# MASTER-THESIS

Titel der Master-Thesis

„The Free Movement of Capital in the EU and Third Countries“

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# LIST OF ABBREVIATIONS

**EC-** European Commission

**ECJ-** European  Court of Justice

**EEC-** European Economic Community

**EU-** European Union

**EMU-** European Monetary Union

**OECD-** Organization for Economic Co-operation and Development

**SEPA-** Single European Payment Area

**TEU-** Treaty on European Union

**TFEU-** Treaty on the Functioning of the European Union

# ABSTRACT GERMAN

Der freie Kapitalverkehr und Zahlungen in der Europäischen Union repräsentiert die Essenz der Europäischen Union und einer der vier Grundfreiheiten des Binnenmarktes. Gemäß dem Artikel 26 AEUV "Der Binnenmarkt umfasst einen Raum ohne Binnengrenzen, in dem der freie Verkehr von Waren, Personen, Dienstleistungen und Kapital gemäß den Bestimmungen des Vertrags gewährleistet ist". Generell in der Master Thesis ich über interne und externe Aspekte der freie Kapitalverkehr und Zahlungen und allen möglichen Ausnahmen sowie Begründungen für Ausnahmen diskutiert. Die Hauptstadt Deregulierung begann im Jahr 1958, nachdem der Vertrag von Rom unterzeichnet wurde und Europäischen Wirtschaftsgemeinschaft gegründet wurde. Selbst in diesem Zeitraum die den freien Kapitalverkehr und Zahlungen hatten Drittland Dimension in den relenvant wirkt. In der Zeit nach dem Brettonwoods Anordnung wurden Verabschiedung der Hauptstadt Richtlinie 88/361 EWG und finnaly Maastrich-Vertrag die Anstrengungen auf die absolute Liberalisierung des Kapitalverkehrs in Bezug auf die Beziehung zwischen den Mitgliedstaaten und Mitgliedstaaten und Drittländer. Nach dem Vertrag von Lissabon alle Beschränkungen mit resepct zu internen und externen Aspekten der Kapitalfreiheit ist untersagt. Dennoch Vertrags über die Arbeitsweise der Europäischen Union sieht vor, auch allgemeine und spezifische exceprions in seinen Bestimmungen, um den Schutz der nationalen Sicherheit, Verteidigung und Finanz welefare bereitzustellen. Darüber hinaus können die Ausnahmen aus Gründen der öffentlichen Ordnung und Sicherheit gerechtfertigt werden kann. Ein weiterer wichtiger Punkt in meiner Master Thesis wold die Diskussion über die Urteile des Europäischen Gerichtshofs und die Schlussanträge des Generalanwalts zu verschiedenen Themen sein. In der Mitte der spezifischen Ausnahmen golden shares Fällen und Kontrolle der Eigentums Überlegungen. Bis in die heutige Zeit die Rechtsprechung des Europäischen Gerichtshofs, um steuerliche Kohärenz und Doppelbesteuerung, eingehende und ausgehende Dividenden Angelegenheiten in Bezug auf den freien Kapitalverkehr bieten unterschiedlich interpretiert Vorschriften übermittelt Vertrag über steuerliche Behandlung von nicht gebietsansässigen und ausländischen Investitionen und Zahlungen. Auch der EuGH wies darauf hin, die Regel für die Mitgliedstaaten auf, angemessene Maßnahmen zu ergreifen, um inkompatiblen über Kapitaltransfer in bilateralen Investitionsabkommen zu beseitigen. Getrennt

von den Kapitalfreiheit exceprions, ich untersuchte auch dritten counbtry Ausnahmen und verglichen sie mit den Ausnahmen innerhalb der Europäischen Union. Im letzten Kapitel habe ich betont die bedeutende contriburion bezüglich Vertrag von Lissabon Regelung gegen den Terrorismus als auf der problematischsten Themen in der heutigen Zeit.

## ABSTRACT ENGLISH


The free movement of capital and payments in the European Union represents the essence of the European Union and one of the four freedoms of the Internal Market. According to the Article 26 TFEU "The internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provision of the treaty". Generally speaking, in the Master Thesis I discussed about internal and external aspects of free movement of capital and payments and all possible exceptions, as well as justifications of exceptions. The capital deregulation started in the 1958, after the Treaty of Rome was signed and European Economic Community was established. Even in that period the free movement of capital and payments had third country dimension in the relenvant acts. In the period after the Brettonwoods arrangement, adoption of Capital Directive 88/361 EEC and finnaly Maastrich Treaty the efforts were focused on absolute capital liberalisation with respect to relationship between Member States and Member States and third countries. After the Lisbon Treaty all restrictions with resepct to internal and external aspects of capital freedom shall be prohibited. Nevertheless, Treaty on the Functioning of the European Union also stipulates general and specific exceprions in its provisions in order to provide protection of national security, defence and financial welefare. Moreover, the exceptions may be justified on the ground of public policy and security. Another key point in my Master Thesis wold be the discussion of the judgments of the European Court of Justice and Opinion of Advocate General on various issues. In the centre of specific exceptions Golden Shares cases and control of ownership considerations. Up to the present time the jurisprudence of the European Court of Justice interpreted differently Treaty provisons on tax treatment of non-resident and foreign investment in order to provide fiscal coherence and double taxation, inbound and outbound dividends matters in relation to free movement of capital and payments. Also, the ECJ pointed

out the rule for Member States to take adequate measures to eliminate incompatibles regarding capital transfer in Bilateral Investment Treaties. Separately from the capital freedom exceprions, I also examined third counbtry exceptions and compared it with the exceptions within the European Union. In the last chapter, I  emphasized the significant contriburion with respect to Lisbon Treaty regulation against terrorism as on of the most problematic issues at the present time.

# 1. INTRODUCTION

From the early beginning of establishing the European Union and internal market as its integral part, the primary aim was, according to the Article 3(c) EC, "the abolition as between Member States, of obstacles to freedom for persons, service and capital". Internal market comprises all necessary elements for establishing an area, which represents the unique category of economic integration. In the center of understanding of the internal market is the custom union, since the European Union is particularly based on the principles of custom union.[1] Adjacent to the free movements of goods, person and service, internal market covers also free movement of capital and payments in the European Union as its broadest freedom. Without the capital freedom, it would be impossible to conceive the functioning of European Financial Market and complete realization of other internal market freedoms. Important to emphasize is that free movement of capital with respect to third countries also fall within the constitutional basis of European Union. In the Post-Maastricht regime, intensive endeavor has been achieved regarding external aspects of capital freedom, different from the previous regulation to the "extent necessary for the functioning of common market".[2] With this in mind, various types of conflicts arise concerning interpretation of relevant capital provision. In the following Master Thesis I will provide legal, historical and economic analysis regarding internal and external aspects of free movement of capital as one of the most significant and developing freedom.

[1] Professor Dr. Dr. hc.Peter Fischer, European Internal Market Law, LLM Program in European and International Business Law, Vienna Law School, 2014, 7.
[2] Article 67(1)EEC.

## 2. FREE MOVEMENT OF CAPITAL FROM 1958 TO 1993

### 2.1 Treaty of Rome and First Capital Directive

The Treaty of Rome[3] is the first and crucial step forward the economic integration process. The main legal rules laid down in Articles 67 to 73 EEC and form Chapter IV, Title III, Part 2 of the EEC Treaty. Article 67(1) EEC [4] was undeniable essential provision liberalizing capital free movement. It stipulates that

"*During to transitional period and to the extent necessary to ensure the proper functioning of common market, member state shall progressively abolish between themselves all restrictions on the movement of capital belonging to persons resident in Member State and any discrimination based on nationality or on the place of residence of the parties or on the place where such capital is invested*."

The Treaty of Rome was not clear in the capital definition, neither is possible to ascertain the direct effect of its provisions.

One of the issue concerning the Article 67(1) is the imprecise definition as to what constitutes capital. It is true that Article 3 EEC indicates differences between types of capital, but still without unambiguous definition.

On the other hand, the First Capital Directive[5], issued to implement Article 67(1), classifies capital movements into four lists, with different degrees of liberalization. These categories include both financial and non-financial assets. This Directive means a milestone in the process of deregulation of the capital movement in the European Economic Community. The First Capital Directive, issued to implement objectives of Article 67(1) EEC and exercise of

[3] Mouhamed Sideek, European Community Law on Free Movement of capital and the EMU, ( Norsteds Tryckeri,Stockholm, 1999) 23 . It was signed in Rome on 25 March 1957 and came into force on 1 January 1958. The aim of the Treaty of Rome establishing the European Economic Community (EEC) was to bring about economic integration within its territorial limits and to project it as a single trade entity in the world market. At the hearth of the EEC is its common market, an autonomous territory embracing fifteen sovereign states stretching from the Mediterranean to the Artic.

[4] Article 67(1) EEC.

[5] Coucil Directive of 11 May 1960, JO!2 July 1960as amended by Directive 63/21EEC of 18 December 1962, JO L9 22 January 1963.

other economic freedoms, liberalized direct investment, short- or medium-term lending for commercial transactions, and purchases of securities traded on the stock exchange.[6]

Since the absence of definition of what constitutes capital is more than obvious, it is necessary to take into consideration the judicial guidelines to resolve this problem. Important to realize, is that the Court also supports the assertion about difficulty to provide precise definition.

The prominent examples, according to the Article 67(1) EEC, was cases *R v Thompson, Johnson and Woodwis*[7], concerning whether specified coins were "capital" *stricte sensu*, and *Graziana Luisi and Giuseppe Carbone v Minstero del Tesoro.*[8] This case incorporated the issue of relation and congruence between Community law and National exchange rules. Italian exchange rule prohibits the export of foreign currency up to 500,000 Lira per year.[9] The argument that Court considered to be correspondingly for the transaction of money to Germany and France, was that export of foreign currency for tourism and medical purposes were payments connected with services.[10] The Court of Justice declared:

"..*current payments covered by Article 106 EEC are transfers of foreign exchange which constitute the consideration within the context of an underlying transactions, whilst the movement of capital covered by Article 67(1) are financial operations essentially concerned with the investment of funds in question rather than remuneration for a service"*

According to the Court of Justice article 106 was directly effective. Under these circumstances and fact that payments connected with services had already been deregulated, the movement of capital should be treated separately from current payments involving movements of service or goods, which consist of real money transaction.[11] However, the Member State preserved the right to estimate the nature of transaction.

