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Article

Implementing the ATAD's CFC Rules by Poland Contrary to EU Primary Law: A Solitary Example or the Beginning of Infamous Trend?

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This article demonstrates that after the seemingly incorrect implementation of Articles 7–8 of the ATAD, the Polish CFC rules have become blatantly incompatible with the free movement of capital to the extent of their application to companies from third countries (the Polish black list). This study, moreover, confirms the thesis that the incompatibility of the Polish CFC rules was most likely caused by two elements of the ATAD: (1) minimum level of protection in Article 3; and (2) the option under Article 7(1)(a) which leaves the decision regarding the exemption from taxation of the CFC's income if a CFC is established outside the EU/EEA and carries on a substantive genuine business activity there to Member States themselves. The analysis also reveals that the CJEU appears to consider that the lack of a factual possibility to exchange of tax information can justify the irrefutable presumptions of tax avoidance or tax evasion by reference to the need to ensure effective fiscal supervision only in respect of the relations between the Member States and third countries. Accordingly, not only the ATAD, but also the CJEU's case law trigger a hidden form of protectionism of Member States at the cost of third countries.

1 Introduction

All Member States of the European Union (EU) are required to transpose the anti-tax avoidance directive (ATAD)[1] into their domestic laws by 31 December 2018. Poland had done so by 31 December 2017. Being an early adopter, however, does not necessarily mean being a good leader. Indeed, it is the aim of this study to show that one of the elements of the ATAD (Articles 7–8, i.e. controlled foreign companies (CFC) rules) was previously implemented by Poland with the effect contradicting EU primary law. In particular, it will be argued, due to the implementation of Articles 7–8 of the ATAD, the Polish CFC rules[2] have become incompatible with the free movement of capital to the extent of their application to companies from third countries, which are considered by Poland's Ministry of Finance (now, Ministry of Development and Finance) as tax havens figuring therefore on the so-called black list. As of 2017, this list includes the following twenty-six countries and territories:[3] (1) Andorra; (2) Anguilla; (3) Antigua and Barbuda; (4) Sint Maarten and Curaçao; (5) Kingdom of Bahrain; (6) British Virgin Islands (BVI); (7) Cook Islands; (8) Commonwealth of Dominica; (9) Grenada; (10) Sark; (11) Hong Kong; (12) Liberia; (13) Macau; (14) Maldives; (15) Marshall Islands; (16) Mauritius; (17) Monaco; (18) Nauru; (19) Niue; (20) Panama; (21) Independent State of Samoa; (22) Seychelles; (23) Saint Lucia; (24) Kingdom of Tonga; (25) United States Virgin Islands; (26) Republic of Vanuatu.

This study will, moreover, confirm the thesis that the incompatibility of the Polish CFC rules to the extent of their application to companies from tax havens was most likely caused by two elements of the ATAD: (1) minimum level of protection in Article 3; and (2) the option under Article 7 (1)(a) which leaves the decision regarding the exemption from taxation of the CFC's income if a CFC is established outside the EU/EEA and carries on a substantive genuine business activity there to Member States themselves. So far, at least one Member State, Poland, has used in combination Article 3 and Article 7(1)(a) of the ATAD to enact extremely restrictive CFC rules on taxpayers who participate in companies from certain third countries.

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[1] Council Directive 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, (Official Journal of the European Union from 19 July 2016, L 193/7).

[2] *See* a comprehensive and in depth study about the Polish CFC rules from an international and comparative perspective in B. Kuźniacki, *Controlled Foreign Companies and Tax Avoidance: International and Comparative Perspectives with Specific Reference to Polish Tax and Constitutional Law, EU Law and Tax Treaties*, (PhD thesis 2017, University of Oslo), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3107382. (accessed 12 Apr. 2018)

[3] *See* the current list of tax havens in the regulation of the Ministry of Development and Finance regarding the determination of countries and territories applying harmful tax competition in the field of PIT 27 May 2017 (PL: *Rozporządzenie Ministra Finansów z dnia 23 kwietnia 2015 r. w sprawie określenia krajów i terytoriów stosujących szkodliwą konkurencję podatkową w zakresie podatku dochodowego od osób fizycznych z 17 maja 2017 r.*), Journal of Laws of 2017, item 998 and the regulation of the Ministry of Development and Finance regarding the determination of countries and territories applying harmful tax competition in the field of CIT of 17 May 2017, (PL: (*Rozporządzenie Ministra Finansów z dnia 17 maja 2017 r. w sprawie określenia krajów i terytoriów stosujących szkodliwą konkurencję podatkową w zakresie podatku dochodowego od osób prawnych*), Journal of Laws of 2017, item 997).

