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Head in the sand when trust income is in sight? Analysis of double taxation of trust income originating from dividends in light of Articles 49 and 63 TFEU.

by

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Summary

This thesis challenges the treatment of trust income received in a country with no trusts in its legal system in light of freedom of establishment and free movement of capital. Can provisions of a Member State that has decided not to have trusts in its legal system make the transfer of shares or even the establishment of a trust elsewhere less favourable?

This question, as the starting point of this thesis, managed to open a Pandora's box of additional aspects and questions to consider, where each deserves a thesis on its own.

In search of answers, the thesis establishes that trusts enjoy the protection of fundamental freedoms.

Further, the thesis dives into comparability analysis by presenting two alternatives of how to find a comparable in a situation where purely equivalent comparable does not exist. If a domestic comparable cannot be found in light of the proposed comparability analysis, the thesis questions the necessity of the comparability analysis altogether.

Along with other nuances, during the determination of the restriction, the thesis challenges whether Member States have to protect the use of establishments they do not use in their system and whether fundamental freedoms can be challenged if the use of said freedoms does not take place in the Member State from what the restriction derives.

Lastly, the thesis presents justifications that might be used for Member States if a restriction indeed is found, with indications of the proportionality of such justifications.

Preface

This thesis is the culmination of my Master's studies in European and International Tax Law at the Lund University School of Economics and Management.

I am deeply grateful to my supervisor Sigrid Hemels for her kind support and constructive critique. Her delicate and masterful guidance had a significant influence on keeping me focused and shaping the thesis as they are today.

Further, my sincerest gratitude goes to Cécile Brokelind for her passion, inspiration and genuine willingness to teach. Participating in her classes was a remarkable experience that I will cherish forever. I am especially thankful for her fruitful and thought-provoking lectures on fundamental freedoms that lead me to my thesis topic.

A Master's program where *every* lecture challenges the way one thinks and, on top of that, leaves with a hunger for more knowledge is not easy to find, and I am grateful that this program was just that.

Thus, my deepest gratitude goes towards all the visiting professors for their invaluable knowledge and creative way of teaching, as well as to all my classmates for the demanding and energetic discussion in the classroom.

This has been a truly unforgettable academic journey. Thank you!

Abbreviation list

AG	Advocate General
CFC	Controlled foreign corporation
CIT	Corporate Income Tax
Commission	Commission of the European Union
DAC	Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC
Directive 77/799/EEC	Council Directive (EU) 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation
DTT	Double Taxation Convention
ECJ	European Court of Justice, Court of Justice of the European Union
EEA	European Economic Area
EEA Agreement	The Agreement of European Economic Area
EFTA	European Free Trade Area
EU	European Union
Hague Trust Convention	Convention of 1 July 1985 on the Law Applicable to Trusts and on their Recognition
I.e.	id est, or 'that is'
Incl.	Including
MLI	Multi-Lateral Instrument
OECD	Organization for Economic Cooperation and Development
TFEU	Treaty on the Functioning of the European Union
TEU	Consolidated version of the Treaty on European Union (TEU) [2012] OJ C326/13

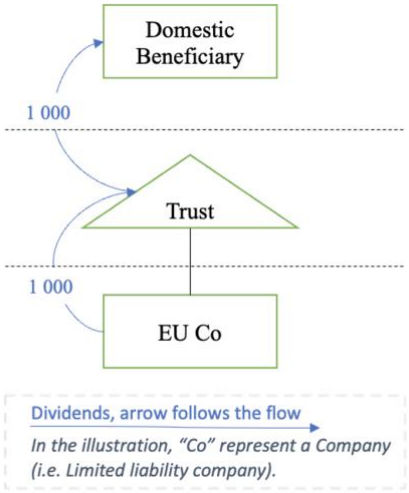
1. Introduction

1.1 Background

1.1.1 Source of inspiration and relevance

The source of inspiration for this thesis originates from evaluating possible tax consequences in Latvia in a situation when a beneficiary that is a Latvian tax resident receives income in the form of flow-through dividends from a foreign trust.

The structure used as inspiration and factual basis for the thesis is illustrated below.



Source: Author's considerations.

Latvian CIT system follows a distribution model where the tax point is deferred until the moment of profit or deemed profit distribution. In the case of flow-through dividends, such dividends are exempt if received from a CIT payer or the tax is paid at the source.[1] Thus, it is ensured that dividends are taxed only at the source, and the risk of double taxation is eliminated.

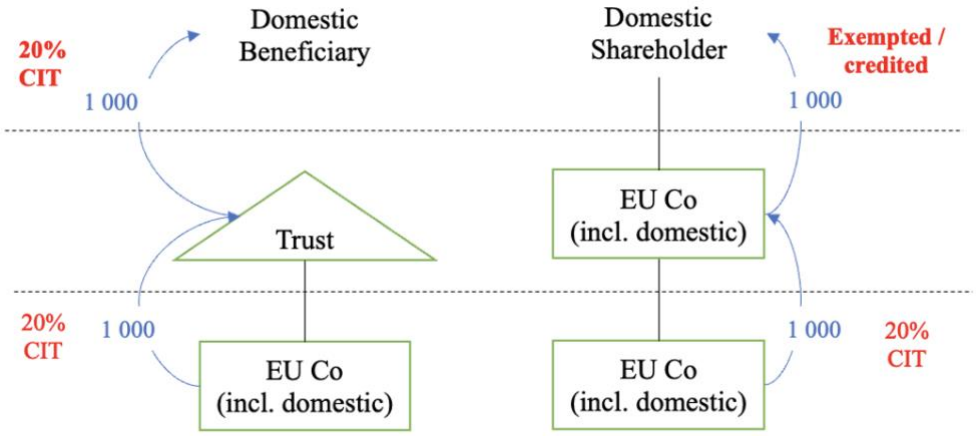
Under local rules, there are no restraints related to what kind of dividend income enjoys such benefit- it applies to dividends received from resident and non-resident companies. It does not matter if such dividends are received through subsidiaries. Furthermore, it is assumed that the local legislation is not created to promote some legal forms over others as it is linked to the dividend definition and not the legal form of the income payer.

When discussing the trust income in light of tax provisions referring to dividends, the Supreme Court of Latvia has established in its case law that a

[1] Latvian Corporate Income Tax Law (*Uzņēmumu ienākuma nodokļu likums*), 2018, Article 6(1).

beneficiary is not the beneficial owner of the capital asset; thus, it does not receive income that could be classified as "dividends".[2]

Accordingly, due to a lack of clear guidance in the CIT law combined with the approach of the Supreme Court of Latvia to dividend definition, there is a risk that the trust income deriving from flow-through dividends does not fall under the exemptions provided by the CIT law. In practice, it would mean that respective dividend flow is taxed twice- at source and in the hands of the beneficiary upon further distribution. Below is an example illustrating the difference in the tax treatment.



Dividend amount	1 000	1 000
Tax at source level	200	200
Tax at beneficiary level	200	0
TOTAL tax liability	**400**	**200**

Dividends, arrow follows the flow

In the illustration, "Co" represent a Company (i.e. Limited liability company).

Source: Author's considerations[3].

Since trusts cannot be registered in the local legislation, it is considered that the risk is limited only to situations with a cross-border element, i.e. when the income flows through a foreign trust. As a purely identical situation involving a trust registered in Latvia is not possible, such an unfavourable outcome would not occur domestically. Due to this, the lack of guidance for trusts may be challenged as affecting only cross-border arrangements, thus opening the door for a discussion of potential restrictions of EU fundamental freedoms.

In essence, the research topic discusses whether a Member State can tax twice the income that flows through another Member State via an arrangement that cannot be established in the first Member State. The underlying cause of

[2] Judgment of May 3, 2019 in Case No. A4200328317 (Latvia), para 14.
[3] The calculations are performed based on Latvian tax accounting principles where instead of withholding CIT from the payment, it constitutes an additional expense. The calculation might differ in different Member States, however the nature of double liability would remain.

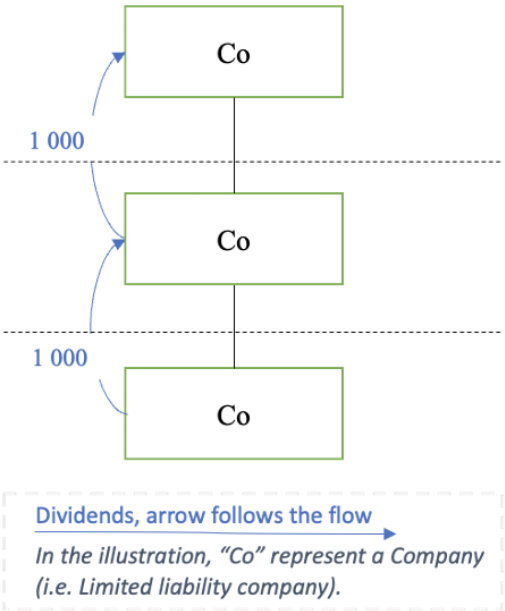
double taxation derives from the use of the flow-through element (i.e. trust), leading to a change in the legal title of the respective income in light of the domestic rules.

While the inspiration of this thesis derives from a possible risk emanating from the legislation of Latvia, the analysis will not be performed by applying Latvian tax rules. The thesis will discuss a hypothetical analogue scenario where one Member State has chosen to enjoy its freedom to have trusts in its legal system in connection with an EU national that enjoys its freedom to use such trusts. In the thesis, it will be considered that the beneficiary resides in a Member State that does not have trust in its legal system.

Further, this thesis has been written considering trusts established by domestic law and, under that law, are not considered companies or firms constituted under civil or commercial law. Moreover, such trusts have not been created for charitable or social purposes but as profit-generating instruments.

1.1.2 Concept of flow-through dividends

Throughout the analysis, a concept of flow-through dividends will be used that represents dividends that are 'flowing through' an entity or arrangement (such as a trust), i.e., dividends that instead of being distributed directly to the ultimate partner are "going up the chain" through other establishments or arrangements. An example is illustrated below.



Source: Author's considerations.

1.2 Aim

This thesis will discuss a dilemma of a clash between the freedom of a Member State to choose whether to have trusts in its legal framework and an EU nation using its freedom in access trust. Is a Member State that chose not to have trusts in its legal system required to ensure unrestricted access to a trust established elsewhere?

Thus, this thesis aims to answer the following question: does restrictive treatment (in the form of double taxation) applied to a dividend-sourced income received from a trust constitute a breach of freedom of establishment (Article 49 TFEU) and free movement of capital (Article 63 TFEU), by assuming that in the Member State in question, trusts cannot be registered.

Currently, the ECJ has dealt with trusts, direct taxation and fundamental freedoms only once[4], thus creating a level of uncertainty in their treatment.

This thesis will analyse aspects of freedom of establishment and free movement of capital as following the ECJ practice in case where it cannot be clarified under which freedom a domestic provision would fall, both can be analysed.[5]

In search of the answer, the Author considers that the situation used as an example in the thesis presents multiple layers of uncertainty, including but not limited to (1) whether trusts enjoy the protection of fundamental freedoms, (2) what is the comparability point if there is no possibility for fully comparable purely domestic situation (i.e. trusts cannot be established in such Member State) and (3) the relationship between justification and proportionality when dealing with an arrangement that is unknown to the respective Member State local legislation- is it the suspicion deriving from unfamiliarity that leads to the restrictive treatment?

1.3 Method

The above aim is achieved following a legal-dogmatic[6] approach by evaluating the application of Articles 49 and 63 TFEU to the situation in question.

The analysis will be performed in light of the ECJ case law and academic literature, as well as the opinions of AG and scholarly writers.

As the situation discussed in this thesis has not been broadly discussed by the ECJ, the Author will challenge the application of fundamental freedoms and use the ECJ case law from cases with a different factual background to draw conclusions from the ECJ approach taken when dealing with similar dilemmas.

1.4 Delimitation

The thesis is only targeted at situations that bear the risk of restrictive tax treatment in the form of double taxation; thus, throughout the research, it is assumed that the tax on respective income has been paid at source. The analysis does not consider situations that would result in double exemption or tax avoidance due to the acknowledgement of a possible breach.

[4] See Case C-646/15 *Trustees of the P Panayi Accumulation & Maintenance Settlements* [2017] EU:C:2017:682.
[5] Case C-375/12 *Bouanich* [2006] EU:C:2014:138, paras 29, 30, 31.
[6] Douma Sjoerd, *Legal Research in International and EU Tax Law* (Wolters Kluwer Business, 2014) 17.

