CFE ECJ Task Force*

Opinion Statement ECJ-TF 4/2019 on the ECJ Decision of 26 February 2019 in *X-GmbH* (Case C-135/17), Concerning the Application of the German CFC Legislation in Relation to Third Countries

This CFE Opinion Statement, submitted to the EU institutions on 12 December 2019, comments on the decision in *X-GmbH* (Case C-135/17), in respect of which the Court of Justice of the European Union (Grand Chamber) (ECJ) delivered its decision on 26 February 2019. In general terms, the ECJ largely followed the Opinion given by Advocate General Mengozzi on 5 December 2018.

1. Executive Summary

X-GmbH (Case C-135/17)[1] concerned the compatibility of German CFC legislation with regard to third countries. In Germany, CFC legislation only applies in cross-border situations and not in purely domestic situations. In general, the application of CFC legislation requires that the shareholders have control over the foreign subsidiary, that the foreign subsidiary be taxed at a lower rate and that it earn passive income. Concerning a special type of passive income, there is even no control requirement. In relation to other EU and EEA countries, Germany does not apply its CFC legislation if the taxpayer proves that the company carries on a genuine economic activity. However, this "*Cadbury Schweppes* exception"[2] does not apply in relation to third countries. The referring German Court asked whether the relevant German tax rules were compatible with the TFEU provisions on the free movement of capital. The first and second question concerned the interpretation of the standstill clause in article 64(1) of the Treaty on the Functioning of the European Union (TFEU) (2007).[3] With its third question, the German Court inquired whether the *Cadbury Schweppes* jurisprudence can be transferred to the free movement of capital.[4]

The ECJ held that the standstill clause also applies if the scope of the domestic CFC legislation is extended after 31 December 1993 to shareholdings that do not involve direct investment. In addition, the Court stated that Member States cannot rely on the standstill clause if they change their legislation after 31 December 1993 and then later replace these changes by legislation essentially identical to that applicable on 31 December 1993 unless these changes were never applied due to their repeal with retroactive effect. Concerning the interpretation of article 63 of the TFEU, the ECJ adopted, in substance, its approach in *Cadbury Schweppes* (Case C-194/04) and held that the German CFC legislation does not infringe the free movement of capital unless the Member State of the shareholder is able to verify the accuracy of the information that the shareholding in the company is not the result of an artificial scheme.

The CFE Tax Advisers Europe note that the Court's decision in *X GmbH* constitutes a continuation of the Court's prior case law regarding the meaning of the standstill clause. The CFE welcomes the clarification with regard to the question of whether a restriction already existed on 31 December 1993.

The Court further developed its *Cadbury Schweppes* (Case C-196/04) jurisprudence, illustrating how to interpret the phrase "wholly artificial arrangements" in relation to the free movement of capital. The Court held that this concept has to be interpreted in a broader way in relation to third countries. It would be helpful if the Court were to give further guidance in a future decision on the meaning of "artificial transfer of profits".

X GmbH is also likely to be relevant in respect of domestic legislation implementing articles 7 and 8 of the EU Anti-Tax Avoidance Directive (2016/1164) (ATAD)[5] in

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1. DE: DE: ECJ, 26 Feb. 2019, Case C-135/17, *X-GmbH v. Finanzamt Stuttgart – Körperschaften*, Case Law IBFD.
2. UK: ECJ, 12 Sept. 2006, Case C-196/04, *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*, Case Law IBFD.
3. Treaty on the Functioning of the European Union of 13 December 2007, OJ C 115 (2008), Primary Sources IBFD.
4. DE: BFH, 12 Oct. 2016, I R 80/14, IStR, p. 316 (2017).
5. Council Directive 2016/1164 of 12 July 2016 Laying down Rules against Tax Avoidance Practices that Directly Affect the Functioning of the Internal Market, OJ L 193/1 (2016), Primary Sources IBFD [ATAD].

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that Member States will also have to apply the "substance escape" to third countries with an exchange of information clause.