There are different interpretation to the scope and effect of Article 67 (1) EEC. The traditional approach combine the "direct effect" and "non-direct effect" considerations. The

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[6] http://www.europarl.europa.eu/aboutparliament/en/displayFtu.html?ftuId=FTU_3.1.6.html
[7] Case 7/78, (1979) ECR 2247, (1979) CMRL 47.
[8] Joined cases 286/82 & 26/83, *Graziana Luisi and Giuseppe Carbone v Minstero del Tesoro* (1984) ECR 377, (1985) 3 CMRL 52.
[9] Decree Law No 476 of 6 June 1956 in exchange regulations.
[10] Michael Bogdan, "Free Movement of Tourists within the EEC? (1977) JWT 468 who supports the application of EEC rules on freedom to provide services to tourist whereas Michael Petersen, in "Capital Movements and Payments Under the EEC Treaty After Casati", (1982) 7 EL Rev 167.
[11] *See* Council Directive 63/340 on the abolition of obstacles to payments for services.

foremost case dealing with these issues is *Public Posecutor v Guerrino Casati*. [12] The facts of the case were expressed in the judgment.

" .. *Mr Casati, an Italian national residing in Federal Republic of Germany, was arraigned before the Tribunale di Bolzano, on a charge of having attempted to export from Italy, without authorization prescribed by Italian exchange control legislation, the sums of Lit. 650.000 and DM. 24 000 which were found in his possession at the frontier between Austria and Italy*"

Mr. Casati relied on Article 67(1) EEC and prohibition of exchange restriction until the end of transitional period. The incompatibility of Italian exchange control legislation with Community law was a crucial point of his defence. The thing that was overlooked and the Court took into consideration was a certain limits with respect to capital deregulation. The Court declared that

"*Article 67(1) must be interpreted as meaning that restrictions on the exportation of bank notes may not be regarded as abolished as from the expiry of the transitional period, irrespective of the provisions of Article 69*"

The "non-direct" effect of relevant provision may be seen in the sense of achieving other economic freedoms and economic policies of Member States. The Courts decision of not specifically defining the direct effect of Article 67(1) EEC would be the basic pillar for different interpretations and indicator of the future progress of free movement of capital.

## 2.2 External aspects of the free movement of capita -third countries and the Treaty of Rome

The objective of the Treaty of Rome in relation to external aspects of free movement of capital was to extend the capital freedom to third countries as well. Until the early 1990s the position of free movement of capital was not in the forefront of liberalization in respect to other economic freedoms. Under those circumstances, free movement of capital towards third

[12] Case 203/80, *Public Posecutor v Guerrino Casati, (1981),* ECR 2595, (1982) 1 CMRL 365.

countries had to develop on the non-completely liberalized capital freedom within the European Economic Community.

Articles 70 and 72 EEC are key Treaty provisions concerning third countries dimension of free movement of capital. The primary aim of Article 70 EEC was to authorize Commission to propose Council measures for co-ordinations of the exchange policies towards third countries. The Council shall "endeavor to attain the highest possible degree of liberalizaton" and unanimity of votes is required if measures constitute a step back regarding the libralization process. This requirement was not amended by Single European Act, although unanimous voting in decision making process was replaced by qualified majority.

It follows from the Article 72 EEC that "Member State shall keep the Commission informed of any movement of capital to and from third countries which come to their knowledge". The Commission may provide opinions with respect to this subject.

### 2.3 Efforts to establish free movement of capital

In the 1971 after serious dollar crisis, breakdown of the Brettonwoods arrangement and energy crisis the Council issued the Directive[13] to regulate international capital flows and neutralizing their undesirable effects on domestic liquidity. The Council Directive effected not only the free movement of capital towards third countries, as its primary objective, but also the capital freedom within the Community. The aim to ensure the establishment of EMU, after Werner report published in 1970, is rendered in Recital 1 of the Directive.[14]

Even in the Pre-Maastricht regime occurred the idea of a liberalization of banking services. The European financial market integration required also to ensure the right of establishment, freedom to provide services.  This financial area was regulated by secondary and judgments of European Court. The process of banking integration was not fast due to incapacity

[13] Council Directive 72/156/EEC, (1972) OJ L91/13.

[14] According to the Recital 1 Of Council Directive 72/156/EEC "Whereas exceptionally large capital movements have caused serious disturbances in the monetary situation and in economic trends in Member States; whereas these disturbances may hinder the establishment by stages of an economic and monetary union; whereas the Council, in its resolution of 9 May 1971, agreed to discuss before' 1 July 1971 the adoption of appropriate measures to deal with this situation.

to overpass legal, political and economic impediments. In spite of all obstacles, the Council adopted in 1973 the Directive on the Freedom of Establishment and Freedom to Provide Services to Liberalize Banking Services.[15]

The first significant contribution to financial sector within European Economic Community, after the objective that all freedoms should have been completely liberealized until the end of 1969[16], was First Banking Directive in 1977.[17] In the Maastricht regime, the Second banking Directive would create more intensive integration process with respect to common financial market.[18]

### 2.4 Capital Directive 88/361/EEC

Secondary legislation also has an impact on free movement of capital. In December 1985 the First Capital Directive was amended by Council Directive 85/583/EEC, [19] and one year later Council adopted Directive 85/583/EEC.[20] The Council Directive 85/566/EEC reduced the four lists into three lists. The List A and B were full and partial liberalized and list C, former list D, still not liberalized. The issuing and placing of securities of domestic undertaking on a foreign market, and of a foreign undertaking on the domestic capital market, cross-border acquisitions and liquidations of units in unit trust, and the granting and repayments of certain long term credits were relocated from list C into new list A. This was the concept of capital freedom until the adoption of Capital Directive 88/361/EEC[21] which continue with categories of capital movements but repealed different degree of liberalization.

The Capital Directive 88/361/EEC presents the first step towards capital liberalization after the Commissions White Paper[22] assertion that:

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[15] Council Directive 73/183/EEC, (1973) OJ l/194/1.
[16] Article 7 EEC.
[17] First Council Directive 77/780/EEC on the co-ordinations of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions, (1997) OJ L322/30.
[18] The Second banking Directive 89/646/EEC came into force on 1 January 1993.
[19] OJ 1985 L372/39.
[20] OJ 1986 L332/22.
[21] OJ 1988 L178/5.
[22] COM (85) 310 final, para 101.

“*the liberalization of financial services, linked to that of capital movements will represent a major step towards Community’s financial integration and widening of internal market*”.

The Directive falls within the scope of reactivating the process of economic integration established by Single European Act.[23] The value of the Directive should be seen in the pursuing the objective of establishment of EMU. The Directive still provide categories of capital movements but does not make difference between levels of liberalization. The Directive determined the same exchange rate for transfer of capital movements and current payments.[24]

The Directive is wide interpreted and based on non-discriminatory principle to achieve the goals in Article 67(1) EEC. Article 1 of the Directive stipulates that “Without prejudice to the following provisions, Member States shall abolish restrictions on movements of capital taking place between persons resident in Member States”.

The Court of Justice on European Union in the joined case of *Monisterio Fiscal and Aldo Bordessa*[25] found that Article 1 of the Directive had direct effect. In this case the Court found that defendants weren’t obliged to apply for prior authorization for transferring bank notes. The requirement was contrary to the Capital Directive 88/361/EEC, and the provisions could be invoked by individuals before national courts. Although alleged infringement of national exchange rules happened before the Directive validity, Spain may continue to apply restrictions on capital movements listed in Annex I of the Directive.[26]

[23] The Single European Act came into force on 1 January 1987

[24] Mouhamed Sideek, European Community Law on Free Movement of capital and the EMU, ( Norsteds Tryckeri, Stockholm, 1999) 83.

[25] Case c-358/93 *Monisterio Fiscal and Aldo Bordessa* [1995] ECR I-361.

[26] Article 6(2) of the Capital Directive 88/361/EEC.

## 3. TREATY OF MAASTRICH AND THE EMU

In the progression of efforts to pursue the objective of capital deregulation, the Maastricht Treaty on European Union represents the major legislative contribution to the complete liberalization of capital movements and payments.[27] Since the Delors report suggested a process towards establishing European and Monetary Union, the Maastricht Treaty on European Union continued and facilitate that process. Important to realize is that complete liberalization of the free movement of capital is essential for monetary integration, and vice versa. (The aim to establish internal market by 1 Jan1993)

The amending Treaty provisions on ‘capital and payments’ are expressed in liberal legal regime and replaced main legal rules laid down in Articles 67 to 73 EEC and form Chapter IV, Title III, Part 2 of the EEC Treaty. The fundamental legal rules are set out in articles 73(a) to 73(h). The new provisions enabled the substantial advancement toward capital liberalization within Community and towards third countries.

In the comparison with article 67(1) EEC, article 73(b) EC paragraph 1 prohibits all restriction on free movement of capital between Member States and between Member States and third countries and in paragraph 2 of article 73(b) equal prohibition with respect to payments. The EC Treaty legal nature is not confined like in the case of the EEC Treaty “to the extent necessary to ensure proper functioning of common market”, but prohibit the imposition of new restriction.

The Court of Justice in *Bordessa* case declared the direct effect of Article 1 of the Directive, which is mere re-production of Article 73(b) of the EC Treaty. Although the Directive as secondary legislation set out capital freedom on the position equal with other economic freedoms, it was necessary to ensure its stability and inherent status. In the light of the current situation and fact that the legal nature of the Directive is different from the Treaty, the EC Treaty gave full legal effect to the objectives specified in the Directive. Another key point is that the Treaty provision also provide vertical and horizontal direct effect of the capita provisions with no need for its prior transformation into national law. The Treaty does not provide suspension to

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[27] *See* http://europa.eu/legislation_summaries/institutional_affairs/treaties/treaties_maastricht_en.htm The Maastricht Treaty on European Union was signed on 7 February 1992 and came into force on 1 November 1993. It create a European union consisting of three pillars. Besides, The EEC has become EC.

what has been achieved under Directive 88/361/EEC, continued with the unanimity voting requirement in case of downgrading capital movements towards third countries and enable restrictions to third countries that exist on 31 December 1993. [28] The free movement of capital within Community had been established as a one of the four freedom, no longer as the objective of common market, and hardly possible to change the course of the capital movements approach.

The *Bordessa* judgment led to the relief of future interpretation of the EC Treaty and relevant capital provisions. The aim to define legal status of Article 73(d) was achieved in another similar *Sanz de Lera and Others* joined case.[29] The defendants had been exporting banknotes for amount of excess of PTA 5 million. The Court again ruled in favour of defendants, considering authorization requirement contrary to Community law. In this case judgment relied on directly applicable Article 73(b) EC Treaty. Moreover, this case extended the scope of capital freedom beyond the boundaries of common market. The consequence was the obligation for all Member States to comply with a Treaty provisions with respect to non-discrimination concerning third country liberalization. The difference between international and European regulations of same objectives is the achievement reciprocity principle and the duration of the obligation to liberalize capital movements.[30] The Court in *Bordessa* and *Sanz de Lera* cases set out principle of proportionality and supremacy of Community law, this time concerning Member States activities in relation to crimes associated with free movement of capital.

