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Austria's Differential Treatment of Domestic and Foreign Intercompany Dividends Infringes the EU's Free Movement of Capital

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1. INTRODUCTION

There has always been dispute with regard to taxation on how the fundamental freedoms in the EC Treaty and secondary Community law, such as the EC Parent-Subsidiary Directive,[1] relate to each other. The question is basically whether or not secondary Community legislation may relieve national legislators from the responsibility of taking into account the effect of the fundamental freedoms on harmonized national law. This problem is especially evident in cases in which a taxpayer's situation is not covered by the personal or material scope of a directive or, if it is, the directive allows for a treatment that differs from that which is granted in purely internal situations.

In this article, the authors discuss these issues with regard to Austria's participation exemption regime, which was recently the subject of a judgment of the Tax Court of Linz (hereinafter: the Court) on 13 January 2005.[2] In this judgment, the Court held that the participation exemption regime granted to domestic distributions must be extended to cross-border inbound distributions received via an investment fund.

2. THE AUSTRIAN PARTICIPATION EXEMPTION REGIME AND COMMUNITY LAW

2.1. The Austrian participation exemption regime

The current Sec. 10 of the Austrian Corporation Tax Act (*Körperschaftsteuergesetz*, KStG), which was last amended by the Budget Supplementary Law 2003,[3] contains a twofold participation exemption regime.[4] Sec.

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1. Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, Official Journal of the European Union, 20 August 1990, L 225/6, as amended by Council Directive 2003/123/EC of 22 December 2003, Official Journal of the European Union, 13 January 2004, L 7/41.
2. UFS Linz of 13 January 2005, GZ. RV/0279-L/04 (not yet reported, but available on the web in German at ufs.bmf.gv.at/Entscheidungen/RV0279L04.pdf). The decision dealt with the special situation of foreign dividends that were being channelled through an investment fund under the "old" law prior to the Budget Supplementary Law 2003 (*Budgetbegleitgesetz* 2003), BGBl (Federal Gazette) I 2003/71, under which a holding in a foreign company had to be direct in order to benefit from the participation exemption, whilst an indirect holding was sufficient in the national context. The authors, however, discuss the general effect of the decision with regard to the current law.
3. BGBl (Federal Gazette) I 2003/71.
4. For this see, for example, Sabine Kristen and Thomas Passeyrer, "Internal Holding Regime Revised", 43 *European Taxation* 9 (2003), p. 326 et seq., Gerald Gahleitner and Roland Fugger, "Changes to Austria's Tax Law Affecting Holding Structures", 57 *Bulletin For International Fiscal Documentation* 11 (2003), p. 542 et seq.; Dietmar Aigner and Georg Kofler, "Internationale Schachtelbeteiligungen – Neuregelung durch das Budgetbegleitgesetz 2003", *ecolex* (2003), p. 485 et seq. and Clemens Hasenauer and Nina Schütte, "Neuerungen zur Besteuerung von ausländischen Kapitalerträgen und zum internationalen Schachtelprivileg in Österreich", *Internationales Steuerrecht* (2003), p. 845 et seq.

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10(1) of the KStG deals with national participations and provides for an exemption in respect of received profit distributions at the corporate shareholder level, irrespective of a minimum holding requirement or a holding period. Sec. 10(2) of the KStG, which is based on Art. 4 of the EC Parent-Subsidiary Directive and was first implemented into domestic law with effect from 1995,[5] governs inbound distributions from EU and third-country subsidiaries and grants an exemption if the Austrian corporate shareholder holds, directly or indirectly, at least 10% of the capital for a minimum holding period of one year.[6]

In addition, under Art. 1(2) of the EC Parent-Subsidiary Directive, the anti-avoidance provision in Sec. 10(4) of the KStG provides for a switchover to the indirect credit system if the foreign distributing company derives mainly passive income and is subject to low taxation in its country of residence. However, in contrast to the national participation exemption, under Sec. 10(1) of the KStG, capital gains and losses derived from the alienation, the appreciation or the depreciation of an international participation are treated as tax neutral, unless an election is made otherwise (Sec. 10(3) of the KStG).

2.2. The decision of the Austrian Court

In recent years, legal scholars in Austria have argued that the differentiation between a purely domestic situation and cross-border distributions constitutes an unjustifiable restriction, prohibited by the freedom of establishment contained in Arts. 43 and 48 of the EC Treaty and the free movement of capital contained in Art. 56 of the EC Treaty, as the case may be.[7] In its 38-page judgment of 13 January 2005, the Court endorsed this unanimous view and held that the differentiations amount to a prohibited restriction under EC law. Accordingly, the participation exemption granted to domestic distributions must be extended to cross-border inbound distributions in situations in which the requirements of Sec. 10(2) of the KStG are not met.[8] In this respect, it was not of decisive importance to the Court that, under Austria's international participation exemption regime, capital gains are also covered by the exemption, whereas, in a domestic context, gains realized on the sale of a holding are principally subject to "normal" corporate taxation.

2.3. Community law

2.3.1. Relevant ECJ judgments

Given the recent European Court of Justice (ECJ) judgments regarding the disadvantageous treatment of inbound dividend and interest flows in the cases of *Commission v. France*,[9] *Lenz*,[10] and *Manninen*,[11] the authors submit that the Court was correct in arriving at the decision described in 2.2. First, it is clear from the ECJ's case law that the cross-border flow of dividends is covered by the free movement of capital,[12] and also, if the participation exceeds a certain threshold,[13] by the freedom of establish-

5. BGBl (Federal Gazette) 681/1994.
6. Another main difference between the two regimes lies in the fact that any domestic company may benefit from the national participation, whilst, for the purposes of the international participation exemption under Sec. 10(2) of the KStG, the recipient company must maintain its accounts in accordance with Sec. 7(3) of the KStG.
7. Peter Haunold, Michael Tumpel and Christian Widhalm, "EuGH: Konzerninterne Übertragung von Verlusten unter Beteiligung ausländischer Gesellschaften", *Steuer & Wirtschaft International* (1998), p. 492; Claus Staringer, "Auslandsdividenden und Kapitalverkehrsfreiheit", *Österreichische Steuer-Zeitung* (2000/119), p. 31; Klaus Hirschler, *Rechtsformplanung im Konzern* (Vienna: Linde, 2000), p. 58 et seq.; Claus Staringer, "Dividendenbesteuerung und Kapitalverkehrsfreiheit", in Eduard Lechner, Claus Staringer and Michael Tumpel (eds.), *Kapitalverkehrsfreiheit und Steuerrecht* (Vienna: Linde, 2000), p. 103 et seq.; Gerd Konezny and Mario Züger, "Ist die internationale Schachtelbeteiligung 'europatauglich'?", *Steuer & Wirtschaft International* (2000), p. 218 et seq.; Michael Tumpel, "Europarechtliche Besteuerungsmaßstäbe für die grenzüberschreitende Organisation und Finanzierung von Unternehmen", in Jürgen Pelka (ed..), *Europa- und verfassungsrechtliche Grenzen der Unternehmensbesteuerung* (Cologne: Schmidt, 2000), p. 358; Gerald Toifl, "Besteuerung ausländischer Dividendeneinkünfte und Kapitalverkehrsfreiheit", *Steuer & Wirtschaft International* (2002), p. 466; Johannes Heinrich, "Der EuGH als 'Motor' der Harmonisierung der direkten Steuern im Binnenmarkt?", *Österreichische Steuer-Zeitung* (2002/970), p. 554 et seq.; Hans Blasina, "Internationales Schachtelprivileg und Gemeinschaftsrecht", *Steuer & Wirtschaft International* (2003), p. 14 et seq.; Dietmar Aigner, "Beschränkung der Niederlassungsfreiheit durch Nichtabzugsfähigkeit von Beteiligungskosten", *Steuer & Wirtschaft International* (2003), p. 63 et seq.; Reinhold Beiser, "Auslandsausschüttungen im Licht der Niederlassungs- und Kapitalverkehrsfreiheit", *Der Gesellschafter* (2003), p.197 et seq.; Georg Kofler, "Bosal: Abzugsverbot für Beteiligungsaufwendungen verstößt gegen die im Lichte der Niederlassungsfreiheit ausgelegte Mutter-Tochter-RL", *Österreichische Steuer-Zeitung* (2003/1175), p. 556; Dietmar Aigner and Georg Kofler, "Internationale Schachtelbeteiligungen – Neuregelung durch das Budgetbegleitgesetz 2003", *ecolex* (2003), p. 489 et seq.; Barbara Postl, "Methodenwechsel nach § 10 Abs 4 KStG gemeinschaftsrechtskonform?", *ecolex* (2004), p. 968 et seq.; Dietmar Aigner, "Inländische Investmentfonds und internationales Schachtelprivileg", *Steuer- und Wirtschaftskartei* (2004), p. 1008 et seq. and Dietmar Aigner, "ECJ – The *Bosal Holding BV* Case: Parent Subsidiary Directive and Freedom of Establishment", *Intertax* (2004), p. 150 et seq.
8. UFS Linz of 13 January 2005, GZ. RV/0279-L/04. Although the decision concerned Austria's participation exemption before the changes that apply from 2004, the Court itself stated that the same reasoning would apply to the amended rules described in 2.1.
9. ECJ, 4 March 2004, Case C-334/02, *Commission of the European Communities v. French Republic*.
10. ECJ, 15 July 2004, Case C-315/02, *Anneliese Lenz v. Finanzlandesdirektion für Tirol*. For comments on this decision, see Tatjana Polivanova-Rosenauer, "ECJ Rules on Austrian Discrimination of Foreign-Source Investment Income", 44 *European Taxation* 9 (2004), p. 416 et seq.; Dietmar Aigner and Georg Kofler, "Austria Clarifies Third Country Impact of ECJ's *Lenz* Decision", 36 *Tax Notes International* (1 November 2004), p. 477 et seq. and Georg Kofler, "Lenz: Österreich darf ausländische Kapitalerträge nicht diskriminieren", *Österreichische Steuer-Zeitung* (2004/757), p. 343 et seq. For prior coverage of the case, see Gerald Toifl and Tatjana Polivanova-Rosenauer, "Preliminary Ruling Requested from ECJ on Austrian Taxation of Foreign Dividends", 43 *European Taxation* 3 (2003), p. 87 et seq. and Markus Stefaner, "ECJ Advocate General Says Austrian Foreign Dividend Tax Regime is Discriminatory", 34 *Tax Notes International* (5 April 2004), p. 8 et seq.
11. ECJ, 7 September 2004, Case C-319/02, *Petri Manninen*. For a discussion on this case, see Lari Hintsanen and Kennet Pettersson, "The Implications of the ECJ Holding the Denial of Finnish Imputation Credits in Cross-Border Situations to be Incompatible with the EC Treaty in the *Manninen* Case", 45 *European Taxation* 4 (2005), p. 130 et seq.
12. See, for example, ECJ, 15 July 2004, Case C-315/02, *Anneliese Lenz v. Finanzlandesdirektion für Tirol*, Para. 16 et seq. and ECJ, 7 September 2004, Case C-319/02, *Petri Manninen*, Para. 18 et seq.
13. From the *Bosal* case (ECJ, 18 September 2003, Case C-168/01, *Bosal Holding BV v. Staatssecretaris van Financiën*, [2003] ECR I- 9409), it may be inferred that dividend flows covered by the EC Parent-Subsidiary Directive fall within the substantive scope of Art. 43 of the EC Treaty. In respect of this, see Joachim Englisch, "Fiscal Cohesion in the Taxation of Cross-Border Dividends (Part One)", 44 *European Taxation* 7 (2004), p. 324, note 15 and Wolfgang Schön, *"Europäische Kapitalverkehrsfreiheit und nationales Steuerrecht"*, in Wolfgang Schön (ed.), *Gedächtnisschrift für Brigitte Knobbe-Keuk* (Cologne: Schmidt, 1997), p. 750 et seq.

