SOME INTERESTING ISSUES REGARDING ARTICLES 56-58 EC TREATY

BORBÁLA KOLOZS

Department of Fiscal and Financial Law
Telephone number: (36-1) 411-6509
E-mail: borbalakolozs@ajk.elte.hu

1. Introduction

This article is about Arts. 56-58 of the EC Treaty. Art. 56 states that "Within the framework of the provisions set out in this Chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited." It is recently a topic to debate what does the "movement between Member States and third countries" mean and how should it be interpreted.[1] Third states are non-member countries i.e. they are not participating in the EU. Art. 56 clearly refers to third countries. However, it is not that clear, how should these Arts. be interpreted. In the present article I would like to deal with this legal matter. First I examine the freedoms in general then I discuss Arts 56-58. I also dedicate some part to the correlation between the freedoms and Hungary's legal norms that hinder the free movement of capital.

2. The freedoms

There are three different approaches to deal with the freedom itself as a concept.[2] The first approach interprets freedoms as a general prohibition for the Member States to adopt or maintain in force national measures that can cause distortions to the internal market. This is the widest interpretation of the freedoms, which means that basically it does not matter whether the national provi-

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1 See for example the recently published book: *EU and Third Countries: Direct Taxation*, edited by Lang/Pistone, 2007. This was also the topic of a conference organized by the Vienna University of Business Administration Institute of Austrian and International Tax Law held in October 2006. This article is based on the contribution and the research of the author to this conference.

2 The three groups of freedom, as an idea and structure have been taken from: Kapteyn/van Themaat, *Introduction to the law of the European Communities*, 3rd edition, 1998, pp. 584-586.

sion in question is applied to international or to domestic situations; the only important thing is that the national provision is in theory able to hinder any free movement. The second concept of freedoms means that the Member States refrain from adopting or maintaining in force freedom-impeding provisions that apply only to the "international movements", i.e. import-export, or immigration-emigration. The third interpretation of the concept of the freedom might be "a pure and simple application of the principle of non-discrimination on grounds of nationality, of origin or destination."[3]

The EC Treaty contains the so-called "freedoms" under Arts. 23-24, 39-42, 43-48, 49-55 and 56-60 of the EC Treaty. The freedoms are the main characteristics of the internal market.[4] "The area without internal frontiers is established through the effect of the principle of freedom, through the principle of mutual acceptance and through harmonized or uniform rules."[5] Member States, however, under certain conditions have the possibility to maintain in force national rules that can hinder the freedoms. These national norms require a justification. The justification shall be treaty-based or case-law based. The treaty-based justifications are found written down in the EC Treaty[6] and they are always strictly interpreted. The national norm that requires protection shall only be of non-economic nature and they "(…) must represent a sufficiently serious threat to one of those protected fundamental interests of the society."[7] Since real life might bring new situations every day that shall not be covered only by the words of the EC Treaty, the European Court of Justice (hereinafter ECJ) has developed a set of non-written measures in its case law for the justification of national provisions hindering the freedoms. This is called the 'rule of reason', and it is "(…) the principle authorizing Member States to derogate, under fixed conditions, from their obligations under the Treaty freedoms, on grounds of imperative reasons of general interest."[8] It follows from its case-law nature that the 'rule of reason' applies only on the field where EC provisions are not available. National measures justifiable under the rule of reason must be non-dis-

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3 Kapteyn/van Themaat, *Introduction to the law of the European Communities*, p. 585.

4 "The internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty." Article 14(2) EC Treaty

5 Kapteyn/van Themaat, *Introduction to the Law of the European Communities*, p. 576.

6 See for example Arts. 30, 45, 58(1) EC Treaty

7 Hinnekens, Basis and Scope of Public Interest Justification of National Tax Measures Infringing Fundamental Treaty Freedoms, in: Vanistendael, *EU Freedoms and Taxation*, 2006, p. 74.