Different from the Article 67(1) EEC, Article 73(b) broadened the scope of application to "between Member States" and "between Member State and third countries". Important to emphasize is that the obligation from Article 73(b) to remove all restrictions on free movement of capital and payments between subjects above is generally stipulated, with possibility not to be limited to public sector. It eliminated "person resident" as a condition for substantiation of the freedom and govern stricter rules for the purpose of automatically abolition of restriction on capital movement.[31] Inseparable part of capital freedom, free movements of payments, was no

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[28] Article 73(c) EC Treaty.
[29] Joined Cases C-163/94, *Sanz de Lera,* C-165/94, *Diaz Jimenz,* (1994) and C-250/94, *Kapaouglu,* (1995) ECR 1-4821, (1006) 1 CMRL 631.
[30] Sideek Mohamed, European Community Law on the Free Movement of Capital and the EMU ( Norsteds Tryckeri, Stocholm, 1999) 218.
[31] *Ibid*, 99.

longer expressed in articles separated from capital movements. The requisite for "Capital and Payments" incorporating was recognized from the inception of capital liberalization.[32]

In the critical overview of Article 73(c) and 73(d) EC Treaty, it may be concluded that the limitations following from this articles supported the free movement of capital towards third countries as non-absolute right. The interpretation of both articles evince the Member States right to enforce certain restrictions forasmuch more exceptions concerning free movement of capital towards third countries.

It is important to emphasis that principles set out in Second Banking Directive was a cornerstone not only for establishing common market in financial services, but also for the interpretation of exceptions stipulated in Article 73(d).[33] The directive amended the First Banking Directive and its principles of mutual recognition, home country control and single banking license contributed the completion of the Internal Market.[34] Nevertheless, the directive extended to the third countries benefits arising from single banking license. There is no prohibition for branches to operate in host state without prior authorization, if the institution is established in Member State.[35] According to the Directive the Commission is responsible to achieve the reciprocity regarding the right of EC investment companies and financial institutions for protection and effective market access in third countries.[36]

In the case of Article 73 (c) restrictions existing under national or Community law in respect of movement of capital to or from third countries involving direct investment, investment in real estate, the provision of financial services or the admission of securities to capital markets could be maintained. On the other hand Article 73(e) authorizes Member States to apply Community law restrictions until 31 December 1995, not prohibiting national law restriction adopted before 1994. It could be assumed that Member States relation with third countries with respect to capital liberalization remained on the former level of capital deregulation. The collision of Article 73(b) and 73(c) should also be viewed in the sense of balancing between

[32] Joined cases 286/82 & 26/83, (1984) ECR 377, (1985) 3 CMRL 52.
[33] The Second banking Directive 89/646/EEC.
[34] Robert Stivens, "The Liberalisation of Banking Services in the Community", (1992) 29 CMRLev 283.
[35] Luc Roeges, "Banking activities through a branch in Another Member State After the Second Banking Directive" (1993) 13 YEL 295.
[36] Article 9 of the Second Banking Directive, Article 7 of the Investment Services Directive 93/22/EEC, (1993) OJ L141/27.

Councils aim to strengthen capital flow towards third counties and Courts power to protect individuals.

The Court proclaimed in *Sanz de Lera* the necessity of judicial examination of Article 73(c) and role of the Court to ensure proper order in relation to unfulfilled Council obligations.[37]

The application of the EC Treaty provision on capital movements is confined to the exceptions provided in Article 73(d) EC and covers both internal and external aspects of capital movements. The exceptions are in relation to prohibit national tax law infringements, prudential supervision of financial institutions or to lay down procedures for the declaration of capital movements for the purposes of administrative or statistical information, or to take measures that are justified on grounds of public policy and security. However, measures must not constitute an arbitrary discrimination or disguised restrictions on the free movement of capital and payments. In relation to other economic freedom, provisions on free movement of capital and payments shall be without prejudice to the applicability of restriction on the right of establishment which are compatible with the Treaty.[38]

The interpretation of Article 36 EEC on the free movements of goods should be useful for the lawful and complete application of restrictions stipulated in article 73(d) EC treaty. The relevant principle developed in this concept limited Member States to apply protective measures only in the field of capital movements with respect to protect national interest and market disturbances. Commission after consulting Monetary Committee, may take an action concerning providing authorization for Member State to enforce restrictions.[39]

Since the protection of national tax system is a matter of legal and economic considerations, the taxation system is expressed in the way that makes a distinction on the basis of residence of tax payers, respectively with regard to the place where their capital is invested. In spite of considering the discriminatory effect of this provision, it will be applicable only with respect to the protective tax provisions which exist at the end of 1993. The Declaration, which adopted after Maastricht Treaty was signed, determines that national tax law will apply only to internal aspects of capital movements. In other words, the relevant tax provision will not be

[37] Para 43 of the judgement.
[38] Article 73(b) EC Treaty.
[39] Case 172/80 *Zuchner v Bayerische Vereinsbank* [1981] ECR 2021.

applicable to the free movement of capital to or from third countries.[40] The legal aspect of this exception may be justified on monitoring basis and the right of Member State to protect own interest and coherence of the tax system.

Other restrictions were for the first time envisaged in the Maastricht Treaty on European Union. Again, the protection of public policy and public security could be compared with the Article 30 EEC on the free movements of goods and prohibition of non-economic restrictions.[41] In another Case *Campus Oil v Minister for Industry and Energy*[42], the Court declared that

"*Member State cannot be allowed to avoid the effect of measures provided for in the Treaty by pleading the economic difficulties caused by elimination of barriers to intra Community trade"*

The economic policy shouldn't be in the same line with the interest to the effective administration and enforcement of the tax system and the effective supervision of financial institution.[43] In the estimation of the restrictions applicability under national law, it must determine whether the matter in issue is regulated by Community law.[44] In that case, Community law prohibitions against free movement of capital will apply.

According to the Article 73(d)(3) all procedures and measures shall not constitute a means of arbitrary discrimination or disguised restrictions on free movement of capital and payments. In analogy to Article 30 EEC, principles of non-discrimination between domestic products and those in relation to import and export is applicable to the interpretation of provision of capital freedom. In order to avoid being categorized as disguised restrictions, Member States shall envisage restrictive measures more favorable to intra- Community Trade.[45]

[40] Declaration (No 7) on Article 73(d).
[41] Case C- 7/61 *Commission v Italy*, [1961] ECR 317, 329.
[42] Case C- 72/83 *Campus Oil Ltd.* ***v****. Minister for Industry and Energy (1984)* ECR 2727.
[43] John A. Usher, *The Law of Money and Financial Services in The European Community,* Claredon Press, Oxford, 1994 ,34 36.
[44] See Case 28/84 *Commission v. Germany* [1985] ECR 3097.
[45] See Case 124/81 *Commission v United Kingdom* [1983] ECR 203.

## 4. CAPITAL MOVEMENTS –DEFINITION AND PURPOSE OF ITS LIBERALISATION

There is no specified definition in the Treaty on the Functioning on European Union (TFEU) of "movement of capital". I should start my examination with Council Directive 88/261/EEC. It follows from the "Nomenclature of the Capital Movements Referred to in Article 1 of the Directive" annexed to the Council Directive 88/361/EEC[46], that capital movement should be categorized but this time different from the First Capital Directive in the sense of level of liberalization[47] and the fact that First capital directive didn't include third countries.[48]

The nomenclature is a 'non- exhaustive list for the notion of capital movements'. The list includes foreign direct investment, real estate investment or purchases, securities investment (bonds, bills, shares), granting of loans and credits and other operation with financial institution. What is in common for all categories is that they are a very indispensable link in international economic integration that are based on cross-border relation between investors and enterprises.

The Directive determine capital movements as ' unilateral financial operations between Member States or one Member State and a third country essentially concerned with the investment of the funds in question rather than remuneration for services, goods and provision of capital'.[49] Nowadays the notion of 'unilateral' was no longer imprecise in sense of interpretation, since the distinction between capital and payments movements were fully liberalized. The exception can only be made with respect to third country relations according to the Article 64 TFEU.

As has been noted, capital movements encompasses financial transactions not only Member States, but also between Member States and third countries. By the same token, cross-

[46] Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty [1988] OJ L178/5-18.
[47]Sideek Muhamed " European Community Law on Free Movement of Capital and the EMU"The First Capital directive issues to implement Article 67(1) EEC categorized Capital into different lists and subject them to varying degrees of liberalization. The overwhelming majority of the items found these lists refer to financial assets. It is true that it also include non-financial assets in List A, such as death duties, dowries, gifts and endowments but it should be read in conjunction with Article 1 of the Directive which directs the Member State to grant "all foreign exchange authorizations" for their free movement. The reference to "exchange authorization" makes it a pre-condition to convert such transaction into financial assets to benefit under Directive
[48] Article 8 of the First Capital Directive.
[49] Joined Cases C-268/82 and C-26/83 *Graziana Luisi and Giuseppe Carbone v Minstero del Tesoro* (1984) ECR 377, (1985) 3 CMR 52, para 20.

border element is linked to the place where capital is invested, capital movement from state A to state B. The notion of transaction is broader than simple transfer of capital from one state to another. All contracts on which the transfer is based will be involved.[50]

The capital movement definition set the ‘investment character’ as a condition for the financial operation to fall within the scope of capital movements.[51] It the comparison with other criteria, ‘investment character’ also carries out the basic principle of capital freedom covered by the Article 63 TFEU.[52] Equally important to emphasize is that capital movements of personal character such as inheritances, dowries, etc. constitutes capital freedom in the light of Article 63 TFEU. Must be remembered that all factors in the individual case must be assessed due to the aim of optimizing capital allocation to the greatest extent possible and to establish effective capital freedom provision.

The scope of capital liberalization comprises essential interest of EU’s citizens, companies and governments, which are complementary and improve the functioning of European financial market and services.

The investor interest is primarily the investment safety in non-domestic companies or buying real estate, and for big, small and medium-sized companies the potential not only to invest in and own other companies, but also to participate in their management and prospective industrial development.

As regards EU’s citizens, they also benefit from the actions of investors such as new employment possibilities. They are able also to freely transfer their financial assets and conduct many operations abroad.