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ment.[14] As Austrian corporate dividend recipients are in a comparable situation irrespective of whether they receive domestic or foreign dividends,[15] the disadvantageous treatment of cross-border situations provided for by Sec. 10(2) of the KStG, compared to domestic situations, results in a prohibited (discriminatory) restriction of these freedoms, notwithstanding the level of foreign taxation and, therefore, may prevail only if this infringement is justified by the "rule of reason" (see 2.3.2.).

With regard to the freedom of establishment, this conclusion can also be inferred from the *ICI*, *X AB and Y AB*, *Baars*, *AMID* and *Bosal* cases,[16] which demonstrate that Community law precludes a Member State of the European Union from treating parent companies less favourably if these companies make use of their freedom of establishment by crossing a border by way of a subsidiary. In addition, the cases of *Bosal*[17] and *Lankhorst-Hohorst*[18] imply that differential treatment in the Member State of origin may not be based on where a subsidiary is liable to tax.[19]

2.3.2. The "rule of reason" and grounds for justification

Under the "rule of reason", a restrictive measure can be justified only if the provision at issue pursues a legitimate aim compatible with the EC Treaty and is justified by pressing reasons of public interest, i.e. objective factors other than nationality, and fulfils the three-prong proportionality test.[20] As the ECJ has frequently rejected justifications based on the protection of tax revenue[21] and the absence of reciprocity,[22] it might be possible to consider the coherence of the tax system as Austria's last resort for a justification in the case of differentiation between domestic and cross-border distributions under Sec. 10(1) and (2) of the KStG. In the early *Bachmann* and *Commission v. Belgium* cases,[23] the ECJ had held that a discriminatory provision could be justified by the public interest in preserving the fiscal coherence of a Member State's tax system. The ECJ has, however, subsequently shown great reluctance to accept the fiscal coherence justification and ever since has denied a justification based on this ground.[24] Under the stricter prerequisites for such a justification, a justification of a discriminatory measure on the grounds of "fiscal coherence" requires the existence of a direct link between the advantage and the disadvantage within the same tax system and at the level of the same taxpayer.[25] From this alone, it is clear that Austria may not rely on the fact that it is unable to tax the profits of the foreign distributing company in order to justify a disadvantageous treatment at the level of the domestic recipient company under Sec. 10 of the KStG.[26]

14. For the parallel application of both freedoms see, Michael Sedlaczek, "Der Begriff der Diskriminierung und der Beschränkung - die Kapitalverkehrsfreiheit als konvergente Grundfreiheit des EG-Vertrages", in Eduard Lechner, Claus Staringer and Michael Tumpel (eds.), *Kapitalverkehrsfreiheit und Steuerrecht* (Vienna: Linde, 2000), p. 46 et seq.; Norbert Dautzenberg, "Kapitalertragsteuer auf deutsche Dividenden an ausländische Kapitalgesellschaften EG-rechtswidrig?" *Betriebs-Berater* (2001), p. 2137 et seq. and Reinhold Beiser, "Auslandsausschüttungen im Licht der Niederlassungs- und Kapitalverkehrsfreiheit", *Der Gesellschafter* (2003), p. 187 et seq.

15. For this, see, for example, ECJ, 15 July 2004, Case C-315/02, *Anneliese Lenz v. Finanzlandesdirektion für Tirol*, Para. 32.

16. ECJ, 16 July 1998, Case C-264/96, *Imperial Chemical Industries plc (ICI) v. Kenneth Hall Colmer (Her Majesty's Inspector of Taxes)* [1998] ECR I-4695, ECJ, 18 November 1999, Case C-200/98, *X AB and Y AB v. Riksskatteverket* [1999] ECR I-8261, ECJ, 13 April 2000, Case C-251/98, *C. Baars v. Inspecteur der Belastingen Particulieren/Ondernemingen Gorinchem* [2000] ECR I-2787, ECJ, 14 December 2000, Case C-141/99, *Algemene Maatschappij voor Investering en Dienstverlening NV (AMID) v. Belgian State* [2000] ECR I-11619 and ECJ, 18 September 2003, Case C-168/01, *Bosal Holding BV v. Staatssecretaris van Financiën* [2003] ECR I-9409.

17. ECJ, 18 September 2003, Case C-168/01, *Bosal Holding BV v. Staatssecretaris van Financiën* [2003] ECR I-9409.

18. ECJ, 12 December 2002, Case C-324/00, *Lankhorst-Hohorst GmbH v. Finanzamt Steinfurt* [2002] ECR I-11779.

19. See also Frans Vanistendael, "*Bosal*?!" *EC Tax Review* (2003), p. 192 and ECJ, 15 July 2004, Case C-315/02, *Anneliese Lenz v. Finanzlandesdirektion für Tirol*, Para. 42.

20. See, for example, ECJ, 28 January 1992, Case C-204/90, *Hanns-Martin Bachmann v. Belgian State* [1992] ECR I-249, Para. 21 et seq.; ECJ, 28 January 1992, Case C-300/90, *Commission of the European Communities v. Kingdom of Belgium* [1992] ECR I-305, Para. 14 et seq. and ECJ, 3 October 2002, Case C-136/00, *Rolf Dieter Danner* [2002] ECR I-8147, Para. 33 et seq. and Para. 44 et seq.

21. See, for example, ECJ, 16 July 1998, Case C-264/96, *Imperial Chemical Industries plc (ICI) v. Kenneth Hall Colmer (Her Majesty's Inspector of Taxes)* [1998] ECR I-4695, Para. 28; ECJ, 8 March 2001, Joined Cases C-397/98 and C-410/98, *Metallgesellschaft Ltd and Others, Hoechst AG and Hoechst (UK) Ltd v. Commissioners of Inland Revenue and HM Attorney General* [2001] ECR I-1727, Para. 59; ECJ, 6 June 2000, Case C-35/98, *Staatssecretaris van Financiën v. B.G.M. Verkooijen* [2000] ECR I-4071, Para. 48; ECJ, 3 October 2002, Case C-136/00, *Rolf Dieter Danner* [2002] ECR I-8147, Para. 56; ECJ, 21 November 2002, Case C-436/00, *X and Y v. Riksskatteverket* [2002] ECR I-10829, Para. 50 and ECJ, 12 December 2002, Case C-324/00, *Lankhorst-Hohorst GmbH v. Finanzamt Steinfurt* [2002] ECR I-11779, Para. 36.

22. See, for example, ECJ, 28 January 1986, Case 270/83, *Commission v. French Republic (Avoir fiscal)* [1986] ECR 273, Para. 26.

23. ECJ, 28 January 1992, Case C-204/90, *Hanns-Martin Bachmann v. Belgian State* [1992] ECR I-276, Para. 21 et seq. and ECJ, 28 January 1992, Case C-300/90, *Commission of the European Communities v. Kingdom of Belgium* [1992] ECR I-305, Para. 14 et seq.

