WHETHER FREEDOM OF ESTABLISHMENT RIGHTS EXIST IN RELATION TO COMPANIES INCORPORATED IN ONE OF THE OVERSEAS COUNTRIES AND TERRITORIES

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1. Introduction and background

One does not expect to find a list of tax havens in the EC Treaty, let alone a suggestion that they may benefit from Community law rights. Yet Part Four of the Treaty on the Functioning of the European Union and Council Decision 2001/822/EC contain provisions that regulate the terms of the association of the Member States with the so-called "overseas countries and territories" (OCTs), whose ranks include the Cayman Islands, the British Virgin Islands, and the Netherlands Antilles.

This article is about those provisions. It considers their effect and, in particular, whether they create freedom of establishment rights in relation to companies incorporated in one of the OCTs.

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1.1. Why freedom of establishment rights?

Council Decision 2001/822/EC, in particular, is a lengthy document that deserves wider consideration than this article can afford. But two factors call for a detailed examination of it's (and TFEU's) freedom of establishment aspects.

First, there is little commentary or source material on the OCT provisions in general; even less on their tax implications; and almost none on their freedom of establishment aspects. (That little has been written on the OCT provisions is understandable given their impenetrability at times.) The aim of this article is to contribute, in some small way, to filling this gap in the literature.

Second, whether freedom of establishment rights exist in relation to OCT companies will be of great interest to corporate tax practitioners. For instance, a UK parent company might be able to challenge a UK controlled foreign company (CFC) apportionment in respect of its wholly owned Cayman Islands subsidiary on *Cadbury Schweppes*[2] grounds. For this reason, the article focuses on whether the OCT provisions could affect the Member States' tax rules.[3]

And the way in which establishment interacts with the other fundamental freedoms makes it particularly important in corporate tax matters. Briefly, establishment appears to be the principal freedom in two situations.[4] First, it appears always to prevail over services and capital (effectively making them irrelevant) if the national tax rule in question applies only where *Baars*[5] 'definite influence' exists.[6] Second, even if the national tax rule applies absent definite influence, establishment still normally prevails if, on the facts of the case, definite influence actually exists.[7]

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2 ECJ, 12 September 2006, Case C-196/04, *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* [2006] ECR I-7995 ('*Cadbury Schweppes*').

3 Note that the OCT authorities' obligations vis-à-vis the nationals of the Member States may be different from the Member States' obligations vis-à-vis the nationals of the OCTs.

4 For an insightful analysis, see S. Hemels and others, "Freedom of Establishment or Free Movement of Capital: Is There an Order of Priority?", EC Tax Review, 2010/1, 19-31.

5 ECJ, 13 April 2000, Case C-251/98, *C Baars v Inspecteur der Belastingen Particulieren/Ondernemingen Gorinchem* [2000] ECR I-2787 ('*Baars*').

6 See, e.g., *Cadbury Schweppes*, paras 29-33; and ECJ, 13 March 2007, Case C-524/04, *Test Claimants in the Thin Cap Group Litigation v Commissioners of Inland Revenue* [2007] ECR I-02107 ('*Thin Cap GLO*'), paras 26-35.

7 See, e.g., ECJ, 12 December 2006, Case C-446/04, *Test Claimants in the FII Group Litigation v Commissioners of Inland Revenue* [2006] ECR I-11753 ('*FII GLO*'), para 38; and ECJ, 21 January 2010, Case C-311/08, *Société de Gestion Industrielle (SGI) v Belgian State* [2010] ECR I-00000 ('*SGI*'), paras 23-37.

There appear to be a few exceptions to this latter "facts of the case" rule. For instance, in *Holböck*[8] the ECJ seemingly accepted that free movement of capital could apply alongside the freedom of establishment, and in *Glaxo Wellcome*[9] it examined a German tax rule solely in the light of the free movement of capital (notwithstanding that definite influence clearly existed in both cases).[10]

But even these exceptions seem to be narrowly drawn. The correct interpretation of *Holböck* is unclear: The ECJ's judgment can be read as expressing doubt that the free movement of capital could apply to a two-thirds shareholding in the first place.[11] And the ECJ's judgment in *Glaxo Wellcome* suggests that for the free movement of capital to prevail over the freedom of establishment, a taxpayer must undertake the action that triggers the national rule "with the sole objective of obtaining [a tax] advantage, and not with the objective of exercising the freedom of establishment or as a result of exercising that freedom".[12]

Therefore, it will normally be prudent to assume that, if definite influence in fact exists, only establishment rights can be relied on. This means that the question whether establishment rights exist in relation to OCT companies is potentially of great importance.[13]

1.2. Existing literature

Very few commentators have addressed the OCT provisions' direct tax implications. Two articles appeared in the EC Tax Review in 2007. Pancham, Fibbe and Ruiter[14] explored whether Aruba's dividend withholding tax and foreign exchange charge

8 ECJ, 24 May 2007, Case C-157/05, *Winfried L. Holböck v Finanzamt Salzburg-Land* [2007] ECR I-4051 ('*Holböck*').

9 ECJ, 17 September 2009, Case C-182/08, *Glaxo Wellcome GmbH & Co KG v Finanzamt München II* [2009] ECR I-00000 ('*Glaxo Wellcome*').

10 The ECJ has also examined provisions primarily in the light of the free movement of capital in various infringement proceedings: see, e.g., ECJ, 28 September 2006, Joined cases C-282/04 and C-283/04, *Commission of the European Communities v Kingdom of the Netherlands* [2006] ECR I-09141 ('*golden shares*'), para 43.

11 See *Holböck*, paras 31 and 44, and S. Hemels (fn. 4), at p. 24.

12 *Glaxo Wellcome*, para 50.

13 There is insufficient space to discuss the position if definite influence does not apply. In particular, one might expect any free movement of capital analysis to apply to OCT companies in much the same way as companies incorporated anywhere else. But the OCTs' legal status and the tax carve-out clause in Article 55 OAD2001 create difficulties: see S. Pancham, G. Fibbe and J. Ruiter, "The meaning of the association of the overseas countries and territories with the European Community for the fiscal relations between the Netherlands and Aruba", EC T.R., 2007/4, 164-175.

14 Ibid.

complied with the OCT provisions. Shortly thereafter, Kavelaars[15] assessed the OCTs' position as part of a wider review of the territorial limits of the Treaty. More recently, in 2008 Smit and Kiekebeld[16] considered selected aspects of the free movement of capital, including its application to the OCTs.

None of these, however, contains a detailed analysis of whether the OCTs have freedom of establishment rights.

While Pancham, Fibbe and Ruiter's article contains a careful analysis of the OCTs' status and of whether the free movement of capital applies to EU-OCT relations, it makes only passing reference to the freedom of establishment.

The scope of Smit and Kiekebeld's book is similarly limited: Freedom of establishment rights are considered only as regards how they interact with free movement of capital rights. Even then, the analysis does not specifically focus on the OCTs.

Finally, although Kavelaars briefly touches on the establishment question, he does not examine the OCT provisions in detail. Moreover, his comments appear contradictory: He initially assumes that the OCTs have freedom of establishment rights[17] before later referring to three Netherlands Supreme Court cases (discussed below) in which "[t]he Netherlands Supreme Court held … that Arts 43 and 56 of the EC Treaty do not apply to OCTs, as those provisions do not form part of Part IV of the Treaty applying only to OCTs."[18]

An examination of whether the OCT provisions create freedom of establishment rights is therefore overdue.

1.3. Structure and approach taken

The article contains four sections, of which this is the first.

Section two provides a brief overview of the OCT provisions.

Section three considers whether (and, if so, to what extent) the OCT provisions create freedom of establishment rights in relation to OCT companies. As there is little commentary or ECJ case law on the establishment aspects of the OCT provisions, a detailed analysis of their terms is unavoidable. It is also instructive to consider the provisions' history, as this sheds some light on their purpose and meaning. The analysis therefore examines various Commission documents and the Council Decisions

15 P. Kavelaars, "The foreign countries of the European Union", EC T.R., 2007/6, 268-273.

16 D. Smit and B. Kiekebeld, EC Free Movement of Capital, Corporate Income Taxation and Third Countries: Four Selected Issues (Kluwer Law International, 2008).

17 See fn. 15 at the top of p. 270.

18 See fn. 15 at the bottom of p. 270.

that preceded OAD2001. Finally, the direct tax implications of the Member States' obligations under the General Agreement on Trade in Services (GATS) are considered, as the OCT provisions cross-refer to these.

Section four draws some conclusions.

2. Overview of the OCT provisions

The key provisions relating to the OCTs are found in Part Four of the Treaty on the Functioning of the European Union (TFEU) and Council Decision 2001/822/EC. Together, these are referred to throughout this article as the OCT provisions.

2.1. The Treaty

The preamble to TFEU notes that the signatories were "intending to confirm the solidarity which binds Europe and the overseas countries and desiring to ensure the development of their prosperity, in accordance with the principles of the Charter of the United Nations." To this end, Article 355(2) TFEU states that "[t]he special arrangements for association set out in Part Four shall apply to the overseas countries and territories listed in Annex II."

Annex II currently lists 21 OCTs. Of these,

- 12 are British overseas territories;[19]
- 6 have a special relationship with France;[20]
- 2 have a special relationship with the Netherlands;[21] and
- 1 has a special relationship with Denmark.[22]

The most note-worthy OCTs – insofar as corporate tax practitioners will be concerned – are Bermuda,[23] the Cayman Islands, the British Virgin Islands, and the Netherlands Antilles.

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19 Anguilla, Bermuda, British Antarctic Territory, British Indian Ocean Territory, the British Virgin Islands, the Cayman Islands, the Falkland Islands, Montserrat, the Pitcairn Islands, Saint Helene, South Georgia and the South Sandwich Islands, and the Turks and Caicos Islands. Note that Gibraltar, which is also a British overseas territory, is in principle part of the EU by virtue of Article 355(3) TFEU.

20 French Polynesia, the French Southern and Antarctic Territories, Mayotte, New Caledonia, Saint-Pierre Miquelon, and the Wallis and Futuna Islands.

21 The Netherlands Antilles, and Aruba.

22 Greenland.

23 Bermuda's position, which differs from that of the other OCTs, is discussed below.

Part Four TFEU comprises Articles 198-204.

Article 198 TFEU introduces the concept of the EU-OCT association. It explains that "[t]he purpose of association shall be to promote the economic and social development of the countries and territories and to establish close economic relations between them and the Union as a whole." Further, association "shall serve primarily to further the interests and prosperity of the inhabitants of these countries and territories in order to lead them to the economic, social and cultural development to which they aspire."

Article 199 TFEU lists the five objectives of the Association. For present purposes, the most important of these is the fifth, which refers to the right of establishment (see below).

Articles 200 and 201 TFEU regulate the levying of customs duties on imports from the overseas countries and territories into the Member States (and vice versa), while Article 202 TFEU provides for freedom of movement within Member States for workers from the countries and territories (and vice versa) to be regulated by acts adopted in accordance with Article 203 TFEU. As such, Articles 200-202 TFEU are not directly relevant here, and they are discussed only insofar as the ECJ's case-law on them sheds light on the effect of Article 199 TFEU.

Article 203 TFEU requires the Council to "lay down provisions as regards the detailed rules and the procedure for the association of the countries and territories with the Union." In doing so it must act "on the basis of the experience acquired under the association of the countries and territories with the Union and of the principles set out in the Treaties".