Europe’s governments are entitled to borrow money with more favorably rates and satisfy public necessity. In respect of the funding in form of loans and grants provided by the European Union, the complexity of funding itself should be complemented with the principle of transparency. The European Commission, in cooperation with national governments, is responsible for the monitoring of consumption of EU funds. Two main types of funding are

[50] Hindelang Steffen, The free movement of capital and foreign direct investment, Oxford Univ. Press, 2009, 52.
[51] Joseph J. Cordes, Robert D. Ebel, Jane G. Gravelle, Taxation & Tax Policy (2nd edn, The Urban Institute Press, 2005) The ‘investment character’ as intention to realize profits with a certain transaction.
[52] Hindelang Steffen, The free movement of capital and foreign direct investment, Oxford Univ. Press, 2009, 56.

grants for specific project and public contracts to buy services, goods or works to ensure the operations of EU institutions or programs.

## 5. LEGAL FRAMEWORK OF CAPITAL FREEEDOM

Free movement of capital presents one of the Internals Market “four freedoms” and gives huge contribution to the functioning of Internal Market especially to development, openness and efficient European financial markets and services. It has the broadest scope in the sense that

According to Article 26(2) TFEU “The internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provision of the treaty”.

The fundamental legal sources on the regulation on the free movement of capital are Provisions of the Treaty on the Functioning of the European Union (TFEU), Protocols and declarations and Transitional measures or other provisions foreseen in the Acts of Accession. An impact on free movement of capital also have the Secondary Legislation, the Court of Justice of European Union (CJEU) and European Commissions Interpretative Communications. The exceptions on the free movement of capital can be divided into exceptions foreseen in the Treaty and the exceptions based on the Case law of the Court of Justice also in relation to Treaty provision.

Overview of the main Treaty provisions regarding free movement of capital and payments consist of four articles. Article 63 TFEU prohibits restrictions on free movement of capital and payments, covering movements from third countries. Article 64(1) TFEU provides exceptions for restrictions exist prior to 1993 in relation to third countries. Second paragraph authorize EU legislation again with respect to third countries. Article 65 TFEU continues with justifications for restrictions imposed by Member States. The last article regarding capital freedom constitutes authorization for the Council, on a proposal from the Commission, to take safeguard measures with regard to third countries in case of economic and monetary union turbulences.

In respect to personal scope of the application, any natural or legal person is allowed to invoke main Treaty provisions. The nationality criterion is not relevant in this case.

Notwithstanding the broad scope of the application of Article 63 TFEU, both on capital and payments, Articles 64, 65(1)(a) and 66 TFEU do not apply for the restrictions of payments.

### 5.1- General principle on the free movement of capital in TFEU

Treaty of the Functioning on the European Union provides general principle on the free movement of capital, exceptions and sanctions (Article 75 and 215 TFEU) on free movement of capital.

The main provision, that set out fundamental principles of capital freedom, is the Article 63 TFEU. This article consist of abolition of restriction on movements of capital and payments as a main objectives of Internal Market. As was foreseen in *Sanz de Lera* case article 63 TFEU is directly applicable with no need for further implementing legislation.[53] In addition it has a general nature, that covers the scope beyond the discriminatory protection.[54]

From the first paragraph of the Article "all restriction on the movement of capital between Member states and between Member States and third countries shall be prohibited". Cross-border element represents the requirement for the application of Article 63 TFEU. Another key point is that third country relations are also covered by this provision.

The second paragraph continue with the abolition of restriction on payments, between Member States and Member states and third countries, which is the primary objective to make cross-border payments easily with equal legal conditions and charges. Since the Single Euro Payments Area introduced its benefits, it would be possible to buy and make other cash payments anywhere in Eurozone like in your own country.[55] This provision made a huge headway to the global aspect of economic integration. This paragraph also is broadly interpreted , since the capital movement is detached from nationality and residence criteria, covers capital

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[53] Case C-163/94, *Sanz de Lera* [1995] ECR I-4821.
[54] See Case C-101/05 Skatteverket v, SS21). And C-367/98, Commissiion/PortugalS 440.
[55] http://ec.europa.eu/finance/payments/sepa/index_en.ht

freedom also in respect to third countries, the Court interpreted capital definition widely and restrictions on free movement of capital strictly.

Important to realize is that also both home and host state should not implement the restriction in sense of discriminating residents from persons established in another Member State. In the *Sanoz* case Court found that the provision "discriminates according to place where the loan is contracted". [56] Equally important is absence of explicit implication of whether Article 63 TFEU applies to non-state actors. In order to solve the issue concerned, actions of non-state actors are not considered appropriate to fall within the scope of application of the Article 63 TFEU.

## 5.2 – Exceptions to free movement of capital

The Treaty on the Functioning in the European Union (TFEU) divided exceptions into General and Specific exceptions of the free movement of capital and payments.

### 5.2.1- General exceptions

The group of general exceptions consist of restriction on property ownership exception[57], national security and defence exception[58] and financial sanctions exception.[59] With respect to property ownership exceptions and according to the Article 345 "The Treaties shall in no way prejudice the rules in Member States governing the system of property ownership". Although the Article 345 is mostly applicable to expropriation cases, this principle has the value also in respect to regulating privatization measures. Given these points, Member State shall not be excluded from the privatization of the firm, since it represents one of the public essential economic interest.[60]

[56] Case C- 439/97 *Sandoz* [1999] ECR I-7041.
[57] Article 345 TFEU.
[58] Article 346 TFEU.
[59] Articles 75, 215 TFEU.
[60] Provisions of the Treaty of the Functioning of the European Union, http://ec.europa.eu/finance/capital/framework/treaty/index_en.htm

The European Court of Justice, taking into account landmark decision on special rights, that "Member States are not entitled to plead by way of justification for obstacles, resulting from privileges attaching to their position as shareholder in a privatized undertaking, to the exercise of the freedoms provided for by the Treaty".[61] Important to realize is that Member States may not have the influence out of the capital freedom framework in the period after the privatization process of the public company.[62]

In the center of Article 345 TFEU laid down the expropriation exception, which is the best way possible to assess through the European Court of Justice judgments. The Court held in Annibaldi case[63] that "the absence of specific Community rules on expropriation" would lead to the exclusively competence of national measure of the Member State regarding issue concerned.[64] In the second case *EFTA Surveillance Authority v The Kingdom of Norway*[65], the EFTA Court found that Member State may "legitimately pursue the objective of establishing a system of public ownership over these properties, provided that the objective is pursued in a non-discriminatory and proportionate manner".[66] In addition the Court noted that rules need to fulfil the requirements under the principle of proportionality.[67] The European Court of Justice applied also non-discrimination principle with respect to property ownership system.[68]

With respect to National Security and Defence provisions, Treaty on the Functioning on the European Union declared Member State right not to provide information, which may be harmful for the security of the State.[69] In addition, Member State takes all necessary measures in order to protect substantial interests of its security concerning production of or military equipment, with attention to conditions of competition that may be affected by measures concerned.[70] Financial sanctions exceptions will be discuss in the chapter regarding third country exceptions.

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[61] *Ibid.*
[62] *Ibid.*
[63]Case C-309/96 *Annibaldi* [1997] ECR I-7493.
[64] *Ibid*, para 23.
[65] E-2/06 - EFTA *Surveillance Authority v The Kingdom of Norway*.
[66] *Ibid*, para 72.
[67] *Ibid*, para 81.
[68] Case C-182/83 *Fearon v Irrish land Commission* [1984] ECR 3677, para 7.
[69] Article 346 (1) (a) TFEU.
[70] Article 346 (1) (a) TFEU.

### 5.2.2. - SPECIFIC Exception

The specific exceptions laid down Articles 64 and 65 TFEU. The Article 64 TFEU concerning exclusively third country restrictions (grandfathered provision). On the other hand Article 65 TFEU applies not only on intra-Community, but also on third country relations. The article foresees Member State allowance to distinguish taxpayers on the basis of their non-residence and foreign investment and indeed to prevent infringement of national law.[71] Apart from tax differentiation, another instrumentality for Member States to prevent the infringement of national law, are prudential supervision of financial institution and protective measures justified on grounds of public policy and security.[72] In the next chapter will discuss about justification for exceptions concerned.

## 6. EXCEPTIONS AND JUSTIFICATION OF EXCEPRIONS

### 6.1- Introduction

As can be seen from the Article 65(1)(b) TFEU, Member States may take measures to restrict the capital freedoms on the basis of justified reasons. In addition, it was indicated in by the Court of Justice and provided in Article 52 TFEU, the Member States may apply restrictions but only for 'objectively justified reasons'. The proportionality criterion has to be attained.[73] In cases of Konle[74] and Ospelt[75], the Court had different view concerning the purchase of agricultural land.

Although national land legislation provide protection of legitimate interest, in the Konle case that measures to control the use of second residence couldn't be accepted. The Court was explicit that each Member State has to ensure that individuals are provided for damage caused by

[71] Article 65(1) (a) TFEU.

[72] Article 65(1) (b), Paragraph 3 of Article 56 TFEU states, that such measures "shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital".

[73] F Weiss and C Kalupa, *European Union Internal Market Law (*first published 1946, Cambridge Univ. Press, 2014) 301.

[74] C-302/97 *Klaus Kolne v Republic Osterreich, [1999] ECR I-3099.*

[75] C-425/01 *Margarethe Ospelt and Schlosle Weissenberg Familienstiftung [2003] ECR I-9743.*

non-compliance with Community law and cannot plead the distribution of power between national bodies in order to free itself liability.

In the Ospelt case, Community law provisions do not require the absence of any prior authorization for the purchase. Restrictive measure, could be applicable, only if it would be necessary to provide the efficient involvement of the acquirer in respect of farm of land and its resident issue.

### 6.2- National champions-Golden Shares cases

Golden Shares cases represents cases in which Member States continue to be involved in the companies with great importance for the economic interest of the State. Before the *Commission v France* case in 2002, the Court has not rejected in the *Church of Scientology case*[76], according to the Article 65 (1b) TFEU, the prior authorization of foreign direct investment for reason of public policy or public security. The Court declared 'the difficulty in identifying and blocking capital once it has entered the Member State'[77], and accepted the restriction. The principle of legal certainty is put in question, since the scope of application Article 56 EC (now Article 63 TFEU) is not precisely determined with respect to protective measures taken by Member States. Church of Scientology case established strict approach in the interpretation of public security exceptions.

After the first judgment in relation to golden shares was delivered by Court of Justice of the European Union in a case against Italy[78], the "golden share" cases provide guidelines to the intellection of special rights of "national champions" and restrictive measures on direct investment.