24. See, for example, ECJ, 14 February 1995, Case C-279/93, *Finanzamt Köln-Altstadt v. Roland Schumacker* [1995] ECR I-225, Para. 40 et seq.; ECJ, 11 August 1995, Case C-80/94, *G.H.E.J. Wielockx v. Inspecteur der Directe Belastingen* [1995] ECR I-2493, Para. 13 et seq.; ECJ, 14 November 1995, Case C-484/93, *Peter Svensson and Lena Gustavsson v. Ministre du Logement et de l'Urbanisme* [1995] ECR I-3955, Para. 15 et seq.; ECJ, 28 October 1999, Case C-55/98, *Skatteministeriet v. Bent Vestergaard* [1999] ECR I-7641, Para. 24; ECJ, 16 July 1998, Case C-264/96, *Imperial Chemical Industries plc (ICI) v. Kenneth Hall Colmer (Her Majesty's Inspector of Taxes)* [1998] ECR I-4695, Para. 29; ECJ, 26 October 1999, Case C-294/97, *Eurowings Luftverkehrs AG v. Finanzamt Dortmund-Unna* [1999] ECR I-7447, Para. 41 et seq.; ECJ, 13 April 2000, Case C-251/98, *C. Baars v. Inspecteur der Belastingen Particulieren/Ondernemingen Gorinchem* [2000] ECR I-2787, Para. 37 et seq.; ECJ, 6 June 2000, Case C-35/98, *Staatssecretaris van Financiën v. B.G.M. Verkooijen* [2000] ECR I-4071, Para. 49 et seq.; ECJ, 8 March 2001, Joined Cases C-397/98 and C-410/98, *Metallgesellschaft Ltd and Others, Hoechst AG and Hoechst (UK) Ltd v. Commissioners of Inland Revenue and HM Attorney General* [2001] ECR I-1727, Para. 67 et seq.; ECJ, 3 October 2002, Case C-136/00, *Rolf Dieter Danner* [2002] ECR I-8147, Para. 33 et seq.; ECJ, 12 December 2002, Case C-324/00, *Lankhorst-Hohorst GmbH v. Finanzamt Steinfurt* [2002] ECR I-11779, Para. 40 et seq. and ECJ, 26 June 2003, Case C-422/01, *Försäkringsaktiebolaget Skandia (publ) and Ola Ramstedt v. Riksskatteverket* [2003] ECR I-6817, Para. 30 et seq. For an extensive discussion of this, see Axel Cordewener, *Europäische Grundfreiheiten und nationales Steuerrecht* (Cologne: Schmidt, 2002), p. 958 et seq.

25. See, for example, ECJ, 14 November 1995, Case C-484/93, *Peter Svensson and Lena Gustavsson v. Ministre du Logement et de l'Urbanisme* [1995] ECR I-3955, Para. 15 et seq., ECJ, 26 October 1999, Case C-294/97, *Eurowings Luftverkehrs AG v. Finanzamt Dortmund-Unna* [1999] ECR I-7447, Para. 20 and ECJ, 26 June 2003, Case C-422/01, *Försäkringsaktiebolaget Skandia (publ) and Ola Ramstedt v. Riksskatteverket* [2003] ECR I-6817, Para. 30 et seq.

26. See especially ECJ, 15 July 2004, Case C-315/02, *Anneliese Lenz v. Finanzlandesdirektion für Tirol*, Para. 42.

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A final step must, however, be taken to exclude the existence of a justification. With regard to the free movement of capital, Art. 58 of the EC Treaty contains an express reference to permissible restrictions, whilst at the same time it prohibits arbitrary discrimination and disguised restrictions. Under Art. 58(1)(a) of the EC Treaty, the Member States retain the right

> to apply the relevant provisions of their tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested.

Art. 58(1) of the EC Treaty is, therefore, similar to Art. 30, Art. 40(3) and Art. 46 of the EC Treaty, in that it sets out the grounds for an express exception to the basic principle of free movement. Art. 58(3) of the EC Treaty, however, specifically states that the national provisions referred to in Art. 58(1)(a) of the EC Treaty do not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments, as defined in Art. 56 of the EC Treaty.[27] Until recently, the interpretation of these clauses was unclear.[28] The prevailing opinion amongst legal scholars, however, suggests that these provisions have a clarifying character.[29] Especially in the cases of *Verkooijen*,[30] *Lenz*,[31] and *Manninen*,[32] the ECJ has basically confirmed this view and classified Art. 58(1)(a) of the EC Treaty as a codification of its prior case law.

In these cases, the ECJ stated that national tax provisions of the kind to which Art. 58(1)(a) of the EC Treaty refers to could be compatible with EC law, provided that the provisions are applied to situations that were not objectively comparable or could be justified by overriding reasons in the general interest, in particular, in relation to the cohesion of the tax system.[33] Accordingly, if taxpayers are in comparable situations (as Austrian parent companies are in respect of distributions received from Austria or from abroad), Art. 58(1)(a) of the EC Treaty does not grant Austria any additional leeway beyond the "rule of reason" in justifying restrictive measures.

2.4. Summary and implications

To summarize, the differential treatment of domestic and foreign distributions entailed by Sec. 10 of the KStG infringes Art. 43 and/or Art. 56 of the EC Treaty, as the case may be. As a result, Austria is principally required to apply Sec. 10(2) of the KStG, especially the holding period and the minimum holding requirement, to distributions from EU companies[34] and also to grant an exemption in respect of these inbound distributions. This seems to be beyond controversy with regard to Austrian legal writing. Nevertheless, it is possible to speculate about the relationship between such an infringement and the implications of the EC Parent-Subsidiary Directive in these situations.

3. THE RELATIONSHIP BETWEEN THE FUNDAMENTAL FREEDOMS AND THE EC PARENT-SUBSIDIARY DIRECTIVE

3.1. The EC Parent-Subsidiary Directive and the Austrian Court's decision

The EC Parent-Subsidiary Directive exempts dividends and profit shares paid by a subsidiary of one Member State to its parent company in another Member State from withholding tax (Art. 5 of the Directive) and requires the Member State of the parent company to avoid the economic double taxation of the distributed profits (by granting a tax exemption or the provision of an indirect tax credit under Art. 4(1) of the Directive). To qualify, the parent company must generally hold at least a 20%[35] share in the registered capital of the subsidiary for a two-year period (Art. 3 of the EC Parent-Subsidiary Directive). Both companies must take one of the legal forms listed in the Annex to the EC Parent-Subsidiary Directive, be resident in the European Union for tax purposes and not be resident in a non-EU country in accordance with a tie-breaker clause in a tax treaty with that country, and be subject to corporation taxation without the possibility of an option to be exempt (Art. 2 of the Directive).

This said, it appears to be clear that Sec. 10(2) of the KStG, especially with regard to the holding period (one year) and the minimum holding requirement (10%) specified, conforms with the EC Parent-Subsidiary Directive. This, of course, raises the question of whether or not a taxpayer may nevertheless rely on the fundamental freedoms in a harmonized area if his situation is not covered by the personal or material scope of the EC Parent-Subsidiary Directive (for example, because the holding does not

27. See Art. 73d(1)(a) and Art.73d(3) of the EC Treaty prior to the Treaty of Amsterdam.
28. For an overview, see, for example, Michael Sedlaczek, "Der Begriff der Diskriminierung und der Beschränkung – die Kapitalverkehrsfreiheit als konvergente Grundfreiheit des EG-Vertrages", in Eduard Lechner, Claus Staringer and Michael Tumpel (eds.), *Kapitalverkehrsfreiheit und Steuerrecht* (Vienna: Linde, 2000), p. 51 et seq.
29. See, for example, Wolfgang Schön, "Europäische Kapitalverkehrsfreiheit und nationales Steuerrecht", in Wolfgang Schön (ed.), *Gedächtnisschrift für Brigitte Knobbe-Keuk* (Cologne: Schmidt, 1997), p. 768; Norbert Dautzenberg, "Die Kapitalverkehrsfreiheit des EG-Vertrages, der Steuervorbehalt des Art 73d EGV und die Folgen für die Besteuerung", 44 *Recht der internationalen Wirtschaft* (1998), p. 544; Hans Georg Ruppe, "Die Bedeutung der Kapitalverkehrsfreiheit für das Steuerrecht", in Eduard Lechner, Claus Staringer and Michael Tumpel (eds.), *Kapitalverkehrsfreiheit und Steuerrecht* (Vienna: Linde, 2000), p. 21 et seq.; Claus Staringer, "Dividendenbesteuerung und Kapitalverkehrsfreiheit", in Eduard Lechner, Claus Staringer and Michael Tumpel (eds.), *Kapitalverkehrsfreiheit und Steuerrecht* (Vienna: Linde, 2000), p. 106 et seq. and Ben Terra and Peter Wattel, *European Tax Law*, third edition (Deventer: Kluwer, 2001), p. 40 et seq.
30. ECJ, 6 June 2000, Case C-35/98, *Staatssecretaris van Financiën v. B.G.M. Verkooijen* [2000] ECR I-4071, Para.42 et seq.
31. ECJ, 15 July 2004, Case C-315/02, *Anneliese Lenz v. Finanzlandesdirektion für Tirol*, Para. 27.
32. ECJ, 7 September 2004, Case C-319/02, *Petri Manninen*, Para. 29.
33. For more on this, see Ben Terra and Peter Wattel, *European Tax Law*, third edition (Deventer: Kluwer, 2001), p. 40 et seq., Axel Cordewener, *Europäische Grundfreiheiten und nationales Steuerrecht* (Cologne: Schmidt, 2002), p. 747 et seq. and Leo Flynn, "Coming of Age: The Free Movement of Capital Case Law 1993-2002", 39 *Common Market Law Review* (2002), p.793 et seq.
34. For third-country distributions, see 5.
35. 15% from 1 January 2007 and 10% from 1 January 2009.

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amount to 20% or the recipient company is not listed in the Annex) or, if the taxpayer's situation is covered by the Directive, the Directive provides for a treatment different other than that granted to purely internal situations by the relevant Member State (for example, with regard to the deductibility of charges relating to the holding under Art. 4(2) of the Directive). It may be argued that, in these areas, secondary Community legislation (for example, the EC Parent-Subsidiary Directive) may relieve national legislators from the responsibility of having to take into account the effect of the fundamental freedoms on harmonized national law. This is because a directive demonstrates a consensus amongst the Member States that should be considered in interpreting the fundamental freedoms.

