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Viewpoints



European *Erga Omnes* Liberalization on Capital and Payments in the EC Treaty

by *Luís Eduardo Schoueri*

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Among the fundamental freedoms provided for by the EC Treaty, the free movement of capital and payments (article 56) requires special attention, as it is the only European fundamental freedom that can be immediately applied to third countries (non-EU members). This freedom was already present as an aspiration in the very beginning of the European Community. Article 56 of the EC Treaty, incorporated in the European *Charta* as a result of the Treaty of Maastricht,¹ determines that:

¹The Treaty of Maastricht should be regarded as a consequence of the whole history of European integration, which began with the Treaty of Rome. In signing the Treaty of Rome, the six countries that formed the Community (France, West Germany, Italy, Belgium, the Netherlands, and Luxembourg) had already committed to harmonizing their national economic and monetary policies. After the Single European Act entered into force, it was clear that a European goal was the

(Footnote continued in next column.)

1. Within the framework of the provisions set out in this chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited. 2. Within the framework of the provisions set out in this chapter, all restrictions on payments between Member States and between Member States and third countries shall be prohibited.

The possibility of applying this freedom to third countries raises several questions, such as:

- To what extent may third countries' nationals make use of this freedom?
- Does article 56 of the EC Treaty provide for an *erga omnes* liberalization?
- Is there a different scope regarding third-country situations?

One should realize the relevance of this discussion to third countries when direct taxation is concerned. Issues of member states' tax law, such as

creation of a single market, which should be "an area without internal frontiers in which the free movement of goods, persons, services and *capital* are ensured in accordance with the provisions of this Treaty." The necessary capital liberalization to implement the single market was set out in Directive 88/361/EEC. It was not only designed to give the single market its full financial dimension, but also enshrined the principle of full liberalization of capital movements effective July 1, 1990, both between member states and with third countries (*erga omnes* liberalization).

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CFC rules, exit taxes, group relief, and limitation on benefits clauses, directly affect third countries on investments that are connected with the European market — inbound to the EU, or outbound from the EU to third countries. These issues can all be affected by the application of the freedom of capital movements, as long as it is interpreted on its broader scope.

Thus, the *erga omnes* liberalization of capital and payments means that article 56 directly and unilaterally provides this freedom to third countries.

In light of the provisions and scope of the EC Treaty, as well as the literature² and case law on the subject, one can list the following main arguments when discussing the *erga omnes* liberalization:

Argument Basis	For	Against
I. Scope and wording of article 56	Clear wording; broad and single scope	Wording depends on scope; narrow and double scope
II. Absence of reciprocity	Gains from unilateral liberalization	No reciprocity from third countries: restricted freedom
III. Transactions' scope	Directive 88/361/CEE, Annex I	Financial transactions only
IV. Relevance to the European market	<i>Erga omnes</i> freedom is necessary for euro and internal market	Euro and internal market only demand currency freedom in relation to third countries
V. Relation to other freedoms	Unlimited by other freedoms	Limited by other freedoms
VI. ECJ case law	<i>Sanz de Lera</i> <i>Fidium Finanz</i>	<i>Fidium Finanz</i>

There is an extensive debate on each of these topics, which can be summarized below.

I. Scope and Wording of Article 56

All the discussion about article 56 and its extent can be somehow related to the broader debate regarding the scope of the freedom of capital and payments. One might say that an *erga omnes* liber-

²Several arguments analyzed in this article have been discussed by the national reporters present at "The EU and Third Countries: Direct Taxation" conference, held in Vienna on October 12-14, 2006.

alization would go beyond the scope of article 56 and of the EC Treaty as a whole, as the treaty is meant for the creation of an economic regional arrangement and not for unilateral liberalization toward countries outside the arrangement. Thus, article 56's wording should be interpreted according to this scope and the freedom of capital and payments would be more limited when third countries are involved compared with those involving only member states.

Nevertheless, the wording of article 56 is particularly clear when applying the freedom to third countries in the same manner as to member states, thus not requiring any interpretation of the treaty's scope. As a matter of fact, when the EC Treaty intended to restrict the application of article 56 for third countries, it was done clearly in articles 57, 59, and 60.