8 Hinnekens, Basis and Scope of Public Interest Justification of National Tax Measures Infringing Fundamental Treaty Freedoms, in: Vanistendael, *EU Freedoms and Taxation*, 2006, p. 75.

criminatory, necessary and meet the requirements of the proportionality test.[9] As far as tax matters are concerned, only a limited number of justifications have been accepted insofar. These justifications are based on the protection of the cohesion of the national tax system, the prevention of the abuse of rights/tax avoidance, the effectiveness of the fiscal supervision and the principle of territoriality. It is true as well that the fiscal cohesion – similarly to the territoriality – has been accepted only once. Some scholars, like PISTONE think that the appearance of third countries in cases regarding the free movement of capital will raise the number of accepted justifications. [10]

2.1. The free movement of goods

Economic integrations start evolving from the form of a free-trade area and – as the highest level of economic integration – countries can reach the level of political union. The levels depend on how much participating countries are involved.[11] The higher the level of economic integration, the higher is the protection of freedoms. Freedoms are of equal importance and there is no hierarchy. Every freedom is related to the others and the interpretation of one freedom generally touches other freedoms as well. However, the free movement of goods – at least from chronological and evolutional points of view – seems to be logical to be established first. "The free movement of goods is one of the central economic ideals of the Community."[12] The provisions regarding the free movement of goods (Arts. 23-25 et seq.) are quite strict and clear, and the ECJ has rarely shown tolerance towards national measures[13] having any negative effect on the internal market. Member States, however, might apply national provisions that can have a discriminatory effect regarding tariff or non-tariff aspects as well, e.g. the provisions on quantitative restrictions of import or export. These restrictions are of non-economic nature and "(…) shall not (…) constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States."[14]

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9 Kapteyn/van Themaat, *Introduction to the Law of the European Communities* 3rd edition, 1998, p. 679.

10 Pistone, The impact of European Law on the Relation with Third Countries in the Field of Direct Taxation, *Intertax*, 2006, pp. 234-244.

11 Hanlon, *European Community Law*, second edition, 2000, p. 179.

12 Hanlon, *European Community Law*, second edition, 2000, p. 179.

13 For example "charges having equivalent effect" (Art. 23 EC Treaty) was defined early.

14 Art. 30 EC Treaty

2.2. The free movement of persons

The concept of free movement of the workers in the coal and steel sector was born with the ECSC Treaty of 1951.[15] "The EC Treaty took over the basic provisions of the ECSC Treaty for the free movement of persons and developed them, so that the free movement was no longer restricted to workers in specific sectors but embraced all occupations, although a distinction was drawn between the free movement of workers, dealt with in Articles 48-51 EC[16], and self-employed, who are covered by Articles 52-58[17] (as are legal persons).[18] The free movement of persons originally referred to persons moving from one Member State to another Member State **and** performing economical activity (see for example *Werner*). Today this freedom shall be invoked by any citizen of the EU, because the citizenship of the EU has been established. The free movement of persons covers the right of migration[19], the right to access to the market and the ancillary rights. Art. 18 of the EC Treaty is about the right of EU citizens to move and reside within the territory of any of the Member States. Some authors, like BECKER,[20] still think that the free movement of persons is vulnerable and ENGLISCH believes that Art. 18 shall not gain importance in all legal fields.[21]

EU nationals can invoke protection of EU freedoms against another EU Member State when they reside in a third country. In the *Boukhalfa* case[22] the ECJ said that "(…) the prohibition of discrimination based on nationality (…), applies to a national of a Member State who is permanently resident in a non-member country, who is employed by another Member State in its embassy in that non-member country and whose contract of employment was entered into and is permanently performed there, as regards all aspects of the employment

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15 Treaty Establishing the European Coal and Steel Community, Art. 69(1) "Member States undertake to remove any restriction based on nationality upon the employment in the coal and steel industries of workers who are nationals of Member States and have recognized qualifications in a coalmining or steelmaking occupation, subject to the limitations imposed by the basic requirements of health and public policy."

16 EC Treaty Arts. 39-42 according to the current numbering

17 EC Treaty Arts. 43-48 according to the current numbering

18 Kapteyn/van Themaat, *Introduction to the Law of the European Communities*, p. 692.

19 Right to exit, right to entry and right to reside.

20 Becker, Managing Diversity in the European Union: Inclusive European Citizenship and Third-Country Nationals, *Yale Human Rights & Development L.J* 2004, p. 132 (p. 183).

21 "The freedom of movement comprises the prohibition of discrimination on grounds of nationality. However, as far as economic activities protected by the special provisions of Articles 39, 43 and 49 are concerned, Article 18 must not be taken into consideration. In tax law matters, Article 18 will therefore gain importance only in a small number of cases regarding non-economic, nevertheless taxable activities." Englisch, The European Tax Treaties Implications for direct taxes, *Intertax* 2006, p. 317.