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This research is therefore relevant to all Member States insofar as Poland's early adoption can be seen a warning to them to avoid taking too restrictive an approach when implementing the ATAD with respect to CFC rules. The analysis is also relevant in light of the case *X-GmbH v. Finanzamt Stuttgart – Körperschaften* (C-135/17) concerning German CFC rules pending before the Court of Justice of the European Union (CJEU) upon the request of a preliminary ruling from the Bundesfinanzhof (Germany) lodged on 15 March 2017.[4] In this regard, the analysis in this article allows me to predict the answer of the CJEU to the third question of Bundesfinanzhof, which is as follows. Article 63 of the TFEU precludes legislation of a Member State under which the basis of an assessment to tax of a taxable person resident in that Member State, which holds at least 1% of the shares in a company established in another State (in the present case, Switzerland), includes positive income earned by that company derived from capital investments pro rata, in the amount of the shareholding, where such income is taxed at a lower rate than in the Member State.

In section 2, the elements of the Polish CFC rules applicable to companies from tax havens before and after the implementation of the ATAD will be presented. Then, in section 3, the article will turn to an examination of the relevance of the principle of the free movement of capital to the Polish CFC rules. Restrictive effects of these rules on the free movement of capital and the examination of their compatibility with that freedom are analysed in sections 4 and 5, respectively. In section 6, the Ministry of Finance's justification for the Polish CFC rules, a dubious Polish tax policy regarding tax havens, and a way of implementation of the ATAD by Poland, is examined. Conclusions follow in section 7.

Because Poland amended the CFC rules according to the ATAD with respect to taxpayers subject to Corporate Income Tax Act (CITA)[5] and Personal Income Tax Act (PITA)[6] alike, even though the ATAD actually covers only the former, the analysis will also look at the CFC rules included under both CITA and PITA.

2 The Polish CFC rules applicable to companies from tax havens before and after the implementation of the ATAD

Article 24a(3) point 1 and Article 30f(1) PITA indicate that a foreign company whose tax residence is in one of the twenty-six tax havens is considered a CFC regardless of the level of control over this company, level at which its profits are taxed, or type of income received by it (i.e. CFC presumption). In other words, the Polish legislature introduced a presumption of tax avoidance and/or harmful tax competition targeting every Polish taxpayer participating in such a foreign company (i.e. a CFC). Moreover, according to the rules, a participant has a 100% right to participate in the company's profits for the whole tax year, irrespective of the participant's real participation (i.e. 100% participation presumption).[7]

Although neither presumption can be challenged, until the end of 2017, Polish taxpayers could apply for an exemption from taxation under the CFC rules in relation to companies established in tax havens and other third countries if: (1) a legal basis allowing for the exchange of tax information between each of them and Poland or the EU was in force; (2) the CFC carried on genuine economic activities; (3) and the CFC's net income did not exceed 10% of the gross income generated by the CFC from its genuine economic activity. Due to the interpretation of Article 7(4) of the ATAD, the Ministry of Development and Finance came to the conclusion that such an exemption may not stand under the Polish CFC rules. This is because the exemption is only permitted if the Member State has incorporated it under Article 7(2)(b); Poland, however, did so under Article 7(2)(a) of the ATAD.[8]

In its understanding of the ATAD, the Ministry has therefore excluded the possibility of exempting taxation of an income from any company (i.e. CFC) established in tax havens, irrespective of the company's actual involvement in tax avoidance and/or harmful tax competition activity.

The possibility to exempt companies engaged in genuine economic activities and established in third countries other than tax havens has also been abandoned. Here, however, the company's income would not be subject to taxation in Poland anyway if one of criteria under which a company can be said to constitute a CFC has not been met. These conditions are: (i) more than 50% shareholding threshold held alone by a taxpayer or together with associate entities; (ii) at least 33% of certain categories of passive income; and (iii) the actual corporate tax paid by the company is 50% lower than the tax that would have been paid if the company had its tax residence in Poland.[9] Criterion no. (ii) presumably

[4] http://curia.europa.eu/juris/document/document.jsf?text=&docid=192500&pageIndex=0&doclang=EN&mode=req&dir=&occ=first&part=1&cid=551762.