The provisions have changed little since the 1957 Treaty of Rome. A single substantive amendment has been made to what is now Article 199 TFEU, concerning what customs duties the OCTs may levy on imports from the Member States; and Article 204 has been introduced to deal with Greenland.[24] The Lisbon Treaty itself appears not to have had a significant effect on EU-OCT relations: Article 202 TFEU has been amended to clarify the manner in which the free movement of workers is implemented; Article 203 TFEU has been amended to clarify that the Commission has the right of initiation and that, even if a special legislative procedure is used, unanimity is still required; and Article 3(s) EC – which made "the association of the overseas countries in order to increase trade and promote jointly economic and social development" an activity of the Community – has not been reproduced in either TFEU or the Treaty on European Union. The other TFEU provisions mirror their predecessor provisions with only minor (consequential) amendments.

24 OAD2001's application to Greenland is subject to the provisions of Council Decision 2006/526/EC.

2.2. The Overseas Association Decisions

This brings us to the "provisions" referred to in Article 203 TFEU. These are contained in Council Decisions (also referred to as the Overseas Association Decisions). The first Decision was introduced in 1964.[25] Since then, revised Decisions have been introduced (or amended) approximately once every five years.[26] The current Decision (OAD2001)[27] entered into force on 2 December 2001 and will expire on 31 December 2013.[28]

Apart from the general and final provisions, OAD2001 has four main parts:

- areas of OCT-EC cooperation;
- instruments of cooperation;
- provisions on establishment and services; and
- the Commission/Member State/OCT partnership arrangements.

Of particular interest here are the provisions of Chapter 2 (Trade in services and rules of establishment) and Chapter 4 (Monetary and tax matters) of Part Three. These are discussed below.

3. Analysis of the OCT provisions

This section considers whether the OCT provisions create freedom of establishment rights as regards EU-OCT relations.

3.1. The main provisions

Article 199 TFEU is the Treaty provision of greatest relevance to the establishment question. It provides that:

> Association shall have the following objectives.
>
> […]

25 Council Decisions 64/349/EEC and 66/304/EEC (which entered into force on 1 June 1964).

26 Council Decisions 70/549/EEC (which entered into force on 1 January 1971), 76/568/EEC (1 April 1976), 80/1186/EEC (1 January 1981), 86/283/EEC (1 July 1986), 91/482/EEC (1 March 1990), and 97/803/EC (30 November 1997).

27 Council Decision 2001/822/EC.

28 OAD2001 was originally due to expire on 31 December 2011, but Council Decision 2007/249/EC extended its shelf life.

> 5. In relations between Member States and the countries and territories the right of establishment of nationals and companies or firms shall be regulated in accordance with the provisions and procedures laid down in the Chapter relating to the right of establishment and on a non-discriminatory basis, subject to any special provisions laid down pursuant to Article 203.

As noted above, the "special provisions laid down pursuant to Article 203" are (currently) contained in OAD2001. Three aspects of OAD2001 are especially significant.

First, para 7 of OAD2001 observes that, "[a]s a general rule, when the Council adopts measures under Article 187 of the Treaty,[29] it must take account both of the principles laid down in Part Four of the Treaty and of the other principles of Community law."

Second, Article 2 (Basic Elements) OAD2001 elaborates that "**[t]he OCT-EC association shall be based on** the principles of liberty, democracy, respect for human rights and **fundamental freedoms** and the rule of law. **These principles**, on which the Union is founded in accordance with Article 6 of the Treaty on European Union, **shall be common to the Member States and the OCTs linked to them**" (emphasis added).

Third, and most important, is Article 45 OAD2001. This is headed "General principles of establishment and the provision of services". Article 45(2) is especially noteworthy because it, like Article 199 TFEU, contains a clear reference to establishment:

> As regards the arrangements applicable to establishment and the provision of services, in line with Article 183(5) of the Treaty[30] and subject to paragraph 3 below:
>
> (a) the Community shall apply to the OCTs the undertakings entered into under the General Agreement on Trade in Services (GATS) under the conditions laid down in that Agreement and in accordance with this Decision; in application of such undertakings, Member States shall not discriminate between inhabitants, companies or enterprises of the OCTs.
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> (b) the OCT authorities shall afford nationals, companies or enterprises of the Member States treatment that is no less favourable than that which they extend to nationals, companies or enterprises of third countries and shall not discriminate between nationals, companies or enterprises of Member States.

29 Now Article 203 TFEU.

30 Now Article 199(5) TFEU.

For completeness, note that:

- Article 45(1) OAD2001 defines various terms, including "OCT companies or enterprises" (see below).
- Article 45(2) OAD2001 refers to "the provision of services, in line with [Article 199(5)] of the Treaty" although Article 199(5) refers only to establishment and non-discrimination. A 1999 Commission report[31] identified this omission and suggested the "insertion of the principle of freedom to provide services alongside the right of establishment in Article 132(5) of the Treaty".[32] (There is a similar oversight as regards free movement of capital.)[33] But nothing turns on this as regards the freedom of establishment.
- Article 45(3) OAD2001, which permits the OCTs to adopt regulations to aid their inhabitants and local activities, is not relevant here.

3.2. Does Article 199(5) TFEU cause the freedom of establishment to apply?

A key question is what effect the reference to the "right of establishment" in Article 199(5) TFEU has. If this results in an "obligation arising out of the Treaty" then Article 4(3) TFEU requires the Member States to "take any appropriate measure, general or particular," to ensure its fulfilment. At first blush, an appropriate measure would be for the Member States to apply the freedom of establishment in their relations with the OCTs just as they do in their relations with one other. This (and Article 199(5) TFEU's interaction with Article 45(2) OAD2001) is discussed further below.

But if Article 199(5) is instead only an objective then the Member States are required merely to "abstain from any measure which could jeopardise" its attainment. This is a much more limited duty. Indeed the ECJ's judgments in *Mutsch*[34] and *Gilly*[35] (concerning what eventually became Article 293 EC)[36] suggest that an objective cannot create legally enforceable rights for taxpayers.

In *Mutsch* the ECJ interpreted the first indent of Article 293 EC, which provided that "Member States shall, so far as is necessary, enter into negotiations with each other with a view to securing for the benefit of their nationals ... the protection of persons and

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31 Communication from the Commission entitled "The status of OCTs associated with the EC and options for 'OCT 2000'" (COM(1999) 163).

32 Now Article 199(5) TFEU.

33 Free movement of capital is mentioned in Article 47 OAD2001, but not in TFEU itself. See, for a possible explanation, Pancham, Fibbe and Ruiter (fn. 13) at p. 167.

34 ECJ, 11 July 1985, Case 137/84, *Criminal proceedings against Robert Heinrich Maria Mutsch* [1985] ECR 2681 ('*Mutsch*').

35 ECJ, 12 May 1998, Case C-336/96, *Mr and Mrs Robert Gilly v Directeur des services fiscaux du Bas-Rhin* [1998] I-02793 ('*Gilly*').

36 TFEU lacks an equivalent provision.

the enjoyment and protection of rights under the same conditions as those accorded by each State to its own nationals". The ECJ held that Article 293

> is not intended to lay down a legal rule directly applicable as such , but merely defines a number of matters on which the member states are to enter into negotiations with each other 'so far as is necessary' . **Its only effect is to define as an objective** the extension by each member state to the nationals of the other member states of the relevant guarantees accorded by it to its own nationals.[37] (Emphasis added.)

The ECJ followed its *Mutsch* judgment in *Gilly*, when it held that the second indent of Article 293 EC made the abolition of double taxation within the Community an objective of the Treaty but did not have direct effect.[38]

It is strongly arguable that Article 199(5) TFEU is distinguishable from Article 293 EC: Although the ECJ did not say as much, one could contend that Article 293 EC failed the *van Gend en Loos*[39] criteria for direct effect because the words "so far as is necessary" prevented it from being "clear and unconditional".[40] By contrast, Article 199(5) TFEU lacks any similar condition.

But the ECJ's judgments suggest that if Article 199(5) TFEU is merely an objective then it cannot create enforceable Community law rights on its own. (Note also that the formulation of the *van Gend en Loos* criteria refers to obligations: "The wording of Article 12 contains a clear and unconditional prohibition which is not a positive but a negative **obligation**. This **obligation**, moreover, is not qualified by any reservation on the part of states which would make its implementation conditional upon a positive legislative measure enacted under national law". (Emphasis added.))

Arguments for Article 199(5) TFEU independently causing the freedom of establishment to apply

Three main arguments support the view that an obligation, not an objective, arises out of Article 199(5) TFEU.

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37 *Mutsch*, para 11

38 *Gilly*, paras 16-17.

39 ECJ, 5 February 1963, Case 26/62, *Van Gend en Loos v Nederlandse Administratie der Belastingen* [1963] ECR 1 ('*Van Gend en Loos*').

40 The ECJ has not, to date, been asked to interpret the meaning of the words "so far as is necessary" in relation to the second indent of Article 293 EC; but its *Überseering* judgment (concerning the third indent of Article 293 EC) arguably suggests they created an obligation for the Member States, which obligation was conditional on the Community being unable to achieve its objective of abolishing double taxation: see T. O'Shea, "EU Tax Law and Double Tax Conventions" (1st edn, Avoir Fiscal Limited), pp. 61-63; and ECJ, 5 November 2002, Case C-208/00, *Überseering* BV v Nordic Construction Company Baumanagement GmbH (NCC) [2002] ECR I-9919 ('*Überseering*').

First, the structure of Article 199(5) TFEU seems to be, first, to state that (as a factual matter) there is a right of establishment, and, second, to explain on what basis that right is to be regulated. It is difficult to see how a statement of this kind can be relegated to the position of a mere objective.

Second, Article 199(5) TFEU says that "the right of establishment ... **shall** be regulated in accordance with the provisions and procedures laid down in the Chapter relating to the right of establishment and on a non-discriminatory basis" (emphasis added). The word "shall" normally imposes an obligation (as opposed to the permissive "may"). It is arguable that here the obligation requires the Treaty provisions relating to the right of establishment to be applied (thus regulating a right of establishment that exists in EU-OCT relations). Indeed, TFEU itself uses "may" and "shall" to distinguish between discretionary and mandatory requests for a preliminary ruling: Article 267 TFEU provides that a court or tribunal of a Member State "**may**, if it considers that a decision on the question is necessary to enable it to give judgment, request the Court to give a ruling thereon," whereas a court or tribunal "against whose decisions there is no judicial remedy under national law … **shall** bring the matter before the Court of Justice"

(emphasis added). For completeness, the author considers any counter-argument that the Member States (or the Community itself) were obligated only to introduce the "special provisions" (so that enacting the Council Decision fulfilled any obligation they had) would be unsustainable— that is simply not what Article 199(5) says.

Third, the ECJ's 1997 judgment in *Road Air*[41] (which concerned the customs duties provision in Article 132(1) EEC)[42] indicates that Article 199 TFEU is capable of giving rise to obligations. In that case, the ECJ appeared tacitly to approve the taxpayer's submission that "Article 132(1) of the Treaty … imposes on Member States the **obligation** to apply to their trade with OCT countries the same treatment as they accord each other under the Treaty"[43] (emphasis added). The 1999 case of *Dutch Antillian Dairy Industry*[44] also suggests that Article 199 TFEU contains more than mere goals: the ECJ commented that Article 132 "sets out the objectives ascribed to association and **lays down certain basic rules**" (emphasis added).[45]

The view that Article 199(5) TFEU causes the freedom of establishment to apply is supported by a 1999 Commission report:

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41 ECJ, 22 April 1997, Case C-310/95, *Road Air BV v Inspecteur der Invoerrechten en Accijnzen* [1997] ECR I-2229 ('*Road Air*').