22 C-214/94 *Ingrid Boukhalfa v. Bundesrepublik Deutschland*

relationship which are governed by the legislation of the employing Member State."[23] Ms Boukhalfa was a Belgian national, worked in Algiers at the German Embassy. Compared to her German national colleagues more disadvantageous measures were applied to her. "It is true that the ECJ has decided that the obligations under the Treaty of Rome are also applicable in third countries when transactions undertaken in third countries have consequences within the territory of the European Union that constitute an infringement of the Treaty rules."[24]

The question of third states might arise from a different point of view as well, namely the situation of natural persons moving to the EU. Third country nationals who move to the EU may enjoy the benefits of moving cross-border within the EU with all the freedoms only if they are EU citizens. So first these persons have to be a citizen of any of the Member States. Member States, however, are free to decide on immigration policy.[25] BECKER[26] is still afraid of the results of this situation. "There is an irreconcilable tension between the common market and Member State control over entry requirements and internal regulation of TCNs *(third country nationals – the author).* So long as immigration policy and TCN rights vary by Member State of entry or residence, it remains impossible to facilitate unimpeded free movement of persons among the Member States."

There is an escape rule for Member States regarding workers as well, based on the justification on grounds of public policy, public security or public health, but since the ECJ is trying to interpret this freedom narrowly, it allows less space for Member States to apply discriminatory measures based on these justifications.

2.3. The freedom of establishment

The freedom of establishment[27] provides the nationals of Member States with the "(…) right to take up and pursue activities as self-employed persons and to set up and manage undertakings (…) under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the chapter relating to capital." The main aim of the freedom of establishment is to integrate markets of Member States by giving

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23 See footnote 22, paragraph 22.

24 Vanistendael, Impact of European Tax Law on Tax Treaties with Third Countries, *EC Tax Review* 1999, p.164.

25 Kolozs, National Report Hungary in: *EU and Third Countries: Direct Taxation*, edited by Lang/Pistone, 2007.

26 Becker, Managing Diversity in the European Union: Inclusive European Citizenship and Third-Country Nationals, *Yale Human Rights & Development L.J* 2004, p. 132 (p. 183).

27 Art. 43 EC Treaty

entrepreneurs the right to take part in another Member State's economy. "The concept of establishment within the meaning of the Treaty is a very broad one, allowing a Community national to participate, on a stable and continuous basis, in the economic life of a Member State other than his state of origin and to profit therefrom, so contributing to economic and social interpenetration within the Community, in the sphere of activities of self-employed persons."[28] "The freedom of establishment requires a Member State to treat other Member State's undertakings equally."[29] In other words it is "(…) nothing more than equal treatment."[30] Equal treatment can be favourable and unfavourable for a company regarding its home state system. For example a company is free to move to another Member State and perform economic activity there only because the tax law system of this other Member State is more advantageous than the home state's. The freedom of establishment covers the primary establishment (i.e. the right to set up a new company), and also the secondary establishment (i.e. the right to set up e.g. a branch).[31] As far as any third state national is concerned, this freedom is provided exclusively for nationals of Member States. However, it is clear from the ECJ's practice that "A Member State national that also holds the nationality of a third country can still benefit from this provision."[32]

2.4. The free movement of services

According to Article 49 the "(…) restrictions on freedom to provide services within the Community shall be prohibited in respect of nationals of Member States who are established in a State of the Community other than that of the person for whom the services are intended." Observing the wording of this Article it might seem that only the freedom to provide services is protected by the treaty, while the freedom to receive a service is not. "Although a number of directives attempted to protect the position of persons, who travel to another Member State to receive a service in effect, it was the ECJ that has extended the Treaty to include this freedom."[33] Services might be activities of an indus-

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28 *European Union Law*, Arnrull, Dashwood, Ross, Wyatt, fourth edition, 2000, p. 429.

29 Kolozs, National Report Hungary in: *EU and Third Countries: Direct Taxation*, edited by Lang/Pistone, 2007.

30 See, for example case C-79/85, *D. H. M. Segers v. Bestuur van de Bedriffsvereniging voor Bank- en Verzekeringswezen, Groothandel en Vrije Beroepen*

31 Várnay/Papp, *Az Európai Unió Joga (The Law of the European Union)* (2001) p. 350 and Panayi, Treaty Shopping and Other Tax Arbitrage Opportunities in the European Union: A Reassessment – Part 1, *European Taxation* 2006, p. 107 and Bater, Setting the Scene: Legal Framework, *European Taxation* 2002, p. 10.