In 2002 CJEU ruled on the cases brought against Portugal, France and Belgium.[79] In the first case brought against Portugal the Court refused to accept justification on limits of foreign direct investment. Member State is entitled, in specific circumstances, to have an impact within undertakings, which should be active in the fields of involving the provision of services in the

[76] Case C-54/99 *Assocition Eglise de Scientologie de Paris and Scientology International Reserves Trust v The Prime Minister[2000] ECR I-1335.*
[77] *Ibid*, para 20.
[78] Case C-58/99 *Commission v Italy* [2000] ECR I-3811.
[79] Joined cases C-367/98 *Commission v Portugal*, C-438/99 *Commission v France* and C-503/99 *Commission v Belgium* [2002] ECR I-4731.

public interest or strategic services. All actions of Member State must be in compliance with Article 295 EC (now Article 345 EC), which applicability shall not have negative impact on relation between Member States' property ownership and fundamental rules of the Treaty or exclude Member States from Treaty freedoms.

The national measures adopted by Member State are infringing in sense of restricting the acquisition, more than given number of shares, by investors from other Member States and forcing of prior authorization for achieving certain level of possession of national undertakings.

As long as the objectives of measures concerned do not fall within the scope of Article 58(1) EC (now Article 65 TFEU) cannot be justified, even if they are legitimate and necessary for the purpose of economic policy, strengthening position on the market and effective production.

The Court considered unacceptable Portugal action to safeguard "national champions" and justify obstacles to free movement of capital.

In the *Commission v France* Case C-438/99, French measures were only justified from the point of the "safeguarding of petroleum products in the crisis". As indicated in previous case, in special circumstances Member State may have an impact on undertakings in order to maintain proper provision of services in public interest or strategic services.

Although the French provisions were legitimate according to the criterion above, they constitute a restriction on movement of capital. The blurred nature of the rules on the competence of national authorities create legal uncertainty. French measures were not limited to the specified legal rules and measures and therefore cannot be justified.[80]

In the *Belgium* Case C-503/99, no infringement of the Treaty and capital freedom occurred. Belgium measures considered to be irreplaceable, since no alternative solution for safeguarding supplies of petroleum products in the event of a crisis was found.

All Belgian requisite measures to insure the gas supply were for the proper functioning of society and did not concern share transfers. Moreover, the Community law provisions have not been harmonized in this field.

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[80] Benyon, Frank S. Direct investment, national champions and EU treaty freedoms: from Maastricht to Lisbon, Oxford [u.a] : Hart, 2010, 35.

Nevertheless, the Court of Justice of European Union stipulated that all fundamental Treaty provisions must be interpreted narrowly and “those grounds must be those grounds must be interpreted strictly, so that their scope cannot be determined unilaterally by each Member State without any control by the Community institutions”.

The protection of ‘Golden Shares’ and advancement of financial capital assets of State may be acceptable but always subject to necessity and proportionality test. The *Woningstichting Sint Servatius* case[81] present another example of how Netherlands exclusive requirements relating to public housing policy and financing of that policy and barrier for investment in Belgium can be justified under Article 63 TFEU, since it presents prime public interest.

The situation was different in respect of ‘golden shares’ held by Dutch state in case *Commission v The Netherlands*[82], where special shares of prior approval of certain decisions were given to Netherlands. This State measures may constitute an impact over the management of enterprises, hence other shareholders would not be able to obtain the same level of influence as much as in the case of State withdrawal. Another key point, is that investment attraction could be effected, if the company interest does not concur with the Netherlands.

The Court also pointed out the possible justification of restriction in respect of postal services, as guaranteeing service of general interest. Undoubtedly, the provision of this services may constitute the overriding reason, but Court found the reason insufficient to prevail over the necessity and proportionality test.

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## 6.3- Ownership power

Another key point following from cases against Spain and Italy is that the ownership organization of company cannot be the only relevant criterion for the determination of how the company operates.

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[81] Case C-567/07 *Woningstichting Sint Servatius (*ECJ, 1 October 2009).
[82] Cases C-282/04 and C-283/04 *Commission v The Netherlands [2006] ECR I-9141*.

In *Commission v Spain* case[83], the Court was explicit in its statement that Spanish prior approval measures for share transferring with regard to tobacco and banking sectors, notwithstanding the Spain posses at least twenty-five percent of the share capital in company concerned. With this in mind, companies were 'not undertakings whose objective is to provide public service'.[84]

On the other hand, provision of petroleum, telecommunication and electricity may constitute a public security reason.[85] Important to realize is that even in the event of a crisis of supply of those sectors, the exercise of power of administrative authorities should be precisely determined. That objective was not reached in this case and therefore obstacle couldn't be justified.

The second *Commission v Spain*[86] case relates to alleged infringement of Article 49 and 63 TFEU, since undefined scope of Member States competence in relation to security of supplies would probably lead to different interpretation and application of free movement of capital provision. The prior authorization for acquisition of shareholding or assets is not measure capable of guaranteeing energy security.[87]

Reverence of proportionality criterion as regards veto power of share transfers in electricity, telecommunication and defence sectors companies, was not contended in *Commission v Italy* case.[88] In the same time, lack of precision, legal uncertainty between Italian measure and endorsement of veto were not in accordance with principles under Article 65 TFEU.

It follows from 'Golden Shares' cases that no general rule concerning justification of restriction could be established, even in respect of providing a service of general economic interest. On the other hand, principle of proportionality and fulfilment of the requirements from Treaty have to be achieved in each case

[83] Case 463/00 *Commission v Spain* [2003] ECR I-4581.
[84] *ibid*, para 70.
[85] *i*bid, para 71.
[86] Case C-207/07 *Commission v Spain* (ECJ , 17 July 2008)
[87] *Ibid*, paras 51,54.
[88] Case C-326/07 Commission v Italy (ECJ, 26 March 2009).

# 7. DIRECT TAXATION IN RELATION TO FREE MOVEMENT OF CAPITAL

## 7.1- Treaty Provisions

General Treaty provisions on free movement of capital allows different tax treatment of non-residence and foreign investment.[89] By all means, the measures and procedures shall not constitute a means of arbitrary discrimination or a disguised restrictions in respect to capital freedom.[90]

For the proper understanding of the view of Court in two following cases concerning tax measures, an essential parts are the principle of prohibition of restriction and their justification. The rule of reason doctrine applies to non-discriminatory restrictions, which can be concluded from Gebhard Case.[91] Indirect discrimination may also fall within the scope of this doctrine, although the interpretation is not so clear in relation to this matter.[92]

The indirect discrimination which was justified on the ground of coherence of fiscal system occurred in *Bachmann* case.[93] Although this ground of justification has been many times analyzed, the fiscal coherence personify the criterion for the justification.

Mr. Bachmann, German citizen, was rejected to make deductions for payments concerning sickness, invalidity and life insurance contract. The Court pointed out that Belgian measure 'may operate to the particular detriment of those workers who are, as general rule, nationals of other Member States'.[94] The logical explanation of the Court was that employed person would normally have concluded their insurance contracts in their home Member State. Most compelling evidence that Court declared was that German insurances would not be taxable in Belgium.[95] The Court stipulated that

"*The cohesion of such a tax system, the formulation of which is a matter for each Member State, therefore presupposes that, in the event of a State being obliged to allow the*

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[89] Article 65 (1) (a) TFEU.
[90] *Ibid.* para 3.
[91] Case C-55/94 *Gebhard vdifferent Consiglio dell' ordine degli avvocati e procuratori di Milano* [1995] ECR-4165.
[92] Mattias Dahlberg, Direct taxation in relation to freedom of establishment and free movement of workers, Kluwer Law International, 2005, 120.
[93] Case C-204/90, *Hanns-Martin Bachmann v. Belgian State* [1992] ECR I-249.
[94] *Ibid*, para 9.
[95] *Ibid*, para 23.

*deduction of life insurance contribution paid in another Member State, it could be able to tax sums payable by insurers*".

The case connected with fiscal coherence, where the ECJ struck down Finnish national measure, was *D*anner case from 2002.[96] Mr. Danner, after moving to Finland, didn't ceased to pay contributions to German insurance institutions. Even though he was also a Finland national, he was limited in his right to tax reduction concerning pension insurance contribution.

The Court was convinced that Finnish restriction would make infringement of both capital freedom and freedom to provide services.[97] Finland measure was liable to hinder fundamental freedoms in a way that hadn't fulfilled the essential non-discrimination principle. Therewithal, nationals from other Member States will be discourage to invest in the huge number of institution among European Union. Since less insured people want to pay contributions in Finland, less insurance institutions will establish themselves in Member State concerned.

*Danner* case stressed the importance of establishing common pension market.[98]

## 7.2 – Double Taxation

Double taxation occur when one income is taxed twice.[99] The most prominent examples are with respect to taxation of income on both corporate and shareholder basis, and in case of taxation in two different countries in respect to foreign direct investment.

In the European Union there is no general rule for avoiding double taxation. Member States are allowed, but not obliged to conclude double taxation treaties with each other. The main source for the matter concerned is an International tax treaty- OECD Model Tax Convention.[100] On the other hand the Council of the European Union issued Parent Subsidiary Directive 2011/96/EU in order to eliminate potential cross-border distribution of profits between a parent company and subsidiary which are both located in the Member States. The Directive

[96] Case C-136/00 *Danner* [2002] ECR I-8147.
[97] *Ibid*, para 29.
[98] http://ec.europa.eu/finance/pensions/iorp/index_en.htm
[99] http://www.investorwords.com/1558/double_taxation.html
[100] http://www.oecd.org/ctp/treaties/2014-model-tax-convention-articles.pdf

avoiding withholding taxes on dividends and double taxation of parent companies regarding profits of the subsidiaries. Another two Directives was adopted to regulate the elimination of unequal treatment of interest and royalties between enterprises in different Member State[101] and for the purpose of eliminating tax disadvantages in cross-border reorganization of enterprises in the EU.[102]

The problem referring to double taxation often arises in the design of cross-border dividends taxation. Originally the double taxation concerning dividends was considered permissible. On the contrary to the traditional tax system, some countries incorporated credit method for avoiding double taxation, hence provide tax credit for shareholders for corporate taxes pro rata with amount of the dividends.

The European Court of Justice issues several cases concerning inbound and outbound dividends. Inbound dividends are dividends paid by companies in one Member State to a domestic shareholder in another Member State.[103] In respect to inbound dividends received by individuals under tax system designed to eliminate double taxation, the ECJ ruled that the Dutch measure to apply exemption method regarding domestic dividends had the effect of making the investment in Dutch companies more attractive compared to foreign companies.[104] The Dutch investors would be discourage to invest in other Member States. The Netherlands' argument was not convincing, since the corporate and shareholder taxes Court considered as "two separate taxes levied on different tax payers".[105] The competence of the Netherlands should be confined to the determination of the level of shareholder tax, also with respect to non-discrimination of corporate taxes.

