investments, which tend to fall, in terms of access, under the free movement of capital under Article 63(1) TFEU, may enjoy wide protection under the non-discrimination requirement, i.e. under the same terms as they apply within an intra-Union context. On the other hand, relatively large third-country investments, which tend to fall, in terms of access, under the freedom of establishment included in the EEA Agreement and the various APC Agreements, may enjoy limited protection, i.e. only a right of national treatment of branches or subsidiaries set up in a Member State by third-country investors.

As far as the justification grounds in situations involving third-country investments are concerned, the following conclusions have been drawn. With respect to reasons relating to the lack of reciprocity, loss of income, and administrative difficulties, these reasons should not be accepted more easily in a third-country context as compared to situations involving intra-Union investments. On the other hand, depending on the precise objective and nature of the contested corporate income tax measure and subject to the principles of suitability and necessity, there may be more room to accept reasons relating to the principle of territoriality, the need to preserve the coherence of the tax system, the need to combat abuse, the need for effective fiscal supervision and the effective collection of tax, the need to safeguard the balanced allocation of taxation powers, the promotion of research and development, the need to combat harmful tax competition, the lack of compensatory taxation (although this is arguable) and, in certain cases, the lack of harmonization. These conclusions are not only valid under the free movement of capital under Article 63(1) TFEU as this provision applies between Member States and third countries, but also under the free movement provisions under the EEA Agreement and the various APC Agreements. At first sight, one could consider the Member States’ leeway to justify third-country corporate income tax restrictions too limited in comparison to intra-Union situations. Notably, one might disagree with the rejection – both by the ECJ and the author – of the lack of reciprocity or the loss of income as a justification for third-country corporate income tax restrictions. However, one should not forget that freedom of investment between Member States and third countries always involves, or at least should involve, a genuine economic link in a third country (in the case of outward investments) or in a Member State (in the case of inward investments). Hence, the existence of a genuine economic link is, or at least should be the gateway to freedom of investment, as was established above. Companies that do not meet this threshold are excluded from the benefits of freedom of investment since they are perceived not to contribute to an efficient allocation of capital. Companies that do
meet this threshold, on the other hand, are perceived to contribute to allocative efficiency from which the Member States may benefit. It would be at odds against this basic premise of efficient capital allocation underlying freedom of investment if Member States were able to justify restrictive corporate income tax measures in third-country situations too easily, for instance on the basis of the lack of reciprocity or loss-of-income arguments.

1.5.3 Practical impact on the six central corporate income tax measures

The above conclusions have broad impact on the central six corporate income tax measures as well. Notably, Member States have more leeway to deny cross-border loss compensation as the exception of final losses should not apply in third-country situations. Also, discriminatory withholding taxes may more easily be justified, particularly in non-tax treaty situations and in situations involving third countries that are under no international obligation to exchange information with the competent authorities of the Member State involved. Restrictive anti-abuse provisions, such as CFC legislation and limitations on interest deduction may be justified more easily as well in situations with third countries. This is particularly the case where a third country is involved in harmful tax practices, applies a low corporate income tax rate, or is under no international obligation to exchange information with the competent authorities of the Member State involved. These reasons may also permit Member States to refrain from providing relief for double taxation in third-country situations. Finally, deferral of taxation upon the transfer of assets from a Member State to a third country may be subject to more strict requirements as well compared to intra-Union situations. This is notably the case where a transfer of assets involves a company which does not carry on genuine economic activities in the third country concerned. The lack of exchange of information or the lack of international assistance in the collection of taxes may also justify immediate taxation.

Lastly, it has been established that there may be room for Member States to successfully request the ECJ to limit the temporal effects of its judgment provided that they succeed in demonstrating that there is a risk of serious economic repercussions for the Member State concerned and that there is an objective, significant uncertainty regarding the implications of Union provision at issue. This is because the six central corporate income taxation themes have not been addressed in substance by the ECJ in its case law up until now as far as third-country relations are concerned, except for the theme of avoidance of double taxation.