32 Panayi, *European Taxation*, 2006, p. 107.

33 Hanlon, *European Community Law*, second edition, 2000, p. 177.

trial or a commercial character, of craftsman or of the professions[34], however, this list is not exhaustive. "The Court has held that the broadcasting of television signals, cable transmission, tourism, medical treatment (including the termination of pregnancy), education, the importation of lottery advertisements and tickets into a Member State, and unsolicited telephone calls to potential clients, are covered by the provisions on the freedom to provide services."[35] Services are, as a general rule, done for any kind of remuneration, it means that this freedom is also of an economic nature. Service providers and receivers can be natural or legal persons as well.

2.5. The free movement of capital and payments[36]

"The free movement of capital within the European Union is necessary for the proper functioning of the monetary union created by the Treaty of Maastricht."[37] The free movement of capital has always been a part of the Treaty of Rome, however, at the beginning it was insignificant.[38] According to the previous numbering of the EC Treaty Arts. 67-73 dealt with the movement of capital. As far as the insignificancy is concerned the "(…) free movement of capital was not originally a self-executing freedom: according to the case law of the ECJ the former Art. 67 constituted nothing more than an obligation of the Member States gradually to eliminate obstacles to the free flow of capital."[39]

While Art. 67(1) dealt with the free movement of capital, Art. 67(2) dealt with the current payments that were related to the movement of capital, e.g. payments of interest. Art. 67(2) could also be described as a special kind of payment. There was, however, another article related to the free movement of payments under Art. 106. These payments were linked to the movement of

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34 Art. 50 EC Treaty

35 European Union Law, Arnrull, Dashwood, Ross, Wyatt, fourth edition, 2000, p. 471.

36 For a more detailed history of the provisions regarding the free movement of capital and payments see Sedlaczek, Capital and Payments: The Prohibition of Discrimination and Restrictions, *European Taxation*, 2000, pp. 14-28.

37 Peters-Gooijer, The Free Movement of Capital and Third Countries: Some Observations, *European Taxation* 2005, p. 476.

38 "From a historical perspective, it is particularly striking that this fundamental freedom appears to have been "left behind" for many years by all of the parties involved, i. e. the Member States when they concluded the Treaty on the European Economic Communities in Rome in 1957, the Community institutions when they began to harmonize national legal systems and the European Court of Justice (ECJ) when it started to instil life into the different freedom guarantees set out in the Treaty itself. Briefly, it can be said that Art. 67 to Art. 73 of the EEC Treaty played an insignificant role for several decades." Cordewener/Kofler/Schindler, Free Movement of Capital, Third Country Relationships and National Tax Law: An Emerging Issue before the ECJ, *European Taxation* 2007, p. 107.

39 Vogel, Which Method Should the European Community Adopt for the Avoidance of Double Taxation?, *Bulletin for International Taxation*, 2002, p. 97.

goods, services or capital. While "movement of capital" meant independent cross-border investments, the "payment" was a part of the free movement of the factors of production.[40] It seems that the free movement of capital (and payments) was only a tool to reach the aim: the free movement of goods, services and workers and the freedom of establishment.

These two freedoms (i.e. the free movement of capital and the free movement of payments) have always meant two different things. "The freedom of payments is a complementary freedom to the four other freedoms (goods, services, persons, capital),"[41] and the attention of the EU is mainly on the free movement of capital. At present it does not make sense to distinguish between the free movement of capital and payments because of Art. 56 that treats these freedoms exactly in the same way.

Directive 88/361/EEC[42] was supposed to introduce the "real" liberalization of the movement of capital.[43] It is the only legal source that provides us with the definition for "capital movements". According to some authors this secondary law "insufficiently reflected the importance of the free movement of capital."[44] On the other hand, in the *Bordessa*[45] case the ECJ found that the Directive had direct effect. The situation has been resolved by the Treaty of Maastricht, which reformed the provisions on the free movement of capital radically. The re-numbered Art. 56 gained direct effect with the *Sanz de Lera*[46] judgement. It can clearly be seen that as the internal market gained more power and the idea of the monetary union took shape, more attention was paid to the chapter in question. At present Title III, Chapter 4 EC Treaty is dedicated to Capital and Payments. The Chapter consists of five Articles. Article 56 is a general obligation for Member States to liberalize the movement of capital and payments to other Member States and towards third countries as well. It prohibits any restrictions on the free movement of capital. It means that any kind of national rule that hinders the movement of capital is prohibited, even if the measure does not in itself discriminate between national and foreign. This is one of the most interesting norms of the whole EC Treaty as it treats third countries simi-

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40 Berke/Boytha/Dienes-Oehm/Király/Martonyi, *Az Európai Közösség Kereskedelmi Joga, (The Commercial Law of The European Community)* (2003) p. 116.