The analysis assumes that the flow-through dividend payment is traceable without considering the possibility that dividends further distributed from the trust could include elements sourced from other income streams.

Considering the wide variety of differentiating aspects, the analysis is limited to trust income deriving from dividends; however, it could be applied to different situations.

While the Author considers how the analysis could be extended to trusts registered in third countries, this thesis will be limited to purely EU transactions. Analysis of the possibility of extending the considerations to third countries in light of the free movement of capital is excluded from this thesis.

The thesis does not evaluate the possibilities of eliminating the risk of double taxation by applying a signed DTT in light of the guidance provided by the OECD. Irrespectively, the Author notes that such discussion could be relevant if the topic were explored further. Indeed, it has been acknowledged that the EU Member States are facing challenges in DTT application for trust income due to different views on the legal nature of the trusts leading to a legal dilemma of whether trusts would constitute a resident of a Contracting State as under some EU Member States local rules trusts would not qualify as a 'person'.[7] Notwithstanding, this thesis will exclude the discussion regarding issues related to double taxation from the DTT standpoint and will consider that DTT does not eliminate double taxation.

1.5 Outline

The structure of the thesis will follow the four-step analysis structure used by the ECJ when dealing with cases related to direct taxation and fundamental freedoms.[8]

First, by analysing existing case law, this thesis will analyse whether trusts enjoy the protection of fundamental freedoms.

Then the Author will deliver a comparability analysis by introducing two methods of how comparability could be found. The Author will also challenge the need for comparability analysis in the situation discussed.

After determining the presence of a domestic comparable, the presence of restriction will be determined by analysing the decision-making power in light of the characteristics of a trust, as well as drawing attention to possible problem areas that might create uncertainty when applying the existing ECJ case law to the situation discussed.

Lastly, the Author will evaluate possible justifications and aspects to consider when determining if they are proportional.

[7] Alexander Rust, 'Scope of the Convention: Article 1. Persons Covered' in Ekkehart Reimer and Alexander Rust (eds), *Klaus Vogel on Double Taxation Conventions* (5th edn, Kluwer Law International BV 2022) 86.

[8] Adam Zalasiński, '35 Years of CJEU Direct Tax Case Law: An Historical Overview on the Occasion of the 60th Anniversary of European Taxation' (2021) 61 European Taxation, IBFD 542.

2. What is a trust?

A trust is a legal relationship created when the owner of the assets (the settlor) transfers title to its assets to another person (trustee), who manages and effectively controls those assets for the benefit of a specific person or persons (beneficiaries) following the directions of the settlor.[9] The trustees' ownership is restricted, as it must adhere to the instructions given by the settlor and cannot deviate from them.[10] The trusts are considered as not having their own legal personality but rather constituting a relationship between property and persons involved.[11]

While tax aspects could influence the decision to set up a trust, in no way it could be automatically considered that trusts are set up for purely tax purposes, i.e. tax avoidance.[12]

The decision to create a trust usually lies with the possibility of separating the decision-making role, i.e. the power of the settlor to set its own rules even when such settlor is deceased or otherwise no longer in the capacity to make decisions combined with the possibility to involve various professionals to fulfil the vision set by the settlor.[13] Additionally, asset owners that are more hesitant to expose their assets publicly tend to opt for trust structures as they would no longer hold the legal title of the said assets.

However, not all countries have implemented trusts in their legal systems, with trusts mostly being recognised in common law jurisdictions with few exceptions deriving from mixed common and civil law jurisdictions.[14]

To solve disparities deriving from the different approaches towards trusts[15], the Hague Trust Convention[16] was signed, setting out the general characteristics of a trust and defining them as follows:

> *[…], the term' trust' refers to the legal relationship created- inter vivos or on death – by a person, the settlor, when assets have been placed under the control of a trustee for the benefit of a beneficiary or for a specific purpose.*
>
> *A trust has the following characteristics-*

[9] Susan M. Lyons (ed), *International Tax Glossary* (3rd edition, International Bureau of Fiscal Documentation, 1996) 318.
[10] Félix Alberto Vega Borrego, *Limitations on Benefit Clauses in Double Taxation Conventions* (2nd edition, Kluwer Law International BV 2017) 25.
[11] Mark Brabazon, *International Taxation of Trust Income: Principles, Planning and Design* (Cambridge University Press, 2019) 7.
[12] Brabazon (n11) 10.
[13] Brabazon (n11) 10.
[14] Brabazon (n11) 5.
[15] Convention of 1 July 1985 on the Law Applicable to Trusts and on their Recognition. Outline. (1985) <https://assets.hcch.net/docs/489deb8e-f3b8-4c97-b349-fd691b7f8591.pdf> accessed May 16, 2023.
[16] Convention on the Law Applicable to Trusts and on their Recognition (opened for signature 1 July 1985, entered into force 1 January 1992) 1797 UNTS 251.

a) the assets constitute a separate fund and are not a part of the trustee's own estate;

b) title of the trust assets stands in the name of the trustee or in the name of another person on behalf of the trustee;

c) the trustee has the power and the duty, in respect of which he is accountable, to manage, employ or dispose of the assets in accordance with the terms of the trust and the special duties imposed upon him by law.[17]

Upon ratification of the Hague Trust Convention, countries create a recognition mechanism for foreign trusts. Currently, when considering EU Member States, the Hague Trust Convention has been signed by France, signed and ratified by Cyprus, Italy, Luxembourg and the Netherlands and signed and accessed by Malta.[18]

However, there is a lot of critique for the Hague Trust Convention, including criticism of the lack of guidance for tax treatment in the Romano-Germanic (Civil Law) legal system.[19] Indeed, as seen from practice in Switzerland, while it has ratified the Hague Trust Convention, under Swiss law, trusts still do not constitute a legal body, thus leading to a risk of double and multiple taxation on trust income deriving from the unclear (and unharmonised) DTT application.[20]

While this issue is present, the scope of this thesis is limited to the analysis in light of fundamental freedoms by excluding discussion in light of DTT. However, the Author considers that discrepancies leading to issues in applying the DTT might also reflect in the safeguarding the fundamental freedoms.

Regarding the presence of trusts in the EU, various Member States have trusts or equivalents in their legal system. Considering the notifications submitted by the EU Member State received by the Commission, trusts *or similar legal arrangements* have only been notified to be present in eleven[21] countries out of twenty-eight EU Member States (including the United Kingdom).[22] From the reported structures, only arrangements present in the Netherlands, Cyprus and Italy have been recognised based on the Hague Trust Convention.[23] In

[17] Hague Trust Convention (n16).
[18] Convention of 1 July 1985 on the Law Applicable to Trusts and on their Recognition. Status table. (2017) <https://www.hcch.net/en/instruments/conventions/status-table/?cid=59> accessed May 9, 2023.
[19] Jeffrey A. Schoenblum, 'The Hague Convention on Trusts: Much Ado About Very Little' (1994) 3 Journal of International Trust and Corporate Planning 5.
[20] Marcel R. Jung, 'Trusts in international taxation: new tax rules' (2008) Volume 10, IBFD: Derivatives & Financial instruments 143.
[21] Belgium, Czechia, Ireland, France, Italy, Cyprus, Luxembourg, Hungary, Malta, The Netherlands and Romania.
[22] Official Journal of the European Union. List of trusts and similar legal arrangements governed under the law of the Member States as notified to the Commission [2019] OJ C360/05.
[23] List of trusts and similar legal arrangements governed under the law of the Member States as notified to the Commission (n22).

the meantime, twelve[24] Member States notified no trusts or similar legal arrangements within their legal system, while four[25] did not submit their notification.[26]

3. Is this a matter of Fundamental Freedoms?

3.1 Preliminary remarks

The EU does not directly oversee the integration of direct taxation as it falls under the competence of the Member States. Notwithstanding, while implementing the domestic rules regarding direct tax matters, Member States must respect and uphold EU fundamental freedoms.[27] Apart from others, these fundamental freedoms include the free movement of capital (Article 63 TFEU) and freedom of establishment (Article 49 TFEU).[28]

Fundamental freedoms safeguard and limit taxation of non-residents, while the decision on the taxation of residents of a Member State remains unlimited by the EU.[29] To continue fundamental freedoms protect objectively comparable situations.[30]

Furthermore, while freedom of establishment safeguards only intra-EU cross-border activity, free movement of capital also protects transactions between Member States and third countries.[31]

Thus, considering the situation discussed in the first question that should be raised is the application of freedom of establishment and the free movement of capital itself. Do these freedoms also apply to trusts?

3.2 Interplay with trusts and their income

3.2.1 *Fred. Olsen and Others* case

For the first time, the trust relationship with fundamental freedoms was addressed at EFTA Court in the *Fred. Olsen and Others*[32] case discusses the freedom of establishment and free movement of capital provided by the

[24] Bulgaria, Denmark, Estonia, Greece, Croatia, Latvia, Lithuania, Poland, Slovenia, Slovakia, Finland and Sweden.
[25] Germany, Spain, Austria and Portugal.
[26] List of trusts and similar legal arrangements governed under the law of the Member States as notified to the Commission (n22).
[27] *Bouanich* (n5), para 28. See also Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation* [2006] EU:C:2006:773, para 36.
[28] Consolidated version of the Treaty on the Functioning of the European Union (TFEU), [2012] OJ C 326/01.
[29] Juliane Kokott *EU tax law: A Handbook* (1st edition, Bloomsbury Publishing, 2022) 359.
[30] Case C-48/13 *Nordea Bank Danmark* [2014] EU:C:2014:2087, paras 23-24. See also: Case C-66/14 *Finanzamt Linz* [2015] EU:C:2015:661, para 31.
[31] TFEU (n28) Art 63. See also: C-157/05 *Holböck* [2007] EU:C:2007:297, para 30.
[32] Judgment of the EFTA Court of 9 July 2014, *Fred. Olsen and Others v the Norwegian State* (E-3/13, E-20/13, EFTA Court Reports 2014, 400).

concluded EEA Agreement. Both freedoms provided by the EEA Agreement correspond to the free movement of establishment provided by Article 49 TFEU[33] as well as the free movement of capital provided by Article 63 TFEU[34].

The facts of the case were similar to the ones discussed in this thesis, i.e. Norwegian beneficiary has received dividend and capital gains deriving from share alienation from Liechtenstein trust where such income incurred economic double taxation at the level of beneficiary due to the inability to access relief under Norwegian participation exemption.[35]

In relation to the freedom of establishment, the Court addressed the question by analysing whether trusts meet the requirement of economic activity as prescribed by Article 31 EEA Agreement (analogue to 49 TFEU). It concluded that a trust 'falls within the scope of Article 31 EEA provided that the trust pursues a real and genuine economic activity within the EEA for an indefinite period and through a fixed establishment'[36].

What the Author finds interesting in this case is the fact that in its judgment, the EFTA Court acknowledged that '[a]ll interested parties, that is to say, the trust's settlors, trustees and beneficiaries hold the rights under Articles 31 and 34 EEA'[37]. Under Liechtenstein's rules, the trust is established via an agreement between the settlor and the trustee.[38] Thus, it is worth highlighting that irrespective of who are the "initiators" of such an arrangement, every party involved (including beneficiaries) can enjoy the protection of freedom of establishment in the eyes of the EFTA Court.

When discussing the free movement of capital, the analysis of the EFTA Court concluded that beneficiaries of a trust enjoy protection ensuring the free movement of capital unless 'they are not found to have exercised definite influence over an independent undertaking in another EEA state or engaged in an economic activity that comes within the scope of the right of establishment'[39].

While decisions of the EFTA Court are only binding for parties of the case[40], the decision in *Fred. Olsen and Others* case shed light on the possibility of introducing trusts to the protection of fundamental freedoms. It acknowledged that not only trusts can enjoy the benefits of freedom of establishment, but also its beneficiaries can rely on the free movement of capital.