[5] PL: *Ustawa z dnia 15 lutego 1992 r. o podatku dochodowym od osób prawnych*, (Dz. U. 2016, 1888, consolidated text).

[6] PL: *Ustawa o podatku dochodowym od osób fizycznych*, (Dz. U. 2016, item 2032 consolidated text).

[7] *See* 24a(8) CITA and Art. 30f(9) PITA. If more than one Polish taxpayer participates in the same CFC established in a tax haven, then the 100% shareholding is divided between them proportionally to their actual share in the profits of the CFC. If the taxpayers fail to prove their proportional shareholding, then it is presumed that they have equal shareholding. If, for instance, one Polish taxpayer holds 50% shares in the CFC while another 20% (the reaming 30% holds non-resident) and they prove it via the articles of association of the CFC, then the shareholding of the former taxpayer will be assumed to be 71.43% while the latter 28.5%.

[8] *See* the Ministry of Development and Finance, *Justification to the Statute Implementing the ATAD* 16, (4 Oct. 2017), http://sejm.gov.pl/Sejm8.nsf/druk.xsp?nr=1878.

[9] *See* Art. 24a(3) point 3 letter a) CITA and Art. 30f(3) point 3 letter a) PITA.

excludes the relevance of the free movement of capital.[10] Furthermore, irrefutable presumptions of tax avoidance and/or harmful tax competition apply only to a Polish taxpayer participating in companies from tax havens. In that regard, factors indicating tax avoidance, such as those indicated above (i)–(iii), which would otherwise be of importance, are disregarded.

This explains why only the income of companies in tax havens is automatically subject to taxation at the level of the Polish taxpayer due to their participation in such companies. There is no legal way in Poland to avoid such taxation now that the ATAD has been implemented, i.e. as of 1 January 2018. The question is therefore whether such restrictive CFC rules are compatible with the free movement of capital.

3 Identifying the relevance of the free movement of capital to the Polish CFC rules

As a point of departure, both the CJEU[11] and scholars[12] consider freedom of establishment, freedom to provide services, and free movement of capital to cover situations of relevance to CFC rules.

Nevertheless, the CJEU decided in the *Cadbury Schweppes* case that the restrictive effects of applying the UK CFC rules on the free movement of services and capital were an unavoidable consequence of any restriction on freedom of establishment, because the contested UK CFC rules applied only to situations in which UK resident companies definitely CFC by owning a holding of more than 50%.[13] This, in turn, in the CJEU's view, did not justify an independent examination of that legislation in the light of freedoms other than the freedom of establishment.[14] Accordingly, the CJEU focused solely on the compatibility of the UK CFC rules with the freedom of establishment.[15] Moreover, even though the CJEU did not emphasize this, one may say that the exclusive application of the freedom of establishment was supported by the facts of this case according to which the UK resident companies in an indirect way wholly owned two Irish CFCs.[16]

Although other case law and the views of scholars allow for a more nuanced approach (the purpose of the legislation vs facts of the case),[17] the CJEU (at least since the judgment in the joined cases *Haribo and Salinen*) mainly determines an applicable freedom on the basis of the purpose of the domestic tax rule (instead of the activity actually performed by the litigating taxpayer).[18] Freedoms other than the freedom of establishment may apply if the purpose of the examined legislation, such as CFC rules, does not apply predominantly to taxpayers with a definite influence on a company's decisions and opportunity to determine its activities. If the purpose of the legislation does not fall predominantly within the ambit of the freedom of establishment, both the freedom of establishment and of free movement of capital can be applied cumulatively because the purpose of the contested domestic law is assumed not to fall predominantly within the scope of freedom of establishment. In a situation in which a CFC is established outside the EU/ European Economic Area (EEA), only the free movement of capital will be implicated, not freedom of establishment.

In this regard, the CJEU analysed the issue of compatibility of UK tax provisions concerning the attribution of gains to a UK taxpayer's holding of more than 10% of the shares in a non-resident company.[19] The scope and effect of their application widely resembled those stipulated under CFC rules.[20] The CJEU stated that a 10% shareholding threshold implies that the contested legislation can apply 'both to holdings enabling their holder to exert a definite influence over the decisions of that company and determine its activities and to holdings acquired for investment purposes'.[21] Consequently, said UK provisions may affect both freedom of establishment

[10] *See* more the s. 3 below.