41 Terra/Wattel: *European Tax Law*, 4th edition, 2005, p. 51.

42 Council Directive of 24 June 1988 for the implementation of Art. 67 of the Treaty (88/361/EEC) OJ, L/178, 1988.

43 The first Article of the Directive 888/361/EEC prescribes the liberalization of the movement of the capital. "(…) Member States shall abolish restrictions on movements of capital taking place between persons resident in Member States."

44 Peters/Gooijer, *European taxation* 2005, p. 476.

45 Joined cases C-358/93 and C-416/93 *Aldo Bordessa and Others*, paragraphs 17 and 33.

46 Joined cases C-163/94, C-165/94, and C-250/94, *Criminal Proceedings against Lucas Emilio Sanz de Lera, Raimundo Díaz Jiménez and Figen Kapanoglu*

lar to EU Member States. The general prohibition of restrictions is therefore valid also for restrictions toward third countries. But is it possible for third country citizens to invoke this freedom? It is clear from the *Svensson-Gustavsson*[47] judgement that non-member states' citizens can also invoke this freedom.

The question is therefore, how this provision should be interpreted. It is clear that legal texts cannot be interpreted only grammatically but the objectives of the legislator should always be taken into consideration. The words of the EC Treaty provide us with an obvious text, all the objectives and aims of the EU cover the EU Member States and none of them mention the interest of the third countries. The abolition of the obstacles to the freedoms regards only Member States.[48] At the end the words of the EC Treaty are interpreted as there is no obligation to grant any benefit for third states. Let us examine then the objectives. The purpose of Art. 56 is to liberalize the movement of capital between the Member States and between a Member State and third countries. There are few cases to show any guideline in the history of the ECJ. At the beginning the *Sanz de Lera* and the *Bordessa* cases were cited as examples for the free movement of capital to/from third countries. These cases are about the pure transportation of banknotes, and both were decided in favour of the third country national. These cases are not very complicated from a juridical point of view, they are rather diplomatic matters and serve as paradigms in the interpretation of Art. 56. It can be claimed, that Art. 56 covers inbound and outbound capital flow between a Member State and a third country as well.

It means that from a Member State's point of view an investment made by a third state national or by an individual of another Member State shall be treated equally as far as the free movement of capital is concerned. But why should Member States let third countries be treated as members of the EU? The EU is the economic integration of certain states. All the aims and goals of the EU suggest that the membership is something fundamental. All the treaties talk about members. The "common market" and the "economic and monetary union" (i.e. the principal aims of the EU) in itself presume a community where only members can take part.[49] As a consequence, not all the states can be members. There are certain criteria that candidate states have to meet. Why should then Member States allow third countries to enjoy the benefits of the "membership" of the EU? After joining the EU a Member State has to share the same aims, as the whole EU has. Third states do not share the same aims because they are not members. They have their own aims and interests.

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47 Case C-484/93, *Peter Svensson and Lena Gustavsson v. Ministre du Logement et de l'Urbanisme*

48 Plansky, The Impact of the fundamental freedoms on tax treaties with third countries, in: Tax Treaty Law and EC Law, edited by Lang/Schuh/Staringer, pp. 293-330.

49 Kapteyn/van Themaat, *Introduction to the Law of the European Communities*, pp. 123 et seq.

The other problem with third countries is that any preference given by the EU shall remain uncompensated. Some authors, like CORDEWENER, KOFLER and SCHINDLER think that this is a "unilateral obligation on the Member States."[50] It is a preference given by the EU, but the EU cannot expect anything as compensation. Third country citizens may invoke the freedoms to protect them, but these third country citizens do not have any obligation towards the EU to fulfil.

The third problem with third countries is the question of interpretation. If the ECJ wants to decide whether a certain national provision restricts the freedoms or not there are two possible methods to examine the correlation between the two Member States' legal systems. The overall approach means that both countries' national provisions are taken into consideration. Some authors, like WEBER thinks that the overall approach is a wrong concept, since restriction cannot arise in the context of two states simultaneously. The per country approach means that the restriction is caused by one country's law.[51] When taking into account one country's legal system, it is still questionable, which of the two (or more) should be examined. The ECJ generally takes into consideration the legal system of the "country of destination", e.g. the Member State where the foreign person was discriminated by the law. However, in certain situations it is necessary to examine also the "state of origin."[52] Regarding third states it means that the third state's legal system should be taken into consideration, but I seriously doubt if the ECJ has the power to examine any law of an independent third country. Even if the ECJ would be entitled to do so, only factual similarities could be observed[53] and decisions would miss the normative comparison.