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[33] Case C-471/04 *Keller Holdings* [2006] EU:C:2006:143, para 49.
[34] Case 452/01 *Ospelt and Schlössle Weissenberg* [2003] EU:C:2003:493, para 28.
[35] *Fred. Olsen and Others* (n32).
[36] *Fred. Olsen and Others* (n32), para 103.
[37] *Fred. Olsen and Others* (n32), para 103.
[38] The World Bank UNODC, 'Guide to Beneficial Ownership Information in Liechtenstein: Legal Entities and Legal Arrangements' (Stolen Asset Recovery Initiative, 2018) <https://star.worldbank.org/sites/star/files/liechtenstein_bo_guide_-_updated_sept_2018_-_final.pdf> accessed 20 April 2023, page 6.
[39] *Fred. Olsen and Others* (n32), para 125.
[40] Halvard Haukeland Fredriksen, 'The EFTA Court' in Robert Howse and others (eds), *The Legitimacy of International Trade Courts and Tribunals* (Cambridge University Press 2018), 174.

3.2.2 *Trustees of the P Panayi* case

The first time[41] when the ECJ had to evaluate whether trusts enjoy the protection of fundamental freedoms was in the *Trustees of the P Panayi*[42] case.

The factual circumstances of *Trustees of the P Panayi* case differed from those discussed by the EFTA Court. It concerned a situation where exit tax for unrealised capital gains (hidden reserves) was calculated at the time when the majority of trustees transferred their residence abroad or upon the appointment of trustees where most of the trustees were non-residents.[43]

What is an important difference in this case when compared to the one discussed in this thesis, is the fact that the adverse consequences leading to a presumed restriction lie with the trustee, while in the situation discussed in this thesis, it is the beneficiary. Notwithstanding, this case is important to discuss as in order for the ECJ to decide whether such treatment is in line with the fundamental freedoms, it first examined whether trusts may rely on the fundamental freedoms.

It was acknowledged by AG Kokott that a 'purely contractual obligation to administer external assets (the definition of a trust) is not in itself sufficient to constitute a company of firm within the meaning of Article 54 TFEU'[44] as well as the fact that trust discussed does not have a legal personality.[45] Thus, the case was analysed by further evaluating whether trusts fall under the *other legal persons* part of the *companies or firms* definition as indicated in Article 54 TFEU.[46]

In search of an answer, AG Kokott acknowledged that 'a separate legal personality is not necessary for the purposes of Article 54 TFEU'[47], by adding that '[t]he distinction which national law occasionally draws between organisational structures according to what they do or do not have legal personality cannot therefore […] be transposed to the EU law'[48].

Further, AG Kokott highlighted that the concept of *other legal persons* must include the existence of the power to engage in legal transactions and have 'a degree of independence allowing it to operate in its own right'[49].

Based on that, AG Kokott arrived at a conclusion that trusts may rely on freedom of establishment- a statement that was upheld by the ECJ[50] by summarizing that

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[41] Case C-646/15 *Trustees of the P Panayi Accumulation & Maintenance Settlements* [2016] EU:C: 2016:1000, Opinion of AG Kokott.
[42] AG Kokott in *Trustees of the P Panayi* (n41).
[43] AG Kokott in *Trustees of the P Panayi* (n41), para 2.
[44] AG Kokott in *Trustees of the P Panayi* (n41), para 27.
[45] AG Kokott in *Trustees of the P Panayi* (n41), para 27.
[46] Case C-646/15 *Trustees of the P Panayi Accumulation & Maintenance Settlements* [2017] EU:C:2017:682, para 25. See also Opinion of AG Kokott in *Trustees of the P Panayi* (n41), para 23.
[47] AG Kokott in *Trustees of the P Panayi* (n41), para 28.
[48] AG Kokott in *Trustees of the P Panayi* (n41), para 29.
[49] AG Kokott in *Trustees of the P Panayi* (n41), para 33.
[50] *Trustees of the P Panayi* (n46), para 29.

> *[a]n entity such as a trust which, under national law, possesses rights and obligations that enable it to act in its own right, and which actually carries on an economic activity, may rely on freedom of establishment.*[51]

Both AG Kokott and the ECJ considered that the power to determine whether such an arrangement (as a trust) acts in its own right lies with the Member State in question.[52] This is not the first time the ECJ has given such power to a Member State. It might be questioned if such freedom attributed to a Member State might continue creating discrepancies in cross-border situations due to possible clashes in treatment.

Additionally, considering the conclusion proposed by AG Kokott and the judgment delivered by the ECJ, it seems that AG Kokott was more lenient in opening doors for trusts to the freedom of establishment than the ECJ was. The conclusion proposed by AG Kokott included an acknowledgement that 'a trust may rely on the fundamental freedoms provided for in Article 54 TFEU even though it has no legal personality under national law'[53], while in its judgment, the ECJ avoided such statements, by simply basing its answer to the question raised in light of freedom of establishment.

Accordingly, if trusts possess rights and obligations to act in their own right, they can rely on freedom of establishment as they fall under the definition of *companies or firms* as provided by Article 54 TFEU.

By this judgment, the ECJ also indirectly extends the freedom of establishments to the freedom of setting up entities with no legal personality.

In the meantime, the leniency of the ECJ in its judgment must be kept in mind as it might impose a higher risk that in a situation with different factual circumstances, the outcome might differ.

3.3 Main takeaways

Considering the above, as established by the ECJ, trusts enjoy the protection of fundamental freedoms as long as they are engaged in an economic activity operating in their own right.

Thus, the situation discussed in the thesis has grounds to challenge the possible restriction of fundamental freedoms.

[51] *Trustees of the P Panayi* (n46), para 34.
[52] *Trustees of the P Panayi* (n46), para 67; AG Kokott in *Trustees of the P Panayi* (n41), paras 34-35.
[53] AG Kokott in *Trustees of the P Panayi* (n41), para 67.

4. Comparability analysis

4.1 Introduction

For a restriction of fundamental freedoms to occur, the cross-border situation must be comparable to a purely domestic situation where such restriction does not occur. Both situations must be compared in light of the object and purpose of the tax measure concerned.[54] The restriction is permissible if it is assumed that the cross-border and domestic situations are not objectively comparable.[55]

In the situation at hand, determining a comparable situation is, in the Authors' opinion, the most challenging step, especially considering that in light of the factual background in the domestic setting trusts cannot be established at all. A further layer of complexity is added by the legal characteristics of the trust itself- can it be considered that it is comparable to a company? Or could it be an investment fund or partnership? Because of that, the comparability is not straightforward and requires additional analysis to determine its presence.

The ECJ usually begins its analysis regarding possible prohibited restriction with the determination of the presence of the restriction itself and not the presence of comparability. However, the Author considers that the result of the analysis is not affected by what analysis are performed first, thus considering the complexity and uncertainty of the comparability analysis, this thesis will determine the presence of a comparable first.

Accordingly, this chapter will discuss multiple ways in how a local comparable could be established. First, the presence of comparability in the transaction parameter (income received from a trust to a domestic beneficiary) will be considered. Further, a broader perspective will be examined by extending the comparability analysis to the source of the payment (subsidiary held by the trust), thus reflecting the economic reality of the transaction. Lastly, the need for comparability will be challenged in light of the factual circumstances of the case by weighing the importance of EU nationals enjoying their rights in using the trusts against the right of the Member State not to have such trusts in their legal systems.

As the ECJ has acknowledged, it does not matter where the comparison point lies, as either way, the analysis arrives at a restriction.[56] Thus, it is considered that it would be sufficient if the comparability would be found only at one layer to challenge the restriction in light of Articles 49 and 63 TFEU.

[54] *Nordea Bank Danmark* (n30), paras 23-24; *Finanzamt Linz* (n30), para 31.
[55] *Nordea Bank Danmark* (n30), paras 22-23.
[56] Case C-196/04 *Cadbury Schweppes and Cadbury Schweppes Overseas* [2006] EU:C:2006:544.

4.2 In search of the comparability

4.2.1 Objective and purpose of the local legislation

The ECJ has established that

> *the comparability of a cross-border situation with an internal one must be examined having regard to the objective pursued by the national provisions at issue as well as their purpose and content, and that only the relevant distinguishing criteria established by the legislation in question must be taken into account in determining whether the difference in treatment resulting from that legislation reflects an objectively different situation.*[57]

Thus, to correctly assess the comparable, it is important to evaluate the underlying purpose of the local legislation.

As established in the factual background, the legal provision discussed provides tax relief for flow-through dividends that have been taxed at source, thus eliminating double taxation on the respective income flow. It has been further acknowledged that because dividends flow through a trust, the income is no longer treated as dividend income. Such consequence is not directly indicated in the provision and derive from the practice of local courts. Furthermore, the local legislation does not indicate any selectivity towards arrangements that could enjoy respective provision, the only requirement is that the dividends have been taxed at source. Thus, in the situation discussed, it indeed is simply the effect of the definition of the dividend income that is not upheld since the dividends flow through a trust, thus failing to meet the criteria constituting dividend payments in the eyes of such legislation.

Accordingly, it is considered that the objective and purpose of the local legislation is to eliminate double taxation, thus ensuring that dividends are taxed only at the source. As the local legislation targets dividends and not certain types of establishments, it could be considered that the local legislation, by targeting the dividend income, has put arrangements distributing such income in a comparable situation.

4.2.2 Comparability point: Transaction parameter

The first dilemma with the comparability point limited to the transaction parameter lies with the decision of what situation will be compared- the moment when the trust was set up (or shares were transferred to the respective trust) or the moment of the flow-through dividend distribution.

On the one hand, the restriction mainly revolves around the settlor via the restriction to transfer shares to a trust or upon establishing such trust. On the other hand, the tax treatment that presumably makes the execution of those activities less favourable occurs when the beneficiary receives dividend-

[57] Case C-480/16 *Fidelity Funds and Others* [2018] EU:C:2018:480, paras 50-51.

sourced trust income. Thus, should the comparison lie at the settlor-beneficiary or trust–beneficiary level?

Considering that the moment of presumably unfavourable treatment effectively lies at the beneficiary level and would not exist unless the beneficiary in the respective Member State would not have received the income, the comparability analysis will be performed at the trust-beneficiary level.

When searching for a comparable, the ECJ acknowledges that 'residents and non-residents are not necessarily in a comparable situation in matters of direct taxation'[58]. However, as soon as Member State imposes charges also on non-residents, the residents and non-residents become comparable.[59] For example, suppose a resident receives dividends from a non-resident company. In that case, the comparable in a domestic setting will be the receipt of dividends from a resident company.[60]

But what happens when a domestic equivalent does not exist in a domestic setting? Such is the case in the situation discussed, as income is received from a trust in a Member State where trusts cannot be established. Does that automatically mean that there are no comparables and, thus, restrictive provisions could be permitted?

The Commission has expressed its opinion in the *Fred. Olsen and Others* case that the absence of a certain type of entity in one State does not mean there will be no comparable in that State.[61] Further, the ECJ has also dealt with a similar dilemma in the *Columbus Container*[62] case. In the given case, German-sourced income was received in Belgium, and the clash occurred where under German legislation, the income payer was considered a partnership (that is not a taxpayer), while under Belgium rules, the arrangement was viewed as being a taxpayer.

In this case, the ECJ acknowledged that

> *[i]n the current state of harmonisation of Community tax law, Member States enjoy a certain autonomy. It follows from that tax competence that the freedom of companies and partnerships to choose, for the purposes of establishment, between different Member States in no way means that the latter are obliged to adapt their own tax systems to the different systems of tax of the other Member States in order to guarantee that a company or partnership that has chosen to establish itself in a given Member State is taxed, at national level, in the same way as a company or*

[58] Case C-379/05 *Amurta* [2007] EU:C:2007:655, para 37.
[59] *Amurta* (n58), paras 38-39.
[60] i.e. Case C-6/16 *Eqiom and Enka* [2017] EU:C:2017:641.
[61] *Fred. Olsen and Others* (n32), para 130.
[62] Case C-298/05 *Columbus Container Services* [2007] EU:C:2007:754.

> *partnership that has chosen to establish itself in another Member State.*[63]

However, the ECJ further clarified that

> *[t]he Member States are at liberty to determine the conditions and the level of taxation for different types of establishments chosen by national companies or partnerships operating abroad, on condition that those companies or partnerships are not treated in a manner that is discriminatory in comparison with comparable national establishments.*[64]

Thus, the ECJ indicated that the evaluation of the fundamental freedoms does not end with a lack of equivalent arrangement in a local setting and must be analysed in light of comparable national establishments.