The decision of the Court, however, dealt with the question of whether or not the EC Parent-Subsidiary Directive may justify differentiation between domestic and inbound distributions entailed by Sec. 10 of the KStG. The Court rejected this briefly. Legal scholars have also arrived at the same conclusion, basically by arguing that the EC Parent-Subsidiary Directive only contains minimum requirements and may, therefore, not serve as a justification for restrictions in the scope of the fundamental freedoms.[36]

3.2. The relationship between the fundamental freedoms and directives

The issue of the relationship between the fundamental freedoms, which are embodied in the EC Treaty as the main document of primary Community law, and directives should be addressed in a broader scope. The ECJ has already given some guidance on how the Community legislation is bound to the fundamental freedoms in the area of the free movement of goods. Here, it is settled law that the prohibition on quantitative restrictions and of all measures with equivalent effect applies not only to national measures, but also to measures adopted by the Community institutions.[37]

This case law is relevant to the other freedoms in general and, specifically, regarding the tax area.[38] In respect of the directives in the tax area, this may also be derived from Art. 94 of the EC Treaty, according to which harmonization measures may be issued in respect of the establishment or the functioning of the common market. As a result, measures under Art. 94 of the EC Treaty may supplement the fundamental freedoms and not contravene their application.[39] This is also inherently logical, as directives are law derived from the EC Treaty under Art. 249(1) and, therefore, must not be intended to restrict effectively the application of the EC Treaty and the fundamental freedoms enshrined therein.[40]

At the specific level of the directives in the tax area, this supplementary character is clear from the preambles to these directives. For example, the EC Parent-Subsidiary Directive, as stated in its preamble, is intended to introduce a common system and to eliminate the disadvantage arising from the application of tax provisions governing relations between parent companies and subsidiaries of the different Member States that are less advantageous than those applying to parent companies and subsidiaries of the same Member State. The EC Parent-Subsidiary Directive was, therefore, created in the interest of the Internal Market, which covers the freedom of establishment, to promote the grouping together of the companies of different Member States.[41] The principal function of the EC Parent-Subsidiary Directive is to supplement and substantiate the fundamental freedoms. Accordingly, it may not provide for a derogation from the fundamental freedoms.[42] If, however, the wording of a directive would create a derogation to this effect

> it would then be necessary to examine whether or not the directive itself offended against the principle of freedom of establishment, a principle enshrined in primary legislation within the Treaty.[43]

It should be noted that the ECJ has consistently held that directives do not infringe the EC Treaty if they leave the Member States a sufficiently wide margin to enable the Member States to transpose the directives into national law in a manner consistent with the requirements of the

36. See, for example, Claus Staringer, "Auslandsdividenden und Kapitalverkehrsfreiheit", *Österreichische Steuer-Zeitung* (2000/119), p. 31; Claus Staringer, "Dividendenbesteuerung und Kapitalverkehrsfreiheit", in Eduard Lechner, Claus Staringer and Michael Tumpel (eds.), *Kapitalverkehrsfreiheit und Steuerrecht* (Vienna: Linde, 2000), p. 101 et seq. and Gerd Konezny and Mario Züger, "Ist die internationale Schachtelbeteiligung 'europatauglich'?", *Steuer & Wirtschaft International* (2000), p. 218 et seq.

37. See, for example, ECJ, 20 April 1978, Joined Cases C-80/77 and C-81/77, *Société Les Commissionnaires Réunis SARL v. Receveur des douanes; SARL Les fils de Henri Ramel v. Receveur des douanes* [1978] ECR 927, Para. 35; ECJ, 29 February 1984, Case C-37/83, *Rewe-Zentral AG v. Direktor der Landwirtschaftskammer Rheinland* [1984] ECR 1229, Para. 18; ECJ, 17 May 1984, Case C-15/83, *Denkavit Nederland BV v. Hoofdproduktschap voor Akkerbouwprodukten* [1984] ECR 2171, Para. 15; ECJ, 9 August 1994, Case C-51/93, *Meyhui NV v. Schott Zwiesel Glaswerke AG* [1994] ECR I-3879, Para. 11; ECJ, 25 June 1997, Case C-114/96, *Criminal proceedings against René Kieffer and Romain Thill* [1997] ECR I-3629, Para. 27; ECJ, 14 July 1998, Case C-284/95, *Safety Hi-Tech Srl v. S. & T. Srl* [1998] ECR I-04301, Para. 63; ECJ, 13 September 2001, Case C-169/99, *Hans Schwarzkopf GmbH & Co. KG v. Zentrale zur Bekämpfung unlauteren Wettbewerbs e.V.* [2001] ECR I-5901, Para. 37; ECJ, 20 May 2003, Case C-469/00, *Ravil SARL v. Bellon import SARL and Biraghi SpA* [2003] ECR I-05053, Para. 86 and ECJ, 14 December 2004, Case C-210/03, *The Queen, on the application of: Swedish Match AB and Swedish Match UK Ltd v. Secretary of State for Health*, Para. 59.

38. See, for example, Wolfgang Schön and Clemens Philipp Schindler, "Zur Besteuerung der grenzüberschreitenden Sitzverlegung einer Europäischen Aktiengesellschaft", *Internationales Steuerrecht* (2004), p. 575 et seq. and Clemens Philipp Schindler, "Steuerrecht", in Susanne Kalss and Hanns F. Hügel (eds.), *SE-Kommentar* (Vienna: Linde, 2004), Part III, Para. 31.

39. Wolfgang Schön and Clemens Philipp Schindler, "Zur Besteuerung der grenzüberschreitenden Sitzverlegung einer Europäischen Aktiengesellschaft", *Internationales Steuerrecht* (2004), p. 575 et seq. and Clemens Philipp Schindler, "Steuerrecht", in Susanne Kalss and Hanns F. Hügel (eds.), *SE-Kommentar* (Vienna: Linde, 2004), Part III, Para. 31.

40. See also Claus Staringer, "Dividendenbesteuerung und Kapitalverkehrsfreiheit", in Eduard Lechner, Claus Staringer and Michael Tumpel (eds.), *Kapitalverkehrsfreiheit und Steuerrecht* (Vienna: Linde, 2000), p. 102 and Andreas Körner, "Das 'Bosal'-Urteil des EuGH – Vorgaben für die Abzugsfähigkeit der Finanzierungsaufwendungen des Beteiligungserwerbs", *Betriebs-Berater* (2003), p. 2438.

41. See also ECJ, 4 October 2001, Case C-294/99, *Athinaïki Zythopoiia AE v. Elleniko Dimosio* [2001] ECR I-6797, Para. 25

42. The same reasoning applies, inter alia, to the EC Merger Directive. See Clemens Philipp Schindler, *"Steuerrecht"*, in Susanne Kalss and Hanns F. Hügel (eds.), *SE-Kommentar* (Vienna: Linde, 2004), Part III, Para. 31.

43. Opinion of Advocate General Alber, ECJ, 24 September 2002, Case C-168/01, *Bosal Holding BV v. Staatssecretaris van Financiën* [2003] ECR I- 9409, Para. 58. See also Harm van den Broek, "Bosal Holding and the Confusion Surrounding the Territoriality Principle", 10 *International Transfer Pricing Journal* 3 (2003), p. 119.

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EC Treaty.[44] This is consistent with the ECJ's approach of adopting a reconciling interpretation of directives in the light of primary Community law. In other words, if the wording of secondary Community law is open to more than one interpretation, preference should be given to an interpretation that renders the provision consistent with the EC Treaty, rather than an interpretation that leads to a directive being incompatible with the EC Treaty.[45]

The problem is, however, different with regard to directive-based national legislation infringing on a fundamental freedom, as it is the case with the Austrian differential treatment of domestic and foreign distributions under Sec. 10 of the KStG. Here, national law is to be measured not only on its compliance with a directive, but also with primary Community law, such as the fundamental freedoms. The question, therefore, is not so much whether or not primary and secondary Community legislation are in compliance, but, rather, whether or not secondary Community law may serve as a justification for national legislation that infringes primary Community law.

The latter argument was set out in the *Bosal* case,[46] in which the Netherlands granted a deduction to Netherlands parent companies in respect of financing costs relating to a holding owned by it only insofar as the subsidiary's profits were subject to Netherlands taxation.[47] The ECJ conceded that the Netherlands rules, insofar as they merely implement the possibility offered by Art. 4(2) of the EC Parent-Subsidiary Directive to refuse the deduction of costs incurred by parent companies in connection with holdings in the capital of their subsidiaries, were compatible with the Directive. Nevertheless, the ECJ did not regard this as unconditional and definitive permission for the Netherlands implementation of its restrictive measure, but rather found that the Netherlands rules infringed on the freedom of establishment.