1.5.4 The temporal scope of freedom of investment: additional limitations under the Treaty, additional protection under the Association, Partnership and Cooperation Agreements

Finally, the temporal scope of the relevant provisions relating to freedom of investment
was examined. Two questions have been addressed in this regard. Firstly, what the impact is in the field of corporate income taxation of the various standstill clauses included in both the Treaty and a large number of APC Agreements concluded between the Member States and third countries has been examined and evaluated. Secondly, it has been examined to which extent, in the case of accession by a third country to the Union, the provisions relating to the freedom of establishment, the free movement of capital and the free movement of services under the Treaty and secondary EU law in the field of corporate income taxation apply *ratione temporis* to investments involving such a country.

From the outset, it has been established that standstill clauses constitute a system of progressive rather than full liberalization. They allow Member States to continue to apply certain restrictive measures already in force on a specified date. To that extent, they can be perceived as promoting international economic integration and the idea of international tax neutrality to a limited extent only. As far as the considerations underlying the standstill clause under Article 64(1) TFEU are concerned, it is apparent that Member States wished to partially maintain their sovereignty with respect to capital movements between the Member States and third countries. In brief, one can establish reciprocity considerations were a significant motive for the insertion of this clause. In addition, it ensured that existing capital restrictions under EU law and the OECD Codes of liberalisation could be maintained. It also prevented possible undesirable takeovers of major EU enterprises by substantive third-country companies. Lastly, it was felt that the liberalization of capital *erga omnes* without further restrictions might harm existing Union policy in both the Union’s internal and external relations. There is, however, no evidence that Article 64(1) TFEU was explicitly designed to preserve Member States’ sovereignty in the area of corporate income taxation. Nonetheless, the ECJ has accepted to apply the standstill clause in the field of corporate income taxation as well without further deliberation.

In the field of corporate income taxation, the essential question appears to be: how should one determine whether an applied corporate income tax restriction already existed on the specified date? Obviously, no peculiarities arise when a corporate income tax restriction already existed before the specified date and was not amended afterwards. In such case, an existing restriction can be identified. Conversely, a new restriction exists once a corporate income tax restriction is introduced after the specified date which did not exist on or before that date. The question upraises, however, what should hold when a corporate income tax measure that existed on a specified date is amended afterwards. In this regard, one can conclude the following. A standstill clause is not applicable in the case of posterior amendments of the underlying tax legislation which actually result in increasing restrictive effects in a particular case compared to those under the previous legislation. In other words, if the taxpayer is worse off under the new legislation compared to the rules as they stood on the specified date, the
standstill clause involved remains inapplicable, even if the underlying legislation has, in substance, not changed or at the same time abolishes or mitigates one or more restrictive elements that previously existed. On the other hand, if an existing restriction has been reduced after the said date, the standstill clause remains applicable. In such a case, the taxpayer is better off compared to the situation prior to the amendment. The same applies where the underlying tax legislation is amended afterwards, but does not lead to increasing or decreasing restrictive effects in a particular case compared to the previous legislation. In such a case, the taxpayer is neither better nor worse off under the new legislation compared to the rules as they stood on the specified date. This might be different, however, where the amended legislation is based on an approach which differs from that of the previous law and which establishes new procedures. In addition, once an existing restriction has been abolished, it cannot be reintroduced. Finally, once it has been established that a restrictive corporate income tax measure infringes a standstill clause, Member States are subsequently required to disapply the contested restriction in such a case, but only to the extent this restriction did not already exist on the specified date.

The approach followed by the ECJ is in line with the idea of progressive rather than full liberalization underlying the standstill clause and can be endorsed to the extent the ECJ focuses on the actual new restrictive effects of posterior amendments in national tax legislation which worsen the position of the taxpayer. To the extent the ECJ focuses solely on the underlying legislation rather than on the actual restrictive effects, the result is less convincing, since taxpayers may be able to claim a higher degree of liberalization even though their factual situation has not worsened compared to the situation as it would have existed on the specified date. In the author’s view, this approach creates an unfair balance between Member States’ apparent wish to partially maintain their sovereignty with respect to capital movements between the Member States and third countries, on the one hand, and the objective of international economic integration, on the other. In the author’s view, the desirable approach would be that the ECJ would only look at the actual restrictive effects on the taxpayer at hand rather than at the underlying legislation as a whole.