A similar approach has been challenged in academic literature, where it has been indicated that if capital flows into a Member State, the treatment of that capital could be compared to capital raised domestically.[65] Thus indicating that an internal comparable could be searched in light of the type of capital raised.

Accordingly, in order to find a domestic comparable, it must be evaluated what would be seen as a trust from the perspective of the respective Member State.

The Author considers that answer to this question would depend on the functions and the structure of each separate trust, as well as depending on the legal arrangements located in the respective Member State. Therefore, a universal answer cannot be provided. However, it is worth mentioning that such a comparison could be challenged to be found in the form of partnerships or companies. A company could be seen as comparable in light of the type of capital raised domestically- analysing the economic substance behind the payment, it is considered a dividend payment as comparable to proceeds distributed from a company deriving from dividends. Meanwhile, comparability to a partnership could be found in the fact that partnerships, similarly to trusts, are created based on an agreement.

Indeed, such an approach is also considered in academic literature, which considers that trusts are treated like partnerships or companies.[66] Further, by analogy, a similar line of thought can be seen to be taken by Belgium when interpreting the MLI rules, where it has been acknowledged that 'there is no

[63] *Columbus Container Services* (n62), para 51.
[64] *Columbus Container Services* (n62), para 53.
[65] Carlo Garbarino 'The Comparability Analysis Developed by the European Court of Justice in the Cases Concerning Direct Taxes' (Bocconi Legal Studies Research Paper No. 233095, 2013) <https://ssrn.com/abstract=2330950> accessed 3 May 2023.
[66] Brabazon (n11), 12.

reason to make a distinction between shares in companies and interests in such entities [partnerships and trusts]'[67].

Moreover, a similar approach was taken by the Commission in the *Fred. Olsen and Others* case, where the Commission expressed that in a situation when a trust carries out economic activity, 'the trust must be seen as a vehicle for carrying on business in the same way as a company or any other type of entity referred to in the second paragraph of Article 34 EEA'[68]. The respective article defines companies or firms as those 'constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law, save for those which are non-profit-making'[69].

Likewise, by analogy a similar intention can be seen in the legislation of EU Member States when clarifying the scope of the CFC rules, where when defining corporations subject to CIT, some Member States have expressed the intention to include trusts in the definition as well. For example, in Italy, it has been indicated that 'all companies/entities that qualify as an autonomous and definitive centre of imputation of rights and obligations are considered separate taxpayers', a definition that has been expressed to include trusts 'even though they do not exclusively carry on business activities'.[70] Further, while not an EU Member State, Norway has clarified that 'taxpayers who are beneficiaries to a foreign trust […] will […] be deemed to be a participant even if they do not have formal ownership in a legal sense'[71]. Similar approach has been taken by Portugal[72], Poland[73], Czechia[74] and Austria[75] and Finland[76]. Finland has even gone as far as indicating in its

[67] Piet De Vos and Caroline Docclo, 'Branch reports Subject 1: Belgium' in International Fiscal Association (ed), *Cahiers de droit fiscal international: Studies on international fiscal law*. *Reconstructing the treaty network* (2020) volume 105A International Fiscal Association (IFA) 181.

[68] *Fred. Olsen and Others* (n32), para 87.

[69] Agreement on the European Economic Area (EEA Agreement) [2016] OJ No L 1, 3.1.1994, art 34.

[70] Stefano Grilli, 'Branch reports Subject 1: Italy' in International Fiscal Association (ed), *Cahiers de droit fiscal international: Studies on international fiscal law. Group approach and separate entity approach in domestic and international tax law* (2022) volume 106A International Fiscal Association (IFA) 434.

[71] Marius Sollund and Morten Platou, 'Branch reports Subject 1: Norway' in *Cahiers de droit fiscal international: Studies on international fiscal law. Group approach and separate entity approach in domestic and international tax law* (n70) 600.

[72] Miguel C. Reis and others, 'Branch reports Subject 1: Portugal' in *Cahiers de droit fiscal international: Studies on international fiscal law. Group approach and separate entity approach in domestic and international tax law* (n70) 657.

[73] Wojciech Morawski and Adam Zalasiński, 'Branch reports Subject 1: Poland' in *Cahiers de droit fiscal international: Studies on international fiscal law. Group approach and separate entity approach in domestic and international tax law* (n70) 640.

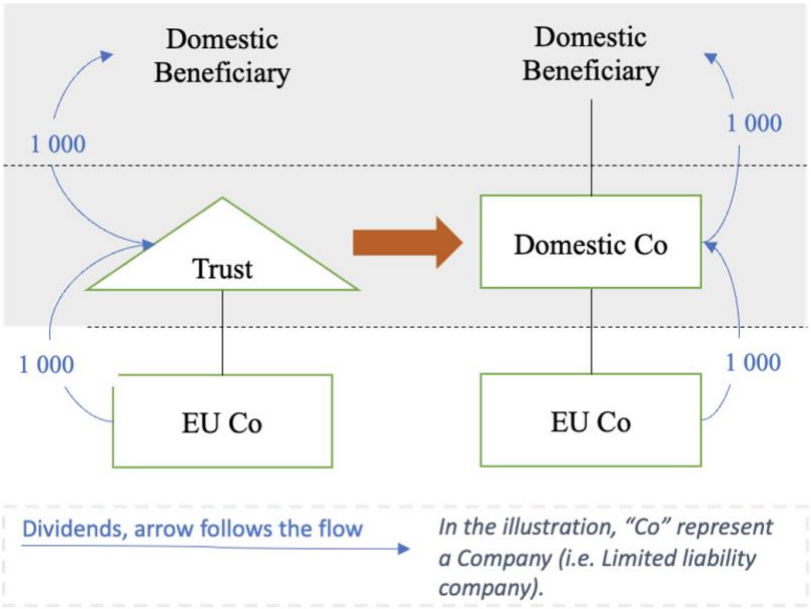
[74] Viktor Šmejkal, 'Branch reports Subject 1: Czech Republic' in *Cahiers de droit fiscal international: Studies on international fiscal law. Group approach and separate entity approach in domestic and international tax law* (n70) 284.

[75] Daniela Hohenwarter-Mayr and Stephanie Zolles, 'Branch reports Subject 1: Austria' in *Cahiers de droit fiscal international: Studies on international fiscal law. Group approach and separate entity approach in domestic and international tax law* (n70) 135.

[76] Emmiliina Kujanpää, 'Branch reports Subject 1: Finland' in *Cahiers de droit fiscal international: Studies on international fiscal law. Group approach and separate entity approach in domestic and international tax law* (n70) 342.

domestic case law that trust is comparable to a Finnish publicly listed limited liability company.[77]

Considering the above, it can be considered that a comparable situation in the transaction parameter could be found by using the closest-domestic-alternative for the foreign trust. The Member State (not having trusts in its legal system) should approach trust by considering what it would be in light of their local rules. This analysis might differ depending on the characteristics of each separate trust and the legal system of the Member State in question. Irrespectively, for the purpose of this thesis, considering that the trust is profit-making and holding shares in another establishment, an assumption will be drawn that it is comparable to a domestic alternative in the form of a domestic company (comparison visualised below).



Source: Author's considerations.

As already established, in such a domestic setting, restrictive tax treatment does not take place.

4.2.3 Comparability point: Economic reality

While in the ECJ case law, the comparability analysis has been mostly performed at the level of the transaction leading to possible restriction itself (as discussed in the previous subpart), it is the Authors' opinion that the best way to illustrate that the situation presumably leading to a restriction is objectively comparable to a domestic one, is by considering the economic reality, i.e. a situation where a trust, that can only be foreign under the local legislation would not exist. Indeed, if the respective flow of income would not be distributed through a foreign trust, a higher tax liability, presumably leading to a restriction, would not have taken place.

The Author considers that this analysis could also be used as an alternative if no domestic comparables can be found in applying the first proposed

[77] Kujanpää (n76) 336.

alternative. In addition, this comparison alternative allows for less analysis of domestic legislation to be performed by the ECJ compared to the first alternative.

A similar approach has been used by the ECJ in the *Miljoen*[78] case challenging the 'perspective of a single Member State'[79] adopted by the ECJ. In the respective case, the ECJ and AG Jääskinen both agreed that comparability analysis should not be performed at the taxpayer level but consider the effective tax burden by indicating that

> *there is, indeed, such a difference in treatment for tax purposes between resident and non-resident natural persons, not only with regards to methods of taxation applied but also vis-à-vis the charges borne, that, in my view, this makes comparison almost impossible if only the dividends are taken into account to that end.*[80]

In the respective case, AG Jääskinen arrived at the conclusion that the comparison must be drawn by comparing dividend tax payable by non-residents and residents holding similar shares.[81]

While the circumstances of the *Miljoen* case differ from those in the situation discussed, the Author considers that it could be applied by analogy due to the fact that the possible restriction circles around the risk of double taxation that is ultimately borne at multiple layers extending from the transaction territory in question.

A similar approach has been proposed by Lang, who stated that

> *whether or not a situation is legally or factually comparable cannot be assessed in isolation, but requires a scale for comparison. Any assessment of equal treatment is not arbitrary but rather looks at essential joint features and differences within their respective contexts. The basis for determining these essential features, i.e. the tertium comparison in according to which the comparison be made, is important.*[82]

It is considered that in the case discussed in this thesis, the restriction derives purely from the fact that the income flows through a foreign element (i.e. trust). If such a foreign element would not exist and the transaction had been purely domestic, the restrictive treatment would not occur.

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[78] Joined Cases C-10/14, C-14/14 and C-17/14 *Miljoen* [2015] EU:C:2015:608.
[79] Garbarino (n65).
[80] Joined Cases C-10/14, C-14/14 and C-17/14 *Miljoen* [2015] EU:C:2015:429, Opinion of AG Jääskinen, para 61.
[81] AG Jääskinen in *Miljoen* (n80) 78.
[82] Michael Lang, *State Aid and Taxation: recent trends in the case law of the ECJ*, (European State Aid Law Quarterly Volume 11, Issue 2, 2012), 420.

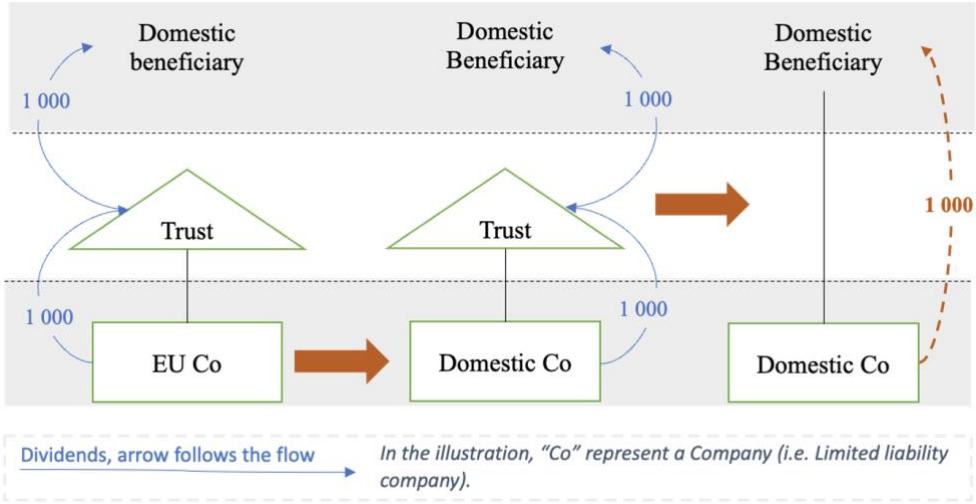
Thus, the domestic comparable could be found in disregarding the trust and considering the tax consequences without trust being in the equation. That would lead to the beneficiary directly holding shares in a subsidiary.

If the subsidiary in question is not established in the same Member State as the beneficiary, then another "step" would be added to the comparability analysis. It has been established by the ECJ that

> *in the context of a tax rule which seeks to prevent or to mitigate the taxation of distributed profits, the situation of a shareholder company receiving foreign-sourced dividends is comparable to that of a shareholder company receiving nationally-sourced dividends in so far as, in each case, the profits made are, in principle, liable to be subject to a series of charges to tax.*[83]

Accordingly, if the respective subsidiary is located in a different Member State, considering that the payment is subject to a series of charges to tax, it is comparable with a domestic subsidiary.

Illustration of the comparability analysis is illustrated below.