In so holding, the ECJ had to overcome the hurdle that the EC Parent-Subsidiary Directive offers an option, which in turn may put parent companies with subsidiaries in other Member States in a position less advantageous than that of purely domestic holdings. In these circumstances, the ECJ simply stated that the possibility under Art. 4(2) of the EC Parent-Subsidiary Directive "may be exercised only in compliance with the fundamental provisions of the Treaty".[48] In addition, the Netherlands limitation "goes against the objective set forth by the directive".[49] From this, it is clear that the Member States must exercise the options granted to them in directives in accordance with, inter alia, the fundamental freedoms, thereby avoiding any discrimination in respect of cross-border situations compared to domestic settings.[50]

It is, however, arguably another question as to whether or not the fundamental freedoms also give protection to taxpayers who are not covered by the personal or material scope of a directive. It may be argued that a directive represents the consensus between the Council and the Member States and, therefore, prevents certain situations from being subject to either a discriminatory or a non-discriminatory restriction. This reasoning may also be put forward in defence of the non-application of the rules reserved for the specific situations described in a directive, although the rules governing internal transactions are more relaxed, as is the case with the twofold participation exemption regime under Sec. 10 of the KStG. The authors, however, submit that such an argument would not be accepted by the ECJ.[51]

Although little guidance on this issue can be derived from the *Bosal* judgment, it is agreed that, for example, the EC Parent-Subsidiary Directive only provides for the implementation of a minimum standard and does not prevent the Member States from granting a more beneficial treatment. If, however, Member States grant such a beneficial treatment in a domestic context, they must extend this treatment to international settings. In addition, under *Bosal*, national law must be assessed on the basis of the fundamental freedoms independently of a directive. This is evident as the ECJ employed a two-step procedure. First, the ECJ tested, and approved, the compliance of national law with the EC Parent-Subsidiary Directive. Then, the ECJ tested the national law directly against the freedom of establishment.[52]

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44. See ECJ, 13 July 1989, Case 5/88, *Hubert Wachauf v. Bundesamt für Ernährung und Forstwirtschaft* [1989] ECR 2609, Para. 22 and ECJ, 17 June 1999, Case C-166/98, *Société critouridienne de distribution (Socridis) v. Receveur principal des douanes* [1999] ECR I-3791, Para. 19.
45. See, for. example, ECJ, 13 December 1983, Case 218/82, *Commission of the European Communities v. Council of the European Communities* [1983] ECR 4063, Para. 15 and ECJ, 4 December 1986, Case 205/84, *Commission of the European Communities v. Federal Republic of Germany* [1986] ECR 3755, Para. 62.
46. ECJ, 18 September 2003, Case C-168/01, *Bosal Holding BV v. Staatssecretaris van Financiën* [2003] ECR I-9409.
47. For a discussion of the *Bosal* case see, for example, Freek P.J. Snel, "*Bosal Holding* Case – Landmark or Business as Usual?", 43 *European Taxation* 11 (2003), p. 420 et seq.; Gerald T.K. Meussen, "*Bosal Holding* Case and the Freedom of Establishment: A Dutch Perspective", 44 *European Taxation* 2/3 (2004), p. 59 et seq.; *Confédération Fiscale Européenne*, "CFE Opinion Statement on the Decision of the European Court of Justice *Bosal Holding BV*, Case C-168/01", 44 *European Taxation* 11 (2004), p. 506 et seq.; Hans van den Hurk and Bouke Wagenaar, "The Far-Reaching Consequences of the ECJ Decision in *Bosal* and the Response of the Netherlands", 58 *Bulletin for International Fiscal Documentation* 6 (2004), p. 269 et seq.; Harm van den Broek, "Bosal Holding and the Confusion Surrounding the Territoriality Principle", 10 *International Transfer Pricing Journal* 3 (2003), p. 116 et seq.; Frans Vanistendael, "*Bosal*?!" *EC Tax Review* (2003), p. 192 et seq.; Dennis Weber, "The *Bosal Holding* Case: Analysis and Critique", *EC Tax Review* (2003), p. 220 et seq.; Dietmar Aigner, "ECJ – The *Bosal Holding BV* Case: Parent-Subsidiary Directive and Freedom of Establishment", *Intertax* (2004), p. 148 et seq.; Georg Kofler, "Bosal: Abzugsverbot für Beteiligungsaufwendungen verstößt gegen die im Lichte der Niederlassungsfreiheit ausgelegte Mutter-Tochter-RL", *Österreichische Steuer-Zeitung* (2003/1175), p. 554 et seq. and Andreas Körner, "Das 'Bosal' – Urteil des EuGH – Vorgaben für die Abzugsfähigkeit der Finanzierungsaufwendungen des Beteiligungserwerbs", *Betriebs-Berater* (2003), p. 2436 et seq.
48. ECJ, 18 September 2003, Case C-168/01, *Bosal Holding BV v. Staatssecretaris van Financiën* [2003] ECR I-9409, Para. 26.
49. Id., Para. 28.
50. See also *Confédération Fiscale Européenne*, "CFE Opinion Statement on the Decision of the European Court of Justice *Bosal Holding BV*, Case C-168/01", 44 *European Taxation* 11 (2004), p. 507.
51. See also Claus Staringer, "Auslandsdividenden und Kapitalverkehrsfreiheit", *Österreichische Steuer-Zeitung* (2000/119), p. 31 and Michael Tumpel, "Europarechtliche Besteuerungsmaßstäbe für die grenzüberschreitende Organisation und Finanzierung von Unternehmen", in Jürgen Pelka (ed.), *Europa- und verfassungsrechtliche Grenzen der Unternehmensbesteuerung* (Cologne: Schmidt, 2000), p. 359.
52. See also Gerald T.K. Meussen, "*Bosal Holding* Case and the Freedom of Establishment: A Dutch Perspective", 44 *European Taxation* 2/3 (2004), p. 59 et seq.; Johannes Heinrich, "Österreich: System der Besteuerung von Dividenden auf dem Prüfstand des EuGH", *Internationales Steuerrecht* (2000), p. 239 and Gerd Konezny and Mario Züger, "Ist die internationale Schachtelbeteiligung 'europatauglich'?" *Steuer & Wirtschaft International* (2000), p. 218 et seq.

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Accordingly, even if national law excludes certain taxpayers from a beneficial treatment because they do not fall within the personal or material scope of the directive, such a national law nevertheless must conform with the principles of non-discrimination and non-restriction. Finally, even if it would become clear that the Member States intended to use a directive to immunize a discrimination or restriction from being considered as such under the EC Treaty, it is apparent that the ECJ would not consider such historical arguments as decisive.[53]

4. THE SWITCHOVER CLAUSE IN SEC. 10(4) OF THE KStG

4.1. The anti-avoidance provisions in Sec. 10(4) of the KStG and EC law

As stated in 2.1., Sec. 10(4) of the KStG contains an anti-avoidance provision in that it provides for a switchover from the exemption method to the indirect tax credit method if the foreign distributing company mainly derives certain passive income and is subject to low taxation in its country of residence. This rule is based on Art. 1(2) of the EC Parent-Subsidiary Directive[54] and only applies to cross-border inbound distributions, whereas domestic distributions made by passive companies remain exempt in any circumstances. Against this background, and especially based on the ECJ's *Lenz* decision, it has been argued in Austrian legal writing that such a differential and disadvantageous treatment, which is in substance based only on the foreign level of taxation, infringes the EC Treaty.[55] Despite many other questions surrounding Sec. 10(4) of the KStG, the question is fundamentally whether or not the indirect tax credit under Sec. 10(4) of the KStG is a permissible derogation from the exemption method set out in Sec. 10(1) and (2) of the KStG.

The exemption and the indirect tax credit methods provided for in Art. 4 of the EC Parent-Subsidiary Directive are considered to be equivalent and it is left to the discretion of the Member States to decide which method should apply. It is also almost undisputed that a Member State may provide for the application of both methods, one method to apply in its relations with some Member States and the other method in its relations with other Member States.[56] In addition, it is even considered to be permissible to provide for the application of both methods in relation with one and the same Member State, the method to be applied being determined according to specified conditions.[57] In this respect, foreign low taxation may serve as a special reason to switch methods.[58] Accordingly, it may readily be concluded that Sec. 10(4) of the KStG complies with the EC Parent-Subsidiary Directive, independently from the question of whether or not Sec. 10(4) of the KStG would theoretically be approved as an anti-abuse provision by Art. 1(2) of the Directive.

Against this background it can also easily be concluded that Sec. 10(4) of the KStG is in accordance with the EC Parent-Subsidiary Directive, as, from an Austrian perspective, all cross-border inbound distributions are treated equally. Whether the exemption method or the indirect tax credit method applies depends, however, on the composition of subsidiary's income and the level of taxation in its Member State of residence. Even though the different treatment is based on the level of foreign taxation (which appears to be a non-criterion under Community law), given the equal treatment under national law and the equality of both methods in the eyes of the EC Parent-Subsidiary Directive, it is hard to see a discrimination.[59]

This would, however, be the final conclusion under EC law only if the situation of two foreign subsidiaries distributing dividends to its Austrian parent company were compared. In general, both of the foreign subsidiaries are treated in the same way, with any different treatment being justified under the EC Parent-Subsidiary Directive. But another question is whether or not this is also true from an EC law point of view if the situation of a foreign subsidiary is compared with that of a domestic subsidiary, both of which distribute dividends to an Austrian parent company. In this case, there is different treatment insofar as the dividend distributions of a domestic subsidiary are always tax exempt, irrespective of whether or not the domestic subsidiary earns only passive income. In other words, the decisive question is whether or not a different treatment in respect of domestic and foreign dividends resulting from the anti-abuse provision of Sec. 10(4) of the KStG is in accordance with the EC fundamental freedoms.