42 Now Article 199(1) TFEU.

43 *Road Air*, para 30.

44 ECJ, 21 September 1999, Case C-106/97, *Dutch Antillian Dairy Industry Inc. and Verenigde Douane-Agenten BV v Rijksdienst voor de keuring van Vee en Vlees* [1999] ECR I-5983 ('*Dutch Antillian Dairy*').

45 *Dutch Antillian Dairy Industry*, para 15.

> In the EC Treaty, the right of establishment for national (*sic*) of the Community and the OCTs is laid down in Article 132(5).[46] According to this article, the right of establishment is regulated in accordance with the provisions and procedures laid down in the Chapter relating to the right of establishment and on a non-discriminatory basis. **Articles 52 to 58 of the Treaty [i.e., those concerning the freedom of establishment] therefore apply, subject to any provisions to the contrary in the Association Decision**.[47] (Emphasis added.)

Unfortunately, the document does not contain any analysis to support this assertion (or indeed any discussion of the Overseas Association Decision's own effect).

Arguments against Article 199(5) TFEU independently causing the freedom of establishment to apply

There are four arguments against Article 199(5) TFEU independently causing the freedom of establishment to apply.

The first counter-argument is that, because the first sentence of Article 199 TFEU says that "Association shall have the following objectives", the rest of that Article – however it is phrased – cannot create more than an objective. There is support for this view in the ECJ's 1999 *Antillean Rice Mills*[48] judgment, when it said that, "[a]s is apparent from its first sentence, [Article 199(1) TFEU (as it now is)] **confines itself to fixing the objectives of the association** of the OCTs by stating that trade with the OCTs is to be placed on the same footing as trade between the Member States"[49] (emphasis added). Although the case dealt with Article 199(1), not Article 199(5), it is difficult to see how Article 199(1) is less obligation-like than Article 199(5). In particular, both Article 199(1) and Article 199(5) use the word "shall".

The second counter-argument is that it is difficult to reconcile an interpretation that Article 199(5) TFEU independently causes the freedom of establishment to apply with previous Overseas Association Decisions. Article 48 OAD1976 provided that:

> As regards the arrangements that may be applied in matters of establishment and provision of services, the relevant authorities of the countries and territories shall treat nationals and companies or firms of Member States on a non-discriminatory basis.

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46 Now Article 199(5) TFEU.

47 Communication from the Commission entitled "The status of OCTs associated with the EC and options for 'OCT 2000'" (COM (1999) 163 final), Volume I, p. 32.

48 ECJ, 11 February 1999, Case C-390/95 P, *Antillean Rice Mills NV, European Rice Brokers AVV and Guyana Investments AVV v Commission of the European Communities* [1999] ECR I-769 ('*Antillean Rice Mills*').

49 *Antillean Rice Mills*, para 42.

> However, if, for a given activity, a Member State is unable to provide similar benefits to nationals or companies or firms of the French Republic, the Kingdom of the Netherlands or the United Kingdom of Great Britain and northern Ireland, established in a country or territory, or to companies or firms subject to the laws of the country or territory concerned and established therein, the relevant authorities of that country or territory shall not be bound to respect the obligation contained in the first paragraph.

OAD1980 and OAD1986 contained materially identical provisions. The correct reading of Article 48 OAD1976 is unclear, but the reference to Member States potentially being "unable to provide similar benefits" arguably implies that (what is now) Article 199(5) TFEU could not have imposed an unconditional obligation on the Member States to grant national treatment to OCT companies. A 1999 Commission report,[50] commenting on a similar provision in OAD1997, observed that "this clause has stirred up much controversy as it appears to allow the Member States to maintain or create discrimination between nationals of one or more OCTs and nationals of the Community."

There are a number of potential rebuttals to this second counter-argument. The first is that Article 48 dealt only with questions of discrimination and that, as discussed below, references to discrimination extend, not curtail, the rights created by the OCT provisions. The second is that, in the ECJ's words, "[t]he implementation of the association arrangements between the OCT and the Community described in Articles 131 to 135 of the Treaty is … a dynamic process",[51] so that previous Overseas Association Decisions have limited value as an aid to interpretation. The third is that Member States could have been "unable to provide similar benefits" even if establishment rights existed. For example, lack of comparability might have meant that no 'national treatment' obligation arose. The fourth (and least convincing) is that the words "[a]s regards the arrangements that may be applied in matters of establishment and provisions of services" were based on an incorrect understanding of Community law. The argument in that regard would be that the ECJ's 1974 *Reyners*[52] judgment had made it clear that the freedom of establishment had been directly applicable since the transitional period expired on 1 January 1970),[53] so that the words "the arrangements that **may** be applied in matters of establishment" (emphasis added) were used mistakenly.

A third counter-argument is based on the ECJ's statement in *Leplat*[54] that the association "is the subject of arrangements defined in Part Four of the Treaty … with

50 COM (1999) 163 final.

51 *Antillean Rice Mills*, para 92.

52 ECJ, 21 June 1974, Case 2/74, *Jean Reyners v Belgian State* [1974] ECR 631 ('*Reyners*').

53 *Reyners*, para 32.

54 ECJ, 12 February 1992, Case C-260/90, *Bernard Leplat v Territory of French Polynesia* [1992] ECR I-643 ('*Leplat*').

the result that, failing express reference, the general provisions of the Treaty do not apply to the countries and territories."[55] The Dutch Supreme Court seems to have taken these words as confirming that the freedom of establishment does not apply in relation to the OCTs. It reached this conclusion in a case concerning the levying of capital duty on the issue of shares by a Dutch company whose actual management was located in the Netherlands Antilles.[56] The taxpayer appears to have challenged the assessment's validity on various grounds, including that it infringed the freedom of establishment.[57]

The Supreme Court rejected this argument:

> [T]he Treaty provisions are not applicable to the overseas territory unless there is an explicit referral to the overseas countries and territories (see Case-181/97 *Van der Kooy* ECJ 28 January 1999). The applicant cannot rely on Article 52 since there is no provision in the EC Treaty or any other Community legislation which declares Article 52 applicable to the overseas territories. (Unofficial translation.)[58]

But, in the author's view, the Supreme Court's judgment is of extremely limited value. The Supreme Court seems not to have considered the effect of Article 199(5) TFEU at all (it appears that the Court of Appeal, which did, concluded that the freedom of establishment applied to the OCTs, but was overruled). Advocate General Wattel's opinion does not shed any light on the issue: Although he also found against the taxpayer, this was on the ground that the case concerned a purely internal situation (something the Supreme Court's judgment was silent on). And *Van der Kooy*[59] merely cites the ECJ's conclusion in *Leplat* that, "failing express reference, the general provisions of the Treaty do not apply to the OCTs". It is strongly arguable that Article 199(5) TFEU contains "express reference" to the Treaty provisions relating to establishment.

Finally, a fourth counter-argument is that, if Article 199(5) TFEU independently created freedom of establishment rights then Article 45(2) OAD2001 would be surplus to requirements. But this line of reasoning is unconvincing. It is questionable how much weight an argument based on redundancy should carry: The "unnecessary" Article 45(2) could simply be an oversight (or a deliberate repetition). Moreover, Article 45(2) would still be needed to bring the GATS undertakings into play.

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55 *Leplat*, para 10.

56 SC, 13 July 2001, 35 333, BNB 2001/323. The Supreme Court later followed its conclusion (but without further analysis) in SC, 24 October 2003, 37 565, BNB 2004/257c*.

57 The precise basis of the taxpayer's complaint (or indeed whether there was in fact an act of establishment) is unclear.

58 The author thanks Jim Margry for his help in this regard.

59 ECJ, 28 January 1999, Case C-181/97, *A.J. van der Kooy v Staatssecretaris van Financiën* [1999] ECR I-483 ('*Van der Kooy*').

Could Article 199(5) give rise to neither an obligation nor an objective?

The cases above hint at the inconsistency of the ECJ's case law on Article 199 TFEU's predecessor provisions. This was also evident in *Leplat*, where the ECJ said that Article 133(1) EEC[60] "gives concrete form to the objective set out in Article 132(1)" before referring later on in the same paragraph to "the obligation laid down in Article 132(1)".[61]

Another possible interpretation is that Article 199(5) TFEU is neither an obligation nor an objective but rather a principle. This is supported by the ECJ's judgment in

Netherlands v Council[62] – where the ECJ stated that Article 132(1) EEC laid down a "principle"[63] – and by para 7 of the preamble to OAD2001. The latter says that "[a]s a general rule, when the Council adopts measures under Article 187 of the Treaty,[64] it must take account both of the **principles** laid down in Part Four of the Treaty and of the other principles of Community law"[65] (emphasis added). This arguably suggests that, although Article 199(5) TFEU might help shape the Council Decision, it does not itself create enforceable rights.

3.3. What is the effect of Article 45(2) OAD2001?

Just as Article 199(5) TFEU's meaning is unclear, so is its interaction with Article 45(2) OAD2001.

Article 45(2) provides, in particular, that

> [a]s regards the arrangements applicable to establishment and the provision of services, in line with [Article 199(5)] of the Treaty …:
>
> (a) the Community shall apply to the OCTs the undertakings entered into under the General Agreement on Trade in Services (GATS) under the conditions laid down in that Agreement and in accordance with this Decision; in application of such undertakings, Member States shall not discriminate between inhabitants, companies or enterprises of the OCTs.

60 Now Article 199(1) TFEU.

61 *Leplat*, para 19.

62 ECJ, 22 November 2001, Case C-301/97, *Kingdom of the Netherlands v Council of the European Union* [2001] ECR I-8853 ('*Netherlands v Council*').

63 *Netherlands v Council*, para 68.

64 Now Article 203 TFEU.

65 See also the ECJ's judgment in *Antillean Rice Mills*, para 93: "It must be stressed that the reference to the 'principles set out in this Treaty' is not merely to the principles set out in Part Four of the Treaty but to all the principles set out in the Treaty, in particular those listed in Part One, entitled 'Principles'."

It is unclear whether the Article is intended:

- first, to create rights by requiring the Community to apply to the OCTs the GATS undertakings (but without the freedom of establishment applying at all);
- second, to acknowledge that Article 199(5) TFEU *prima facie* causes the freedom of establishment to apply, but then to restrict the meaning of this purely to the GATS undertakings;
- third, to cause the freedom of establishment to apply and to create additional rights by requiring the Community to apply to the OCTs the GATS undertakings; or
- fourth, to acknowledge that Article 199(5) TFEU *prima facie* causes the freedom of establishment to apply, and then create additional rights by requiring the Community to apply to the OCTs the GATS undertakings.

In the author's view, the first three readings present significant difficulties.