[11] *See Cadbury Schweppes*, C-196/04, paras 1 and 32–33; *Test Claimants in the CFC and Dividend Group Litigation*, C-201/05, paras 1, 30 and 73; and *Commission v. United Kingdom*, C-112/14, paras 16–17.

[12] *See* Ch. H. J. I. Panayi, *European Union Corporate Tax Law*, 346 (New York: Cambridge University Press 2013); G. Maisto & P. Pistone, vol. 48 *A European Model for Member States' Legislation on the Taxation of Controlled Foreign Subsidiaries (CFCs) – Part 1 & Part 2*, (10 & 11) Eur. Tax'n 503–511 & 554–570 (2008); A. Rust, *CFC Legislation and EC Law*, 36(11) Intertax 492–501 (2008); H-J. Aigner & U. Scheuerle, *General Report: CFC Legislation, Domestic Provisions, Tax Treaties and EC Law* 38–41 (M. Lang, et al. eds, Eucotax, the Hague: Kluwer Law International 2004).

[13] *See Cadbury Schweppes*, C-196/04, paras 6, 32 and 33. *See also Test Claimants in the CFC and Dividend Group Litigation*, C-201/05, paras 72–73.

[14] *See Cadbury Schweppes*, C-196/04, para. 33.

[15] *See* more D. Weber, *Tax Avoidance and the EC Treaty Freedoms A Study of the Limitations Under European Law to the Prevention of Tax Avoidance* vol. 11, 81–156 (Eucotax Series on European Taxation, the Hague: Kluwer Law International 2005).

[16] *See Cadbury Schweppes*, C-196/04, para. 13.

[17] I.e. if the purpose of the legislation does not fall predominantly within the ambit of the freedom of establishment, then the facts of a case could indicate which fundamental freedom is applicable exclusively or cumulatively, *see Burda*, C-284/06, paras 70–75; *Beker*, C-168/11, paras 29–31; *KBC Bank*, C-439/07 and C-499/07, paras 69–70; *Aberdeen*, C-303/07, paras 30 et seq.; *Accor*, C-310/09, paras 37–38. Cf. *Joined cases, Fred. Olsen and Others and Petter Olsen and Others v. the Norwegian State*, represented by the Central Tax Office for Large Enterprises and the Directorate of Taxes, EFTA Ct. Report 2014-1, at 402, 9 July 2014, E-3/13 and E-20/13, para. 125. *See also* D. Smit, *EU Freedoms, Non EU-Countries and Company Taxation* 475–476 (EUCOTAX Series on European Taxation, Alphen aan den Rijn: Wolters Kluwer Law & Business 2012), or which underlying tax measure is decisive for determining the exclusive or cumulative application of the fundamental freedoms, *see Test Claimants in the FII Group Litigation*, C-35/11, paras 100–104; *Test Claimants in the FII Group Litigation*, C-446/04, para. 38; and *Holböck*, C-157/05, para. 24.

[18] *See Haribo*, C-436/08 and C-437/08, para. 34.

[19] *See Commission v. United Kingdom*, C-112/14, para. 16.

[20] *See Commission v. United Kingdom*, C-112/14, paras 2–5.

[21] *See Commission v. United Kingdom*, C-112/14, para. 16.

and free movement of capital. In this matter, the CJEU confined itself to examining the case only as regards the free movement of capital, because that was what the European Commission, being an applicant in the case, sought primarily to have examined.[22]

As this analysis demonstrates, the overarching issue is to determine whether the purpose of the Polish CFC rules applies predominantly to taxpayers with a definite influence on a company's decisions and opportunity to determine its activities. If so, these rules fall predominantly within the scope of the freedom of establishment. The answer to this question will therefore allow to conclude whether the freedom of establishment is relevant *only* to cases involving the compatibility of Polish CFC rules with EU law, or to the free movement of capital as well.

The CJEU assumes the existence of definite influence for a very wide range of shareholdings from 100% to 10%.[23] By contrast, a shareholding of less than 10% was not considered by the CJEU as guaranteeing definite influence.[24] This divergence is not surprising, since on closer scrutiny CJEU case law shows that even if the size of the shareholding is considered an important indicator of definite influence, such influence must nevertheless be determined on a case-by-case basis by taking into account all relevant factual and legal circumstances, with a special view to the applicable company law of the Member State(s) in question.[25] This tells us that definite influence does not always depend on the extent of the taxpayer's shareholding; other factual and legal factors may be of pertinence. Other CJEU case law confirms this interpretation. For instance, control, direction, and financial support, i.e. existence of organic and functional links between companies,[26] as well the supply of administrative, accounting, and information technology services by one company to another,[27] have all be taken to indicate a definite influence.