2. Background and Issues

X GmbH is a German resident company that holds 30% of the shares of Y, a company resident in Switzerland. Y earned income from profit participation rights bought from another German company. X GmbH was subject to the German CFC legislation, which resulted in a pro-rata incorporation of Y's income into X GmbH's tax base. While the German CFC legislation, in general, requires control, low taxation and passive income, for a specific type of passive income ("*Zwischeneinkünfte mit Kapitalanlagecharacter*" – controlled company income from invested capital) the participation threshold is lowered to 1%. As the income from the profit participation rights fell within that specific category, the 30% participation was enough to trigger CFC legislation.

The German rules on CFC legislation were significantly changed after 31 December 1993. First, the participation threshold regarding controlled company income from invested capital was lowered from 10% to 1%. Second, the German Tax Reduction Act 2000 (*Steuersenkungsgesetz*, GTR Act)[6] altered the whole concept of CFC legislation. While in the past, the CFC legislation led to an anticipated dividend distribution, the GTR Act attributed the income earned by the CFC to the shareholder and subjected it to the German corporate tax rate. Later distributions from the CFC were then taxable at the reduced rate for dividends. The GTR Act entered into force for the 2001 tax year. The effect of the attribution of the income of the CFC to the shareholder would only be felt in 2002. However, the new CFC rules contained in the GTR Act were repealed by the Act on the Further Development of Company Taxation (*Unternehmenssteuerfortentwicklungsgesetz*, FDCT Act) of 20 December 2001. The FDCT Act reestablished a CFC system similar to the one originally in force. As a consequence, the shareholders were never subject to the new system provided by the GTR Act.

X GmbH brought an action against the inclusion of the CFC income in the tax assessment, arguing that the profits earned by Y did not constitute income from invested capital. The Finanzgericht Baden-Württemberg dismissed the action and held that the application of the CFC legislation was correct, as the profits earned by Y were correctly characterized as income from invested capital.[7] EU law issues were not raised at that level. X GmbH appealed the decision and claimed that the German CFC rules at issue violated the free movement of capital. The *Bundesfinanzhof* confirmed that the German CFC legislation was correctly applied but had doubts about the compatibility of the German rules with the free movement of capital. The *Bundesfinanzhof* stayed the proceedings and referred the following questions to the ECJ for a preliminary ruling:

(1) Is Article 57(1) EC (now Article 64(1) TFEU) to be interpreted as meaning that a restriction in a Member State which existed on 31 December 1993 in respect of the movement of capital to and from third countries involving direct investments is not affected by Article 56 EC (now Article 63 TFEU) if the national law in force at the relevant date restricting the movement of capital to and from third countries essentially applied only to direct investments, but was extended after that date to cover also portfolio holdings in foreign companies below the threshold of 10%?

(2) If the first question is to be answered in the affirmative: Is Article 57(1) EC to be interpreted as meaning that a provision of national law restricting the movement of capital to or from third countries involving direct investments, existing on the relevant date of 31 December 1993, is to be regarded as applicable by reason of the fact that a later provision of national law that is essentially identical to the restriction in force at the relevant date is applicable, but where the restriction existing at the relevant date was substantially amended after that date and for a short period by legislation which formally entered into force but was in practice never applied due to the fact that it was replaced, before it could be applied to a specific case for the first time, by the provision that is now applicable?

(3) If either of the first two questions is to be answered in the negative: Does Article 56 EC preclude legislation of a Member State under which the basis of assessment to tax of a taxable person resident in that Member State, which holds at least 1% of the shares in a company established in another State (in the present case, Switzerland), includes, pro-rata to the percentage of the shareholding, positive income obtained by that company from invested capital, where such income is taxed at a lower rate than in the Member State?

3. The Decision of the Court of Justice

The Court began by analysing the scope of the standstill clause contained in article 64 of the TFEU. The Court first had to deal with the question of whether the standstill clause also applies to situations in which a Member State extends the ambit of the CFC legislation – i.e. the restriction to the free movement of capital – after 31 December 1993 by lowering the participation threshold from 10% to 1%.