The first and second readings would effectively mean there are no "arrangements applicable to establishment" in the Treaty sense of that word, because any establishment rights would be limited to the GATS concepts of "commercial presence" or "presence of natural persons". It is also hard to understand how the OCTs' rights could be limited to the GATS undertakings when reference to these has been included only since 1997 (see below). It is also clear from the history of the 1997 Council Decision that reference to the GATS undertakings was intended to augment the rights afforded to the OCTs (see below), whereas if the only rights afforded to the OCTs were in relation to the GATS undertakings this would have the opposite effect. Moreover, the first and second readings would also make the reference in Article 199(5) TFEU to right of establishment being regulated "in accordance with the provisions and procedures laid down in the Chapter relating to the right of establishment" meaningless, since that Chapter would not be regulating anything. And limiting the right of establishment in this manner would fail to "serve primarily to further the interests and prosperity of the inhabitants of these countries and territories" (Article 198 TFEU); nor would it make the fundamental freedoms "common to the Member States and the OCTs linked to them" (Article 2 OAD2001). In fact, if any establishment-related obligations extended only to the application of the GATS undertakings and an associated non-discrimination obligation then the OCTs would be in a worse position now than they were when 97/803/EC was in force (as its non-discrimination obligation, unlike OAD2001's, was not explicitly linked to the GATS undertakings).

The third reading seems improbable, as it is not easy to see how anything in OAD2001 could cause the freedom of establishment to apply. (For this reason, it appears unlikely that the freedom of establishment will apply unless Article 199(5) TFEU causes it to.)

The author therefore prefers the fourth reading (which does not present these difficulties), but the analysis is plainly far from clear.

3.4. What does the right of establishment here entail?

Does the right of establishment affect host state rules only?

Both Article 199(5) TFEU and Article 45(2) OAD2001 refer to discrimination, not restriction. Article 199(5) says that "the right of establishment ... shall be regulated in accordance with the provisions and procedures laid down in the Chapter relating to the right of establishment **and on a non-discriminatory basis**" (emphasis added). The wording of Article 45(2) is similar:

As regards the arrangements applicable to establishment …, in line with Article 183(5) of the Treaty … the Community shall apply to the OCTs the undertakings entered into under the General Agreement on Trade in Services (GATS) under the conditions laid down in that Agreement and in accordance with this Decision; in application of such undertakings, Member States **shall not discriminate** between inhabitants, companies or enterprises of the OCTs. (Emphasis added.)

The reference to discrimination is odd for two reasons.

First, because the Treaty provisions relating to establishment and services refer only to restriction, not discrimination. By contrast, the word discrimination is used in the general non-discrimination provision (Article 18 TFEU) and the specific Treaty provisions relating to workers and capital. The OCT provisions might therefore be expected to refer only to restriction as well.

Second, because the ECJ's case-law on freedom of establishment clearly covers discrimination (both overt/direct[66] and covert/indirect[67] and overt). Indeed, the ECJ's 1974 *Reyners* judgment made it clear that a restriction on the freedom of establishment actually entailed a particular type of discrimination:

> 15. Article 7 of the Treaty, which forms part of the 'principles' of the Community, provides that within the scope of application of the Treaty and without prejudice to any special provisions contained therein, 'any discrimination on grounds of nationality shall be prohibited'.
>
> 16. **Article 52 provides for the implementation of this general provision in the special sphere of the right of establishment**. (Emphasis added.)

The ECJ's judgments in *Avoir fiscal*[68] and *Halliburton*[69] are consistent with this view. In *Avoir fiscal* the ECJ observed that "Article 52 … prohibits, as a restriction on

66 E.g., *RBS*.

67 E.g., *Avoir fiscal*.

68 ECJ, 28 January 1986, Case 270/83, *Commission of the European Communities v French Republic* [1986] ECR 273 ('*Avoir Fiscal*').

freedom of establishment, any discrimination on grounds of nationality resulting from the legislation of the [host] Member State". And in *Halliburton* it stated that "Article 52 is essentially intended to give effect, in the field of activities as self-employed persons, to the principle of equal treatment enshrined in Article 7."[70]

It therefore seems unnecessary for the OCT provisions to refer to discrimination. Moreover, discrimination is arguably relevant only to a host state.[71] Could this mean that the reference to discrimination actually *limits* any establishment rights, perhaps by indicating that these are limited to a host state environment? If so, this would significantly curtail their value— most corporate tax practitioners, for instance, will be primarily interested in effect of the OCT provisions on the Member States' tax rules when these are acting as origin states.

But in the author's view this is unlikely. The natural reading of Article 199(5) TFEU is that the words "and on a non-discriminatory basis" broaden its scope. As noted above, the Treaty provisions relating to establishment refer only to restrictions, and the drafters of Article 199(5) TFEU's predecessor provision may have wanted to ensure that discrimination was also within its scope (of course, the ECJ's *Reyners* judgment was issued 17 years after that provision was enacted).

Is there a difference between the "right of establishment" and the "freedom of establishment"?

Article 199(5) TFEU refers simply to the "right of establishment," and only OAD2001's preamble refers to the "freedom of establishment". By contrast, Articles 49 and 50 TFEU contain numerous references to the "freedom of establishment". But little should be made of the distinction. It seems clear that "the Chapter relating to the right of establishment" is Chapter Two of Part Three TFEU (i.e. Articles 49-55 TFEU, which contain the main establishment-related provisions). The Treaty provisions relating to the freedom to provide services contain a similar reference.[72]

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69 ECJ, 12 April 1994, Case C-1/93, *Halliburton Services BV v Staatssecretaris van Financiën* [1994] ECR I-1137 ('*Halliburton*').

70 *Halliburton*, para 12.

71 In an origin state situation the correct comparison appears to be between two origin state nationals, one of whom crosses the border and the other who does not. Consequently an origin state's rules can normally only restrict the exercise of the freedoms. The author thanks Dr Tom O'Shea for his guidance in this regard.

72 Per Article 57 TFEU: "Without prejudice to the provisions of **the Chapter relating to the right of establishment**, the person providing a service may, in order to do so, temporarily pursue his activity in the Member State where the service is provided, under the same conditions as are imposed by that State on its own nationals." (Emphasis added.)

Which companies qualify for the right of establishment?

Article 199(5) TFEU refers to "the right of establishment of nationals and companies or firms". Clearly not all companies can be relevant for these purposes. But what defines the class of relevant companies?

There are two ways of approaching this, both of which present some difficulties.

The first way is to interpret Article 199(5) TFEU's reference to "the provisions … laid down in the Chapter relating to the right of establishment" as meaning that the quasi-definition in Article 54 TFEU is relevant:

> Companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Union shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States.

But unless Article 54 is construed *mutatis mutandis* (which Article 199(5) does not provide for), it appears that only "[c]ompanies or firms formed in accordance with the law of a Member State" are relevant. This could exclude most, if not all,[73] OCT companies, which cannot be the desired result. The problem could be resolved by adopting a rather strained construction of the words "in accordance with" (as including necessary adaptations).

The second way is by reference to the definitions in Article 45 OAD2001. Article 45(1) defines "OCT companies or enterprises" as being "those formed in accordance with the law applicable in a given OCT and whose registered office, central administration or principal place of business is in that OCT". This is subject to the proviso that "a company or enterprise having only its registered office in a country or territory must be engaged in an activity which has an actual and continuous link with the economy of that country or territory" (a definition which is consistent with the General Programme for the abolition of restrictions on freedom of establishment and the ECJ's judgment in *Überseering*).[74]

But this also presents a difficulty: While the term which Article 45(1) defines ("OCT companies or enterprises") does not actually appear elsewhere in OAD2001, presumably it relates to the non-discrimination clause in Article 45(2) (which requires that "member States shall not discriminate between inhabitants, companies or enterprises of the OCTs"). Nothing obviously causes it to apply for purposes of Article 199(5) TFEU.

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73 The local company law for each OCT would need consideration.

74 *Überseering*, para 75.

3.5. Does the ECJ's case-law apply to the OCT provisions?

In *Hengartner and Gasser*[75] (a case concerning the correct interpretation of the EU-Switzerland agreement on the free movement of persons) the ECJ observed that "the Swiss Confederation did not join the internal market of the Community". It continued,

> in those circumstances, the interpretation given to the provisions of European Union law concerning the internal market cannot be automatically applied by analogy to the interpretation of the Agreement, unless there are express provisions to that effect laid down by the Agreement itself ….[76]

The ECJ has made similar remarks concerning the OCTs' exclusion from the internal market: In *Antillean Rice Mills* it observed that "the aim of the system of free movement of goods between the OCT and the Community under Part Four of the Treaty is not to establish an internal market of the kind set up by the Treaty between the Member States."[77] And similar comments have been made in the OCT provisions themselves: Article 3(1)(c) EC (which has not been reproduced in either TFEU or the Treaty on European Union) referred to "an internal market characterised by the abolition, **as between Member States**, of obstacles to the free movement of goods, persons, services and capital" (emphasis added); while the sixth paragraph of the preamble to OAD2001 confirms that "the OCTs do not form part of the single market".

Could this mean that, even if the OCT provisions created freedom of establishment rights, the ECJ's case-law would not apply?

In the author's view, this result seems unlikely. Article 199(5) TFEU contains a clear reference to "the provisions and procedures laid down in the Chapter relating to the right of establishment". Moreover, Article 2(1) OAD2001 provides that "**[t]he OCT-EC association shall be based on the** principles of liberty, democracy, respect for human rights and **fundamental freedoms** and the rule of law. **These principles**, on which the Union is founded in accordance with Article 6 of the Treaty on European Union, **shall be common to the Member States and the OCTs linked to them**" (emphasis added). Against this background, it would seem illogical for the Treaty provisions to apply differently to the OCTs.

3.6. Why refer to the GATS undertakings?

Article 45(2)(a) OAD2001 provides that "the Community shall apply to the OCTs the undertakings entered into under the General Agreement on Trade in Services (GATS) under the conditions laid down in that Agreement and in accordance with this Decision".

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75 See T. O'Shea, "Swiss Must Pay Higher Austrian Hunting Taxes, ECJ Says", 2010 WTD 144-6; and ECJ, 15 July 2010, Case C-70/09, *Alexander Hengartner and Rudolf Gasser v Landesregierung Vorarlberg* [2010] ECR I-00000 ('*Hengartner and Gasser*').

76 *Hengartner and Gasser*, paras 41-42.

77 *Antillean Rice Mills*, para 91.

Overview of the GATS

Briefly, the GATS is a multilateral trade agreement (covering, as its name suggests, trade in services) that entered into force in January 1995. It covers four modes of supply. These are set out below because, as discussed later, limitations inherent in the European Union's specific commitments mean that distinguishing between them is potentially important.

Mode 1 (cross-border trade) covers services supplied from the territory of one Member (broadly meaning a WTO Member) into the territory of any other Member.[78] This is similar to the situation in *Eurowings*.[79] Guidance published by the WTO Secretariat gives the following example (from the perspective of an "importing" country A):

> A user in country A receives services from abroad through its telecommunications or postal infrastructure. Such supplies may include consultancy or market research reports, tele-medical advice, distance training or architectural drawings.[80]

Mode 2 (consumption abroad) covers services supplied in the territory of one Member to the service consumer of any other Member.[81] This is, in a sense, similar to the position in *Vestergaard*.[82] Here the example is:

> Nationals of A have moved abroad as tourists, students or patients to consume the respective services.

Mode 3 (commercial presence) covers services supplied by a service supplier of one Member, through commercial presence, in the territory of any other Member.[83] It is therefore similar to the concept of a "fixed place of business" permanent establishment. But it also covers subsidiaries, as the example in the WTO Secretariat's guidance illustrates:

> The service is provided within A by a locally established affiliate, subsidiary or representative office of a foreign-owned and -controlled company (bank, hotel group, construction company, etc.).