All in all, the case law of the CJEU analysed above allows to conclude that a domestic tax measure falls exclusively within the freedom of establishment in situations if it applies: (1) to shareholdings of more than 50%[28] or (2) in situations literally defined as 'shareholder exercising a definite control over the subsidiary (regardless the level of shareholding)'. All other situations cannot be automatically regarded as falling exclusively within the purview of the freedom of establishment.

According to Article 24a(3) points 1 and (8) CITA and Article 30f(3) points 1 and (9) PITA, if a foreign company has its registered office or place of management in the one of the twenty-six tax havens, the company is automatically considered to be a CFC, regardless of the level of control wielded by its participants, the level of taxation of its profits or type of income received by it. It is also presumed that the Polish taxpayers will have a 100% share in the company's profits for the whole of the tax year. The Polish taxpayers may not challenge these presumptions.[29] It is therefore clear that, in this case, the Polish CFC rules do not apply predominantly to Polish taxpayers exerting a definite influence on the company's decisions and possessing a right to determine its activities such that, to the extent mentioned above, the Polish CFC rules cannot be seen to fall exclusively within the scope of the freedom of establishment. The free movement of capital will apply in such cases, however.

Still, although factual and legal factors may change that conclusion, it seems unlikely. As follows from the CJEU's judgment in the *Accor* case (C-310/09), whenever facts regarding control or a definite influence are disputed, for example that the tax authorities claim the existence of control while taxpayers argue to the contrary and this dispute is not resolved by the domestic court, then both the freedom of establishment and the free movement of capital will apply.[30] This may occur quite often under the Polish CFC rules because the determination of facts concerning relations with tax havens is typically complicated and thus disputed. So the free movement of capital will most likely apply whenever the taxpayer claims lack of control or definite influence over a company established in a tax haven, unless the tax authorities gather evidence to the contrary.[31] They are unlikely to gather such evidence, however, due to the difficulties hindering the exchange of tax information, at least with some tax havens.

The author is aware of the more recent case law of the CJEU, such as the judgment in the *Equiom* case (C-6/16), which implies that the activity actually performed by the litigating taxpayer may be decisive in determining the relevant fundamental freedom restricted by the domestic law, if the purpose of such a law does not allow the authorities to determine whether the law predominantly applies to the taxpayer exercising a definite influence over the decisions of the foreign company.[32] However,

[22] *See Commission v. United Kingdom*, C-112/14, para. 17.

[23] *See* G. Kofler, *CFC rules*, in *Common Consolidated Corporate Tax Base* 743 (M. Lang, et. al. eds, Vienna: Linde Verlag 2008). *See Aberdeen*, C-303/07, paras 3–34; *Test Claimants in Class IV of the ACT Group Litigation*, C-374/04, para. 37; *Lasertec*, C-492/04, para. 23; *Holböck*, C-157/05, paras 9 and 31; *Cadbury Schweppes*, C-196/04, paras 6 and 32; *Idryma Typou*, C-81/09, para. 51; and *Accor*, C-310/09, paras 33–34.

[24] *See Haribo*, C-436/08 and C-437/08, para. 36.

[25] *See* C-311/08, para. 29. Concurring: D. Smit, *The Netherlands: Pending Cases X BV, C-24/12 and TBG Limited, C-27/12: Discriminatory Taxation of Outbound Dividends, the Netherlands Overseas Countries & Territories and the Free Movement of Capital*, in *ECJ – Recent Developments in Direct Taxation* 177 (M. Lang, et al. eds, Vienna: Linde Verlag 2012).

[26] *See Cassa di Risparmio di Firenze and Others*, C-222/04, para. 117.

[27] *See Floridienne and Berginvest*, C-142/99, paras 18–19.

[28] *See* in particular *Cadbury Schweppes*, C-196/04, paras 6, 32 and 33. *See also Test Claimants in the CFC and Dividend Group Litigation*, C-201/05, paras 72–73.

[29] *See supra* s. 2.

[30] *See Accor*, C-310/09, paras 36–38.

[31] Cf. the opinion of AG Alber delivered on 14 Oct. 1999 in *Baars* (C-251/98), paras 27 and 30.