The ECJ confirmed its jurisprudence that a shareholding that confers the possibility of effectively participating in the management and control of the company could be regarded as a direct investment in the sense of article 64 of the TFEU.[8] X GmbH had a shareholding of 30%, which the referring court classified as a direct investment, and the ECJ accepted this.[9]

According to the Court, the standstill clause not only covers situations in which the national legislation exclusively restricts direct investment, but also protects legislation restricting direct investment in situations in which national legislation applies to both direct and portfolio investments.[10] The scope of the standstill clause does not depend on the specific purpose of the national legislation but on the effect of that restriction on the movement of capital.[11] The ECJ concluded that an extension of the participation threshold from 10% to 1% after 31 Decem-

6. DE: Tax Reduction Act 2000 (*Steuersenkungsgesetz* 2000).
7. DE: FG Baden-Württemberg, 21 Oct. 2014, 6 K 2550/12.
8. *X GmbH* (C-135/17), para. 26.
9. Id., para. 29.
10. The Court cited its decision in NL: ECJ, 15 Feb. 2017, Case C-317/15, *X v. Staatssecretaris van Financiën*, paras. 21 and 22, Case Law IBFD.
11. *X GmbH* (C-135/17), para. 31.

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ber 1993 did not prejudice the application of the standstill clause of article 64 of the TFEU to restrictions that already existed on 31 December 1993 provided that those restrictions concerned direct investment.[12]

The Court then turned to the second question asked by the *Bundesfinanzhof*. It had to analyse whether a fundamental change of the national rules after 31 December also prevents the application of the standstill clause in cases where that change is subsequently repealed and legislation essentially identical to the one that existed before the change is reintroduced with retroactive effect.[13]

The ECJ referred to its settled case law, stating that changes to national legislation taking place after 31 December 1993 do not automatically exclude the application of the standstill clause. Restrictions adopted after 31 December 1993 can be treated as equivalent to existing restrictions if they are, in essence, identical to previous legislation or if they reduce or eliminate an obstacle to the free movement of capital.[14]

It is, however, a requirement that the national provisions relating to the restriction in question have formed part of the legal order of the Member State continuously since 31 December 1993.[15] As a result, the standstill clause cannot be invoked with regard to provisions adopted by a Member State that reintroduce an obstacle to the free movement of capital that existed on or before 31 December 1993 but that was repealed after that date. In such instances, the restriction would not have existed continuously since 31 December 1993. The Court once again stressed that, as the standstill clause constitutes a derogation from the fundamental principle of the free movement of capital, it must be interpreted strictly.[16]

The ECJ went on to state that a repeal or amendment takes place on the day the repealing or amending legislation enters into force. However, a restriction must be regarded as having been maintained continuously where the applicability of the repealing or amending provisions is deferred under national law and those provisions are themselves repealed before they ever become applicable.[17]

After this general explanation, the Court examined two different scenarios: If the GTR Act was adopted together with provisions deferring the applicability of that law, so that the amendments to the CFC legislation were never applicable during the period between 1 January and 25 December 2001 when the FDCT Act entered into force, then it would be appropriate to consider that the old CFC legislation has been maintained since 31 December 1993 continuously. If, on the other hand, the GTR Act became applicable as soon as it entered into force on 1 January 2001, then the restriction cannot be regarded as existing continuously since 31 December 1993. This would be the case if the entry into force of the GTR Act meant that controlled-company income arising in 2001 was bound to be incorporated into the tax base of the shareholder, notwithstanding the fact that, as a result of the repeal of the GTR Act on 25 December 2001, the tax authorities ultimately did not apply those rules in order to collect, in 2002, the tax on that income. It is for the *Bundesfinanzhof* to ascertain which of the two scenarios are met in this situation.[18]

As it is for the referring court to decide if the requirements of the standstill clause are fulfilled, the ECJ went on to analyse whether the application of the German CFC legislation in relation to Switzerland constituted a violation of the free movement of capital enshrined in article 63 of the TFEU.[19] As a taxpayer holding shares in a Swiss company earning income from invested capital was subject to CFC legislation while the same taxpayer holding shares in a similar German company was not subject to that legislation, the Court concluded that the German provisions constitute a restriction on the free movement of capital.