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78 Article I(2)(a) GATS.

79 ECJ, 26 October 1999, Case C-294/97, *Eurowings Luftverkehrs AG v Finanzamt Dortmund-Unna* [1999] ECR I-7447 ('*Eurowings*').

80 This and the following three examples are included in: WTO Secretariat (WTO Trade in Services Division), A Handbook on the GATS Agreement (1st edn, Cambridge University Press), p. 5.

81 Article I(2)(b) GATS.

82 ECJ, 28 October 1999, Case C-55/98, *Skatteministeriet v Bent Vestergaard* [1999] ECR I-7641 ('*Vestergaard*').

83 Article I(2)(c) GATS.

Finally, mode 4 (presence of natural persons) covers services supplied by a service supplier of one Member, through the presence of natural persons of a Member in the territory of any other Member.[84] Here the example is:

> A foreign national provides a service within A as an independent supplier (e.g. consultant, health worker) or employee of a service supplier (e.g. consultancy firm, hospital, construction company).

The second half of the example is similar to the concept of a "dependent agent" permanent establishment, whereas the first half seems more like the situation in *Gerritse*.[85]

Why does Article 45(2)(a) OAD2001 refer to the GATS undertakings?

Article 45(2)(a)'s history shows that the reference to the GATS undertakings was added to ensure that the OCTs were no worse off than third countries.

The reference was introduced by Council Decision 97/803/EC, which inserted a new Article 233a into Council Decision 91/482 EEC (OAD2001's immediate predecessor).

Previously, a 1994 review of the Association by the Commission[86] had observed that "[a]nother point is to ensure that the OCT enjoy at least the same advantages as those accorded to third countries in the negotiations on the GATS". The 1994 review proposed a new article that would "extend to the OCT the Community's GATS offer in return for an undertaking on non-discrimination on their part".

This is consistent with a later Commission report,[87] published shortly after Council Decision 97/803/EC had entered into force, which noted that "[v]arious questions have also been raised concerning Article 233a, the purpose of which is to extend the benefit of commitments entered into by the Community under GATS to the OCTs under the present Decision". It went on to explain that

> [t]he reasons for [Article 233a's] inclusion in the Decision were twofold:
>
> - it met the requirements of Article 113(3) of the Association Decision according to which the Decision could be amended to take account of the results of multilateral trade talks within GATT;

84 Article I(2)(d) GATS.

85 ECJ, 12 June 2003, Case C-234/01, *Arnoud Gerritse v Finanzamt Neukölln-Nord* [2003] ECR I-5933 ('*Gerritse*').

86 COM(94) 538 final.

87 COM(1999) 163 final.

- the OCTs were in an ambiguous position in that not only were they excluded from the commitments entered into by the Community and the Member States under GATS (most of the OCTs are WTO contracting parties (*sic*) but also the other provisions in the EC Treaty on services did not apply directly to them (because the OCTs do not form part of the "European territory" of the Member State to which they are linked).

3.7. The effect of the GATS undertakings

With this background in mind, it is perhaps inherently unlikely that the GATS undertakings would create (or affect) any freedom of establishment rights specific to the OCT. Much of the following analysis therefore potentially applies also to other WTO Members' service suppliers.

A detailed examination of the GATS undertakings and their interaction with Community law is outside the scope of this article. But some preliminary points can be made.

Article II GATS (Most-Favoured-Nation Treatment)

Article II(1) GATS imposes the following most-favoured-nation treatment (MFN) obligation on Members:

> With respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country.

Measures mean measures taken by central, regional or local governments and authorities[88] (which *prima facie* would include national or local taxes).

In principle, the MFN obligation applies "to any measure that affects trade in services in any sector falling under the Agreement, whether specific commitments have been made or not."[89]

Since 2006, a single schedule of commitments has been filed covering 25 of the (now) 27 Member States,[90] which appear in effect to have formed a single Member for GATS

88 Article I(3) GATS.

89 WTO Secretariat, op. cit., p. 8.

90 In that their commitments are covered by a single schedule of commitments (S/C/W/273).

purposes.[91] The exceptions are Bulgaria and Romania (which became Member States in 2007).

The omission of Bulgaria and Romania introduces the intriguing possibility that (non-EU) Members' service providers could qualify for quasi-Community law rights.

Suppose that a German lessee was able to deduct only part of its lease payments to a Bulgarian lessor, whereas it would have been able to deduct the whole of them if they had been to a German lessor. This difference of treatment might well be challenged on *Eurowings* grounds. Could other Members' service providers contend that Article II(1) GATS gives them a right to be treated no less favourably than the Bulgarian lessor, entitling them in effect to quasi-Community law rights?

Nothing in the GATS obviously precludes such an argument. In particular, although Article XIV GATS (General Exceptions – discussed further below) contains a tax carve-out clause, it has only limited power to qualify a Member's MFN obligation. This is because the Article permits Members to apply measures inconsistent with Article II GATS only if "the difference in treatment is the result of an agreement on the avoidance of double taxation or provisions on the avoidance of double taxation in any other international agreement or arrangement by which the Member is bound." Article XIV GATS therefore prevents Members' tax treaties from being subject to an MFN obligation— but it does not seem to permit Members to apply discriminatory tax rules that have nothing to do with the avoidance of double taxation.

No MFN exemption in respect of the OCTs

For completeness, note that Members were permitted to seek exemptions from the most-favoured-nation treatment obligation when the GATS entered into force or, if later, on accession. The European Communities (as they then were) sought various exemptions.[92] Two are these are of particular interest, because they appear to have been designed to prevent an MFN obligation from arising by reference to establishment rights in the European Communities' external agreements. The first relates to

> [m]easures based on a bilateral agreement between the European Communities and Switzerland on direct insurance other than life insurance. This agreement provides on a reciprocal basis for freedom of establishment and the right to take up or pursue non-life insurance business for agencies and branches of undertakings whose head office is situated in the territory of the other contracting party.

91 Complicated questions of competence arise in relation to the Member States' position vis-à-vis the WTO: E. Steinberger, "The WTO Treaty as a mixed agreement: problems with the EC's and the EC Member States' membership of the WTO", E.J.I.L. 2006, 17(4), 837-862.

92 GATS/EL/31.

The second relates to

> [m]easures based on existing or future bilateral agreements between the European Communities and certain Member States and the countries and principalities concerned [i.e., San Marino, Monaco, Andorra, and Vatican City State], providing for
>
> a) the right of establishment for juridical and natural persons and; (*sic*)
>
> b) waiving the requirements of work permits for natural persons supplying services.

No exemption was sought in relation to the OCTs. It is, however, difficult to know what to make of this, since the OCTs are in a different position vis-à-vis the Member States than are, for example, Switzerland and Monaco.

Specific commitments

Members are also required to submit a schedule of specific commitments which details what market access and national treatment obligations they undertake on a sector-by-sector basis.

Any market access obligations are unlikely to create significant tax benefits to other Members' service providers unless these differ significantly from the default commitments. The market access commitment (in Article XVI(1) GATS) provides that "[w]ith respect to market access through the modes of supply identified in Article I, each Member shall accord services and service suppliers of any other Member treatment no less favourable than that provided for under the terms, limitations and conditions agreed and specified in its Schedule." But, with the possible exception of a requirement to (or not to) operate through a given legal entity, the measures Article XVI(2) GATS prohibits by default[93] are unlikely directly to have tax consequences anyway.

National treatment obligations may, however, be of greater interest. Article XVII(1) states that "[i]n the sectors inscribed in its Schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers, treatment no less favourable than that it accords to its own like services and service suppliers."

93 i.e., quantitative restrictions (on the number of service suppliers, the total value of service transactions, and the number of natural persons employed in a particular service sector); measures concerning which vehicles services can be supplied through; and (broadly) shareholding thresholds.

In this regard, the European Union's horizontal commitments under mode 3 (commercial presence), national treatment, include the following proviso:

a) Treatment accorded to subsidiaries (of third-country companies) formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Communities is not extended to branches or agencies established in a Member State by a third-country company. However, this does not prevent a Member State from extending this treatment to branches or agencies established in another Member State by a third-country company or firm, as regards their operation in the first Member State's territory, unless such extension is explicitly prohibited by Community law.

b) Treatment less favourable may be accorded to subsidiaries (of third-country companies) formed in accordance with the law of a Member State which have only their registered office in the territory of the Communities, unless it can be shown that they possess an effective and continuous link with the economy of one of the Member States.

This is described in the European Communities' draft consolidated GATS schedule[94] as "the EC limitation". It appears to be designed to limit the effect of Community law on the Member States' GATS commitments.

Part a) seems to be intended to prevent a non-resident service provider incorporated otherwise than in a Member State from being indirectly entitled to national treatment (in its Community law sense) in circumstances where a non-resident company incorporated in a Member State would be. The purpose of part b) is less clear, but presumably it is designed to prevent the GATS from affecting the scope of Article 48 EC ("[c]ompanies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community shall … be treated in the same way as natural persons who are nationals of Member States").

But while the EC limitation reduces the value of the European Union's GATS national treatment obligation for service providers which fall within mode 3 (commercial presence), nothing obviously affects the three other modes of supply (i.e. mode 1 (cross-border); mode 2 (consumption abroad); or mode 4 (movement of natural persons)). Consequently, a service provider that falls within one of those modes may be able to contend that it has a right to be treated by an "importing" Member State no less favourably than that Member State's own service providers (it would be necessary to examine the European Communities' schedule to see what commitments and limitations, if any, have been made in respect of the relevant service).

94 S/C/W/273*, p. 298.

This said, a widely drawn tax carve-out clause applies to all Members' national treatment obligations. Article XIV GATS (General Exceptions) provides that

> [s]ubject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member of measures:
>
> […]
>
> (d) inconsistent with Article XVII, provided that the difference in treatment is aimed at ensuring the equitable or effective imposition or collection of direct taxes in respect of services or service suppliers of other Members.…

As regards the scope of Article XIV(d) GATS, the notes to the GATS state that

> [m]easures that are aimed at ensuring the equitable or effective imposition or collection of direct taxes include measures taken by a Member under its taxation system which:
>
> […]
>
> (iii) apply to non-residents or residents in order to prevent the avoidance or evasion of taxes, including compliance measures;
>
> […]; or
>
> (vi) determine, allocate, or apportion income, profit, gain, loss, deduction or credit of resident persons or branches, or between related persons or branches of the same person, in order to safeguard the Member's tax base.
>
> Tax terms or concepts in paragraph (d) of Article XIV and in this footnote are determined according to tax definitions and concepts, or equivalent definitions and concepts, under the domestic law of the Member taking the measure.

Measures such as controlled foreign company (CFC) rules therefore fall within Article XIV(d). And, although that Article's opening words prohibit arbitrary or unjustifiable discrimination, this is only where the discrimination is "between countries where like conditions prevail" (which clearly gives Members more leeway than if arbitrary or unjustifiable discrimination "against other countries" had been prohibited). As such, the meaning of "a disguised restriction on trade in services" is likely to be important (and, in this regard, a review of previous GATS and GATT disputes might be a suitable topic for future research).

Finally, two points specific to the OCTs deserve mention.

First, the Member States' GATS obligations vis-à-vis the OCTs appear to be subject to OAD2001's own tax carve-out clause (discussed below) as well as the tax carve-out clause in the GATS itself.