The judgment of the Court of 13 January 2005 also dealt with this question and clarified that the correct comparison

53. For this, see ECJ, 17 October 1996, Joined Cases C-283/94, C-291/94 and C-292/94, *Denkavit International BV, VITIC Amsterdam BV and Voormeer BV v. Bundesamt für Finanzen* [1996] ECR I-5063, Para. 29, which states that: "Expressions of intent on the part of Member States in the Council, such as those on which the Governments rely in their observations, have no legal status if they are not actually expressed in the legislation".
54. For a discussion whether or not Sec. 10(4) of the KStG conforms with Art. 1(2) of the EC Parent-Subsidiary Directive, see, for example, Georg Kofler, *Die steuerliche Abschirmwirkung ausländischer Finanzierungsgesellschaften* (Vienna: Linde, 2002), p. 386 et seq.
55. See Johannes Heinrich, "Der EuGH als 'Motor' der Harmonisierung der direkten Steuern im Binnenmarkt", *Österreichische Steuer-Zeitung* (2002/970), p. 554 et seq.; Reinhold Beiser, "Auslandsausschüttungen im Licht der Niederlassungs- und Kapitalverkehrsfreiheit", *Der Gesellschafter* (2003), p. 197 et seq.; Gerald Toifl, *"Diskriminierung ausländischer Kapitalerträge"*, *Recht der Wirtschaft* (2004/230), p. 251; Tatjana Polivanova-Rosenauer and Gerald Toifl, "Besteuerung ausländischer Kapitalerträge und jüngste Rechtsprechung des EuGH", *Steuer & Wirtschaft International* (2004), p. 237 and Barbara Postl, "Methodenwechsel nach § 10 Abs 4 KStG gemeinschaftsrechtskonform?", *ecolex* (2004), p. 969 et seq.
56. See Otmar Thömmes, "Commentary on the Parent/Subsidiary Directive", in Otmar Thömmes and Ephraim Fuks (eds.), *EC Corporate Tax Law* (Amsterdam: IBFD, loose-leaf), Chapter 6.4., Para. 15; Fred C. de Hosson, "The Parent-Subsidiary Directive", *Intertax* (1990), p. 432; Ben Terra and Peter Wattel, *European Tax Law,* third edition (Deventer: Kluwer, 2001), p. 347; Michael Tumpel, *Harmonisierung der direkten Unternehmensbesteuerung in der EU* (Vienna: ÖSD,1994), p. 270 and Eveline Deutsch, "Internationales Schachtelprivileg und Quellenbesteuerung nach der Mutter-Tochter-Richtlinie", *Österreichische Steuer-Zeitung* (1995), p. 458 et seq.
57. Otmar Thömmes, "Commentary on the Parent/Subsidiary Directive", in Otmar Thömmes and Ephraim Fuks (eds.), *EC Corporate Tax Law* (Amsterdam: IBFD, loose-leaf), Chapter 6.4., Para. 15.
58. Fred C. de Hosson, "The Parent-Subsidiary Directive", *Intertax* (1990), p. 432 et seq. and Ben Terra and Peter Wattel, *European Tax Law*, third edition (Deventer: Kluwer, 2001), p. 347. See also Otmar Thömmes, "Commentary on the Parent/Subsidiary Directive", in Otmar Thömmes and Ephraim Fuks (eds.), *EC Corporate Tax Law* (Amsterdam: IBFD, loose-leaf), Chapter 6.4., Para. 15.
59. See also Georg W. Kofler, "Lenz: Österreich darf ausländische Kapitalerträge nicht diskriminieren", *Österreichische Steuer-Zeitung* (2004/757), p. 348 et seq.

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must be drawn not between two foreign subsidiaries, but, rather, between a foreign and a domestic subsidiary, with the dividend distributions of the latter always being tax exempt under the national participation exemption in Sec. 10(1) of the KStG. As this provision does not make the exemption dependent on a certain composition of income or on effective taxation, *prima vista*, Sec. 10(4) of the KStG also does not apply to international participations, since its application would result in a discrimination in respect of cross-border distributions as opposed to domestic distribution.[60]

It might be speculated as to whether or not Sec. 10(4) of the KStG serves as an anti-avoidance provision and may, therefore, be justified as preventing tax evasion or tax avoidance – two reasons of justification, in principle, already accepted by the ECJ.[61] It is true that the primary purpose of Sec. 10(4) of the KStG is to prevent the circumvention of Austrian taxation by the transferring down of passive assets to low-taxed subsidiaries and subsequently repatriating the income thereby derived tax free under the participation exemption of Sec. 10(2) of the KStG. Accordingly, it may be argued that Sec. 10(4) of the KStG has the specific purpose of preventing wholly artificial arrangements that are designed to circumvent Austrian tax legislation.[62]

The requirements for the justification of an anti-avoidance rule are, however, high. The ECJ clearly stated in the *Leur-Bloem* and the *Commission v. Belgium* cases[63] that a general rule automatically excluding certain situations from a tax advantage, whether or not there is actually tax evasion or tax avoidance, would go further than is necessary in preventing such tax evasion or tax avoidance. As a result, "a general presumption of tax evasion or tax fraud cannot justify a fiscal measure".

Although it is subject to discussion in Austria as to whether or not Sec. 10(4) of the KStG entails only a rebuttable presumption,[64] leaving the taxpayer with the option to prove the non-avoidance intention before the courts, the Austrian tax authorities do not support this view.[65] In addition, even if Sec. 10(4) of the KStG were interpreted in this way, such an additional burden of proof could amount to a prohibited discrimination on its own.[66]

4.2. The authors' submission

Accordingly, the authors submit that Sec. 10(4) of the KStG does not apply to inbound distributions made by EU subsidiaries, as its application entails a discrimination compared to purely domestic distributions. This is because Sec. 10(4) of the KStG represents a disproportionate anti-avoidance measure, as it exceeds that which is strictly required for the purpose of countering tax avoidance to the detriment of the fundamental freedoms.[67] Sec. 10(4) of the KStG may, however, still be relevant with regard to the exemption of capital gains, which is not available under Sec. 10(1) of the KStG.

5. ONE FINAL ISSUE: DISTRIBUTIONS FROM THIRD-COUNTRY COMPANIES

5.1. The Austrian participation exemption and cross-border inbound distributions

One question remains. Must the Austrian participation exemption granted to domestic distributions and, now under EC law, to cross-border inbound distributions of Member States' subsidiaries also be extended to cross-border inbound distributions received from third-country companies? Although there had been some general reluctance to draw such a conclusion in Austrian legal writing,[68] the Court held that this is so with regard to foreign-source dividends channelled through an investment fund. The authors argue that the Court was correct in this finding on the specific issue of dividends received through an investment fund. In the authors' opinion, however, this ruling cannot be completely transferred to the Austrian participation exemption regime as such.

5.2. The EC law perspective

First, it should be remembered that Art. 56(1) of the EC Treaty prohibits "all restrictions on the movement of capital between Member States and between Member States and third countries". Two limitations follow from this

60. See Reinhold Beiser, "Auslandsausschüttungen im Licht der Niederlassungs- und Kapitalverkehrsfreiheit", *Der Gesellschafter* (2003), p.197 et seq.
61. ECJ, 16 July 1998, Case C-264/96, *Imperial Chemical Industries plc (ICI) v. Kenneth Hall Colmer (Her Majesty's Inspector of Taxes)* [1998] ECR I-4695, Para. 26; ECJ, 8 March 2001, Joined Cases C-397/98 and C-410/98, *Metallgesellschaft Ltd and Others, Hoechst AG and Hoechst (UK) Ltd v. Commissioners of Inland Revenue and H.M. Attorney General* [2001] ECR I-1727, Para. 57 and ECJ, 12 December 2002, Case C-324/00, *Lankhorst-Hohorst GmbH v. Finanzamt Steinfurt* [2002] ECR I-11779, Para. 37.
62. See, for this requirement, ECJ, 12 December 2002, Case C-324/00, *Lankhorst-Hohorst GmbH v. Finanzamt Steinfurt* [2002] ECR I-11779, Para. 37.
63. ECJ, 17 July 1997, Case C-28/95, *A. Leur-Bloem v. Inspecteur der Belastingdienst/Ondernemingen Amsterdam 2* [1997] ECR I-4161, Para. 44 and ECJ, 26 September 2000, Case C-478/98, *Commission of the European Communities v. Kingdom of Belgium* [2000] ECR I-7587, Para. 45.
64. See Georg Kofler, *Die steuerliche Abschirmwirkung ausländischer Finanzierungsgesellschaften* (Vienna: Linde, 2002), p. 394 et seq. and the references therein.
65. See, for example, Peter Quantschnigg, "Verordnungen zur Mutter-Tochter-Richtlinie", *Österreichische Steuer-Zeitung* (1995), p. 13; Helmut Loukota and Peter Quantschnigg, "Neues österreichisches Mißbrauchsabwehrrecht gegenüber ausländischen Basisgesellschaften", *Steuer & Wirtschaft International* (1995), p. 13 et seq. and Werner Wiesner, "Die österreichischen Mißbrauchsbestimmungen auf dem Gebiet des Außensteuerrechts – § 10 Abs 3 KStG 1988", *Steuer & Wirtschaft International* (1995), p. 130.
66. For this, see ECJ, 28 October 1999, Case C-55/98, *Skatteministeriet v. Bent Vestergaard* [1999] ECR I-7641, Para. 21 (regarding the Danish rules which made the right to deduct costs relating to a participation in professional training courses held in an ordinary tourist resort in another Member State conditional on the rebuttal, by the taxpayer, of a presumption that the courses had such a significant tourism element such that the costs could not be treated as deductible operating costs, whilst such a presumption did not exist for courses held in ordinary tourist resorts located in Denmark) and Johannes Heinrich, "Der EuGH als 'Motor' der Harmonisierung der direkten Steuern im Binnenmarkt?" *Österreichische Steuer-Zeitung* (2002/970), p. 554 et seq.
67. For the strict proportionality requirements, see also ECJ, 11 March 2004, Case C-9/02, *Hughes de Lasteyrie du Saillant v. Ministère de l'Économie, des Finances et de l'Industrie*, Para. 50 et seq.
68. For this, see Georg Kofler, "Lenz: Österreich darf ausländische Kapitalerträge nicht diskriminieren", *Österreichische Steuer-Zeitung* (2004/757), p. 349 et seq.