The fourth problem is the definition of capital. There is no exact definition for the term "capital". Directive 88/361/EEC presents a non-exhaustive list of the kinds of capital movements. But even if there were any provision like this, it would not be binding on third countries. It might sound strange that "inheri-

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50 Cordewener/Kofler/Schindler, Free Movement of Capital, Third Country Relationships and National Tax Law: An Emerging Issue before the ECJ, *European Taxation* 2007, p. 111.

51 Blokland, Inaugural Lecture by Prof. Dr. D.M. Weber: In Search of a (New) Equilibrium between Tax Sovereignty and the Freedom of Movement in the EC, *European Taxation*, 2007, pp. 69-72.

52 "Forbidden obstacles obstructing the free movement between the Member States can undoubtedly emanate not only from the state of destination, but just as well from the state of origin." Englisch, *Intertax*, 2006, p. 314.

53 "Prominent scholars have recently stated that only factual rather than normative similarity should matter. The essence of this statement is certainly correct: the national legislator cannot rule on the comparability just by deciding to treat two situations alike or differently." Englisch, *Intertax* 2006, p. 314.

tances and legacies" are a form of capital, but the *van Hilten-van der Heijden*[54] case dealt with exactly this problem and no one knows what third countries' legal systems may contain. Some authors think that this benefit given by the EU might "(…) weaken the EU's bargaining power, not only to protect its financial operators from any form of discrimination in a third country but also to ensure that Member States of the Community receive a reciprocal treatment in third countries"[55].

The changes made in the Chapter on capital were justified with the developing EU and with the closer and more realistic appearance of the monetary union. The wording of Art. 56 shows that the original intent of the legislator was to eliminate all possible obstacles as far as the movement of capital is concerned. However, it also seems obvious, that the legislator was worried about the complete liberalization. These worries have been drafted with Art. 57 and 58. Art. 57 is the so-called "grandfather clause" or "standstill clause", while Art. 58 creates the treaty-based getaway rule for those who apply restrictions contrary to Art. 56.

Art. 57(1) is a direct limitation[56] of the free movement of capital, because it contains provisions that affect capital flow directly. This direct limitation (the 'standstill clause') can only be used against third countries, but not in intra-EU situations. As these limitations are part of the national legal system, they are not uniform. These limitations might therefore appear on any level of national legislation and might touch any field of law or economic policy. There are, however, certain common measures that these national provisions have to meet. The most important common rule for these various national measures is the 'time-limit'. No more national provisions could be implemented after the 31 December 1993 in respect of the major part of the Member States, and 31 December 1999 in respect of Estonia and Hungary. Therefore national legal systems can still hinder the free movement of capital toward third countries, but only with those norms that were in force before the above mentioned 'drafting deadline'.

The second measure is that the national provision shall restrict only direct investment (including real estate), establishment, and provision of financial services and admissions of securities to capital markets. Candidate member states, like Hungary, went through a legal harmonization process and had the possibility to decide which areas to protect. Hungary decided to hinder the free

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54 C-513/03 *Erven van M. E. A. van Hilten-van der Heijden v. Inspecteur van de belastingdienst/ParticulierenOndernemingen buitenland te Herleen*

55 Plansky, The Impact of the fundamental freedoms on tax treaties with third countries, in: Tax Treaty Law and EC Law, edited by Lang/Schuh/Staringer, pp. 293-330.

56 Várnay/Papp, *Az Európai Unió Joga (The Law of the European Union)* p. 395.

movement of capital through provisions related to the ownership of agricultural land. This is of crucial importance as land is very cheap in Hungary compared to average EU prices. According to experts this situation would endanger the agriculture of Hungary as well. An exception is allowed for the nationals of other Member States who have (legally) been performing agricultural activity in Hungary **and** residing in Hungary for more than three years. These provisions, however, shall not be applied after seven years from the day when Hungary has joined the EU.