What is the impact of the standstill clauses included in the Treaty and the various APC Agreements in situations involving third country investments in the field of corporate income taxation? The answers to this question present a diversified picture. This is because the scope of the various standstill clauses included in the Treaty and a large number of APC Agreements diverge substantially. Nonetheless, broadly speaking, one can conclude that the standstill clause under Article 64(1) TFEU applies to relatively larger third-country investments and limits the protection that third-country investors could otherwise derive from the free movement of capital as guaranteed under Article 63(1) TFEU. This is under the condition that the restrictive corporate income tax measure being applied already existed by the end of 31 December 1993.
As far as the various standstill clauses included in the various APC Agreements are concerned, the opposite conclusion can be drawn. Here, broadly speaking, these clauses may apply to both relatively large and small third-country investors. Their scope is not to restrict the scope of protection that third-country investors could otherwise derive from the free movement provisions included in the APC Agreement concerned. Rather, they protect third-country investors against newly introduced restrictive corporate income tax measures applied by a Member State which would otherwise not be prohibited under the free movement provisions included in the APC Agreements at issue.

One balance, standstill clauses can be perceived as promoting international economic integration and, consequently, international tax neutrality although only to the extent that they prevent Member States from introducing new restrictive corporate income tax measures vis-à-vis third countries. Consequently, in each individual case, assessment of a possibly applicable standstill clause is essential when examining the scope of protection that a third-country investor is offered under freedom of investment. It has been concluded in this regard that in the case of collision between a standstill clause in one international Agreement and a liberalization requirement imposed under another, the most liberal provision should prevail.

The answer to the second question was more straightforward. In principle, no significant problems arise where a third country becomes a Member State through accession to the Union. The main rule here is that substantive rules of Union law can be applied to situations existing before their entry into force only in so far as it clearly follows from their terms, objectives or general scheme that such an effect must be given to them. This means that the application by a Member State of a restrictive corporate income tax measure vis-à-vis a company established in a new Member State which was already applied before the date of that state’s accession to the Union is caught ratione temporis, as of the date of accession, by the free movement provisions in the Treaty. In principle, the same holds true as far as the provision of the Parent-Subsidiary Directive, the Merger Directive and the Interest & Royalty Directive are concerned. On the other hand, procedural rules of Union law are generally held to apply to all proceedings pending at the time when these rules enter into force. This means that the provisions of the Mutual Assistance Directive, the Recovery Directive and the Arbitration Convention, all being of a procedural rather than a substantive nature, can be applied to the assessment or, as the case may be, to the collection of taxes not only to the extent this relates to taxes due as from the date of accession, but also as far as it relates to taxes due prior to the accession of the new Member State.
1.6 Indirectly held third-country investments: substantial intra-Union protection?

From the previous conclusions, one can infer that Member States have more room for manoeuvre to maintain restrictive corporate income tax measures in situations involving third-country investments compared to situations involving intra-Union investments under EU law, and that within the heterogeneous relations between the Member States and third countries the degree of liberalization between each particular Member State and third country may diverge accordingly among the different Member States. Given this lack of uniformity in the relations with third countries, and given the fact that the degree of liberalization between Member States is significantly wider than the degree of liberalization between Member States and third countries in the field of corporate income taxation, third-country corporate investors could easily decide to structure their investments made in or from a Member State through an intermediate company established in another Member State which applies, of all Member States, the most liberal corporate income tax regime vis-à-vis the third country concerned. By doing so, the benefits available under the Treaty freedoms and secondary EU law in the field of corporate income taxation for companies investing within a Member State could effectively be extended to third-country corporate investors as well through the setting up of an intermediate company in another Member State. The question is the extent to which a Member State is allowed to deny the benefits deriving from the Treaty freedoms and the Directives in the field of corporate income taxation in such case. This question has been answered as follows.