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basic principle of free movement – a grandfather clause relating to third-country-directed restrictions (Art. 57 of the EC Treaty) and an exceptions clause (Art. 58 of the EC Treaty). In addition, Art. 59 and Art. 60 of the EC Treaty draw attention to the fact that the free movement of capital in relation to third countries may be subject to restrictions.[69] As for the personal scope of Art. 56(1) of the EC Treaty, the persons invoking the free movement of capital need not be nationals of a Member State.[70] This breadth can be seen in cases such as *Svensson and Gustavsson*[71] and *Bordessa*,[72] in respect of both of which third-country nationals invoked this freedom. Finally, the most interesting and unique feature of Art. 56 of the EC Treaty is its extra-community dimension, as, according to its wording, it clearly covers third countries. Its scope also extends to capital movements into and out of the Community, as well as within it, and the ECJ has held on several occasions that Art. 56 of the EC Treaty also has direct effect in relation to third countries.[73]

Given the clear wording of Art. 56 of the EC Treaty, it is almost undisputed that this provision covers tax restrictions in relation to third countries and has, in principle, the same meaning in relation to third countries as it has in relation to other Member States.[74] Although it might be questioned what are the policy reasons for such a unilateral extension of the free movement of capital,[75] the case law of the ECJ appears to treat both situations equally. Although the ECJ has not, to date, been compelled to deal with the application of the free movement of capital in relation to third countries in tax cases, this conclusion may nevertheless be inferred from the *Sanz de Lera* case,[76] which also concerned national conditions for the export of money from a Member State to a third country, and the *Ospelt* case,[77] which involved investment in Austria by a Liechtenstein Foundation.

In legal writing, there is little doubt that Art. 56 of the EC Treaty has the same scope with regard to third-country capital movements as it has within the Community.[78] The Austrian Supreme Administrative Court also appears to adhere to this view,[79] and even the Ministry of Finance extended the effect of the *Lenz* decision regarding the old Austrian regime of foreign-source capital income taxation without hesitation to third-country source capital income.[80]

Accordingly, *prima vista*, the effect on the participation exemption issue also appears to be clear. Under Art. 56 of the EC Treaty, distributions from third-country subsidiaries should enjoy the benefits of the domestic participation exemption regime under Sec. 10(1) of the KStG. The question, however, remains as to whether or not the grandfather clause relating to third-country-directed restrictions contained in Art. 57(1) of the EC Treaty applies.[81] This provision allows the application of any restrictions in respect of third countries that existed on 31 December 1993 under national or Community law adopted in respect of the free movement of capital to or from third countries involving direct investment (including investment in real estate), establishment, the provision of financial services or the admission of securities to capital markets. As a result, Art. 57(1) of the EC Treaty has two main prerequisites. These are that (1) the restriction must have existed on 31 December 1993 (see 5.2.1.) and (2) the restriction must relate, inter alia, to direct investment (see 5.2.2.).

69. Art. 59 of the EC Treaty allows safeguard measures to be taken by the Council in order to deal with exceptional circumstances in which movements of capital to or from third countries cause, or threaten to cause, serious difficulties for the operation of the Economic and Monetary Union. Such measures with regard to third countries may last for up to six months and must be strictly necessary. Art. 60(1) of the EC Treaty allows the Council, when adopting sanctions against third countries under Art. 301 of the EC Treaty, to take the necessary urgent measures on the movement of capital and on payments as regards those third countries. Art. 60(2) of the EC Treaty allows individual Member States to act individually where the Council has not acted under Art. 60(1) of the EC Treaty against a third country with regard to capital movements and payments. This unilateral action can only be undertaken for serious political reasons and on grounds of urgency, and must occur within the framework of consultation established under Art. 297 of the EC Treaty. In addition, the Council may require the Member State concerned to abolish or amend any such measures.

70. Whilst Art. 67 of the EEC Treaty, the predecessor of Art. 56, had merely required residence in, not nationality of, a Member State, the text of Art. 56 of the EC Treaty is wider, referring only to the movement of capital between Member States.

71. ECJ, 14 November 1995, Case C-484/93, *Peter Svensson and Lena Gustavsson v. Ministre du Logement et de l'Urbanisme* [1995] ECR I-3955.

72. ECJ, 23 February 1995, Joined Case C-358/93 and 416/93, *Criminal proceedings against Aldo Bordessa and Vicente Marí Mellado and Concepción Barbero Maestre* [1995] ECR I-361.

73. ECJ, 14 December 1995, Joined Cases C-163/94, C-165/94 and C-250/94, *Criminal proceedings against Lucas Emilio Sanz de Lera, Raimundo Díaz Jiménez and Figen Kapanoglu* [1995] ECR I-4821, Para. 44 et seq. See also ECJ, 23 September 2003, Case C-452/01, *Margarethe Ospelt and Schlössle Weissenberg Familienstiftung* [2003] ECR I-9743 and compare further Ben Terra and Peter Wattel, *European Tax Law*, third edition (Deventer: Kluwer, 2001), p. 39. However, whilst Art. 56(1) of the EC Treaty deals with external capital movements in the same broad terms as are used for intra-Community capital movements, the existence of Arts. 57, 59 and 60 of the EC Treaty clearly creates a less liberalized framework.

74. See, for example, Michael Sedlaczek, "Capital and Payments: The Prohibition of Discrimination and Restrictions", 40 *European Taxation* 1/2 (2000), p. 19 et seq.

75. See Kristina Ståhl, "Free movement of capital between Member States and third countries", *EC Tax Review* (2004), p. 50.

76. ECJ, 14 December 1995, Joined Cases C-163/94, C-165/94 and C-250/94, *Criminal proceedings against Lucas Emilio Sanz de Lera, Raimundo Díaz Jiménez and Figen Kapanoglu* [1995] ECR I-4821.

77. ECJ, 23 September 2003, Case C-452/01, *Margarethe Ospelt and Schlössle Weissenberg Familienstiftung* [2003] ECR I-9743.

78. See, *ex multis*, Reinhold Beiser, "Auslandsausschüttungen im Licht der Niederlassungs- und Kapitalverkehrsfreiheit", *Der Gesellschafter* (2003), p. 187 et seq. However, see also, for the level of justification, Dietmar Aigner and Georg Kofler, "Austria Clarifies Third Country Impact of ECJ's *Lenz* Decision", 36 *Tax Notes International* (1 November 2004), p. 480 et seq. and Kristina Ståhl, "Free movement of capital between Member States and third countries", *EC Tax Review* (2004), p. 54 et seq.

79. See the reference by the Austrian Federal Administrative Court (VwGH) of 27 August 2002, 99/14/0164, *Supplement to Österreichische Steuer-Zeitung* (2002), No. 660 in the *Lenz* case.

80. See *"Auswirkungen des EuGH-Urteils vom 15.7.2004, C-315/02, Lenz"* (Consequences of the ECJ's *Lenz* decision), Information provided by the Austrian Federal Ministry of Finance, 30 July 2004, Zl. 06 1602/2-IV/6/04 (available in the German language at www.bmf.gv.at/steuern/einkommensteuer/erlaesse/lenzinfo.htm). For a discussion of this, see Dietmar Aigner and Georg Kofler, "Austria Clarifies Third Country Impact of ECJ's *Lenz* Decision", 36 *Tax Notes International* (1 November 2004), p. 477 et seq.

81. It should be noted that the Court did not deal with this issue, but, rather, found that investment through an investment fund does not constitute "direct investment" within the meaning of Art. 57(1) of the EC Treaty, thereby making this provision inapplicable.

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5.2.1. The existence of the restriction on 31 December 1993

With regard to prerequisite (1) in 5.2., it should be noted that Austria had already enacted limitations in respect of the international participation exemption prior to 31 December 1993, the relevant date for the grandfather clause contained in Art. 57(1) of the EC Treaty. These limitations involved a minimum holding period of one year and a (direct) holding requirement of 25%. Sec. 10 of the KStG was, however, subject to significant amendment in the subsequent years. Specifically, with effect from Austria's accession to the European Union on 1 January 1995, the minimum holding period was increased to two years and the holding requirement retained at 25%, the requirement then stated in the EC Parent-Subsidiary Directive. These amendments apply from the taxable year 2004 onwards.

Accordingly, the question arises as to whether or not Austria may invoke the grandfather clause. Although the safeguard provisions in Art. 57(1) of the EC Treaty have not yet been subject to a decision by the ECJ, insight into the manner in which it could be interpreted can be obtained from the *Konle*, *Beck and Bergdorf* and *Salzmann* judgments[82] regarding a grandfather clause in Austria's Act of Accession. In these cases, the ECJ held that the fact that a provision was adopted after the date of accession is not decisive if it is in substance identical to the previous legislation or if it is limited to reducing or eliminating an obstacle to the exercise of Community rights and freedoms in the earlier legislation, in which case it will be covered by the derogation.[83] Against this background and returning to the development of Austria's rules on the participation exemption, it may be concluded that the amendments made after 31 December 1993 regarding the holding requirement qualify as existing legislation and are, therefore, covered by Art. 57(1) of the EC Treaty, whilst the amendments to the minimum holding period are not.