The Court went on to explain the meaning of article 65(1)(a) of the TFEU, which provides that:

> the provisions of Article 63 TFEU shall be without prejudice to the rights of Member States … 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.

That provision cannot be interpreted as meaning that all tax legislation that treats taxpayers differently based on their place of investment is automatically in line with the TFEU. According to the settled case law of the Court, such differences in treatment are only allowed when they concern situations that are not objectively comparable or when they are justified by an overriding reason in the general interest.[20]

Concerning comparability, the Court held that as soon as a Member State taxes a resident company on the income obtained by a company established in a third country, in which the resident company holds shares, the situation of that resident company becomes comparable to that of a resident company that holds shares in another resident company.[21]

12. Id., para. 33.
13. *X GmbH* (C-135/17), para. 35 et seq.
14. Id., para. 37, referring to UK: ECJ, 12 Dec. 2006, Case C-446/04, *Test Claimants in the Franked Investment Income Group Litigation v. Commissioners of Inland Revenue*, paras. 189 and 192, Case Law IBFD; AT: ECJ, 24 May 2007, Case C-157/05, *Winfried L. Holböck v. Finanzamt Salzburg-Land*, para. 41, Case Law IBFD; and SE: ECJ, 18 Dec. 2007, Case C-101/05, *Skatteverket v. A*, para. 49, Case Law IBFD.
15. *X GmbH* (C-135/17), para. 38, referring to *A* (C-101/05), para. 48; FR: 5 May 2011, Case C-384/09, *Prunus SARL, Polonium SA v. Directeur des Services Fiscaux*, para. 34, Case Law IBFD; and PT: ECJ, 24 Nov. 2016, Case C-464/14, *SECIL – Companhia Geral de Cal e Cimento SA v. Fazenda Pública*, para. 81, Case Law IBFD.
16. *X GmbH* (C-135/17), para. 43.
17. Id., para. 47.
18. Id., paras. 47-51.
19. Id., paras. 52-96.
20. *X GmbH* (C-135/17), para. 61, referring to NL: ECJ, 6 June 2000, Case C-35/98, *Staatssecretaris van Financiën v. B.G.M. Verkooijen*, para. 43, Case Law IBFD; FI: ECJ, 7 Sept. 2004, Case C-319/02, *Petri Manninen*, para. 29, Case Law IBFD; and DE: ECJ, 17 Sept. 2009, Case C-182/08, *Glaxo Wellcome GmbH & Co. KG v. Finanzamt München II*, para. 68, Case Law IBFD.
21. *X GmbH* (C-135/17), para. 68. This line of case law has a long history; *see*, for example, DE: ECJ, 21 Sept. 1999, Case C-307/97, *Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v. Finanzamt Aachen-Innenstadt,* para. 49, Case Law IBFD.

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With regard to the justification, the ECJ cited its settled case law that a justification requires that the measure be suitable to securing the attainment of the objective in question and that the measure not go beyond what is necessary in order to obtain it.[22] The Court confirmed that the need to safeguard the balanced allocation of taxing rights, the need to prevent tax evasion and avoidance and the need to guarantee the effectiveness of fiscal supervision constitute overriding reasons in the public interest capable of justifying a restriction on the free movement of capital.[23]

As the German CFC legislation offsets the effects of any artificial transfer of income to low-taxed third countries, it is, in principle, suitable for ensuring the attainment of the objectives it pursues.