Source: Author's considerations.

Thus, in the situation discussed, the Author proposes a two-step comparability analysis, where the comparability analysis element could be found by:

- "excluding" trust from the equation, i.e., by considering the tax effect if the dividends would be directly received from the respective entity;
- in case the dividends are sourced from a company established in a Member State other than the Member State of the beneficiary, a domestic comparable could be a domestic company.

[83] Case C-446/04 *Test Claimants in the FII Group Litigation* [2006] EU:C:2006:774, para 62.

As indicated in the factual background, if dividends are received from a subsidiary where they have been taxed at source, they are not taxed again in the hands of the recipient.

4.3 Need of comparability – unnecessary?

The need of comparability dates back to 1977 when the ECJ acknowledged that '[*the sanctions*] must moreover have regard to the principle of equal treatment of nationals and aliens and the sanctions must be comparable with those imposed on nationals for acts of a comparable nature'[84]. Thus, the necessity for comparability derives from the need to ensure that all EU nationals are treated equally.

This thesis has already established that a purely domestic comparable in the case discussed can be found. However, what would happen if a domestic comparable could not be found when applying the proposed comparison alternatives? In such a case, the Author challenges that in the situation discussed in this thesis, a comparable is not be necessary to be found in the domestic legislation in order for such legislation to constitute a prohibited restriction.

Otherwise, the Author considers that the prohibition to restrict the use of fundamental freedoms combined with the right to establish different legal vehicles, because they are not fully harmonized within the EU[85], contradict each other. It is unfair for a Member State to be given the power to decide which vehicles can be established in their territory and for the EU citizens to have access to those vehicles only to later allow another Member State to restrict such access due to a lack of comparability. The EU should ensure that this situation does not occur.

It has been seen from the case law when dealing with direct tax cases that the complexity when searching for comparability has increased significantly.[86] There are even cases where comparability has not been discussed at all, and the ECJ has evaluated the case purely in the light of the restriction.[87] Possibly, it indeed is time to move on from the necessity of comparability analysis in situations such as the one discussed, where the restriction alone would be enough to preclude domestic legislation that has created a restriction. There might be justifications for a Member State allowing such restriction, however, it should not be the lack of comparability.

A similar line of thought can be seen in various opinions[88] proposed by AG Kokott, which could be summarised with her opinion in the *Nordea Bank*

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[84] Case C-8/77 *Sagulo m.fl.* [1977] EU:C:1977:131, para 11.
[85] Case C-342/20 *Veronsaajien oikeudenvalvontayksikkö* [2022] EU:C:2022:276, para 57.
[86] Peter Wattel, 'Non-Discrimination à la Cour: The ECJ' s (Lack of) Comparability Analysis in Direct Tax Cases' (2015) 55 Eur. Taxn. 12, Journal Articles & Opinion Pieces IBFD.
[87] Case C-414/06 *Lidl Belgium* [2008] EU:C:2008:278, paras 18-25; Case C-157/07 *Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt* [2008] EU:C:2008:588, paras 27-39; Case 81/87 *Daily Mail* [1988] EU:C:1988:456; Case C-210/06 *Cartesio* [2008] C-210/06.
[88] Case C-48/13 *Nordea Bank Danmark* [2014] EU:C:2014:153, Opinion of AG Kokott, para 22; Case C-123/11 *A* [2012] EU:C:2012:488, Opinion of AG Kokott, paras 40 – 41; Case C-39/13 *SCA Group Holding and Others* [2014] EU:C:2014:104, Opinion of AG Kokott, para 32; Case C-75/18 *Vodafone Magyarország* [2019] EU:C:2019:492, Opinion of AG Kokott, para 105.

Danmark case, where when performing the comparability analysis, she remarked that

> *[a]lthough I have carried out such examinations myself in the past, it seems to me that the time has come to dispense with them. First, not only is a demarcation with examining a ground of justification not possible but also there are not any readily apparent criteria for determining those cases in which situations must be said not to be objectively comparable in the first place. Secondly, such a finding also made it impossible to strike an appropriate balance between the fundamental freedom and the reason for the difference in treatment in the case concerned.*[89]

In the respective case, the ECJ upheld the necessity of comparability analysis and did not follow the approach proposed by AG Kokott by indicating that '[i]t is clear from the Court's case-law that such a restriction is permissible only if it relates to situations which are not objectively comparable or if it is justified by an overriding reason in the public interest'[90].

Meanwhile, Wattel supports the ECJ by highlighting the risk of shifting the interpretation of the domestic legislation to the justification part, thus putting a Member State and the ECJ in a position where (1) a Member State has to justify all tax measures and (2) the ECJ has to evaluate domestic legislation that it does not have the competence to do.[91]

Further, while AG Hogan, in his opinion, recalled the approach proposed by AG Kokott[92], when analysing comparability, he emphasized the opinion of AG Wahl (that was upheld by the ECJ[93]), indicating that carrying out the comparability analysis ensures that

> *a tax measure is assessed against a framework that includes all relevant provisions, and not against provisions that have been carved out artificially from a broader legislative framework, which constitutes a concern which also had to prevail in relation to free movement.*[94]

Based on the aspects presented, the Author agrees with the views expressed by AG Kokott and considers that if the ECJ would find that there is no comparable simply because a Member State has decided not to have a purely analogue vehicle in their system, such comparability analysis would lead to an unnecessary risk of the ECJ blocking freedoms performed by EU nationals purely because of the freedom of Member States. In the meantime, the Author acknowledges that the scope of this thesis do not allow to fully analyse all

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[89] AG Kokott in *Nordea Bank Danmark* (n88) 22.
[90] *Nordea Bank Danmark* (n30) 23.
[91] Wattel (n86).
[92] Case C-388/19 *Autoridade Tributária e Aduaneira (Impôt sur les plus-values immobilières)* [2020] EU:C:2020:940, Opinon of AG Hogan, para 40.
[93] Case C-203/16 *Andres v Commis*sion [2018] EU:C:2018:505, para 103.
[94] Case C-203/16 *Andres v Commis*sion [2017] EU:C:2017:1017, Opinion of AG Wahl, para 109.

aspects necessary to arrive to a definite answer of whether comparability analysis could be abandoned.

Accordingly, the Author considers that if the proposed comparability analysis would fail to find a domestic comparable, it might open doors for an intriguing discussion where the need for comparability would be evaluated against the risk of a situation where the rights of an EU national setting up a trust is disregarded in light of a Member State exercising their right not to have a possibility to establish a trust in their local legislation.

4.4 If it looks like a dividend, acts like a dividend… can it be compared to a dividend?

The thesis has been written under the assumption that the payment should be viewed based on its economic substance considering that if the payment was sourced from a dividend payment and is fully transparent and traceable upon further distribution, it should be seen as a dividend. A similar idea was found in the comparability analysis, where Commission, scholarly writers and Member States had expressed comparability between trusts and companies, thus leading to an assumption that by analogy also proceeds from a trust is comparable with proceeds from companies (dividends).

However, some layer of criticism for the comparability analysis performed could be found in the assumption of treating the income received from the trust as dividends, as the analysis concentrates on the characteristics of the outflow and not the inflow stream of income. What is meant by that? The thesis has looked at the economic substance from the trust's perspective- it has received dividends, and it further distributes said dividends, hence they should be treated as dividends.

However, it might be challenged that the thesis lacks the analysis of what the respective flow would be seen from the beneficiary perspective, especially considering that it is the layer where the unfavourable tax treatment takes place. Can a shareholder receiving dividends from a company be compared to a beneficiary receiving trust income?

On the one hand, the economic substance (as already established) is the same. In both cases, the payment is sourced from a received dividend payment. On the other hand, there is a difference when obtaining the right to receive dividends. In the case of a shareholder, the dividend income (also flow-through dividend income) is sourced from equity injection or acquisition of shares. In comparison, the beneficiary (unless the settlor is also the beneficiary) has in no way attributed to the capital of the "dividend" payer. From the perspective of the beneficiary, the trust income, in essence, is of a windfall nature- the beneficiary did nothing to receive it, yet it did.

Does this imply that the proceeds cannot be compared to dividend income, rendering the analysis incomplete? While the *Trustees of the P Panayi* case discussed trusts in light of freedom of establishment, it discussed tax liability imposed on trustees. Could this difference be used to block access to fundamental freedoms in the situation discussed?

The dividend definition in light of tax provisions is not clearly defined. Even the OECD when applying DTT has acknowledged that '[i]n view of the great

differences between the laws of OECD member countries, it is impossible to define "dividends" fully and exhaustively'[95]. Thus, there is no standard definition for what qualifies as a dividend that could help to find a universal answer.

However, in light of this thesis and the research question raised, it is considered that while the dividend definition could raise an interesting discussion related to comparability and the restriction itself, the thesis will focus on the receipt of the dividends as a consequence of the exercise of one of the freedoms. The legal title of such "consequence" or "continuation of the exercise of freedom" will not be evaluated. Accordingly, throughout the analysis, the economic substance will be considered over the legal title that might be applied depending on the Member State in question and will consider as not affecting the comparability analysis or determination of a restriction.

4.5 Main takeaways

When performing the comparability analysis within the transaction parameter, following the opinions expressed by the Commission and scholarly writers, a comparable for a trust can be found in a domestic company, partnership or other types of companies that are profit-making.

Comparison can also be found by evaluating the economic reality behind the transaction. In such a way, it is assumed that if a trust had not been involved in the transaction, there would be no adverse tax consequences. To find a comparable first trust is eliminated from the transaction, leading to the beneficiary holding shares in a subsidiary. If the subsidiary is a non-resident, it can be compared to a local subsidiary.

Lastly, if comparability could not be found, the need for comparability might be challenged in light of the comparability analysis running a risk of the EU national losing its freedom due to the Member State exercising theirs when choosing what legal forms to have in its legislation and what not.

5. Presence of a restrictive treatment

5.1 Preliminary remarks

5.1.1 Whose freedom is restricted?

Based on the factual background of the situation discussed, fundamental freedoms are presumably restricted at the level of settlor and/or trustee. With respect to freedom of establishment, it is the possible restriction for a trustee and settlor in establishing a trust, while for free movement of capital, possible restriction revolves around adverse tax consequences that would occur when the settlor decides to transfer its shares to a trust. In the meantime, the source

[95] OECD (2019), Model Tax Convention on Income and on Capital 2017 (Full Version), OECD Publishing, Paris <https://doi.org/10.1787/g2g972ee-en> last accessed May 13 2023, c(10) para 23.

of restriction itself, i.e., effectively higher tax liability, takes place at the beneficiary level.

In the *Fred. Olsen and Others* case discussing a dilemma of similar nature, the Commission expressed its opinion that to correctly analyse the applicable freedom, instead of analysing the relationship of the beneficiary or trustee, attention should be paid to the time when the settlor set up the trust.[96]

Thus, considering that the potential restriction would affect the decision-making in relation to setting up a trust or transferring shares to such trust irrespectively at what level the restriction takes place, further analysis will follow the opinion expressed by the Commission and evaluate the restriction at the settlor and/or trustee level.

5.1.2 Double Taxation

It has been acknowledged that 'the Member States are not obliged to adapt their own tax systems to the different systems of tax of the other Member States in order, inter alia, to eliminate double taxation'[97]. Furthermore, the fact alone that two Member States are liable to tax the same income does not imply that the resident Member State is liable to prevent disadvantages deriving from two Member States exercising their competence in parallel.[98]

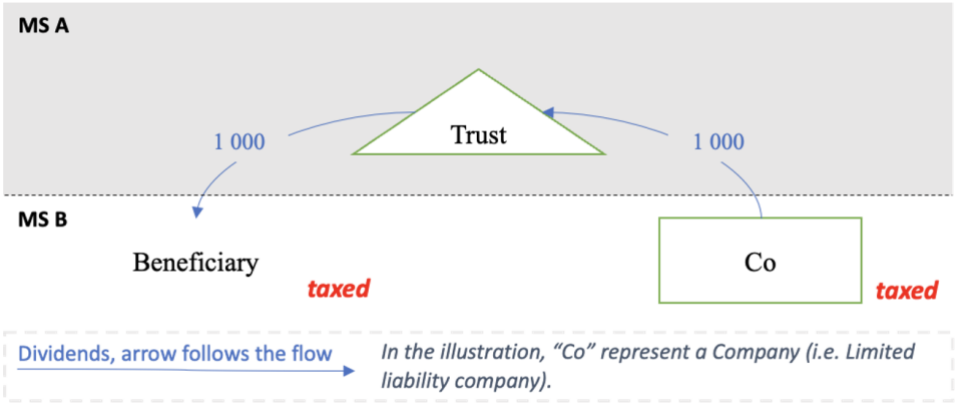
From above, one may consider that the situation discussed is caused by two countries exercising their fiscal sovereignty in parallel, which has resulted in double taxation and thus could be challenged as not being a restricted disadvantage in the first place.