In the *Anneliese Lenz v. Finanzlandesdirektion für Tirol*[106] case Court also found that Austrian measure to tax dividends from domestic companies with favourable flat tax rate-25 percent, had the "the effect of deterring" regarding Austrians to invest abroad and thereby foreign companies to invest in Austria.[107] The Court also considered irrelevant for Austrian

[101] Interest-Royalty Directive 2003/49/EC.
[102] Merger Directive 2009/113/EC.
[103] Dividend Taxation of Individual Shareholders, www.linklaters.com
[104] Case C-35/98, Staatssecretaris van Financien v. B.G.M. Verkooijen, [2000] ECR I-4071.
[105] *Ibid*, para 58.
[106] Case C-315/02, Anneliese Lenz v. Finanzlandesdirektion für Tirol, [2004] ECR I-7063
[107] *Ibid*, para 20.

legislation to rely on revenue of the corporation's income in different Member State, since corporate and shareholder taxes were "two distinct taxes which affect different taxpayers".[108]

Outbound dividends are dividends paid by domestic companies in one Member State to shareholders in another Member State.[109] The European Free Trade Area (EFTA) Court in case *Fokus Bank v. Norway*[110] stipulated, relying on European Court of Justice judgments concerning inbound dividends, that the Norway may not confined shareholder credit to domestic shareholders, but also to broaden the scope to non-domestic shareholders.[111] The EFTA Court neither accept the Norwegian argument that the only purpose for the taxation of dividends of domestic shareholders was the assessment of equal treatment between domestic and outbound dividends.

In the *Margaretta Bouanich v. Skatteverket*[112] case, the Court held that Sweden might not continue to apply its legislation, which placed France in less favourable position than the Swedish shareholders. At the same time, the Court verified the supremacy of the essential principles of the European Law over tax treaty between France and Sweden.[113]

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# 8. THE DIRECT INVESTMENT, FOREIGN DIRECT INVESTMENT AND BILATERAL INVESTMENT TREATIES WITH RESPECT TO FREE MOVEMENT OF CAPITAL AND PAYMENTS IN THE EU

## 8.1 – Notion of the Direct Investment and Foreign Direct Investment.

From the economic point of view, direct investment eventuates when investor seeks to gain managing control over economic activities. In case of foreign direct investment investor seeks to gain managing control over economic activities but now in state different from his or her home state. The term foreign direct investment, with respect to Treaty of the Functioning of the

[108] *Ibid*, para 36.
[109] Dividend Taxation of Individual Shareholders, www.linklaters.com
[110] EFTA Case E-1/04, judgment of 23 Nov. 2004.
[111] Michael J. Graetz and Alvin C. Warren, Jr, Dividend Taxation in Europe: When The ECJ Makes Tax Policy, 2007 Kluwer Law International. Printed in the Netherlands, 24, http://www.researchgate.net/publication/228132350_Dividend_Taxation_in_Europe_When_the_ECJ_Makes_Tax_Policy.
[112] Case C-265/04, Margaretta Bouanich v. Skatteverket, [2006] ECR I-923.
[113] The issue concerned was admissible OECD Model Tax Treaty. See Commentary, OECD MTC, Art. 10, paras. 28, 31.

European Union, is practically applicable to relationship between Member State and non-Member State.

Direct investment can be defined as subcategory of capital add is highly disputed whether the assessment of transformation a portfolio investment[114] into a direct investment should be grounded on general and objectively justified conditions or the investor's intention is required as an additional criterion. Since the notion of direct investment is not described in the Treaty, only the Directive 88/361/EEC provides substantive contribution in the designation of its scope.[115] It comprises "investments of all kind by natural persons or commercial, industrial or financial undertaking, and which serve to establish or to maintain lasting and direct link between the person providing the capital and the entrepreneur to whom or the undertaking to which the capital is made available in order to carry on an economic activity".[116]

The Directive provides that natural person or other undertaking may participate effectively in the management of the company or in its control, in order to satisfy lasting economic links.[117] However, the current legislation on capital flow is quite different from the Directive. The interpretation is not based on putting transaction in one or another group, with the primary idea to cover capital freedom at whole.

As was aforementioned, investor is gaining managing control over economic activities and therefore must have a possibility to achieve his entrepreneurial goals.[118] The direct investment should place investor in desirable position with respect to decision making process. For the purpose of assessment the investor's position, no general rule for individual cases should be established.

In respect to third country capital movements, foreign direct investment and sufficient economic link is present if one of the party is a European Union resident or the benefit from the investment is resulted from the economic circumstances one of the Member State. Point often overlooked is that capital transaction within Member States contains sometimes also link to a third country. Nevertheless, that link does not always create foreign direct investment concerning

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[114] Portfolio investment is an investment made by investor who is not involved in the management of the company. This is in contrast to direct investment. www.investopedia.com

[115] Annex I, Explanatory Notes Directive 88/361/EEC.

[116] *Ibid.*

[117] *Ibid.*

[118] Hindelang Steffen, The free movement of capital and foreign direct investment, Oxford Univ. Press, 2009, 70.

European Union capital movements. Again, each situation is to be assessed individually. The interpretation of Articles 64 and 66 TFEU cannot restricted broadly capital liberalization, even though both are designed to protect essential interests of Member States. In case of Article 64 TFEU Member States endeavor to control over the system of rights of possession in the particular territory.[119] Article 66 TFEU entitle institutions of the European Union to restrict third country capital movements, including foreign direct investment, in case of serious difficulties for the operation of Economic and Monetary Union (EMU). Identically, regarding foreign direct investment, economic transaction acquires control of enterprise. With attention to Article 75 TFEU, conclusion concerning foreign direct investment definition is hardly to be achieved.

## 8.2 - The jurisprudence of the European Court of Justice with respect to BIT

The jurisprudence of the European Court of Justice was explicit in the explanation that Republic of Austria, Kingdom of Sweden and Republic of Finland did not follow the requirements stipulated by Article 307(2), [now Article 351 TFEU to eliminate their Bilateral Investment Treaties (BITs) which are incompatible with the relevant Treaty provisions. Those bilateral agreements would potentially infringe the adoption of measures by the Council in order to restrict free movement of capital and payments.[120]

In the following three cases, Court relied on Article 307 EC (now 351 TFEU) that "obliges the Member States to take all appropriate steps to eliminate incompatibilities with Community law which have been established in agreements concluded prior to their accession. Under that provision, the Member States are required, where necessary, to assist each other to that end and, where appropriate, to adopt a common attitude".

In the first case *Commission v Republic of Austria*[121], Commission considered unacceptable for the Republic of Austria to maintain bilateral agreements, and thereof prevent the inimitable application of the Community law among Member States. The Republic of Austria argued that incompatibility is hypothetical, if in the bilateral agreements are not incompatible

[119] The same purpose is pursued by the inclusion of the category of establishment.
[120] The Council may take restrictive measures under Articles 64 (2), 66, 75 TFEU.
[121] Case C-205/06 *Commission* v *Austria* [2009] ECR I-1301.

with the Council restrictive measures. Also, this statement was supported by the Federal Republic of Germany, the Republic of Lithuania, the Republic of Hungary and the Republic of Finland.[122]

Member States justified their reasons on the competence of the Council to exercise Article 351 TFEU, insufficient level of certainty with respect to alleged inconsistency and importance of the effective application of Community law rather than simple fulfilment of formal conditions.[123]

On the contrary, the Court pointed out that bilateral agreements are strict in sense that make no excuses in the application and therefore is impossible to achieve objectives contained in the Treaty. With this in mind, the Court stipulated that the Republic of Austria didn't take adequate measures to eliminate incompatibilities concerning capital transfer contained in bilateral investment agreement.[124]Consequences for the Republic of Austria with respect to investment protection of nationals abroad and attraction of foreign direct investment were adverse, since third countries were not so pleased with the idea to change the contractual conditions.[125]

The European Commission brought an action against Kingdom of Sweden[126], claiming that Kingdom of Sweden didn't eliminate incompatibilities regarding capital transfer in bilateral investment treaties. The facts of the case were no greatly different from the previous case, with attention to inability to apply Council measures, Court of Justice in its judgment declared that

"the periods of time necessarily involved in any international negotiations which would be required in order to reopen discussion of the agreements at issue is inherently incompatible with the practical effectiveness of those measures (unilateral restriction adopted by the Council) and the possibility of relying on other mechanisms offered by international law, such as suspension of the agreement, or even denunciation of the agreements at issue or of some of their provisions, is too uncertain in its effects to guarantee that the measures adopted by the Council

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[122] Univ. Prof Dr. Dr. h.c. Peter Fischer, Can the European Court of Justice foretell the future? Some Reflections on the Recent Judgment of 3 March 2009 in the Case Commission v. Republic of Austria, 5.
[123] *Ibid*, 6.
[124] Case C-205/06 Commission v Austria [2009] ECR I-1301 , para 45.
[125] Univ. Prof Dr. Dr. h.c. Peter Fischer, Can the European Court of Justice foretell the future? Some Reflections on the Recent Judgment of 3 March 2009 in the Case Commission v. Republic of Austria,9.
[126] Case C-249/06 *Commission v Kingdom of Sweden* [2009] ECR I-1335*;*

could be applied effectively". The Kingdom of Sweden was not successful in the fulfillment of its obligation under Article 307 EC (now 351 TFEU).

In the last case *Commission v Finland*[127], Court took the same view regarding issue concerned. It refused to accept the Federal Republic of Germany and Republic of Hungary intervention, which intended to accuse Commission for discriminatory approach regarding not taking actions against other Member States with similar situation.[128] The European Union legal system cannot realize reciprocity requirement in the field of application of European Union Law. Consequently, the Court again pointed out that Finland failed to accomplish its obligation under Article 307 EC (now 351 TFEU).