The Court then analysed the proportionality of the restriction and stated that the mere fact that a resident company holds shares in another company established in a third country cannot, as such, give rise to a general presumption of tax evasion and avoidance. A national measure restricting the free movement of capital may only be justified when it specifically targets conduct that consists in creating wholly artificial arrangements.[24] The Court referred to its *Cadbury Schweppes* decision wherein it had assumed a "wholly artificial arrangement" to exist when the subsidiary was a fictitious establishment that did not carry out any genuine economic activity in the territory of the host Member State. The Court took account of the extent to which that company physically existed in terms of premises, staff and equipment.[25]

In the context of the free movement of capital, the term "wholly artificial arrangement" must be interpreted in a broader way. As regards cross-border movements of capital, the artificial creation of a scheme to escape taxation or to enjoy a tax advantage can take several forms. This includes situations in which the taxpayer acquires shares in a company that does not pursue any economic activities of its own but also situations in which a scheme has, as its primary objective, or one of its primary objectives, the artificial transfer of the profits made by way of activities carried out in the territory of a Member State to third countries with a low tax rate.[26]

The Court then concluded that the German CFC legislation was not specifically designed to target artificial arrangements. It applied to all situations in which the foreign corporation earned income from invested capital that was subject to a low tax and did not grant the taxpayer the opportunity to show that his shareholding was not the result of an artificial scheme. A low tax rate, in combination with passive income, can serve as an indication of conduct that might amount to tax evasion or avoidance, but these factors should not be employed as an irrebuttable presumption of an artificial scheme in all cases. As a result, as regards relationships between Member States, national legislation that is intended to be proportionate must give the taxpayer an opportunity to provide evidence of any commercial justification that there may have been for the transaction at issue without subjecting him to undue administrative constraints.[27]

However, the ECJ reiterated its holding that case law concerning restrictions on the exercise of the fundamental freedoms within the European Union cannot be transposed in its entirety to movements of capital between Member States and third countries since such movements take place in a different legal context.[28] In particular, a Member State must have the possibility to verify whether the evidence provided by the taxpayer is accurate and true. Where the legislation of a Member State makes entitlement to a tax advantage dependent on the satisfaction of conditions, the compliance with which can be verified only by obtaining information from the competent authorities of a third country, it is, in principle, legitimate for that Member State to refuse to grant that advantage if, for example, that third country has no treaty obligation to provide information and it, therefore, proves impossible to obtain that information from that third country.[29]

The ECJ concluded that it is for the referring court to examine whether the treaty provisions between Germany and Switzerland empower the German tax authorities to verify the accuracy of the information provided by the taxpayer. If such legal framework does not exist, then the German CFC rules do not violate the free movement of capital. If such a legal framework, by contrast, exists, the taxpayer must be given the opportunity to show his commercial reasons for the investment in Switzerland. Without granting such an opportunity, the German CFC rules violate article 63 of the TFEU.

4. Comments

In many regards, X-GmbH confirms prior case law of the ECJ. The decision further illustrates the meaning of the standstill clause contained in article 64 of the TFEU. Moreover, it gives additional guidance on the meaning of the term "wholly artificial arrangements" within the framework of the free movement of capital in relation to third countries.

With regard to the interpretation of the standstill clause, the Court has now clarified that extending the substantive scope of a restriction after 31 December 1993 to cover portfolio investment does not make the standstill clause inapplicable to investments that otherwise qualify as direct.

22. *X GmbH* (C-135/17), para. 70, referring to FR: ECJ, 11 Oct. 2007, Case C-451/05, *Européenne et Luxembourgeoise d'investissements SA v. Directeur général des Impôts, Direction des services généraux et de l'informatique and Ministère public (ELISA)*, paras. 79 and 82, Case Law IBFD; DE: ECJ, 23 Jan. 2014, Case C-164/12, *DMC Beteiligungsgesellschaft mbH v. Finanzamt Hamburg-Mitte*, para. 44, Case Law IBFD; and DK: ECJ, 21 June 2018, Case C-480/16, *Fidelity Funds v. Skatteministeriet*, para. 64, Case Law IBFD.
23. *X GmbH* (C-135/17), paras. 72-74.
24. Id., para. 80.
25. Id., para. 82, referring to *Cadbury Schweppes* (C-196/04), para. 67 et seq.
26. Id., para. 84.
27. Id., para. 87.
28. Id., para. 90, referring to FR: ECJ, 28 Oct. 2010, Case C-72/09, *Société Etablissements Rimbaud v. Direction Générale des Impôts*, para. 40, Case Law IBFD.
29. *X GmbH* (C-135/17), para. 92