Hungary is also allowed to maintain in force national provisions that hinder the free movement of capital regarding the ownership of the secondary abode in Hungary. It means that for five years from the date when Hungary has joined the EU, Hungary shall prescribe as a mandatory requirement for nationals of other Member States to ask for the authorization of the Hungarian authorities when purchasing an abode in Hungary as a secondary place of residence. Nationals of other Member States/EEA States and nationals living previously in Hungary for more than four years do not fall within the scope of this provision.[57]

Art. 58(1)a and 58(1)b are indirect limitations of Art. 56. According to some authors, it overtly violates the basic treaty freedoms, because it allows Member States to apply discriminatory rules in the field of taxation.[58] It "legitimizes, to a certain extent, different tax treatment of resident and non-resident taxpayers, and of domestic and foreign-source investment income, at least as far as capital and payments are concerned."[59] However, Art. 58 does not differentiate between persons, investments, situations, etc. of Member States and of third states. It makes a difference between "(…) taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested."[60] The fact that capital flew from/to a third country did not change anything, see for example the *Sanz de Lera* case or the *van Hilten-van der Heijden* case.[61] The Member States did not even try to justify the disadvantageous national measure with the presence of a third country national/situation. Article 58(1) also suggests that the harmonization of direct tax laws is not an urgent matter for the EU itself, as in this way Member States remain free to distinguish between foreign and domestic capital and investors.

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57 For both these derogations, see the Act concerning the conditions of accession of the Czech Republic, the Republic of Estonia, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Republic of Hungary, the Republic of Malta, the Republic of Poland, the Republic of Slovenia and the Slovak Republic and the adjustments to the Treaties on which the European Union is founded OJ. 2003. L 236. p. 33 (p. 50).

58 Várnay/Papp, *Az Európai Unió Joga (The Law of the European Union)* p. 397.

59 Terra/Wattel *European Tax Law*' p. 22.

60 Art. 58(1) EC Treaty

61 C-513/03 *Erven van M. E. A. van Hilten-van der Heijden v. Inspecteur van de belastingdienst/ParticulierenOndernemingen buitenland te Herleen*

3. Correlations between the freedoms

3.1. Correlation between the freedom of establishment and the free movement of capital

Directive 88/361/EEC listed the most important kinds of capital movements. One of the capital movements mentioned was the establishment of branches and subsidiaries in other Member States.[62] This is a matter that also falls within the scope of the right of establishment. The correlation between the right of establishment and the free movement of capital can be interpreted on the EC Treaty level or on the case-law level. On the level of the EC Treaty we can see an interesting correlation between the freedom of establishment and the free movement of capital. As far as the text of the EC Treaty itself is concerned, Art. 43(2) makes a reference to the chapter on capital and payments.[63] In the present legal text of the EC Treaty Art. 58 (2) makes a reference back to the freedom of establishment.[64] It might be interesting to study why these articles refer to each other. One possible interpretation is that in 1957 Art. 43(2) was originally numbered Art. 52(2) – but the content is the same even today. This means that the last part of the sentence ("(…) subject to the provisions of the chapter relating to capital.") must have referred to the 1957's text on the freedom of capital, e.g. the gradual liberalization of the flow of capital, which had a completely different meaning. Another possible interpretation is that Member States have the right to apply restrictions to the freedom of establishment within the framework of the EC Treaty, but these restrictions may not concern capital flows, because those restrictions on the free movement of capital should be treated separately. A third possible interpretation is that Art. 43(2) establishes the freedom to take up any entrepreneurial activity in any other Member State in general, with regard to this Member State's national law. Art. 58(1) allows Member States to apply different rules based on nationality. These two parts put together might mean that a company is free to be established in another Member State, but when doing so, this company has to follow the company law and tax law of that other Member State. The reference to the freedom

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62 "Establishment and extension of branches or new undertakings belonging solely to the person providing the capital, and the acquisition in full of existing undertakings and participation in new or existing undertaking with a view to establishing or maintaining lasting economic links" Directive 88/361/EEC Annex I.

63 Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article 48, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the Chapter relating to capital.

64 The provisions of this Chapter shall be without prejudice to the applicability of restrictions on the right of establishment which are compatible with this Treaty.

of establishment seems to enforce this latter explanation.[65] An interesting interpretation is that these two articles refer to each other in order to be able to avoid the abuse of one provision referring to the other,[66] i.e. Art. 58(2) limits the free movement of capital through the freedom of establishment.[67]

The link between the freedom of establishment and the free movement of capital exists not only in written-form, but also in case law form. Since setting up a company might qualify as capital movement and establishment as well the ECJ also developed an important rule on this question in its case-law. I would like to cite PANAYI[68] who clearly summarized this correlation: "(…) if the EU national has a sufficient ownership interest to be able to control or exercise influence over an undertaking, then the freedom of establishment applies. If not, then the free movement of capital applies." Among the several cases that dealt with the problem the most important may be the *Baars* case[69], where the ECJ held that "(…) a national of a Member State who has a holding in the capital of a company established in another Member State which gives him definite influence over the company's decisions and allows him to determine its activities is exercising his right of establishment."