Second, the precise scope of those obligations is unclear. Arguably, the natural reading of Article 45(2)(a) OAD2001 is that, in applying the GATS undertakings, the Member States are in principle prevented only from discriminating between inhabitants, companies or enterprises of the OCTs (which would suggest there existed only a limited MFN obligation and no national treatment obligation), not against them. But the Commission's proposal for OAD2001[95] contradicts this view. It states that "[a]s in the past, the Community may not discriminate **against** OCT companies, firms or nationals in its market with the rider that this 'national treatment' is granted to them only in the context of undertakings entered into under the GATS to avoid the Community being forced to extent such favourable treatment across the board to all WTO members" (emphasis added).

3.8. Are some OCTs more equal than others?

Arguments exist that the freedom of establishment applies only to a Member State's relations with OCTs for which it does not have responsibility. If correct, this could mean that, even if (for instance) a UK parent could validly challenge a CFC apportionment in respect of a Netherlands Antilles subsidiary on *Cadbury Schweppes* grounds, it would be unable to do so if the subsidiary were instead incorporated in (say) the Cayman Islands or the British Virgin Islands.

There are essentially two lines of challenge in this regard.

One is that, on first principles, the freedom of establishment is not engaged in relations between a Member State and an OCT for which it has responsibility. The other is based on Article 45(2) OAD2001's predecessor provision.

Is the relationship between an OCT and the Member State with which it has a special relationship a purely internal matter?

Writing on the OCTs, Kevelaars[96] observes that

> it can be gathered from, inter alia, the *Jersey ruling*[97] … that this freedom of establishment can only be invoked against a Member State other than the Member State to which the OCT is linked.… The background to this mainly

95 COM(2000) 732 final.

96 See fn. 15.

97 ECJ, 8 November 2005, Case C-293/02, *Jersey Produce Marketing Organisation Ltd v States of Jersey and Jersey Potato Export Marketing Board* [2005] ECR I-9543 (the '*Jersey ruling*').

> seems to be that the relationship between the OCT and the mother country is regarded in particular as a purely internal matter and is therefore, in that respect, to be classed as an internal matter not covered by the scope of the EC Treaty.

However, in the author's view, it is strongly arguable that the ECJ's holding in the *Jersey ruling* –namely, that "the Channel Islands, the Isle of Man and the United Kingdom must be treated as one Member State"[98] – does not also apply to the OCTs by analogy.

The ECJ reached its conclusion in the *Jersey ruling* based on how the Treaty applied to the Channel Islands and on the Channel Islands' close constitutional links with the UK.[99] In both these respects, the position of the 12 OCTs that are British overseas territories is quite different.[100]

First, the Treaty applies to the Channel Islands (albeit with a significantly curtailed scope).[101] By contrast, the ECJ has held that "the general provisions of the Treaty do not apply to the [overseas] countries and territories,"[102] and the sixth paragraph of the preamble to OAD2001 confirms that "the OCTs do not form part of the single market". The ECJ has also remarked that "although the OCTs are associated countries and territories having particular links with the Community, **they are not part of it** and are, as regards the Community, in the same situation as non-member countries" (emphasis added).[103] Against this background it would strange for the 12 OCTs that are British overseas territories to be treated as forming part of the UK.

Second, the ECJ placed great weight on the statement in Article 1 of Protocol No 3 that "[t]he Community rules on customs matters and quantitative restrictions … shall apply to the Channel Islands and the Isle of Man under the same conditions as they apply to the United Kingdom." The ECJ observed that "[s]uch wording suggests that, for the purposes of the application of those Community rules, the United Kingdom and the [Channel] Islands are, as a rule, to be regarded as a single Member State."[104] Yet Protocol No 3 quite simply does not apply to the OCTs. (The ECJ also referred to

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98 The *Jersey ruling*, para 54.

99 See in particular, the *Jersey ruling*, paras 45-47.

100 Gibraltar (which is a British overseas territory but not an overseas country or territory) may be in a different position to the other 12 British overseas territories. Note that HMRC Statement of Practice 2/92 (Transactions within Section 765A ICTA 1988: Movements of capital between residents of EC member states), refers (at para 5) to movements of capital between residents of Gibraltar and residents of the UK as being "wholly internal to the United Kingdom".

101 By virtue of Articles 355(3) and 355(5)(c) TFEU. See also, the *Jersey ruling*, paras 42-44.

102 *Leplat*, para 10.

103 ECJ, 8 February 2000, Case C-17/98, *Emesa Sugar (Free Zone) NV v Aruba* [2000] ECR I-675 ('*Emesa Sugar*'), para 29.

104 The *Jersey ruling*, para 47.

Regulation No 706/73,[105] which stated that "the United Kingdom and the islands shall be treated as a single Member State".[106] Again, the Regulation does not apply to the OCTs.)

Third, the ECJ recalled its judgment in *Pereira Roque*[107] (a case concerning the deportation of a Portuguese national from Jersey), observing that "just as the distinction between Channel Islanders and other citizens of the United Kingdom cannot be likened to the difference in nationality between the nationals of two member States, neither, because of other aspects of the status of those Islands, can relations between the Channel Islands and the United Kingdom be regarded as similar to those between two Member States." In *Pereira Roque*, the ECJ had observed that "Channel Islanders are British nationals".[108] Yet the British overseas territories have different constitutional links with the UK than the Channel Islands (which are Crown protectorates). For instance, while (most) Channel Islanders have automatically had British citizenship since commencement of the British Nationality Act 1981,[109] it was not until 21 May 2002 that British overseas territories citizens could automatically become British citizens.[110]

Finally, the ECJ's conclusion that "the Channel Islands, the Isle of Man and the United Kingdom must be treated as one Member State" was only "for the purposes of Articles 23 EC, 25 EC, 28 EC and 29 EC"[111] (i.e. the Treaty provisions relating to the free movement of goods, customs duties, and quantitative restrictions). The ECJ might well have reached a different conclusion if the freedom of establishment had been in point.

In the light of the analysis above, it is arguable that the 12 OCTs that are British overseas territories do not form part of a single Member State with the UK. This would mean that (on first principles) any establishment-related question concerning an OCT company should not be a "purely internal matter" as far as the UK is concerned.[112]

105 Concerning the Community arrangements applicable to the Channel Islands and the Isle of Man for trade in agricultural products.

106 The *Jersey ruling*, para 51.

107 ECJ, 16 July 1998, Case C-171/96, *Rui Alberto Pereira Roque v His Excellency the Lieutenant Governor of Jersey* [1998] ECR I-4607 ('*Pereira Roque*').

108 *Pereira Roque*, paras 41-42.

109 S50(1) British Nationality Act 1981 defines "the United Kingdom" as including the Channel Islands.

110 By virtue of s3 British Overseas Territories Act 2002 and the British Overseas Territories Act 2002 (Commencement) Order 2002 (SI 2002/1252).

111 The *Jersey ruling*, para 54.

112 Other Member States' position vis-à-vis the OCTs with which they have a special relationship would need to be considered separately.

What is the effect of Article 45(2)'s predecessor provision?

Material differences exist between the 1997 Decision and both the 1991 Decision (which it amended) and OAD2001 (which replaced it).

Article 232 of the 1991 Decision originally provided simply that

> [a]s regards the arrangements applicable to establishment and provision of services, the relevant authorities of the OCT shall treat nationals and companies or enterprises of Member States on a non-discriminatory basis.

The Commission's mid-term review of the 1991 Decision [113] revealed significant concerns over the Article's drafting, including its apparent lack of reciprocity:

> [T]he issue here is to clarify the provisions laying down the conditions governing the right of establishment and the provision of services in relations between the Community and the OCT….
>
> Decision 91/482/EEC covers only those cases where individuals, companies or firms of a Member State wish to establish themselves in a country or territory….
>
> These rules are the upshot of successive rounds of amendments every five years and leave much room for uncertainty….
>
> All the memorandums received [from the relevant OCT authorities] pointed to the need for clarification, the main thing being to spell out that (*sic*) the fact that non-discriminatory treatment works both ways.

Notably, this appears to have been viewed purely as a matter of clarification.

Accordingly, the Commission proposed to substitute a new Article 232 that would state categorically that the non-discrimination obligation worked both ways:

> As regards the arrangements applicable to establishment and provision of services, in line with Article 132(5) of the Treaty and subject to paragraphs 1 and 2 of this Article,[114]
>
> - the Member States shall treat nationals and companies or enterprises of the OCT on a non-discriminatory basis,

113 COM(94) 538 final, p. 27.

114 This would have preserved certain derogations for the OCTs (which derogations are irrelevant here).

- the relevant authorities of the OCT shall treat nationals and companies or enterprises of Member States on a non-discriminatory basis.[115]

And in due course the 1997 Decision amended the 1991 Decision. But while the replacement Article 232 it introduced was similar to the Commission's proposed version, a few important differences existed:

> As regard the arrangements applicable to establishment and provision of services, in line with Article 132 (5) of the Treaty and subject to paragraphs 2 and 3 of this Article:[116]
>
> - each Member State shall treat nationals and companies or enterprises of the OCTs **for which it does not have responsibility** on a non-discriminatory basis,
> - the relevant authorities of the OCTs shall treat nationals and companies or enterprises of Member States on a non-discriminatory basis. (Emphasis added.)

In other words, Article 45(2)(a)'s predecessor disapplied a Member State's non-discrimination obligation in relation to the OCTs for which it has responsibility. Does this curtail the scope of any freedom of establishment rights that exist in relation to OCT companies? And, if it does, should Article 45(2)(a) itself be read in the light of this?

As regards the first question (i.e. whether Article 232 curtailed the scope of the OCT provisions), it is arguable that the references to "discrimination" in the OCT provisions were, if anything, intended to broaden the scope of the OCT provisions. Assuming this is so, the fact that the amended Article 232 disapplied the non-discrimination obligation in certain circumstances should not affect any freedom of establishment rights.
In any event, the issue as regards an origin state rule (such as the UK's CFC rules) would not normally be one of discrimination but rather of restricting the exercise by (say) a UK parent company in relation to its Cayman Islands subsidiary.

As regards the second question (i.e. whether Article 45(2)(a) should be read in the light of Article 232), the ECJ has previously described "[t]he implementation of the association arrangements between the OCT and the Community" as "a dynamic process".[117] It is therefore arguable that the 1997 Decision is of little relevance to the OAD2001.

115 COM(94) 538 final, p. 54.

116 See fn. 114 above.

117 *Antillean Rice Mills*, para 92.

3.9. What is the effect of the tax carve-out clause in Article 55 OAD2001?

OAD2001 introduced a tax carve-out clause for the first time. Article 55 provides that:

1. Without prejudice to the provisions of Article 56, the most-favoured-nation treatment granted in accordance with the provisions of this Decision shall not apply to tax advantages which the Member States or OCT authorities are providing or may provide in the future on the basis of agreements to avoid double taxation or other tax arrangements, or domestic fiscal legislation in force.

2. Nothing in this Decision may be construed to prevent the adoption or enforcement of any measure aimed at preventing the avoidance or fraud of taxes pursuant to the tax provisions of agreements to avoid double taxation or other tax arrangements, or domestic fiscal legislation in force.

3. Nothing in this Decision shall be construed to prevent the respective competent authorities from distinguishing, in the application of the relevant provisions of their fiscal legislation, between taxpayers who are not in the same situation, in particular with regard to their place of residence, or with regard to the place where their capital is invested.