The Treaty of the functioning of the European Union also provide remedies if Member State has failed to fulfil obligations.[129] If the Member State doesn't follow the Commission opinion, the Court of Justice will be competent to solve the alleged infringement. In the event that the Court ascertains that Member State has failed to fulfil its obligation, appropriate measures must be taken. The Commission again may bring the case before the Court, complaining negligence of the Member State with respect to adjudicated obligations.[130] Although this may be true, Member State must be able to submit its observations of the case concerned.[131] Ultimately, the Court may impose a lump sum or penalty payments.[132]

From the three cases aforementioned is possible to conclude that no justification in respect to extension of application of Bilateral Investment Treaties between Member State and third country will be sustainable, if it does not comply with the Council measures taken on the basis of Articles 64, 66, 75 TFEU (ex-Articles 57(2), 59 and 60 (1) EC). May add for Austria _ Bud

[127]Case C-118/07 *Commission v Finland* [2009] ECR I-1301, I-1335 and I-10889.
[128] EU Law Blog, Bilateral Investment Treaties, Pre-Accession Agreements and Free Movement of Capital (and Reciprocity): Case C-118/07, http://eulaw.typepad.com/eulawblog/2009/12/bilateral-investment-treaties-pre-accession-agreements-and-free-movement-of-capital-and-reciprocity-case-c-11807.html.
[129] Articles 258 and 260 TFEU.
[130] Article 260, para 2.
[131] *Ibid.*
[132] Article 260, para 4.

# 9. THIRD COUNTRY EXCEPTIONS

The Treaty on the functioning of the European Union (TFEU) liberalizes free movement of capital not only in respect to Member States, but also to third country relations. As has been noted, the capital flow is subject to a various exceptions.

## 9.1- The Grandfathering Clause of Article 64 TFEU

The exceptions exclusively applicable to third countries capital movements are in particular stipulated in Article 64 TFEU. As can be seen from the wording of Article 64 TFEU, it does not apply to each third country capital restriction. Its scope of application consists of four categories of capital movements, hat are considered principal for the liberalization and comprehensive prosperity. These categories are direct investment, including in real estate, establishment; the provision of financial services and the admission of securities to capital markets. All things considered, Member States may take action for establishing criterion in order to assess whether capital movements fall within these categories.[133] The nature of the Article 64 TFEU may be interpreted as broad in sense that no proportionality criterion applied regarding capital liberalization in third country relations.[134] Equally important is the issue considering the relevant day for the each restrictions from national and Union to continue their applicability after '31 December 1993'.[135] The possible dates could be the date when the law was passed, entry into force or the date on which law effectively becomes applicable. The last date considered the most appropriate, since the aim of the Treaty and its provision is to enable the highest possible level of fundamental freedom esteem.

## 9.2- Direct Investment and Article 64(1) TFEU

As was aforementioned, the Treaty does not provide the definition of direct investment. The notion of direct investment should not be interpreted broadly and may be confined to 'The lasting and direct link between the person providing the capital and the entrepreneur to whom or

[133] Hindelang Steffen, The free movement of capital and foreign direct investment, Oxford Univ. Press, 2009, 277.
[134] *Ibid*, 278.
[135] *Ibid,* 294.

the undertaking to which the capital is made available in order to carry on an economic activity'.[136]

In the following two cases will discuss about possible different approaches with respect to whether dividend payments will constitute 'direct investment' within the Article 64 TFEU, and hereof whether dividend payments will be subject to broader scope of restrictions. Important to realize is that Article 64 TFEU departs from the general liberalization of capital and payments within Union law, since the rule will be applicable only to measures restricting the freedom of capital, not payments.

In the first case *Staatssecretaris van Financien v B.G.M. Verkooijen*[137] the Court considered the distribution of dividends as inseparable part of the capital movement and therefore restriction on dividend payments may be treated equal to capital movements.[138] The dividend payments were linked to portfolio investment and do not ensure the involvement of the investor in the management of the company.

In the line with dividend payments in issue are the *Test Claimants in the FII Group Litigation v Commissioners of Inland Revenue*[139]and *Winfried Holbock v Finanzamt Salzburg-Land* [140] cases. Different from the previous case dividend payments constitute the notion of direct investment, which entitle investor to attain managing control over economic activity. Consequently, the Court pointed out that in this cases Article 64 (1) TFEU will apply.

Under the circumstances that distinction between capital and payments movements is not so clear with respect to dividend payments, for that reason two possible approaches may be relevant. On the first place common rule for dividend payments and capital movements. Second possibility to place dividend payments within the scope of 'direct investment' and thus apply Article 64 (1) TFEU.

Equally important is the criterion relevant for the capital restriction, which shall be exclusively based only on measures derive from 'national or Community Law'.[141] Actually, law

[136] *Ibid, 291.*
[137] Case C-35/98 *Staatssecretaris van Financien v B.G.M. Verkooijen* ECR I-4071.
[138] *Ibid,* para 27.
[139] Case C-446/04 *Test Claimants in the FII Group Litigation v Commissioners of Inland Revenue* [2006] ECR I-11753.
[140] Case C-157/05 *Winfried Holbock v Finanzamt Salzburg- Land* [2007] ECR I-4051.
[141] Hindelang Steffen, The free movement of capital and foreign direct investment, Oxford Univ. Press, 2009, 284.

must be intended to the direct or portfolio investments. In event that the law does not cover the investment concerned, Article 64 TFEU will not be enforceable.

The individual cases are also considered relevant for the interpretation of the scope of the application of the law, since Member States, such as Germany and France, definitely support in their interpretations direct influence of the law on direct or portfolio investment. From the case already mentioned[142], it is possible to conclude that Mr Holcock's dividends were taxed in accordance with national law and therefore fall within the scope of Article 64 TFEU, "inasmuch as it relates to holdings acquired with a view to establishing or maintaining lasting and direct economic links between the shareholder and the company concerned and which allow the shareholder to participate effectively in the management of the company or in its control".[143]

Nevertheless, scope of the Article 64 TFEU should not be extended in a way that each Member State would have the competence to adjust the translation of the article to individual situations, in order to obtain certain economic benefits in the European Union Internal Market. Another key point is that Member State may not prevent other Member States to work for the benefit of other third countries and their investors. The European Union Internal Market represents the mechanism, which prohibits the dominant position of only one Member State to affect the third country penetration in the market.

Given these points, for a law to be covered by Article 64 TFEU, some goals have to be achieved. First, formal requirement regarding adopting procedure for the irrevocable rules. Second, law must be enforceable to direct investment and third country relation. Important to mention is that national tax rules will not be included in the scope of the Article 64 TFEU. Their scope of application is often blurred regarding differentiation between Member States and third countries.[144]

As has been noted, Member States may only apply restrictions regarding third country capital flow, if the restrictions concerned were effective before 31 December 1993. Third country investors may be in financial directives subject to condition, such as economic difficulties, to take up economic and management activities in companies within European

[142] Case C-157/05 Winfried Holbock v Finanzamt Salzburg- Land [2007] ECR I-4051.
[143] *Ibid,* para 37.
[144] Luca Ceroni, The European Union and Direct Taxation: A Solution for a Difficult Relationship, Routledge 2 Park Square, Milton Park, Abindgon, Oxon, OX14 4RN and Routledge 711 Third Avenue, New York, NY 10017, 2015, 78.

Union.[145] Restrictions adopted later than 31 December 1993 must not be taken into consideration. From the directives is difficult to conclude whether third country investors are entitled to establish a subsidiary in one of the Member State. If Member States introduced restrictions with respect to third country establishment of subsidiary, they must again comply with requirement concerning restriction to become effective before 31 December 1993.

Generally speaking the reciprocity principle is pertinent in relationship between Member States and third countries. According to the Directive 2000/12/EC two approaches are established in order to inform the Commission about all the subsidiaries of third countries' undertakings[146] and to assess the actual treatment of Community credit institutions in third countries as regards establishment and other financial activities.[147] The Commission have the competence to initiate the negotiation process with third country, if third country does not provide the same treatment as treatment received by the Community. In case that Commission failed to achieve preferred outcome, Council would decide on future measure.

Not only the in the financial, but also in the insurance filed the authority may reject authorization of primary establishment or subsidiary "if the laws, regulation or administrative provisions of non-member country governing one or more natural or legal persons with which the undertaking has close links, or difficulties involved in their enforcement, prevent the effective exercise of their supervisory functions''.[148] This restriction does not fall within the scope of Article 64 TFEU, since it was introduced after 31 December 1993. The reciprocity criterion would also apply in respect to insurance sector.[149] In respect to direct investment in European transport the situation is different. According to the Regulation 2407/92, the European air transport is saved for European Union Members States or nationals of Member States.[150]

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[145] Capital Requirements Directive 2000/12/EC.
[146] *Ibid,* Article 23.
[147] *Ibid,* Article 24.
[148] Proposal for a Directive of the European Parliament and of the Council on reinsurance and amending Council Directives 73/239/EEC, 92/49/EEC and Directives 98/78/EC and 2002/83/EC.
[149] Directive 2002/83/EC of the European Parliament and of the Council concerning life assurance.
[150] Regulation 2707/92, Article 4(2)

### 9.3.- The power of Article 64(2) TFEU

As has been noted, the prominent aim of capital provisions regarding relationship between Member States and third countries is to establish capital freedom to the greatest extent possible. According to the Article 64(2), the Council, after the proposal by the European Parliament, may adopt measures with respect to third countries, involving direct investment, provision of financial services or the admission of securities of the capital. For this reason, the qualified majority of the Council is required.

Important to realize is that group of measures found in Article 64(2) TFEU is not so extensive.[151] The Court of Justice in *Kadi* case[152] rejected the implementation of United Nations measure to freeze all assets of the persons from the list. The Court declared that international agreements have to comply with the constitutional principles of the Treaty, rule of law doctrine and autonomy of Union legal system.[153] By all means, restrictive measures do not fall within the meaning of Article 64(2) TFEU. In the next chapter, *Kadi* case will be considered with respect to financial sanctions and security policy.

In reality, Article 64(2) should be interpreted strictly. In the hope that measure taken by Council would not affect negatively capital freedom, measure that 'constitute step backward in Union law as regards the liberalization of movement of capital to or from third countries' must be unanimously accepted.[154]

Although from the initial glance is possible to conclude that provision primarily covers the interest of the Member States, the actual situation is quite different. Assuming that European investors seeking to get access to the third countries markets, they need sureness concerning legal regulation. Third countries are also striving to the same goal. On the basis of principle of proportionality, equal treatment of investors is becoming less elusive.[155]

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[151] Philipa Watson, Steiner & Woods EU Law, Oxford Univ. Press, 2012, 439.
[152] Cases C-402/05 P and C-415/05 P.
[153] "Joined Cases C-402/05 P and C-415/05 P, and C-401 Kadi and AlBaraakat", <http://courtofjustice.blogspot.com/2008/09/joined-cases-c-40205-p-and-c-41505-p-c.html> accessed 11 November 2008.
[154] Article 64 (3) TFEU.
[155] Hindelang Steffen, The free movement of capital and foreign direct investment, Oxford Univ. Press, 2009, 300.