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The Court also had to deal with the question of whether a substantial change after 31 December 1993, which was then retroactively repealed, would lead to the inapplicability of article 64. Granting this possibility would make it possible for Member States to reintroduce restrictions on the free movement of capital they had previously abolished. A change that had no effect, as it was never applied, should not, however, jeopardize the application of article 64 of the TFEU.

The ECJ found a worthy solution. It focused on the question of whether the provisions that were later repealed were applicable after their entry into force. If the changes were repealed before they ever became applicable, a Member State could still rely on article 64 of the TFEU. If, however, the changes became applicable after their entry into force, meaning that the CFC income was bound to be incorporated into the tax base of the taxpayer, although he was never taxed on that income, then article 64 of the TFEU can no longer be relied upon.

Following that guidance, the *Bundesfinanzhof* came to the conclusion that the standstill clause can no longer apply.[30] As the income from invested capital had to be calculated as of 1 January 2001, the provision of the S*teuersenkungsgesetz* was actually "applied" so that the later repeal of that legislation could not undo the effects of that change.

Concerning the analysis of article 63 of the TFEU, the Court followed its prior case law to the effect that a restrictive measure, in order to be compatible with the fundamental freedoms, has to pursue an overriding goal in the general interest, must be capable of attaining that goal and must not go beyond what is necessary. As the German CFC legislation is not specifically targeted at fighting "wholly artificial arrangements" and does not grant the taxpayer the opportunity to prove commercial reasons, it would clearly be disproportionate under *Cadbury Schweppes*.[31]

The Court, however, further explained how to interpret the term "wholly artificial arrangements" in the context of the free movement of capital. It held that the concept has a broader meaning with regard to article 63 of the TFEU. It not only includes the acquisition of shares in a company that does not pursue any economic activity, but also the artificial transfer of profits to a company in a low-tax jurisdiction. Unfortunately, the Court does not further illustrate what it means by an artificial transfer. In general, a shareholder is free to decide whether he wants to finance a subsidiary with debt or equity. In addition, companies are free to sell and acquire debt claims or other assets leading to the generation of passive income. It would have been interesting to know which link to the income and what amount of activity going on in the subsidiary the ECJ deems necessary in order to regard a transfer of profits as legitimate.

The ECJ also confirmed its prior case law that the free movement of capital between Member States versus such movement between third countries, takes place in a different legal context and that, therefore, the case law concerning intra-EU situations cannot be transposed in its entirety to situations involving third countries. If a Member State cannot verify the information provided by the taxpayer, it is not obliged to take that information into account. By contrast, if there is an exchange of information agreement in place, the taxpayer must be given the opportunity to show a commercial justification, even though the German rules did not provide the opportunity to rebut the presumption. The Court acknowledged that such exchange of information could take place "inter alia, by treaties".[32] Indeed, in earlier case law, the Court accepted that an obligation for the non-Member State to provide information may follow from an exchange of information provision in a tax treaty (for example, a standard exchange of information provision along the lines of article 26 of the OECD Model (2017))[33] or any other agreement (for example, a Tax Information Exchange Agreement or the OECD/Council of Europe Multilateral Convention on Exchange of Information).[34]

In its follow-up decision, the *Bundesfinanzhof* analysed the Germany-Switzerland Income and Capital Tax Treaty (1971)[35] and concluded that it does not contain a so-called major information clause.[36] Switzerland was not obliged to provide information concerning the fulfilment of requirements contained in the domestic tax law of Germany. As Germany cannot verify the information provided by the taxpayer, the German CFC legislation does not violate the free movement of capital.