3.2. Correlation between the freedom of establishment and the freedom to provide services

The interpretation of the freedom of establishment sometimes goes together with the interpretation of other freedoms. "The freedom of establishment has much in common with the freedom to provide (and receive) services. Both involve the free exercise of a trade or profession."[70] The border line might be drawn based on the permanent presence[71], as Art. 50 explains: "Without prejudice to the provisions of the Chapter relating to the right of establishment, the person providing a service may, in order to do so, temporarily pursue his activity in the State where the service is provided, under the same conditions as are imposed by that State on its own nationals."

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65 Art. 58(2) EC Treaty provides: "The provisions of this chapter shall be without prejudice to the applicability of restrictions on the right of establishment which are compatible with this Treaty."

66 Cortut, National Report Romania, in: *EU and Third Countries: Direct Taxation*, edited by Lang/Pistone, pp. 837-862.

67 Kolozs, National Report Hungary, in: *EU and Third Countries: Direct Taxation*, edited by Lang/Pistone, pp. 287-318.

68 Panayi, *European Taxation,* 2006, p. 109.

69 C-251/98 *C. Baars and Inspecteur der Belastingdienst Particulieren/Ondernemingen Gorinchem,* paragraph 22. see also ECJ Opinion C-446/04 *Test Claimants in the FII Group Litigation,* par. 30.

70 Kapteyn/van Themaat, *Introduction to the Law of the European Communities*, p. 730.

71 Kapteyn/van Themaat, *Introduction to the Law of the European Communities*, p. 750.

4. How does Hungary restrict the free movement of capital?

As it is mentioned above Hungary has been licensed to keep certain restrictive national provisions in force. Besides those approved norms, there are other national measures that hinder the free movement of capital. To explain it in a few words and superficially only: the Hungarian Personal Income Tax Act contains provisions related to the capital gains deriving from the selling of any immovable property. The income deriving from the selling of the immovable property is tax exempt if the taxpayer acquires a new immovable property within the territory of Hungary. It is, therefore a provision that deters persons from acquiring any immovable property outside the territory of Hungary. This situation is not new to the ECJ since similar national provisions have been found in the Portuguese[72] and Swedish[73] legislation.

5. Conclusion

Drafting international law is very difficult because the legal drafter should be very general. It sometimes leads to interpretational problems as nobody will ever understand what the original idea behind the text of the law was. The free movement of inbound capital must be an important aim of the EU but as far as the outbound investments are concerned I do not believe in such a liberal concept. There are several reasons to mention why the flow of capital to and from third countries does not exclusively have a bright side, e.g. missing collaboration between tax authorities and third countries – but money laundering is an important issue as well. It would be good to know what the limits of the free movement of capital in respect to third countries are. If there are limits, it would also be good to know how those limits have been established and what they are.

[72] C-345/05 *Commission of the European Communities v. Portuguese Republic*
[73] C-104/06 *Commission of the European Communities v. Kingdom of Sweden*

SUMMARY

Some interesting issues regarding Articles 56-58 EC Treaty

BORBÁLA KOLOZS

Article 56 of the EC Treaty is unique since it provides for the complete liberalization of the free movement of capital between Member States and between Member States and third countries. The present study examines the various interpretations of the freedoms and thoroughly analyses Article 56. Possible interpretations of Article 56 and how it is related to different freedoms are discussed. Finally, a Hungarian statutory provision is presented that potentially restricts the free movement of capital.

RESÜMEE

Einige interessante Aspekte bezüglich Artikel 56-58 des EG Vertrages

BORBÁLA KOLOZS

Artikel 56 ist eine der interessantesten Vorschriften im gesamten Römischen Vertrag. Er verfügt über die vollständige Liberalisierung des Kapitalverkehrs innerhalb der Gemeinschaft und erweitert diese auch auf Drittländer. Die Verfasserin untersucht in der vorliegenden Studie, was unter den einzelnen „Freizügigkeiten" zu verstehen ist, und analysiert eingehend Artikel 56. Es werden die möglichen Interpretationen des Artikels, sowie der Zusammenhang zwischen dem Artikel und den sonstigen „Freizügigkeiten" dargelegt. Des Weiteren wird eine ungarische Rechtsvorschriftsstelle vorgestellt, die den freien Kapitalverkehr hindert.