Indirect inward and outward third-country investments fall, in principle, under the scope of the Treaty freedoms and secondary EU law within the Union. However, the benefits could still be denied in the case of abuse. In the author’s view, again the idea of a genuine economic link serves, or at least should serve as a benchmark in this regard. This means that where an EU intermediate company which was set up by a third-country investor or which holds a third-country investment, lacks a genuine economic link with that Member State, the benefits can be denied. Otherwise, Member States may be deprived of their right to tax income from activities carried out in their own territory. Where the contested corporate income tax measure aims at combating abuse under domestic tax law (which will most often be the case in situations involving indirectly held third-country investments), the principle of proportionality comes into play as well. This means that the intermediate company must be given the opportunity to prove that the principal aim of its creation and/or maintenance was not to obtain a tax advantage. Apart from anti-abuse considerations, Member States have only limited room for manoeuvre to justify a restrictive corporate income tax measure applied to an intra-Union investment for the reason that this investment ultimately involves a third-country investor or third-country investment. Similar considerations mutatis mutandis hold true under secondary EU law in the field of corporate income taxation.
From a corporate income tax law perspective, there is no reason to draw different conclusions for inward and outward dual resident companies. However, one can conclude that these types of companies enjoy only very little protection under the Treaty freedoms and secondary EU law in the field of corporate income taxation within the Union. In the author’s view, here too the benchmark should be whether such a dual resident company has a genuine economic link with a Member State. If this is the case, the benefits of the Treaty freedoms and secondary EU tax law should not, in the author’s view, be denied.

1.7 Recommendations: a call for uniformity vis-à-vis third countries in the field of corporate income taxation

On balance, one can conclude that Member States have more room for manoeuvre to maintain restrictive corporate income tax measures in situations involving third-country investments than in situations involving intra-Union investments under EU freedom of investment de lege lata. Consequently, international tax neutrality is currently not achieved. This holds even more since freedom of investment only lays down a minimum standard of liberalization between Member States and third countries. If this minimum standard is not met, Member States are allowed to apply a given restrictive corporate income tax measure. They are, however, not required to apply any restrictive corporate income tax measures in case the standard of genuine economic link is not met. In other words, Member States remain free to apply a more liberal approach to direct or indirect third-country investments and thus refrain from applying any restrictive corporate income tax measure vis-à-vis third countries. As a result of this lack of uniformity in the Member States’ relations with third countries in the field of corporate income taxation, corporate income tax distortions may continue to exist. In order to solve this, it has been proposed to turn things around. That is to say, where the minimum standard of a genuine economic link is not met, Member States should be obliged (rather than allowed) to apply a given restrictive corporate income tax measure vis-à-vis third countries. In such a case, uniformity in the relations with third countries should be promoted and, accordingly, corporate income tax distortions should be reduced. Under reference to the principles of proportionality and subsidiarity, it has been proposed to amend the existing directives in the field of corporate income taxation. These proposed amendments should introduce a common system for the avoidance of double taxation of inward dividend income received from third-country investments, common CFC rules, a common system of withholding taxes on payments of dividend, interest and royalty payments made within a group of EU companies which are ultimately held by a non-EU corporate investor in case the receiving company lacks economic substance, and a common system of deferral of taxation upon transfer of business assets from the territory of a Member State to a third country within a transnational corporation. Under these proposals, international tax neutrality should be promoted.
1.8 Final conclusions

On balance, one can conclude the following. The impact of freedom of investment between Member States and non-Member States, including their associated and dependent territories, on Member States’ corporate income tax systems is less substantial *de lege lata* compared to the impact the Treaty freedoms have on intra-Union investments in the field of corporate income taxation. As far as free movement of capital under the Treaty is concerned, one can conclude that majority investments from or to third countries tend to be categorically excluded from any protection whereas minority portfolio investors tend to be fully protected against corporate income tax discrimination by Member States. The remaining group of direct investors takes a middle position in that they only enjoy protection against restrictive corporate income tax measures introduced by a Member State after 31 December 1993. Under the international economic agreements concluded between the Member States and third countries, the conclusion tends to be the other way around. Majority third-country investors may enjoy a right of national treatment (no more, no less) of their investments made in the Union, whereas minority portfolio investors and the remaining group of direct investors generally speaking enjoy no or limited protection under these agreements.