The last part of the *X GmbH* decision might also have consequences for the implementation of articles 7 and 8 of the ATAD. In the authors' view, the Court's case law suggests[37] that the three-pronged test in article 7(1)(a) of the ATAD, which not only relies on control characteristics (i.e. more than 50% of capital ownership or voting rights), but alternatively also on a non-control characteristic (i.e. entitlement "to receive more than 50 percent of the profits of that entity"), generally opens up the rule to a freedom of capital movement inquiry. Moreover, Member

30. DE: BFH, 22 May 2019, Case I R 11/19, ECLI: DE: BFH:2019:U.220519:IR11.19.0., para 27.
31. In the authors' view, the notion of "commercial" as used by the Court extends well beyond a narrow understanding, such as a trading activity, and would cover any economic reason, especially in the context of the free movement of capital.
32. *X GmbH* (C-135/17), para. 95
33. *OECD Model Tax Convention on Income and on Capital* (21 Nov. 2017), Treaties & Models IBFD.
34. *Convention between the Member States of the Council of Europe and the Member Countries of the OECD on Mutual Administrative Assistance in Tax Matters* (25 Jan. 1988) (amended by the 2010 Protocol), Treaties & Models IBFD. *See SECIL* (C-464/14), para. 64, referring to DE: ECJ, 17 Oct. 2013, Case C-181/12, *Yvon Welte v. Finanzamt Velbert*, EU:C:2013:662, para. 63, Case Law IBFD.
35. *Convention between the German Federal Republic and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital* (unofficial translation) (11 Aug. 1971) (as amended through 2010), Treaties & Models IBFD.
36. I R 11/19 (22 May 2019), para. 34.
37. *See*, for example, PT: ECJ, 3 Oct. 2013, Case C-282/12, *Fazenda Pública v. Itelcar – Automóveis de Aluguer, Lda*, para. 16 et seq., Case Law IBFD; PL: ECJ, 10 Apr. 2014, Case C-190/12, *Emerging Markets Series of DFA Investment Trust Company v. Dyrektor Izby Skarbowej w Bydgoszczy*, para. 30, Case Law IBFD; DE: ECJ, 11 Sept. 2014, Case C-47/12, *Kronos International Inc. v. Finanzamt Leverkusen*, para. 37 et seq., Case Law IBFD; and *SECIL* (C-464/14), para. 33.

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States may go beyond the minimum standard set by the ATAD (article 3 of the ATAD) and also apply it generally to non-controlling shareholdings, i.e. capital movements. In those situations, it needs to be recalled that article 7(2)(a) of the ATAD obliges Member States to introduce a *Cadbury Schweppes*-inspired "substance escape": The CFC rule shall not be applied if the taxpayer shows that the CFC "carries on a substantive economic activity supported by staff, equipment, assets and premises, as evidenced by relevant facts and circumstances". The ATAD, however, gives Member States the option not to apply this exception in relation to third countries. According to *X GmbH*, in the above situations, it seems that Member States may no longer exercise that option (but rather apply the "substance escape") in relation to third countries if the other state has concluded a tax treaty with the Member State that contains an exchange of information clause. Member States will have to take the decision into account in implementing articles 7 and 8 of the ATAD.

5. The Statement

The Court's decision in *X GmbH* constitutes a continuation of the Court's prior case law regarding the meaning of the standstill clause. The CFE welcomes the clarification with regard to the question of whether a restriction already existed on 31 December 1993.

The Court further developed its *Cadbury Schweppes* case law, illustrating how to interpret the phrase "wholly artificial arrangements" in relation to the free movement of capital. The Court held that this concept has to be interpreted in a broader way in relation to third countries. It would be helpful if the Court were to give further guidance in a future decision on the meaning of "artificial transfer of profits".

X GmbH is likely also relevant to domestic legislation implementing articles 7 and 8 of the ATAD, in that Member States will have to also apply the "substance escape" to third countries with an exchange of information clause.

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