Moreover, even if the scope is taken into account, it seems that the *erga omnes* liberalization would be according to — and demanded by — the scope of the EC Treaty, because an unlimited commercial expansion has been envisaged ever since the Treaty of Rome. Historically, markets were conquered through war. Now integration's main objective is a new means of expanding markets, created by the European nations in a postwar context.

To achieve this goal, the increase of the European market must be unlimited. The European Community itself should be understood as a step toward a universal market's integration. In this sense, a political union in Europe would be more of a failure than an achievement of the community's goals, as it would limit the market's expansion, frustrating integration's main purpose.

Also, individual cases of unilateral liberalization, such as in Chile,³ show that countries that open their economies have gains. The liberalization of markets has been an international goal since GATT's elaboration. GATT encourages the constitution of regional arrangements, since it allows an exception to its most favored nation treatment when the privileged treatment between two or more of its members derives from a regional arrangement between the members. The reason for the exception is the belief that regional agreements are just a step on

³Chile is a good example of an open economy integrated in global markets. The military government in 1973 first promoted the liberalization movement. In 1985 the democratic government came into power and continued the trade and investment liberalization policy. Chilean trade and investment policy includes unilateral and multilateral reduction of tariffs, elimination of nontariff barriers, a uniform treatment of all sectors of the economic activity, and a nondiscriminatory treatment of foreign investors.

the way to a mature global economic integration.⁴ Considering that the liberalization envisioned by GATT represents a trend of international commercial practices, it is reasonable to assume that Europe would follow it.

Thus, Europe's true calling seems to be an unlimited expansion, with a constant conquering of markets through integration. Both the EU-Russia treaty and the EU-Switzerland treaty seem to confirm it, since the rights granted between EU nationals and the nationals of those countries do not differ from the fundamental freedoms granted to the EU member states.

If the actual scope of the EC Treaty is an unlimited expansion and liberalization, the *erga omnes* liberalization of capital and payments is not only in accordance with the scope, but necessary to its achievement.

II. Absence of Reciprocity

It does not seem adequate to argue that the capital liberalization for third countries could not be understood in the same manner as the liberalization among member states only because the reciprocity is lacking between member states and third countries. Both reciprocal and unilateral liberalization can be seen as a means of reducing the European Community's true goal of unlimited expansion and integration. Therefore, the absence of reciprocity should not compromise the application of a unilateral liberalization measure such as the *erga omnes* capital and payments liberalization.

III. Transactions' Scope

Next in the discussion about the scope of article 56, one should ask which transactions are covered by the freedom. One must refer to Annex I of Directive 88/361/CEE. This directive, which became effective on July 1, 1990, grants an unconditional liberalization of capital movements among the member states, which was considered essential for the proper functioning of the internal market. In this sense, the annex provides for a vast range of operations, such as direct investments, real estate, securities, and financial assets.

⁴Accordingly, it is true that the GATT allows regional agreements. This should not be seen, however, as a measure against full liberalization, but rather as a first step toward it. In other words, by entering into regional agreements, local economies will be better prepared to compete internationally and thus will also be able to profit from a broader liberalization. In this sense, a regional agreement needs to be seen as a means to stimulate strong economies capable of acting in a free international market.

Even though some may argue that the scope of transactions under article 56 is narrower when third countries are involved (that it covers only currency flows and does not protect direct investments or real estate), the application of the freedom to all of the cases foreseen by Directive 88/361/CEE Annex I (both to member states and third countries) is in harmony with the *erga omnes* scope of the freedom. That scope was already present in the directive, as it stated that "the Community shall endeavor to attain the highest possible degree of liberalization in respect of the movement of capital between its residents and those of third countries."

IV. Relevance to European Market

An *erga omnes* approach is often contemplated as essential to the strengthening and development of the euro and the European internal market. If these goals only require full capital liberalization among member states, it seems that they can be achieved in a much more efficient way if liberalization is implemented also for third countries.

Among the factors that permit a market and a currency to be strong, one should consider the economies in which the currency is employed and, furthermore, the freedom that foreign investors may be granted inbound and outbound. The *erga omnes* liberalization is much more capable of providing for those factors, as it would increase foreign investments in Europe and investments made in the euro, which would lead to a greater currency strengthening and market development.