[32] *See Equiom*, C-6/16, paras 45–46.

this author agrees with scholars who suggest that the factually based approach of the CJEU should be rejected because it would effectively deprive Article 64(1) TFEU of any meaning. It follows from the fact that this provision:

> grandfathers restrictions of the free movement of capital in third country settings with regard to certain investments, which, almost automatically, coincide with activities that would be protected by either the freedom of establishment or the freedom to provide services in intra-EU settings. If, however, the primarily affected fundamental freedom were to be determined according to the specific situation of a taxpayer, for example by reference to the size of his shareholding, Art. 57(1) of the EC Treaty [now: Art. 64(1) TFEU] could never apply to direct investments.[33]

Consequently, although it cannot be denied that the CJEU may consider Article 24a(3) points 1 and (8) CITA and Article 30f(3) points 1 and (9) PITA as falling within the scope of the freedom of establishment rather than the free movement of capital, if the facts of the case indicate that a Polish owns more than 50% of a company from a tax haven or otherwise has a definite influence over that company, this outcome of CJEU case law seems to be unlikely. Simply speaking, there is nothing in the wording of Article 24a(3) points 1 and (8) CITA and Article 30f(3) points 1 and (9) PITA that would allow the CJEU to affirm whether this law falls predominantly within the scope of the freedom of establishment, and the determination of undisputed facts to the contrary is neither probable nor should it be decisive.

4 Restrictions of the free movement of capital

The CJEU settled case law indicates that the domestic law restricts the free movement of capital if they discourage non-residents from making investments in a Member State or to discourage that Member State's residents from doing so in other states, including Member States and third countries.[34] The application of UK provisions functioning largely as CFC rules (section 13 TCGA (1992)) was seen by the CJEU to have a restrictive effect on the free movement of capital.[35] In general, the CJEU in the cases regarding CFC rules (or rules considerably similar)[36] implies that the wider scope of tax liability of resident companies under CFC rules in comparison to resident companies that are not taxable under CFC rules constitutes a restriction (disadvantage) on the former to exercise the freedom of establishment or the free movement of capital.

Clearly, this restrictive tax treatment follows from the Polish CFC rules insofar as their application may lead to taxation of a Polish taxpayer in respect of an income of a non-resident taxpayer, e.g. a company incorporated in a tax haven, regardless of whether the income has been distributed to them or placed at their disposal. By comparison, in a purely domestic situation, the Polish taxpayer cannot be tax on an income of another taxpayer, for instance a Polish Limited Liability Company (LLC), unless such income has been distributed to them or placed at their disposal.[37] Accordingly, the taxation under the Polish CFC rules may dissuade Polish resident taxpayers from making investments in tax havens or other destinations of CFCs outside Poland and therefore restrict the free movement of capital.

Interestingly to this study, only in relation to CFCs from tax havens the restriction of the free movement of capital by the Polish CFC rules seems to be extremely far reaching. The following comparison sheds light on it.

To all companies apart from those with tax residence in a tax havens, the Polish CFC rules allow for taxation of a Polish taxpayer in respect of the company's income only if: (1) they control the company (more than 50% control threshold); and (2) the company derives at least 33% of certain categories of passive income; and (3) the actual corporate tax paid by the company is 50% lower than the tax that would have been paid if the company had tax residence in Poland – cumulatively meeting these three criteria means that a foreign company is a CFC.[38]

Furthermore, among third countries, the legislature makes the distinction by allocating the burden of proof. If a company comes from a third country with which Poland or EU has a legal basis for exchanging tax information, then the obligation to show that these criteria have been met lies with the tax authorities.[39] In the absence of such legal basis, a taxpayer is obliged to convince the tax authorities that one of the said criterion is not met, for instance that the company is not controlled by them. If they do so, they will not be taxed under the Polish CFC rules in relation to the CFC's income.[40] But if they fail in this case, or the tax

[33] *See* A. Cordewener, G. W. Kofler, C. Ph. Schindler, *Free Movement of Capital and Third Countries: Exploring the Outer Boundaries with Lasertec, A and B and Holböck*, Eur. Tax'n 373 (2007).

[34] *See* judgments in: *van Caster*, C-326/12, para. 25; *Santander*, C-338/11 to C-347/11, para. 15 and the case law cited, and *Bouanich*, C-375/12, para. 43.

[35] *See Commission v. United Kingdom*, C-112/14, paras 19–20.