It is unclear precisely why Article 55 was introduced. Notably, however, there are similar clauses in many of the EU's other agreements. In particular, the EU's Partnership Agreement with the African, Caribbean and Pacific Group of States (the ACPs) contains a materially identical provision.[118] Article 55 may therefore have been introduced to align OAD2001 with the ACP-EC Partnership Agreement (neither OAD2001 nor the Commission's proposal document[119] addresses the point). But the position of the ACPs and the OCTs is quite different: Unlike Article 199(5) TFEU and OAD2001, neither the ACP-EC Partnership Agreement nor the Treaty provisions that form its legal basis[120] refer to establishment. It is therefore possible that Article 55 OAD2001 was introduced without much thought as to how it would interact with any freedom of establishment rights that applied in relation to OCT companies.

The author is aware of only a single case on Article 55 OAD2001, when the provision's potential application was raised briefly in proceedings brought by the Cayman Islands. The Court of First Instance held that the Article did not prevent the Cayman Islands from requesting a Partnership Working Party to discuss the implications for the

118 See Article 52 of 2000/483/EC (the ACP-EC Partnership Agreement, also referred to as the Cotonou Agreement).

119 COM/2000/0732.

120 Formerly Articles 177-181 EC; now (after some amendment) Articles 208-211 TFEU.

Cayman Islands of the adoption of the Savings Directive.[121] The judgment is of little wider assistance.

Article 55 OAD2001's first paragraph seems to be aimed at the customs duties-related provisions in Articles 36 and 40, the MFN which Article 45(2)(a) indirectly imposes on the Member States by referring to the GATS undertakings (see below), and the MFN obligation which Article 45(2)(b) imposes on the OCTs themselves as regards establishment and services. For the reasons discussed above, it is arguable that, as such, it should not affect any establishment rights that exist in relation to OCT companies.

The second and third paragraphs are, however, potentially greater obstacles.

Nothing clearly stops them limiting OCT companies' establishment rights.

If Article 199(5) TFEU independently causes the freedom of establishment to apply (see above), it might be contended that they cannot curtail its scope (because Article 199(5) is not in OAD2001).

But such an argument seems unlikely to succeed: The rejoinder would presumably be that Article 199(5) TFEU is expressly "subject to the provisions of Article 203"; that these include Article 55 OAD2001; and that Article 55 OAD2001's purpose it to regulate the scope of the OCT provisions (including Article 199(5) TFEU). Moreover, the ECJ has previously held that what is now Article 203 TFEU is a "discretionary power" that entitles the Council (in the field of customs duties) to limit "exceptionally, partially and temporarily the freedom to import products from the OCT into the Community".[122]

Failing such a claim, the second and third paragraphs may curtail significantly the value of OAD2001 to taxpayers. Once again, the provisions' drafting raises various questions.

A preliminary question is whether Article 55 OAD2001 must be interpreted consistently with similar tax carve-out clauses in other agreements the EU has concluded. If so, the scope of the tax carve-out clause is perhaps likely to be given a broad interpretation. But it is arguable that any such clauses are distinguished because of the OCTs' unique position. The following analysis therefore proceeds on the basis that Article 55 OAD2001 should be analysed on its own merits.

Starting with Article 55 OAD2001's second paragraph, it is unclear what is meant by the words "avoidance or fraud of taxes".[123] In the ECJ's case-law, for instance, both artificially transferring profits by way of specially designed transactions (*Cadbury*

121 ECJ, 26 March 2003, Case T-85/03 R, *Government of the Cayman Islands v Commission of the European Communities* [2003] ECR I-00000, paras 58-59.

122 *Antillean Rice Mills*, para 95.

123 The ACP-EC Partnership Agreement uses the words "avoidance or evasion of taxes".

Schweppes) and loss-trafficking (*Marks & Spencer*)[124] have been described tax avoidance. Yet these concepts have quite different flavours.[125] In the light of the second paragraph's context (namely, the reference to double tax arrangements – which brings to mind information exchange provisions – and the existence of the third paragraph, see below), the *Cadbury Schweppes* concept of tax avoidance is arguably most relevant here.

In any event, the third paragraph is a greater obstacle for taxpayers. It is worded similarly to Article 65(1)(a) TFEU— but lacks an express equivalent to Article 65(3) TFEU.

This raises the question how wide the scope of Article 65(1)(a) is in the first place. Here, the ECJ's earlier case-law on Article 65 TFEU's predecessor provisions is instructive. For clarity, references in the quoted passages have been updated for TFEU.

In *Manninen*[126] the ECJ observed that

> Article 65(1)(a) of the Treaty, which, as a derogation from the fundamental principle of the free movement of capital, must be interpreted strictly, cannot be interpreted as meaning that any tax legislation making a distinction between taxpayers by reference to the place where they invest their capital is automatically compatible with the Treaty. The derogation in Article 65(1)(a) TFEU is itself limited by Article 65(3) TFEU, which provides that the national provisions referred to in Article 65(1) 'shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article 63'….
>
> A distinction must therefore be made between unequal treatment which is permitted under Article 65(1)(a) TFEU and arbitrary discrimination which is prohibited by Article 65(3).[127]

The first sentence of the quoted passage is ambiguous: It could mean that Article 65(1)(a) must first be interpreted strictly and that its scope is then cut back further by Article 65(3); or that, even without Article 65(3), Article 65(1)(a)'s scope is so limited.

There is support for this second view in the ECJ's *Verkooijen*[128] judgment, which suggests that Article 65(1)(a) TFEU may merely have been intended to clarify that

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124 ECJ, 13 December 2005, Case C-446/03, *Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes)* [2005] ECR I-10837 ('*Marks & Spencer*').

125 It appears that the former is a standalone justification whereas the second is a justification only when combined with the need to preserve the balanced allocation of taxing rights: see *SGI*, paras 65-66. The author thanks Dr Tom O'Shea for his guidance in this regard.

126 ECJ, 7 September 2004, Case C-319/02, *Petri Manninen* [2004] ECR I-7477 ('*Manninen*').

127 *Manninen*, paras 28-29. For clarity, references have been updated for TFEU.

existing case-law concerning the other freedoms applied also to the free movement of capital:

> [T]he possibility granted to the Member States by Article 65(1)(a) of the Treaty of applying the relevant provisions of their tax legislation which distinguish between taxpayers according to their place of residence or the place where their capital is invested has already been upheld by the Court. According to that case-law, before the entry into force of Article 65(1)(a) of the Treaty, national tax provisions of the kind to which that article refers, in so far as they establish certain distinctions based, in particular, on the residence of taxpayers, could be compatible with Community law provided that they applied to situations which were not objectively … or could be justified by overriding reasons in the general interest, in particular in relation to the cohesion of the tax system ….
>
> In any event, Article 65(3) of the Treaty states specifically that the national provisions referred to by Article 65(1)(a) are not to constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments, as defined in Article 63.[129]

It is also strongly arguable that Article 65(1)(a) must prohibit undisguised restrictions on the free movement of capital and payments itself because Article 65(3) refers only to disguised restrictions.[130]

The response would presumably be that, first, the ECJ's case-law on the free movement of capital cannot be applied to Article 55 OAD2001; second, when the ECJ said in *Manninen* that "Article 65(1)(a) of the Treaty … cannot be interpreted as meaning that any tax legislation making a distinction between taxpayers by reference to the place where they invest their capital is automatically compatible with the Treaty" it was simply stating the effect of Article 65(3) TFEU; and, third, for Article 65(3) TFEU to have any meaning, Article 65(1)(a) TFEU must be capable of permitting arbitrary discrimination or a disguised restriction.

The author's preferred view is that, if freedom of establishment rights exist in relation to the OCT companies then Article 55, like Article 65(1)(a), must be interpreted strictly, and that it serves to clarify that the ECJ's case-law applies to the establishment rights created. A review of similar tax carve-out clauses (such as that in the ACP-EC Partnership Agreement) might shed further light on the issue, but even then its value would be limited given the OCTs' unique position.

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128 ECJ, 6 June 2000, Case C-35/98, *Staatssecretaris van Financiën v B.G.M. Verkooijen* [2000] ECR I-4071 ('*Verkooijen*').

129 *Verkooijen*, paras 43-44. For clarity, references have been updated for TFEU.

130 F. Siddiqui, "Judicial activism or protectionism in the Court's dividend cases? The legacy of *Avoir Fiscal*", I.T. Rep. 2010, Jun, 1-12.

3.10. In what circumstances does the ECJ have jurisdiction to interpret the OCT provisions?

In summary, the ECJ should have jurisdiction to give a preliminary ruling as regards the OCT provisions' effect on a Member State's tax rule. The position in relation to the OCTs' tax rules – discussed below for completeness – is less clear.

The extent of the ECJ's jurisdiction was considered in *Kaefer and Procacci*.[131] That case concerned challenges brought before the Tribunal administratif, Papeete, concerning decisions of the High Commissioner of the French Republic in French Polynesia (who had refused to grant a residence permit to Mr Kaefer and ordered the expulsion of Mr Procacci). The Tribunal administratif sought a preliminary ruling from the ECJ under Article 177 EEC on the effect of the relevant OCT provisions.

The United Kingdom put forward two reasons why the ECJ lacked jurisdiction to give the ruling:

(i) the Tribunal administratif, Papeete, was not a court or tribunal "of a Member State" within the meaning of Article 177 EEC (now Article 267 TFEU);[132] and

(ii) Part Four EEC (now Part Four TFEU) was a *lex specialis* which applied to the overseas countries and territories to the exclusion of the other provisions of the Treaty (including, in particular, Article 177 EEC).[133]

The ECJ dismissed both and held that the request was admissible.[134] As regards (i), the ECJ noted simply that the Tribunal administratif, Papeete, was a French court;[135] as regards (ii), it observed that the 1986 Decision had been laid down pursuant to the powers conferred on the Council by Article 136 EEC.[136]

Although the ECJ did not expand on (ii), the implication is that this entitled the ECJ to give a preliminary ruling on the ground that OAD1986 was an act of a Community institution falling within Article 177(1)(b) EEC.[137] The same should be true of OAD2001.

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131 ECJ, 12 December 1990, Joined cases C-100/89 and C-101/89, *Peter Kaefer and Andréa Procacci v French State* [1990] ECR I-4647 ('*Kaefer and Procacci*').

132 *Kaefer and Procacci*, para 6.

133 *Kaefer and Procacci*, para 7.

134 *Kaefer and Procacci*, para 10.

135 *Kaefer and Procacci*, para 8.

136 *Kaefer and Procacci*, para 9.

137 Now Article 267(1)(b) TFEU.

The analysis of (i), however, may depend on whether a Member State's or an OCT's tax rule is in point.

In particular, it appears that the British overseas territories' courts and tribunals would not pass the "of a Member State" test because each of those territories operates an independent legal system, albeit one based on English common law. However, in certain circumstances appeal may lie from a British overseas territory's Court of Appeal to Her Majesty in Council (i.e. the Judicial Committee of the Privy Council). Could the Privy Council validly request a preliminary ruling from the ECJ? It is strongly arguable that at times – for example, while hearing cases that arise in the UK, such as devolution issues relating to Scotland and Wales[138] – the Privy Council is a "court or tribunal of a Member State". But if Article 267 TFEU would require the Privy Council to be acting as a UK court when it makes the request (the wording of the Article is ambiguous), then it may be in the same position as the British overseas territories' own courts and tribunals.