V. Relation to Other Freedoms

Some may deny the *erga omnes* liberalization because extending the freedom of capital movements to third countries could not be as broad as granting other freedoms to third countries that are restricted to member states. Thus, one could not apply the freedom of capital to third countries in a manner that would also grant them, for example, freedom of establishment or services. This would leave only a few transactions to be covered by article 56.

Nevertheless, ECJ case law⁵ and literature⁶ do not accept hierarchy between the EC Treaty's freedoms. Their application should be nonexclusive,

⁵See the several cases mentioned by Schön in: Gocke, Gosch, and Lang (eds.), *Körperschaftsteuer — Internationales Steuerrecht — Doppelbesteuerung: Festschrift für Franz Wassermeyer zum 65. Geburtstag* (2005) p. 499. Also see *infra* note 7.

⁶See, with a summary of the literature, Schön in: Gocke, Gosch, and Lang (eds.), *Körperschaftsteuer — Internationales* (Footnote continued on next page.)

meaning the same situation may be covered by more than one freedom. This would give all freedoms the greatest protection, corresponding to the *effet utile* in interpreting the treaty. Therefore, the broad application of article 56 should not be avoided just because it would apparently grant to the third country other freedoms restricted to member states. If one freedom does not apply and another one does, the latter should be applied to its greatest extent.

VI. ECJ Case Law

Finally, the ECJ has relevant rulings on interpreting the extent of the *erga omnes* liberalization. The *Sanz de Lera* decision,⁷ for example, extended to third countries the *Bordessa* decision.⁸ In *Bordessa* there were rules that made the export of coins, banknotes, or bearer checks conditional on an administrative authorization and, in the absence of such authorization, subject to criminal penalties. The ECJ held that these rules were contrary to the freedom of capital and payment. While *Bordessa* was a member state situation, *Sanz de Lera* involved third countries. The Court had no problem extending the *Bordessa* decision to *Sanz de Lera*.

In the *Fidium Finanz* decision,⁹ the ECJ confirmed the possibility that two or more freedoms could be simultaneously applicable to a single and same situation. The ECJ has also said there is no order of priority between the fundamental freedoms.¹⁰ Therefore, the Court's reasoning on *Fidium Finanz* seems to lead to the conclusion that the freedom of capital and payments should not be restricted by other fundamental freedoms.

Steuerrecht — Doppelbesteuerung: Festschrift für Franz Wassermeyer zum 65. Geburtstag (2005), pp. 498-499.

⁷ECJ, joined cases C-163/94, C-165/94, and C-250/94, *Sanz de Lera and Others*, (1995) ECR I-4821.

⁸ECJ, joined cases C-358/93 and C-416/93, *Bordessa*, (1995) ECR I-00361.

⁹ECJ, C-452/04, *Fidium Finanz AG*.

¹⁰ECJ, C-452/04, *Fidium Finanz AG*, para. 32.

However, in *Fidium Finanz*, the ECJ held that the capital movement in question was only possible if a service was rendered first. In other words, the facts of the case showed that the capital movement was dependent on, or derived from, a previous service rendering. Thus, as it would only be possible to think about capital movement (and its related freedom) if the freedom to provide services were first granted, the latter freedom should be tested before. Since the freedom is granted only to member states, the ECJ held in this case that the national from a third country would not be protected by the EC Treaty.

It is clear that the ECJ did not rule in *Fidium Finanz* that other freedoms may limit the freedom of capital, but instead, solely that the facts of the case led to the conclusion that the capital movement was ancillary to the service rendering. Nevertheless, some hold this decision is a negative trend by the ECJ toward the *erga omnes* liberalization.

VII. Conclusion

Liberalization requires a major political decision that can take different forms and be put into practice in many ways. It may derive from negotiation between the partners in an economic arrangement or a multilateral treaty (such as GATT). In both cases, the liberalization would be based on a sinalagmatic relationship (*do ut des*) and thus only extend to the members of that arrangement, or treaty parties. Unilateral liberalization, on the other hand, does not depend on any sinalagmatic relationship, but can lead to good economic results if done properly.

It should not be surprising to find that the European Union, as an economic arrangement, is taking a step forward and providing, in addition to the fundamental freedoms among its member states, unilateral capital and payments liberalization to third countries.

Such liberalization points toward a new stage in the EU's evolution based on the cornerstone of its creation: to be an ever-growing global process that seeks peace through the conquest of markets by integration, rather than a stagnant political union. ♦