This outcome is mainly due to the fact that the ECJ tends to interpret the free movement of capital, for unspecified reasons, in a rather strict fashion by easily giving priority to the freedom of establishment where third-country investments involve, as a factual matter, a definite influence, thus excluding the majority of restrictive corporate income tax measures applicable to the transnational corporation from its scope. It follows that the relationship between the free movement provisions of which freedom of investment consists (establishment, capital and financial services) is essential when determining the scope of freedom of investment in situations involving third-country investments. In the author’s view, this question of concurrence between the free movement provisions is, or at least should be addressed, as a question of causality. Nevertheless, although the ECJ rightly presents its decisions as a matter of causality, taking the purpose and effects of the contested tax measure into account, in the majority of cases it basically has decided the matter – wrongly – as a matter of exclusivity. From an international tax neutrality perspective, this approach must be regretted. On the basis of this benchmark, the condition of a “genuine economic link” rather than the absence of “definite influence” should be the gateway to freedom of investment. Under this condition, international tax neutrality would be better promoted if generous access was granted to majority third-country investors as well while denying the benefits on a case-by-case basis in the context of justification grounds and a standstill clause, if applicable. Notably, Member States have more leeway to deny cross-border loss compensation as the exception of final losses should not apply in third-country situations. Also, discriminatory withholding taxes may more easily be justified, particularly in non-tax treaty situations.
and in situations involving third countries that are under no international obligation to exchange information with the competent authorities of the Member State involved. Restrictive anti-abuse provisions, such as CFC legislation and limitations on interest deduction, may be justified more easily as well in situations with third countries. This is particularly the case where a third country is involved in harmful tax practices, applies a low corporate income tax rate, or is under no international obligation to exchange information with the competent authorities of the Member State involved. These reasons may also permit Member States to refrain from providing relief for double taxation in third-country situations. Finally, deferral of taxation upon the transfer of assets from a Member State to a third country may be subject to more strict requirements as well compared to intra-Union situations. This is notably the case where a transfer of assets involves a company which does not carry on genuine economic activities in the third country concerned. The lack of exchange of information or the lack of international assistance in the collection of taxes may also justify immediate taxation. Notwithstanding the above, the ECJ has introduced a rigid all-or-nothing approach which does not foster economic efficiency between the Member States and third countries.

Given the fact that the degree of liberalization between Member States is significantly wider than the degree of liberalization between Member States and third countries in the field of corporate income taxation, third-country corporate investors could easily decide to structure their investments made in or from a Member State through an intermediate company established in another Member State which applies, of all Member States, the most liberal corporate income tax regime vis-à-vis the third country concerned. By doing so, the benefits available under the Treaty freedoms and secondary EU law in the field of corporate income taxation for companies investing within a Member State could effectively be extended to third-country corporate investors as well. In the author’s view, here too the idea of a genuine economic link serves, or at least should serve as a benchmark in this regard. This means that where an EU intermediate company which was set up by a third-country investor or which holds a third-country investment lacks a genuine economic link with that Member State, the benefits of the Treaty freedoms and secondary EU law in the field of corporate income taxation can be denied, subject to the requirement of proportionality.

The fact that Member States are allowed, either de lege lata or de lege ferenda, to continue to apply corporate income tax restrictions in their relations with third countries if the standard of a genuine economic link is not met does not necessarily foster economic efficiency between the Member States and third countries. This is because Member States remain free to apply a more liberal approach to direct or indirect third-country investments and thus may refrain from applying any restrictive corporate income tax measure vis-à-vis third countries. As a result of this lack of uniformity in the Member States’ relations with third countries in the field of corporate income taxation, corporate
income tax distortions may continue to exist. In order to solve this, it has been proposed to turn things around. That is to say, where the minimum standard of a genuine economic link is not met, Member States should be obliged (rather than allowed) to apply a given restrictive corporate income tax measure vis-à-vis third countries. In such a case, uniformity in the relations with third countries should be promoted and, accordingly, corporate income tax distortions should be reduced. Under reference to the principles of proportionality and subsidiarity, it has been proposed to amend the existing directives in the field of corporate income taxation. These proposed amendments should introduce a common system for the avoidance of double taxation of inward dividend income received from third-country investments, common CFC rules, a common system of withholding taxes on dividend, interest and royalty payments made within a group of EU companies which are ultimately held by a non-EU corporate investor in cases where the receiving company lacks economic substance, and a common system of deferral of taxation upon transfer of business assets from the territory of a Member State to a third country within a transnational corporation. Under these proposals, international tax neutrality should be promoted.