In this regard, attention should be paid to how double taxation was formed. The ECJ referred to double taxation as resulting 'from the exercise in parallel by two Member States of their fiscal sovereignty'[99]. Thus, in a classical sense, cases discussing double taxation deal with situations where payment goes from one Member State to another where both Member States want to tax the respective payment.

However, the case discussed is not a situation with two Member States willing to tax the same income twice- it is rather a situation where the same income is effectively taxed twice simply because the income flows through a foreign trust, which in eyes of the domestic rules, changes its legal status thus preventing it from accessing provisions that eliminate double taxation.

In theory, the same risk would be present if the recipient (beneficiary) and the source (subsidiary) would reside in the same country- in such a scenario, the risk of double taxation would also be present because of flowing through a foreign trust. And here, it would be *one* Member State exercising its power to tax, leading to double taxation *because* income flows through a foreign, unfamiliar arrangement.

[96] *Fred. Olsen and Others* (n32), para 86.
[97] Case C-67/08 *Block* [2009] EU:C:2009:92, para 31.
[98] Case C-128/08 *Damseaux* [2009] EU:C:2009:471, para 34.
[99] Case C-513/04 *Kerckhaert and Morres* [2006] EU:C:2006:713, paras 20-24.



Source: Authors' considerations.

Accordingly, it can be considered that the situation discussed should not be considered double taxation in a classical sense. Even if it would be challenged that Articles 49 and 63 TFEU are not intended to protect taxpayers from the risk of double taxation, that would not be the situation at hand.

5.1.3 Indirect discrimination

It has been established by the ECJ that

> *a compulsory levy which provides for a criterion of differentiation that is apparently objective but that disadvantages in most cases, given its features, companies that have their seat in other Member States and which are in a situation comparable to that of companies whose seat is situated in the Member State of taxation, constitutes indirect discrimination based on the location of the seat of the companies, which is prohibited under Articles 49 and 54 TFEU.*[100]

In the situation discussed, trusts cannot be established in a domestic setting, thus, any application of legal provisions to such trusts (or their income) will be made with a foreign establishment. Accordingly, it might be argued that legal provisions that are designed in a way where they do not consider all forms of foreign arrangements indirectly discriminate the foreign arrangements over those available domestically.

In so-called Hungarian cases[101], AG Kokott highlighted that to determine indirect discrimination, a two-step analysis should be performed, i.e.

> *it must be clarified, first of all, what requirements are to be applied to the correlation between the chosen distinguishing criterion — here turnover — and the seat of the undertakings […]. Second, it must be examined whether indirect discrimination is to be taken to exist in any case if the*

[100] Case C-236/16 *ANGED* [2018] EU:C:2018:291, para 18.
[101] Case C-323/18 *Tesco-Global Áruházak* [2020] EU:C:2020:140; Case C-43/19 *Vodafone Portugal* [2020] EU:C:2020:465.

> *distinguishing criterion was intentionally chosen with a discriminatory objective.*[102]

In the second step of the analysis, AG Kokott presented multiple aspects that should be analysed: the 'relevance of a political intention for the assessment of indirect discrimination'[103] and the 'proof of a relevant intention to discriminate'[104].

Meanwhile, AG Kokott highlighted that 'a merely incidental link, even if it is sufficiently high in quantitative terms, cannot therefore be sufficient, in principle, to establish indirect discrimination'[105].

For the purpose of this thesis, the Author considers that adverse tax consequences derive from the lack of unclarity of the present rules (that could be argued as a merely incidental link) and not because of a hidden intention to discriminate against such foreign arrangements. Moreover, the Author considers that if such a situation would be viewed as restricted indirect discrimination, it would lead to an unproportional burden for the Member State to constantly screen and safeguard all possible legal arrangements and their effective treatment when drafting or amending local legislation.

Thus, the following analysis will be limited to evaluating possible restrictions in light of the free movement of capital and freedom of establishment without discussing the possible presence of indirect discrimination.

5.2 Is there a restriction?

5.2.1 Purpose of the legislation concerned

It is a long-standing ECJ case law, that the restriction of free movement of capital and freedom of establishment is considered in light of the purpose and aim of the legislation.[106]

Indeed, it has also been expressed by AG Hogan, in his opinion for the *E* case, that

> *factors such as the objects of incorporation, the corporate form, the kind of business conduct or the rules applicable to companies at issue, are not, in themselves, decisive: it is the aim pursued by the tax measure at issue which will determine the relevant critics.*[107]

Returning to the situation discussed, the analysis of the aim of local legislation is somewhat puzzling. On the one hand, focusing on the aim of the local legislation could be used as an argument supporting that there can be no

[102] Case C-323/18 *Tesco-Global Áruházak Zrt* [2019] EU:C:2019:567, Opinion of AG Kokott, para 56.
[103] AG Kokott in *Tesco-Global Áruházak Zrt* (n102) 81-88.
[104] AG Kokott in *Tesco-Global Áruházak Zrt* (n102) 89-103.
[105] AG Kokott in *Tesco-Global Áruházak Zrt* (n102) 70.
[106] *Holböck* (n31), para 222.
[107] Case C-480/19 E [2020] EU:C:2020:942, Opinion of AG Hogan, para 41.

adverse tax consequences simply because income flows through an unfamiliar arrangement. On the other hand, a certain level of reluctance and scepticism can be drawn when considering the aim of local legislation when dealing with a situation that respective local legislation did not intend to encounter. Is it possible to objectively evaluate the aim of the local tax legislation when in a domestic setting, such legislation was not intended to be applied to trust income?

For the purpose of this thesis, in light of the factual background, it will be considered that the aim of domestic legislation is to avoid double taxation for the receipt of dividend income. Considering the economic substance of the legal form, in light of the purpose of the legal provision, trust income that has been sourced from dividends will be treated as dividend income. Accordingly, possible restrictions for freedom of establishment and free movement of capital will be examined in light of the need to eliminate double taxation on dividend income.

5.2.2 Relevance on the decision-making power

In the discussion regarding the free movement of capital and freedom of establishment, the ECJ has observed that

> *national legislation intended to apply only to those shareholdings which enable the holder to exert a definite influence on a company's decisions and to determine its activities falls within the scope of Article 49 TFEU on freedom of establishment […] On the other hand, national provisions which apply to shareholdings acquired solely with the intention of making a financial investment without any intention to influence the management and control of the undertaking must be examined <u>exclusively</u>* [emphasis added by the Author] *in the light of the free movement of capital.*[108]

An important nuance is the use of "exclusively", as it is used only when discussing the free movement of capital and not freedom of establishment. In light of that, it could be considered that if the taxpayer holds sufficient decision-making power, it can access both freedom of establishment and free movement of capital. However, if it does not hold sufficient decision-making power, then such a situation is limited "exclusively" to the free movement of capital, blocking access to freedom of establishment.

In the situation discussed, the free movement of capital is discussed at the point where the settlor transfers its shares to the trust. Considering the case law cited, irrespectively of the decision-making power, it can challenge the free movement of capital provision.

However, what happens to access to the freedom of establishment? The *Trustees of the P Panayi* case were dealt with in light of freedom of establishment, however, in that case, the restriction took the form of the

[108] *Bouanich* (n5), para 28.

unfavourable tax treatment of the trustee. Considering the functions of trust, the trustee, indeed, is the one making daily decisions and thus can be seen as having the influence over the decision-making process required by the ECJ. The situation at hand, however, slightly differs as the restriction lies in the set-up of the trust itself, which is mainly driven by the settlor via an agreement signed with the trustee. When analysing decision-making power in the situation at hand, is the decision-making power of the trustee or the settlor considered?

The Author considers that the answer lies in the technical details of setting up and managing trusts, which differ from investment funds and companies. Firstly, while the settlor has no day-to-day decision-making power (as it lies with the trustee), it is the sole purpose of the trustee to maintain and uphold the vision set by the settlor. Its use of decision-making power is thus interlinked with the decision made by the trustee. Secondly, a trust cannot be established by a settlor or trustee alone, while it is possible to establish i.e. a company by one person.

Accordingly, the Author considers that the trustee-settlor relationship in relation to decision-making power should be viewed differently than when dealing with other establishments- it should be viewed as a whole. Following such an approach, the necessity for the decision-making power when accessing freedom of establishment would be upheld.

With regards to the free movement of capital, decision-making power does not restrict access to said freedom and considering that the Author challenges it from a different perspective (transfer of shares and not the set-up of the trust), it will be analysed separately.

5.2.3 Article 49 TFEU and a restriction to establish a trust

Freedom of establishment entails the right

> *to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article 54 [TFEU], under the conditions laid down for its own nationals by the law of the country where such establishment is effected.*[109]

Accordingly, the question of whether trust constitutes *a company or firm* must be clarified before starting the discussion of possible restrictions.

As discussed, the ECJ has already established the answer to that question in the *Trustees of the P Panayi* case, where it acknowledged that trusts enjoy protection under the freedom of establishment as they fall under the definition of companies or firms established in Article 54 TFEU.

However, in the Author's opinion, an acknowledgement that trusts enjoy the freedom of establishment still is insufficient to begin a discussion of a possible restriction. The ECJ has clarified in its case law that

[109] TFEU (n28) Art 49.

> *the concept of establishment within the meaning of Article 52 et seq. of the Treaty involves the actual pursuit of an economic activity through a fixed establishment in another Member State for an indefinite period.*[110]

Further, it has been acknowledged that the above statement 'presupposes actual establishment of the company concerned in the host Member State and the pursuit of genuine economic activity there'[111].

Thus, it should be understood whether trust can be considered as carrying out *a genuine economic activity.*

The answer to this question depends on the specific details of each trust, including how it operates, who manages it, and other factors outlined in the trust agreement. Thus, considering the delicate nature of establishing the presence of artificial arrangements (i.e. economic players with no genuine economic activity), the Author considers that due to the restricted nature of the factual circumstances in the case discussed, it would be unreasonable, if not impossible, to provide a universal answer.

Notwithstanding, in light of the situation discussed, it must be recognised that even if it would be considered that a trust forms such an artificial arrangement, the taxpayer does have a right to provide evidence indicating the commercial nature of such an establishment.[112] In a situation such as that discussed in this thesis, the commercial nature of the trust could be argued to take the form of holding and managing shares. Thus, further analysis will assume that established trust would not be considered an artificial arrangement.

For a breach of freedom of establishment to take place, the ability of the EU nationals to establish themselves in another EU country must be rendered. Furthermore, it has already been pointed out by the ECJ on various occasions that 'different treatment runs the risk of hindering taxpayer from establishing in another Member State'[113].

As concluded in the *Avoir Fiscal*[114] case, Article 49 TFEU 'expressively leaves traders free to choose the appropriate legal form in another Member State and that freedom must not be limited by discriminatory tax provisions'[115]. Thus, domestic legislation also cannot restrict such freedom by limiting the legal forms that EU nationals would decide to choose.

When challenging domestic provisions of having a risk of breach of freedom of establishment, it is not a prerequisite to prove that such legal provision has actually refrained a national from establishing abroad.[116] Thus, if the domestic

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[110] Case C-221/89 *Factortame and Others* [1991] EU:C:1991:320, para 20; Case C-246/89 *Commission* v *United Kingdom* [1991] EU:C:1991:375, para 21.
[111] *Cadbury Schweppes and Cadbury Schweppes Overseas* (n56), para 54.
[112] Case C-524/04 *Test Claimants in the Thin Cap Group Litigation* [2007] EU:C:2007:161, para 82.
[113] Case C-168/01 *Bosal* [2003] EU:C:2003:479, para 27; Case C-347/04 *Rewe Zentralfinanz* [2007] EU:C:2007:194, paras 28-38.
[114] Case C-270/83 *Avoir fiscal* [1986] EU:C:1986:37.
[115] *Avoir fiscal* (n114), para 22.
[116] *Test Claimants in the Thin Cap Group Litigation* (n112), para 42.

rules would run the risk of adverse tax consequences that would abstain an EU national from establishing in another Member State (or not establishing in a specific form), it would be enough to consider that such domestic rules hinder freedom of establishment.