5.2.2. The relationship of the restriction to direct investment

As to prerequisite (2) in 5.2. in relation to Art. 57(1) of the EC Treaty, the term "direct investment" appears to derive from Annex II of the First Directive regarding the implementation of Art. 67 of the EC Treaty.[84] This was described in the notes to the Annex as meaning:

> investment of all kinds by natural persons or commercial, industrial or financial undertakings, and which serve to establish or maintain lasting and direct links between the person providing the capital and the entrepreneur to whom the undertaking to which the capital is made available in order to carry on an economic activity.[85]

The explanatory notes to Annex I to Directive 88/361/EEC[86] state that direct investment is characterized, in particular, by the possibility of participating effectively in the management of a company or in its control.[87] Accordingly, Art. 57 of the EC Treaty covers only investments with a view to establishing or maintaining lasting economic links, and, therefore, leaves portfolio investments outside its scope.[88]

With regard to the participation in an undertaking by means of a shareholding, it appears to be sensible to draw the line between portfolio and direct investment with a view to the holding threshold as set out in the EC Parent-Subsidiary Directive, i.e. at 20%.[89] Accordingly, if it is assumed that cross-border distributions as a consequence of a direct investment can fall within the scope of Art. 57(1) of the EC Treaty,[90] the puzzling conclusion is arrived at that Art. 57(1) of the EC Treaty is hardly of any relevance to the issue. Although the minimum holding requirement would arguably be grandfathered by Art. 57(1) of the EC Treaty, this has no relevance for portfolio investments in respect of which only the minimum holding requirement could be relevant. Conversely, if Art. 57(1) of the EC Treaty were also to apply from a timing perspective because it relates to direct investment, there would usually be little incentive to rely on it, as Sec. 10(2) of the KStG grants an exemption anyway.[91]

82. ECJ, 1 June 1999, Case C-302/97, *Klaus Konle v. Republik Österreich* [1999] ECR I-3099, ECJ, 7 September 1999, Case C-355/97, *Landesgrundverkehrsreferent der Tiroler Landesregierung v. Beck Liegenschaftsverwaltungsgesellschaft mbH and Bergdorf Wohnbau GmbH, in liquidation* [1999] ECR I-4977 and ECJ, 15 May 2003, Case C-300/01, *Doris Salzmann* [2003] ECR I-4899.
83. ECJ, 1 June 1999, Case C-302/97, *Klaus Konle v. Republik Österreich* [1999] ECR I-3099, Para. 52; ECJ, 7 September 1999, Case C-355/97, *Landesgrundverkehrsreferent der Tiroler Landesregierung v. Beck Liegenschaftsverwaltungsgesellschaft mbH and Bergdorf Wohnbau GmbH, in liquidation* [1999] ECR I-4977, Para. 34 and ECJ, 15 May 2003, Case C-300/01, *Doris Salzmann* [2003] ECR I-4899, Para. 54. However, the criterion of substantive identity, which allows legislation adopted after the date of accession to be included within the scope of the grandfather clause, must be strictly interpreted, so that later legislation that is based on an approach which differs from that of the previous law and establishes new procedures cannot be treated as legislation existing at the time of accession. With regard to this, see ECJ, 1 June 1999, Case C-302/97, *Klaus Konle v. Republik Österreich* [1999] ECR I-3099, Para. 53 and ECJ, 15 May 2003, Case C-300/01, *Doris Salzmann* [2003] ECR I-4899, Para. 55.
84. First Council Directive of 11 May 1960 for the implementation of Article 67 of the Treaty, Official Journal of the European Union, 1960 (No. 43), at 921/60.
85. Leo Flynn, "Coming of Age: The Free Movement of Capital Case Law 1993-2002", 39 *Common Market Law Review* (2002), p. 776.
86. Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty, Official Journal of the European Union, 8 July 1988, L 178/5.
87. See ECJ, 4 June 2002, Case C-367/98, *Commission of the European Communities v. Portuguese Republic* [2002] ECR I-4731, Para. 38.
88. See Tatjana Polivanova-Rosenauer, "ECJ Rules on Austrian Discrimination of Foreign-Source Investment Income", 44 *European Taxation* 9 (2004), p. 419 and Reinhold Beiser, "Auslandsausschüttungen im Licht der Niederlassungs- und Kapitalverkehrsfreiheit", *Der Gesellschafter* (2003), p. 187 et seq.
89. See also Wolfgang Schön, "Europäische Kapitalverkehrsfreiheit und nationales Steuerrecht", in Wolfgang Schön (ed.), *Gedächtnisschrift für Brigitte Knobbe-Keuk* (Cologne: Schmidt, 1997), p. 750 et seq.
90. For a contrary position, see, for example, Reinhold Beiser, "Auslandsausschüttungen im Licht der Niederlassungs- und Kapitalverkehrsfreiheit", *Der Gesellschafter* (2003), p. 187 et seq., who argues that the restriction entailed in Sec. 10(2) of the KStG does not target restrictions on direct investments, but rather serves to raise revenue on inbound distributions.
91. It should be noted that the switch-over rule in Sec. 10(4) of the KStG was introduced by *BGBl* (Federal Gazette) 681/1994, with effect from 1 January 1995 and, therefore, is in no case covered by Art. 57(1) of the EC Treaty.

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5.3. The European Economic Area (EEA) implications

It should also be noted that the EEA unites, from 1 May 2004, the 25 EU Member States and the three EFTA States (Iceland, Liechtenstein and Norway) into an Internal Market governed by the same basic rules. As under the EC Treaty, the tax system of an EEA State is, as a general rule, not covered by the EEA Agreement. The EFTA Court has repeatedly held that the EEA States must, however, exercise their taxation power consistently with EEA law.[92] The free movement of capital is one of the fundamental principles of the EEA Agreement and is, as with Art. 56 of the EC Treaty, directly applicable.[93] It is beyond doubt that Art. 40 of the EEA Agreement has a comparable effect on dividend taxation as Art. 56 of the EC Treaty within the Community.[94] In addition, in no event may the grandfather clause relating to third-country-directed restrictions (Art. 57 of the EC Treaty) be invoked in relation to other EEA States.[95] Accordingly, distributions from EEA subsidiaries are to be treated no less favourably than domestic distributions.

5.4. The justification of restrictive measures

Finally, at the level of justification, there are good reasons to argue that the possibilities for Member States to justify restrictive measures should be much greater with regard to third countries than when it relates to the free movement of capital within the European Union.[96] Despite the legal merits of this reasoning, Austria has shown some reluctance to argue in this way. For example, after the ECJ's *Lenz* decision the Ministry of Finance extended, without further hesitation, the effects of this decision to third countries, although the ECJ has explicitly refrained from ruling on such third-country situations.[97]

6. CONCLUSIONS

In its judgment of 13 January 2005, the Court held that the different treatment of domestic and foreign distributions received by an Austrian company under Sec. 10 of the KStG infringes Art. 43 and/or Art. 56 of the EC Treaty, as the case may be. The decision applies irrespective of whether or not the EC Parent-Subsidiary Directive requires a Member State to grant certain benefits to cross-border dividend distributions only if certain conditions are met, i.e. a minimum holding period and a minimum holding threshold. This is because the EC Parent-Subsidiary Directive only provides for the implementation of a minimum standard and does not prevent the Member States from granting a more beneficial treatment to cross-border dividend distributions. If, therefore, a Member State grants beneficial treatment in a domestic context and the conditions set out in the EC Parent-Subsidiary Directive are not met, the Member State is required to extend the beneficial treatment to international settings as well. In other words, Austria is principally required not to apply Sec. 10(2) of the KStG, especially the minimum holding period and the minimum holding threshold, to distributions from subsidiaries resident in another Member State and also to grant an exemption in respect of these inbound distributions.

Against this background, the anti-abuse provision of Sec. 10(4) of the KStG also does not apply to inbound distributions received from subsidiaries resident in another Member State. Under Sec. 10(4) of the KStG, a switchover from the exemption method to the indirect tax credit method occurs if the foreign distributing company mainly derives certain passive income and is subject to low taxation in its country of residence. The reasoning behind this is that the application of the anti-abuse provision of Sec. 10(4) of the KStG entails a discrimination compared to purely domestic distributions, as Sec. 10(4) of the KStG represents a disproportionate anti-avoidance measure because it exceeds the extent that is strictly required for the purpose of countering tax avoidance to the detriment of the fundamental freedoms.

Finally, the question of whether or not the Austrian national participation exemption regime must also be extended to cross-border inbound distributions received from third-country subsidiaries remains unresolved. In its judgment of 13 January 2005, the Court held that this is the case with regard to foreign-source dividends channelled through an investment fund. In the authors' opinion, the Court was correct in this finding. There may, however, also be cases in which a different result is correct. This is especially so, as at the level of justification, there are good reasons to argue that the possibilities for the Member States to justify restrictive measures should be much greater towards third countries than when it concerns the free movement of capital within the European Union.

92. EFTA Court, 20 May 1999, Case E-6/98, *Norway v. EFTA Surveillance Authority* [1999] EFTA Court Report 74, Para. 34 and EFTA Court, 22 February 2002, Case E-1/01, *Hörður Einarsson v. The Icelandic State* [2002] EFTA Court Report 1, Para. 17.
93. See, for example, EFTA Court, Case E-1/00, *State Debt Management Agency v. Íslandsbanki-FBA hf.* EFTA Court Report [2000-2001], Para. 8. Art. 40 of the EEA Agreement states that "[w]ithin the framework of the provisions of this Agreement, there shall be no restrictions between the Contracting Parties on the movement of capital belonging to persons resident in EC Member States or EFTA States and no discrimination based on the nationality or on the place of residence of the parties or on the place where such capital is invested. Annex XII contains the provisions necessary to implement this Article."
94. See the instructive judgment of the EFTA Court, 23 November 2004, Case E-1/04, *Fokus Bank ASA v. The Norwegian State* (regarding tax credits under an imputation system for outbound dividends). For a discussion of the *Fokus Bank* case, see Andreas Bullen, "Norwegian Withholding Tax Contrary to Rules on Free Movement of Capital in EEA Agreement", 45 *European Taxation* 2 (2005), p. 75 et seq.
95. See ECJ, 23 September 2003, Case C-452/01, *Margarethe Ospelt and Schlössle Weissenberg Familienstiftung* [2003] ECR I-9743, Para. 30 et seq.
96. Dietmar Aigner and Georg Kofler, "Austria Clarifies Third Country Impact of ECJ's Lenz Decision", 36 *Tax Notes International* (1 November 2004), p. 480 et seq. See also Kristina Ståhl, "Free movement of capital between Member States and third countries", *EC Tax Review* (2004), p. 54 et seq.
97. ECJ, 15 July 2004, Case C-315/02, *Anneliese Lenz v. Finanzlandesdirektion für Tirol*, Para. 17.

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