The Article 64(2) TFEU encompasses both internal and external competences of the Union. In principal competence is 'without prejudice to the other chapters of this Treaty'. The legal instruments for exercising the competence are secondary measures[156] and international agreements and protocols.[157] In order to ensure international competence, it is not required to be explicit declared in the Treaty, nor secondary legislation.[158]

In the comparison with other Internal Market freedoms, there is no specified and comprehensive readiness, in order to alleviate obstacles regarding free movement of capital and payments. For the purpose of facilitating capital liberalization, European authorities rely on Article 114 TFEU.[159] Generally speaking, in spite of positive influence of Article 64(2) TFEU regarding capital liberalization, the unrestricted effect of the article has not been fully achieved.

### 9.4- Third country exceptions regarding Economic and Monetary Union

One of the central interests of the Union law is to ensure economic welfare and financial stability among Member States and lately between Member States and third countries. However, regarding third country relations the Union has to provide tool for restrictions in exceptional circumstances.

The Treaty of the Functioning of the European Union in Article 66 TFEU that

"*Where in exceptional circumstances, movement of capital to or from third country cause, or threaten to cause, serious difficulties for the operation of economic and monetary union, the Council, on a proposal from the Commission, and after consulting the European Central Bank, may take safeguard measures with regard to third countries for a period not exceeding six mounts of such measures are strictly necessary*''.

Important to realize is that the provision is strictly interpreted, since it applies only to capital movement to or from third countries, in cases of serious difficulties for the functioning of European and Monetary Union, and limitation of safeguard measures to a period of six mounts.

[156] Regulation 2271/96/EC.
[157] Partnership and Cooperation Agreements, WTO-related agreements, Energy Charter Treaty and Protocool.
[158] Hindelang Steffen, The free movement of capital and foreign direct investment, Oxford Univ. Press, 2009, 302.
[159] Philipa Watson, Steiner & Woods EU Law, Oxford Univ. Press, 2012, 440.

The notion of ‘serious difficulties’ is difficult to determine. According to the *Honrath* and *Molzhan* studies determination is based on ‘serious fiscal difficulties within one Member State suffice to activate Article 63 TFEU’.  On the other hand, I will support the view that general requirement, covering all similar cases, would not satisfy the objective of effective operation of the EMU. Therefore, each case should be assessed separately. Individual analyses would minimize inequality regarding enacting safeguard measures.

Article 66 TFEU is not explicit in the definition of which form of safeguard measure Council may take. The answer is complementary to the previous paragraph and the idea that safeguard measure could be taken in cases of ‘exceptional circumstances’ and ‘serious difficulties’ for the operation of economic and monetary union. For this reason, when taking safeguard measure the proportionality test and non-discrimination principle[160] must apply.

At the present time, nine countries of twenty-eight Member States of the European Union do not form part of the Eurozone and do not have representation in the European Central Bank (ECB). In the center of discussion are two question with respect to whether Article 66 TFEU applies to the Member States out of Eurozone, and whether the Eurozone countries would be exclusively entitled to vote within the Council on safeguard measures.[161] From my point of view, Article 66 TFEU should apply to all Member States irrespectively of their membership in the Eurozone, otherwise that would distort the unity of Internal Market and Union law, and would probably cause the recourse to the Member States which do not form part of Eurozone, With respect to voting rights within the Council on safeguard measures, it would be inconvenient to distinguish operation of monetary union from operation of the economic union.[162] Therefore, all Member States would be entitled to vote in the Council.

Another key point is that Council substantial discretion right should not be interpreted in its broadest scope. The most prominent cases in which Article 66 TFEU should not apply are economic crisis situations and speculation regarding the Euro as consequence.[163] The capital liberalization would be affected only in justified situations and for a limited period of time.

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[160] Article 18 TFEU.

[161] Grahn Ralf, “EMU: Balance of payments crisis and safeguard measures”, <http://grahnlaw.blogspot.com/2008/11/emu-balance-of-payments-crisis-and.html> accessed 23 November 2008.

[162] Hindelang Steffen, The free movement of capital and foreign direct investment, Oxford Univ. Press, 2009, 310.

[163] Peter-Christian Muller-Graff / Erling Selvig,, European Law in an Era of Crisis, BMW Verlag, 2012, 17.

## 10. FINANCIAL SANCTIONS AND SECURITY POLICY

Nowadays fight against terrorism represents one of the most problematic issues with respect suppression of terrorism activities and providing adequate sanctions In the light of establishing effective framework for the fight against terrorism and improved relationship between International and European law, the Treaty of Lisbon declared adoption of sanctions against individuals and group of non-State entities.[164]

Before the Lisbon Treaty, the EC Treaty only envisaged "the necessary urgent measures on free movement of capital and payments as regards third country concerned".[165] Individuals were not explicit declared as subjects of restrictive measures. In fact, before Lisbon Treaty de facto financial sanctions applied on individuals.[166]Nevertheless, particular provisions regarding individuals and terrorist organizations was for the first time pointed out in the Treaty of Lisbon.[167] In the past pillar structure of European Union, Council may only invoke measures based on police and judicial collaboration.[168]

Group of Articles 60 and 301 EC, were replaced by Articles 75 and 215 TFEU, which pointed out the benefit regarding individual and non-State actors liability. According to the Article 75 TFEU, the European Parliament and the Council, on the proposal of the Commission, may impose financial sanctions[169] on individuals and non-State entities regarding capital movements and payments, in order to prevent and combat terrorism and related activities. It may be interpreted that this provision refers to internal EU terrorist actions. On the contrary, Article 215(1) TFEU may refer to external EU terrorism activities. The primary aim is interruption and reduction of financial and economic relations with third countries. In the second paragraph of Article 215 TFEU, Council shall adopt restrictive measures also against natural or legal persons and non-State entities. Qualified majority is required from the High Representative of the Union for Foreign Affairs and Security policy.

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[164] Article 75 TFEU.
[165] Legal basis of Article 60 (1) and 301 TEC.
[166] Council Regulation (EC) No2488/2000 of 10 November 2000 imposing a freeze of funds on Mr. Milosevic and Serbian Representatives.
[167] Peter Van Elsuwege, "The Adoption of "Targeted Sanctions" and the Potential for Inter-institutional Litigation after Lisbon" < http://www.jcer.net/index.php/jcer/article/view/401>
[168] *Ibid.*
[169] Financial sanctions such as freezing of funds, financial assets, or economic gains.

.Generally speaking the aim of establishing Area of Freedom, Security and Justice (AFSJ) as essential principle of Article 75 TFEU must be viewed in the complementary manner, with respect to Common Foreign and Security Policy (CFSP), as governing principle of Article 215 TFEU.[170] In order to provide AFSJ, the Treaty provides adequate administrative measures concerning capital movements and payments.[171] In case of defining scope of competence of CFSP as "all areas of foreign policy and all questions relating to Union's security'' is possible to conclude that Article 215 would apply to activities outside the EU. Moreover, the Lisbon Treaty explicitly pointed out in Article 37 TFEU that Union may conclude agreements with International organizations in respect to Union's external actions. Although in the both cases protection against terrorism would be achieved, various difficulties arise with respect to differentiation between Article 75 and 215 TFEU. Under those circumstances, it would be hard to solve all the potential conflicts with respect to adoption and realization of foreseen measures and the exclusive competence of Article 75 or 215 TFEU. Although the distinction between Articles is blurred, both provisions are equally significant.

Important to realize is that, according to the Article 215 (2) TFEU, consulting role of European Parliament regarding individual sanctions is abolished.[172] As has been mentioned, according to the 215(1) TFEU, the Council is entitled to adopt restrictive measures against legal or natural persons. Different from the ordinary legislative procedure, which provides communion of Council and European Parliament in the adoption of measure[173], Article 215(2) declares the exclusive role of the Council in the adoption of necessary measures. All things considered, European Parliament will not be involved in the external Security policy and will not in that case imposed sanctions against individuals.

Up to the present time, the issue regarding relationship between Article 75 and 215 TFEU caused various discussions and conflicts. One of the most prominent case is *European Parliament v. Council*[174], where European Parliament did not approved the adoption of amendments to Regulation 881/2002 concerning restrictive measures against certain persons and

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170 Peter Van Elsuwege, "The Adoption of "Targeted Sanctions" and the Potential for Inter-institutional Litigation after Lisbon" < http://www.jcer.net/index.php/jcer/article/view/401>

171 Article 75 TFEU.

172 C-130/10 *European Parliamnet v. Council.*

173 Article 294 TFEU.

174 C-130/10 *European Parliament v. Council.*

entities associated with Usama bin Laden, the Al-Qaida network and the Taliban. Assuming that, according to 215 TFEU, Council will just inform the European Parliament about adopted measure, the European Parliament considered that the Article 75 TFEU would be convenient base for the amending Regulation 881/2002. As shown above, it would be very hard to define relevant criteria concerning the scope of application of both Articles.

From my point of view, the notion of security should be explicated as comprehensive and coeval way with respect to terrorism and related activities. The strict differentiation between internal or external aspects of security would not facilitate the actual fight against terrorism. Therefore, the true prevention and combating terrorism, and strong cooperation between EU and UN institutions would lead to the substantial results.

# 11. CONCLUSION

As can be seen free movement of capital and payments has been faced during the deregulation period with divers obstacles and challenges. Initially, the issues were based on the impediment regarding capital definition and direct effect of relevant Treaty provisions. Later, the effort to establish capital liberalization with respect to third countries was also confronted with slow improvement. Therefore, it was necessary to establish the effective framework for the proper interpretation and adequate implementation of constitutional acts. First in the line was secondary legislation contribution in sense of setting the principles such as direct effect of Treaty provision, supremacy and proportionality of Community law. After the Lisbon Treaty, the position of capital freedom has been finally placed in line with the contemporary economic endeavor to expand extroversion and trade in respect to internal and external aspect of European Union relations. Up to the present time, the jurisprudence of the European Court of Justice determined the effective stronghold, according to which all future cases would be examined. The aim of the European Court of Justice is to ensure the equal fulfilling of requirements in relationship between Member States and between Member States and third countries. Important to realize that without effective implementation of rules and reverence of the judgments of European Court of Justice, it would be impossible to establish inimitable mechanism, which would be able in each unexpected situation to provide the most suitable solution. Above all, free movement of capital and payments is the indispensable segment of each trade relations and important link in the cooperation between European and International institutions. Consequently in the focus of future studies, the greatest attention should be paid on establishing closer cooperation between the countries in all financial operations. The European Union may also try to integrate the solutions from the other legal traditions and compare their different approaches to various issues. With this in mind, the internal market and free movement of capital and payments as its part, will be ready for the challenges not only in the internal purview, but also in case of improving trade collaboration on global level and repression of negative economic crisis effects.

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