Accordingly, it can be considered that if domestic legislation creates a more unfavourable treatment for proceeds deriving from a foreign trust in comparison to purely domestic alternatives, such a provision would restrict EU nationals' choice to access foreign trusts. Thus, provided that the trust is not seen as an artificial establishment, such local provision would be seen as restricting freedom of establishment.

5.2.4 Article 63 TFEU and a restriction to transfer shares to the trust

In most cases, the ECJ examines freedom of establishment and free movement of capital simultaneously. However, in the current scenario, the Author believes that the potentially restricting provision applies to both freedoms in different ways - namely, the creation of the trust (freedom of establishment) and the transfer of shares to said trust (free movement of capital). Moreover, it is important to assess whether the free movement of capital has been restricted if, due to the lack of decision-making power, freedom of establishment could not be challenged.

It is a long-standing opinion of the ECJ that

> *Article 63(1) TFEU prohibits, as restrictions on the movement of capital, measures that are such as to discourage non-residents from making investments in a Member State or to discourage that Member State's residents from doing so in other States.*[117]

Further, the ECJ has elaborated that 'any measure that makes the cross-border transfer of capital more difficult or less attractive and is thus liable to deter the investor constitutes a restriction of the free movement of capital'[118].

When discussing what exactly is meant by capital, it has been considered by Helminen that when analysing the ECJ case law, the scope of "capital" was intended to be broad.[119] Notwithstanding, it is considered that shares fall under the definition of capital.

While it is true that adverse tax implications in the situation at hand are not considered to take place upon the transfer of shares but upon receipt of the proceeds (i.e. dividends), it is considered that the trust is created with a goal to generate income, and thus the decision to transfer shares is motivated by the desire to generate dividend income. Accordingly, creating adverse consequences for the proceeds would restrict the transfer of such shares.

Indeed, the ECJ has acknowledged that

> *[t]reating dividends paid to companies established in another Member State less favourably than dividends paid*

[117] Case C-565/18 *Société Générale* [2020] EU:C:2020:318, para 22.
[118] Case C-319/02 *Manninen* [2004] EU:C:2004:164, Opinion of AG Kokott, para 28.
[119] Marjaana Helminen *EU Tax Law - Direct Taxation* (IBFD 2018) 122.

> *to companies established in the Netherlands is liable to deter companies established in another Member State from investing in the Netherlands and thus constitutes a restriction on the free movement of capital.*[120]

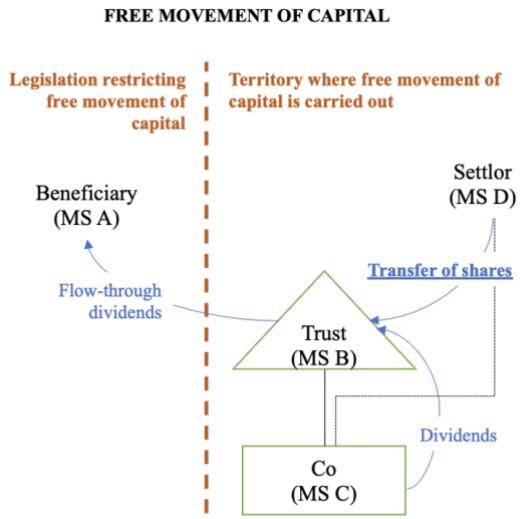
Based on the above, it can be considered that imposing unfavourable tax consequences on dividend proceeds could potentially hinder the free movement of capital by preventing EU citizens from transferring their shares to a trust.

5.3 Not my territory, not my nationals- not my problem?

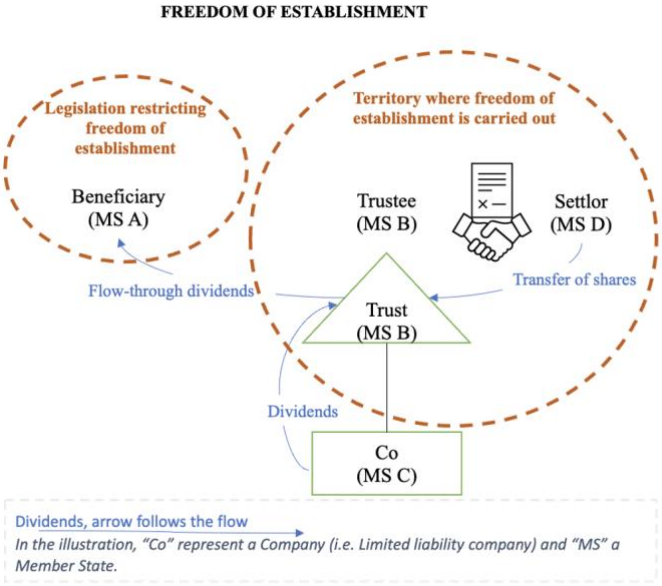
It has been established that the situation discussed does constitute a restriction of freedom of establishment and free movement of capital. Both freedoms are considered to restrict actions performed by the settlor and/or trustee, while the source of restrictive treatment originates at the level of a beneficiary.

Accordingly, in the situation discussed, the thesis has arrived at a restriction created by one Member State (referred to as "MS A" in the illustration below) that restricts the basic freedoms of an EU national residing in a different Member State (MS D). The case discussed can even include a situation where the freedom enjoyed by the national of Member State D is used in a third Member State (MS B). In other words, in the situation discussed, the restrictive treatment occurs in a Member State other than the Member State involved in the exercise of the freedoms.

Indeed, in the ECJ case law, both freedoms are usually defined in light of non-residents exercising their rights in the resident Member State or residents accessing non-resident Member State.[121] The question thus might be asked if restriction would exist where the domestic legislation restricts the exercise of freedoms by non-residents in a non-resident Member State thus leaving the resident Member State outside the transaction parameter of the exercised freedom.



[120] *Amurta* (n58) 28.
[121] *Société Générale* (n117) 22.



Source: Authors' considerations.

When discussing the presence of economic activity for trusts in light of the EEA Agreement, the Commission indicated that '[i]t is not required that the economic activities take effect in the EEA State of the establishment. It suffices that they take effect in the EEA.'[122]

The same analogy could be applied when the source of a restriction affects freedom executed in a different Member State, thus making it irrelevant where the restriction occurs as long as it is within the EU.

Accordingly, while this question may challenge how far the EU and protection of fundamental freedoms can stretch, it would be improper to consider that freedom of establishment or free movement of capital can be restricted by a Member State simply because the exercise of such freedom does not take place in its territory or is not exercised by nationals of such Member State. In the Authors opinion, such a conclusion would go against the values of the EU to create an environment with no internal borders.

5.4 What I don't recognise I don't have to protect… or do I?

During the analysis, a question arises whether the absence of a specific legal form in a domestic situation would remove the restrictive nature of a provision. Is it still a restriction if the local Member State does not have such an arrangement in its local system?

As an inspiration, the opinion of AG Tizzano and the ECJ in the *SEVIC Systems AG*[123] case could be considered, where both agreed that

> *the right of establishment covers all measures which permit or even merely facilitate access to another Member State*

[122] *Fred. Olsen and Others* (n32), para 99.
[123] Case C-411/03 *SEVIC Systems* [2005] EU:C:2005:762.

> *and the pursuit of an economic activity in that State by allowing the persons concerned to participate in the economic life of the country effectively and under the same conditions as national operators.*[124]

Thus, the restrictive treatment caused by using vehicles not present in a domestic setting (a trust) is considered as restricting participation in the economic life of another Member State.

The necessity of the protection of such establishments has also been highlighted in the ECJ case law in light of both freedom of establishment and the free movement of capital.

When it comes to freedom of establishment, the ECJ acknowledged that

> *the circumstance that in Finnish law there is no type of company with a legal form identical to that of a SICAV governed by Luxembourg law cannot in itself justify a difference in treatment, since, as the company law of the Member States has not been fully harmonised at Community level, that would deprive the freedom of establishment of all effectiveness.*[125]

The use of the language the ECJ chose to use in its judgment has left to wonder about the scope of application of such consideration. Indeed, in the *E*[126] case following this judgment, AG Hogan emphasised the use of 'in itself' by considering that in such a way, the ECJ did not close the door to the possibility of such circumstances being relevant in different cases.[127]

In relation to the free movement of capital, if it would be challenged that the restriction would not take place as capital is transferred to an establishment not recognised by the respective legislation, similarly as when discussing freedom of establishment, the ECJ has acknowledged that

> *the free movement of capital would be rendered ineffective if a non-resident collective investment undertaking, constituted according to the legal form authorised or required by the legislation of the Member State in which it is established and which operates in accordance with that legislation, were to be deprived of a tax advantage in another Member State in which it invests solely on the ground that its legal form does not correspond to the legal form required for collective investment undertakings in that latter Member State*[128].

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[124] *SEVIC Systems* (n123), para 18; Case C-411/03 *SEVIC Systems* [2005] EU:C:2005:437, Opinion of AG Tizzano, para 30.
[125] Case C-303/07 *Aberdeen Property Fininvest Alpha* [2009] EU:C:2009:377, para 50.
[126] Case C-480/19 *E* [2020] EU:C:2021:334.
[127] AG Hogan in *E* (n107), para 43.
[128] *Veronsaajien oikeudenvalvontayksikkö* (n85) 61.

Furthermore, the ECJ has already acknowledged that the fact alone that respective Member State does not have arrangements in question in their legal systems is not a sufficient justification as that would deprive fundamental freedoms of their effectiveness.[129]

Therefore, it can be considered that the fact alone that local legislation did not intend to be dealing with such arrangements does not deprive it of protecting the use of those arrangements.

Accordingly, it is necessary to evaluate other ways how respective Member State could justify such treatment.

6. Justification and Proportionality

6.1 Introduction

It has been established that in the situation discussed, a restriction exists. It can be found in light of the free movement of capital by restricting the transfer of shares to a trust as well as in light of freedom of establishment by restricting establishing the trust itself.

However, it has been established by the ECJ case law that even if a restriction is found to be present in the local legislation, the restrictive treatment is not considered in breach of fundamental freedoms if it can be justified. In the words of Lazarov, 'there are some higher, nobler goals that are worthy of protection and, thus, justify setting aside the economic fundamental freedoms'[130].

It is the Member State whose provisions are under scrutiny that provides the justification.[131] Thus, considering the hypothetical nature of this thesis, the thesis will evaluate possible justifications the Member State might use in the situation discussed by considering justifications previously accepted by the ECJ.

While the ECJ has accepted various justifications in its case law (i.e safeguarding the effectiveness of fiscal supervision[132]; the need to ensure recovery of a tax debt; anti-avoidance purpose; safeguarding balanced allocation of taxing rights between Member States[133]; need to prevent double use of losses; safeguarding fiscal cohesion of the national tax system[134]; territoriality principle[135]), the thesis will only discuss justifications in light of fiscal supervision, allocation of taxing powers and anti-abuse (anti-tax

[129] *Aberdeen Property Fininvest Alpha* (n125), para 50.
[130] Ivan Lazarov, 'The Relevance of the Fundamental Freedoms for Direct Taxation', in Michael Lang *Introduction to European Tax Law on Direct Taxation* (6th edn, Linde 2020) 89 (258).
[131] Case C-35/19, *Belgian State (Indemnité pour personnes handicapées)* [2019] EU:C:2019:894, paras 37-38.
[132] Case C-493/09 *Commission v Portugal* [2011] EU:C:2011:635, para 42.
[133] Joined Cases C-338/11 to C-347/11 *Santander Asser Management SGIIC and Others* [2012] EU:C:2012:286, para 47.
[134] *Santander Asser Management SGIIC and Others* (n133), para 50.
[135] Marjaana Helminen *EU Tax Law - Direct Taxation* (2021 edition, IBFD) 146.

avoidance). The Author considers these justifications most likely to be challenged in light of the situation discussed.

Finding a justification, however, is not enough to consider the restriction a permitted restriction- it must also observe the principle of proportionality i.e. 'it must be appropriate for securing the attainment of the objective it pursues and must not go beyond what is necessary to attain it'[136]. Thus, in this section, if any of the justifications will be considered viable, proportionality in light of the respective justification will be analysed.