The ECJ might, however, still be willing to give a preliminary ruling even if the requestor failed the "of a Member State" test: It did so in *Barr and Montrose*[139] even

though the requestor – the Deputy High Bailiff's Court, Douglas (Isle of Man) – did not form part of the UK's court system.[140] The ECJ found the request to be admissible based on certain provisions in the Treaty of Accession 1972 and the need to ensure the uniform application of the provisions in question. Its judgment can be read as suggesting that the latter ground (which could be applied by analogy to the OCT provisions)[141] would have made the ruling admissible on its own.[142]

3.11. How does Bermuda's position compare to that of the other OCTs?

Although Bermuda is an OCT, it has opted not to fall within the scope of the Overseas Association Decisions.[143] This might be expected to prejudice its position. Certainly it is hard to see how the GATS undertakings could apply to Bermuda.

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138 The author thanks Professor Philip Baker OBE QC for his guidance regarding the Privy Council's functions.

139 ECJ, 3 July 1991, Case C-355/89, *Department of Health and Social Security v Christopher Stewart Barr and Montrose Holdings Ltd* [1991] ECR I-3479 ('*Barr and Montrose*').

140 *Barr and Montrose*, para 6.

141 See A. Arnull, "The evolution of the court's jurisdiction under Article 177 EEC", E.L. Rev. 1993, 18(2), 129-137, at 133.

142 *Barr and Montrose*, paras 9-10.

143 Paragraph 22 of the preamble to OAD2001 records that "[t]he arrangements for association laid down in this Decision should not be applied to Bermuda in accordance with the wishes of the Government of Bermuda."

The positions as regards any establishment rights is less clear, and will depend on the correct interpretation of Article 199(5) TFEU. If Article 199(5) TFEU does not have direct effect then on the face of it no freedom of establishment rights would apply in EU-Bermuda relations anyway, and Bermuda would be worse off only if OAD2001 creates freedom of establishment rights itself. As discussed above, this seems unlikely. But if that Article independently causes the freedom of establishment to apply then Bermuda could in theory be in a *better* position than the other OCTs (because it would be outside the scope of Article 55 OAD2001). This would be an odd result, and one the ECJ might well be eager to avoid. The ECJ could, if it wished, resolve the difficulty by interpreting Article 55 OAD2001 in the manner described above (i.e. as clarifying that the ECJ's existing case-law concerning when a restrictive measure nonetheless complies with Community law applies to any freedom of establishment rights created by Article 199(5) TFEU).

3.12. The Prunus case

Since this article was originally drafted, the ECJ has examined the extent of the OCTs' free movement of capital rights in the *Prunus* case.[144] *Prunus* concerned the compatibility with Community law of a French property tax, which had previously come under scrutiny in *ELISA*[145] and *Établissements Rimbaud*.[146] As discussed below, whilst the ECJ held against the taxpayer in *Prunus*, it decided the case on free movement of capital grounds and by reference to comments in *Leplat* which could not be applied by analogy to a freedom of establishment scenario. The case is therefore of limited direct relevance, but is nevertheless of interest given the limited body of case law on the OCTs.

The French rules at issue in the three cases imposed a 3% tax on the market value of French real estate held by a company or other legal person. Higher-tier holding companies were chargeable on interests held by their subsidiaries, and companies in a chain could be jointly and severally liable for any charge that arose.

Various exemptions from the charge applied. These included where the company disclosed certain details about the land it held and its shareholders. Presumably the intention of the rules was to discourage French nationals from avoiding French tax by holding property interests via an intermediary. In the case of a company whose effective centre of management was in France, disclosure was all that was required.

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144 ECJ, 5 May 2011, Case C-384/09, *Prunus SARL and Polonium SA v Directeur des services fiscaux* [2011] ECR I-00000 ('*Prunus'*). See T.O'Shea, *"B.V.I. Companies Do Not Benefit From EU Tax Treatment, ECJ Says",* Tax Notes International, 6 Jun. 2011, 772-775.

145 ECJ, 11 October 2007, Case C-451/05, *Européenne et Luxembourgeoise d'investissements SA (ELISSA) v Directeur général des impôts and Ministère public* [2007] I-08251.

146 ECJ, 28 October 2010, Case C-72/09, *Établissements Rimbaud SA v Directeur général des impôts and Directeur des services fiscaux d'Aix-en-Provence* [2010] I-00000 ('*Établissements Rimbaud*').

Other companies, however, had also to (1) have their seat in a country or territory which had concluded with France a convention on administrative assistance to combat tax evasion and avoidance or (2) benefit from a double tax treaty's non-discrimination clause that prevented them from being subject to a heavier tax burden.

This difference of treatment gave rise to several complaints. In *ELISA* a Luxembourg 1929 holding company had acquired French real estate. It was unable to qualify for exemption because, as a 1929 holding company, it was excluded from the scope of France's double tax treaty with Luxembourg. The ECJ held that:

- the Luxembourg company had exercised its free movement of capital rights (the freedom of establishment was not in point, because ELISA did not actively manage or use the property);
- the difference of treatment constituted a restriction on that freedom (because it made it less attractive for non-resident companies like the Luxembourg company to invest in French real estate); and
- that restriction was disproportionate, because companies like ELISA were denied an opportunity to rebut the general presumption of tax avoidance. The French government could have adopted less restrictive measures, such as permitting disclosure in the absence of a suitable administrative assistance convention or double tax treaty.

Similar issues arose in *Établissements Rimbaud*, this time in the context of the EEA Agreement (Article 40 of which prohibits restrictions on capital movements). The taxpayer in that case was a Liechtenstein company which held French real estate. As in *ELISA*, the lack of a suitable convention or double tax treaty meant it could not qualify for exemption. This time, however, the result was different. The ECJ noted that "the case-law concerning restrictions on the exercise of the freedoms of movement within the European Union cannot be transposed in its entirety to movements of capital between Member States and non-member States, since such movements take place in a different legal context".[147] It observed that the framework established by the Mutual Assistance Directive (Directive 77/799/EEC) which existed between two Member States did not apply between a Member State and Liechtenstein. This, the ECJ said, enabled the French rules to satisfy the requirement of proportionality.[148]

In *Prunus*, a French company (Prunus) held the French real estate. It was owned by a Luxembourg company (Polonium) which in turn was owned by two BVI companies (Grebell and Lovett). Prunus and Polonium complied with their reporting obligations and were exempt from payment of the 3% tax. But Grebell and Lovett were charged to

147 *Établissements Rimbaud*, para 40.

148 For a more detailed analysis, see T. O'Shea, *"ECJ's Rimbaud Ruling Bolsters Mutual Assistance View",* Tax Notes International, 29 November 2010, pp. 648-652.

the tax (there was again no suitable convention or double tax treaty); and Prunus was then held jointly and severally liable for this.

In the proceedings, after rejecting the United Kingdom's argument that the freedom of establishment was in point,[149] the ECJ found the French rules again to constitute a restriction on the free movement of capital. But this time it held that the restriction was covered by the standstill clause in Article 64(1) TFEU. (Note that the standstill clause was not relevant in *ELISA* as that case concerned a Luxembourg company. Whilst the EEA Agreement contains its own standstill provisions, these were not in point in *Établissements Rimbaud*.)

In concluding that Article 64(1) TFEU could apply (which required that the OCTs be third countries), the ECJ cited *Leplat*, recalling that "failing express reference, the general provisions of the Treaty, whose territorial scope is in principle confined to the Member States, do not apply to [the OCTs]" and "OCTs therefore benefit from the provisions of European Union law in a similar manner to the Member States only when European Union law expressly provides that OCTs and Member States are to be treated in such a manner."[150]

Then, noting that TEU and TFEU lacked an express reference to capital movements between Member States and the OCTs,[151] it concluded that "the OCTs benefit from the liberalisation of the movement of capital provided for in Article 63 TFEU in their capacity as non-Member States".[152]

The wording of this sentence of the judgment is confusing: the question of interpretation is surely whether the OCTs are third countries, as must be the case for Article 64(1) to apply, not whether they are non-Member States. As the Advocate General explained,[153] OCTs seem to occupy a mid ground between Member States and third countries. It would have been helpful if the ECJ had tackled the point more directly.

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149 At the hearing (on 23 September 2009) agents of the United Kingdom submitted that the proceedings were concerned with an exercise of freedom of establishment rather than free movement of capital. The author understands from subsequent discussions that the United Kingdom's position was, in essence, that: whilst the acquisition of immovable properties by Prunus clearly constituted a capital movement, this involved no cross-border element and therefore no question of Community law; and from Lovett and Grebell's perspective, the capital movement associated with their investment in Polonium should have been subordinate to any exercise of freedom of establishment. Had the ECJ agreed with this analysis, it would have needed to consider whether Lovett and Grebell had any freedom of establishment rights. Sadly it did not.

150 *Prunus*, para 29.

151 *Prunus*, para 30.

152 *Prunus*, para 31.

153 *Prunus*, point AG31.

The ECJ went on to conclude that the French rule was a pre-existing measure at 31 December 1993 and therefore found against the taxpayer.

As noted above, the case is of limited direct relevance as it was decided on free movement of capital grounds. Moreover, the ECJ's conclusion that the OCTs were third countries (so that the standstill clause could apply) was reached by reference to comments in *Leplat* that would simply not be relevant in an establishment context because Article 199(5) TFEU contains an express reference to establishment. We may need to wait a while longer for the OCTs' position to be clarified.

4. Conclusions

This article has sought to contribute to filling the gap in the literature regarding the OCT provisions' tax implications. It has built on Pancham, Fibbe and Ruiter's careful analysis of the OCT provisions' free movement of capital aspects by examining whether they also create freedom of establishment rights in relation to companies incorporated in one of the OCTs.

As the article shows, the key to understanding the OCT provisions' effect is clarifying the true meaning of Article 199(5) TFEU, Articles 45 OAD2001, and 55 OAD2001.

There is certainly an argument that Article 199(5) TFEU creates freedom of establishment rights in relation to OCT companies.

And, while a revenue authority would presumably seek to argue that, even if any establishment rights do exist, the tax carve-out clause in Article 55 OAD2001 means they have little effect, there are tenable arguments that Article 55's scope is limited to clarifying that the ECJ's case-law applies to any establishment rights created. A review of similar tax carve-out clauses in the Community's other agreements – such as the ACP-EC Partnership Agreement – might shed further light on the issue, but its value would be limited given the OCTs' unique position.[154]

But the OCT provisions are far from a model of clarity, and (perhaps unsurprisingly, given the age of Article 199(5)'s predecessor provisions) they appear to have been enacted with little or no thought given to their effect on direct tax affairs. The dearth of relevant case-law or commentary means it is impossible to be certain whether freedom of establishment-related arguments based on the OCT provisions would succeed, and this is likely to remain the case until a test case is taken to the ECJ.

This article has also considered the direct tax implications of the Member States' obligations under the General Agreement on Trade in Services (GATS), as the OCT provisions cross-refer to these. In principle it may be possible to argue that the Member

154 That is, Article 199(5) TFEU and Article 45 OAD2001 both lack an obvious equivalent.

States' most-favoured-nation treatment (MFN) obligation provides quasi-Community law rights to service providers of other WTO Members (because Bulgaria and Romania, the most recent Member States to accede to the Union, are GATS Members (only) in their own right, and their service providers have Community law rights). Nothing in the GATS obviously precludes this argument. Additional arguments may exist in relation to specific services, but these are weaker than the MFN-related argument because of the scope of the GATS' own tax carve-out clause.