6.2 In search of a justification

6.2.1 Fiscal supervision

Considering that in the given situation, the discussion circles around a Member State where trusts cannot be established, the justification of effective fiscal supervision is very fitting. Indeed, how could the government ensure supervision when dealing with arrangements that are foreign to them?

A similar justification was challenged in the *Emerging Markets Series of DFA Investment Trust Company* case, where the ECJ dealt with an investment fund in a third country. The need to ensure fiscal supervision was presented from a perspective of lack of a common legal framework related to administrative cooperation with that third country, thus lacking a legal instrument for the Member State to check the evidence and information submitted by the third country.[137]

In the respective case, it was discussed that Directive 77/799/EEC[138] (which is now replaced by the DAC[139]) did not apply to third countries, thus limiting the safeguarding options for the Member State.

Accordingly, a question can be raised- does the DAC applies to trusts?

The DAC, in its preamble, has established the intention to consider trusts.[140] Furthermore, the Author agrees with Hemels in acknowledgement that the scope of Article 3(11) of the DAC defining persons is wide and can be interpreted as involving a trust that 'owns or manages assets which, including the income derived therefrom, are subject to any of the taxes covered'[141].

As a result, it can be considered that trusts are covered by the DAC, ergo, a justification in the form of fiscal supervision could not be upheld as the supervision could be ensured by applying the DAC.

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[136] Case C-262/09 *Meilicke and Others* [2011] EU:C:2011:438, para 42.
[137] Case C-190/12 *Emerging Markets Series of DFA Investment Trust Company* [2014] EU:C:2014:249, para 72 -73.
[138] Council Directive (EU) 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation [1997] *OJ L 33.*
[139] Council Directive (EU) 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC (DAC) [2011] *OJ L 64.*
[140] DAC (n139) preamble para 7.
[141] Sigrid Hemels, 'Administrative Cooperation in the Assessment and Recovery of Direct Tax Claims' in Peter Wattel and others (eds) *European Tax Law: Volume 1- General Topics and Direct Taxation* (Student edn, Wolters Kluwer 2018) 283.

6.2.2 The allocation of the power to tax and safeguarding tax revenue

It has been established by the ECJ, that

> *[w]here, however, a Member State has chosen not to tax recipient companies established in its territory in respect of this kind of income, it cannot rely on the argument that there is a need to safeguard the balanced apportionment of the power to tax between the Member States in order to justify the taxation of recipient companies established in another Member State.*[142]

Further, AG Kokott has summarised the allocation of the taxing power as including (1) the principle of territoriality, ensuring Member States right to protect its profits, especially those generated in its territory, (2) the principle of autonomy, ensuring Member States right to organise its system autonomously, (3) the principle of symmetry as well as (4) prohibition of free choice between tax systems.[143]

At its current stage, the EU law does not lay down rules for the allocation of taxing powers between Member States.[144] AG Kokott has remarked that

> *[t]he Member States have, as a rule, delimited their powers in accordance with international taxation practice in such a way that a State has the power to tax both the world-wide income of domestic companies and the domestically granted income of permanent establishments of foreign companies.*[145]

Moreover, it is acknowledged that in light of international practice, Member States preserve the allocation of their powers of taxation in relation to activities carried out in their territory.[146]

Considering the above, as the respective income does not originate in the territory of the beneficiary, then, considering the international agreements, the Member State of the beneficiary does not have the right to tax respective income, thus making the justification of allocation of taxing powers insufficient.

However, it is worth recalling the challenges in applying DTT in situations originating from trusts, particularly when dealing with countries without trusts in their legal system. In such a situation, there is a risk that the application of DTT is challenged due to the inability to meet the first requirement needed to apply the DTT- to be considered a person.[147]

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[142] *Amurta* (n58), para 59.
[143] Case C-405/18 *AURES Holdings* [2019] EU:C:2019:879, Opinion of AG Kokott, 33-44.
[144] *Damseaux* (n98), paras 30 - 33.
[145] Case C-18/11 *Philips Electronics UK* [2012] EU:C:2012:222, Opinion AG Kokott, para 45.
[146] *Cadbury Schweppes and Cadbury Schweppes Overseas* (n56), para 56, *Rewe Zentralfinanz* (n113), para 42; Case C-231/05 *Oy AA* [2007] EU:C:2007:439, para 54; Case C-371/10 *National Grid Indus* [2011] EU:C:2011:785, para 46.
[147] Vega Borrego (n10) 26.

It can be considered that this question opens yet another door to further areas to explore. For the purpose of this thesis, the Author will focus on the fact that the respective income has been taxed at source, thus considering that the Member State of income recipient was not intended to have the power to tax respective income. Irrespectively, it is considered that if a Member State in question could prove its right to tax respective income (or, in other words, could prove that it has not given up such power in light of DTT), it could open the door for justification in light of balances allocation of powers.

6.2.3 Anti-tax avoidance

Discussing the presumption of tax avoidance (or anti-abuse in general) can be seen as a walk on thin ice.

On one side, there is the ECJ case law that allows taxpayers to use more beneficial tax systems available to them by acknowledging that

> *the right of taxpayers to take advantage of competition engaged in by the Member States on account of the lack of harmonisation of taxation of income cannot be raised against the application of the general principle that abusive practices are prohibited.*[148]

It has been clearly established that such use of tax regime most favourable to the taxpayer 'cannot, as such, set up a general presumption of fraud or abuse'[149].

However, at the same time, the ECJ has limited the use of the freedom to choose the most favourable legislation by excluding situations

> *where the transaction at issue is purely artificial economically and is designed to circumvent the application of the legislation of the Member State concerned.*[150]

For tax matters, the ECJ has indicated the presence of a prohibited abusive practice is 'where the accrual of a tax advantage constitutes the essential aim of the transactions at issue'[151].

Moreover, to use the prevention of abusive practices as a ground for justification, the restriction,

> *the specific objective of such a restriction must be to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory .*[152]

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[148] Case C-116/16 *T Danmark* [2019] EU:C:2019:135, para 80.
[149] *Cadbury Schweppes and Cadbury Schweppes Overseas* (n56), para 50; *National Grid Indus* (n146), para 84; Case C-464/14 *SECIL* [2016] EU:C:2016:896, para 60.
[150] *Cadbury Schweppes and Cadbury Schweppes Overseas* (n56), para 51; Case C-322/11 *K* [2013] EU:C:2013:716, para 61.
[151] Case C-425/06 *Part Service* [2008] EU:C:2008:108, para 45; Case C-251/16 *Cussens and Others* [2017] EU:C:2017:881, para 53.
[152] *Cadbury Schweppes and Cadbury Schweppes Overseas* (n56), para 55.

It was established in the *Halifax* case that the 'transactions, or series of transactions, the essential aim of which is to evade taxes, constitutes abuse and is contrary to EU law'[153].

Thus, if in the situation discussed, a Member State would justify its restrictive provision with an anti-abuse (i.e. anti-tax avoidance) purpose, it would have to prove that firstly the provision itself was aimed at eliminating the risk of tax abuse, as well as it would have to prove objective or subjective abuse by the taxpayer. The objective element is that the trust itself is an artificial establishment, while the subjective element would be present if, while the trust is not artificial itself, the arrangement has been created to obtain a tax benefit.[154]

This analysis would highly depend on a further examination depending on the trust itself (what type of trust, specifics of the trust agreement). Thus, this thesis will not examine them further and will assume that the anti-abuse (tax avoidance) justification could be used by the Member State to justify the restrictive treatment.

6.3 Is the justification proportional?

Based on the analysis performed, it is considered that a Member State could justify its restricting measure due to the risk of abuse in the form of tax avoidance.

It must be recalled that an accepted justification for a restriction imposed by the local legislation is not enough for the restriction to constitute a permitted restriction- it must also be proportional.

As set out by the TEU[155], '[u]nder the principle of proportionality, the content and form of Union action shall not exceed what is necessary to achieve the objectives of the treaties'[156].

Accordingly, it is considered that for a measure to be considered proportional, it must fulfil the suitability test proving that the measure contributes to achieving its goal, and the necessity test proving that it is the least discriminatory provision to achieve such a goal.[157] In the words of Lazarov, when it comes to the latter test, it should not be general in nature but rather a 'tailor-made provision such that catches only those practices dealing within the scope of justification'[158].

Thus, for a Member State to justify its provision as an anti-abuse provision, it must be able to prove that the provision not only works as an anti-abuse provision but also that it is drafted in a way that it only catches the anti-abusive practices.

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[153] Case C-255/02 *Halifax and Others* [2006] EU:C:2006:121, para 68.
[154] See for approach: Cécile Brokelind and Peter J. Wattel, 'Free Movement and Tax Base Integrity' in Peter Wattel and others (eds) *European Tax Law: Volume 1- General Topics and Direct Taxation* (Student edn, Wolters Kluwer 2018) 340.
[155] Consolidated version of the Treaty on European Union (TEU) [2012] OJ C326/13.
[156] TEU (n155) Art 5(4).
[157] Lazarov (n130) 101.
[158] Lazarov (n130) 101.

It has been established by the ECJ that a general presumption of anti-abuse is not sufficient to justify the provision- the same goes for provisions that also catch anti-abusive practices.[159]

Accordingly, it is not enough for a Member State to consider that the arrangement falling under the provision is abusive- it should give the taxpayer a possibility to prove that its activities are not abusive. Indeed, the ECJ has indicated in its case law that

> *the taxpayer should not be precluded a priori from providing relevant documentary evidence enabling the tax authorities of the Member State imposing the tax to ascertain, clearly and precisely, that he is not attempting to avoid or evade the payment of taxes.*[160]

In the situation discussed, it is understood that a pre-requisite to access the double-taxation-eliminating provision is that the respective income has been taxed at source. Thus, it might be challenged that for the justification to be proportional, the Member State must have given a possibility in the case at hand to prove that the income has been taxed at source.

Accordingly, it could be considered that if a Member State does not provide an option for the beneficiary to submit proof that the respective income has been taxed, a provision taxing such income in light of anti-tax avoidance cannot be seen as being proportional.

[159] Case C-504/16 *Deister Holding* [2017] EU:C:2017:1009, paras 61-62.
[160] Case C-101/05 *A* [2007] EU:C:2007:804, para 59.

7. Conclusion

As a result of this thesis, it can be concluded that a restrictive treatment applied to a dividend-sourced income that is received from a trust has grounds to constitute a breach of freedom of establishment (Article 49 TFEU) and free movement of capital (Article 63 TFEU), where in the Member State in question, trusts cannot be registered.

However, it is emphasised that considering the multitude of additional aspects challenged in this thesis, the actual outcome of such a situation would highly depend on the trust and the Member State in question.

The thesis acknowledged two layers of restriction. The first one leads to a restriction of the freedom of establishment, restricting the establishment of trust. Restriction lies with the fact that EU nationals are free to choose in what legal forms they want to use, and such freedom would be restricted if it would be considered that proceeds from such establishment would lead to adverse tax consequences when compared to a domestic alternative. The second restriction was determined in light of the free movement of capital, where unfavourable tax consequences upon distributing the proceeds would restrict the settlor from transferring its shares to the said trust.

Furthermore, irrespective of the lack of purely equivalent domestic arrangement, the thesis found not one but two alternatives in performing comparability analysis. Firstly, a purely domestic comparable was found by comparing the trust to a local alternative such as a company or partnership. Secondly, a purely domestic comparison was found by disregarding the trust from the equation, i.e. by considering that the adverse tax treatment derives purely from having the foreign trust in the chain of transactions, that would not be the case if it would be decided not to use the foreign trust. In the meantime, if no comparison could be found, the thesis questioned if, due to the technicality behind trusts, the comparability analysis should be performed at all.

Lastly, it was concluded that while the Member State could justify the restriction in light of anti-tax avoidance, such justification would not be proportional if the EU nationals would not given a chance to prove that no tax avoidance took place.

Head in the sand when trust income is in sight?

This is the question that somewhat metaphorically began the discussion of trust income in light of fundamental freedoms. As a result of the thesis, it is concluded that Member States cannot ignore establishments that are not present in their local system and should ensure that their legal system does not interfere with the EU fundamental freedoms.

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