[36] *See Cadbury Schweppes*, C-196/04, paras 45–46 and *Commission v. United Kingdom*, C-112/14, paras 19–20.

[37] *See* Art. 10(1) CITA and Art. 10(1) point 7 in conjunction with Art. 11 and Art. 30b PITA.

[38] *See* Art. 24a(3) points 2 and 3 CITA and Art. 30f (3)points 2 and 3 PITA.

[39] *See* Art. 122 in conjunction with Art. 180 and Arts 187–191 of the Tax Ordinance Act (TOA) of 29 Aug. 1997 (PL: *Ustawa z dnia 29 sierpnia 1997 r. – Ordynacja podatkowa*), Journal of Laws of 1997, No. 137, item 926. *See also* Constitutional Tribunal's judgment of 18 July 2013, Case No. SK 18/09. Cf. B. Kuźniacki, *Polskie CFC rules w świetle międzynarodowego prawa podatkowego. Wybrane aspekty wystąpienia ryzyka niezgodności CFC rules z umowami o unikaniu podwójnego opodatkowania (1)*, 1 Przegląd Podatkowy 40–41 (2015).

[40] *See* 24a(9)-(10) CITA and Art. 30f(10)-(11) PITA. The term 'CFC' will still be used with respect to that company, though. In other

authorities succeed in the previous, then the income attributed to the Polish taxpayer constitutes the company's income for the period in which the taxpayer controlled the company (i.e. the CFC) and in the part which corresponds with the participant's holding of 'the shares related to the right to participate in the company's profits', after deduction of the amount of dividend received by the participant from the company and the amount of capital gains from the disposing of shares in the CFC from the amount of income attributed.[41]

Finally, if a company meets all the criteria for a CFC, but is established in a Member State of the EU or the EEA, then the taxpayer entirely escapes the scope of the CFC rules (i.e. neither taxation nor documentation obligation), providing that they establish that the CFC carries on a substantive economic activity in a EU/EEA state of it establishment.[42]

By comparison, if a company has tax residence in a tax haven and a Polish taxpayer has a share in its profits, capital, or a voting right, irrespective of their size, it is irrefutably assumed that this taxpayer has a 100% share related to the right to participate in the CFC's profits for the whole tax year, regardless of the real percentage and time of participation.[43] Accordingly, the whole of the CFC's income is attributed to the taxpayer whenever the tax authorities know that the taxpayer participates in a company located in a tax haven, even though this participation is actually close to zero and the CFC carries on a substantive economic activity in that jurisdiction, i. e. it is an investment fund.

This shows that although the Polish CFC rules have a restrictive effect on the fundamental freedoms to all foreign companies, such restriction is extreme only in relation to companies established in tax havens. Can it be justified under EU law?

5 Examining the Compatibility of the Polish CFC Rules with the Free Movement of Capital

5.1 Preliminary Remarks: Restriction Can Be Compatible with EU Law

The fact that the application of the Polish CFC rules constitutes a restriction of fundamental freedoms does not mean their application is incompatible with EU law. In cases where restriction of freedoms is alleged, the CJEU examines whether it can be justified, and whether such justification is relevant and proportionate.[44] If the Court finds the CFC rules to be justified, i.e. relevant and proportionate, then their application is deemed compatible with EU law.

In the field of restrictive domestic anti-avoidance provisions (e.g. CFC rules), as opposed to the discriminatory provisions, the CJEU does not rely on written justifications explicitly mentioned in the TFEU,[45] but on unwritten 'overriding reasons of general interest' developed under its case law.[46] Both the AG Philippe Léger and the in the *Cadbury Schweppes* case,[47] as well as the CJEU in the *Commission vs. the UK* case,[48] concluded that the restriction of the freedom of establishment and free movement of capital caused by the application of the UK CFC rules and section 13 TCGA (1992) ought to be justified by overriding reasons of general interest.

The author examines below such overriding reasons that are of general interest and relevance to justifying restrictions on the free movement of capital imposed by the Polish CFC rules.[49] The analysis starts with the most

words, although the company is always a CFC, the company's income may not be taxed under the Polish CFC rules with regard to its participants if they successfully demonstrate the absence of one or more of the CFC's identification criteria.

[41] *See* Art. 24a(4) and (9) in conjunction with (3) point 3 letter a) CITA and Art. 30f(5) and (10) in conjunction with (3) point 3 letter a) PITA.

[42] *See* Art. 24a(16) CITA and Art. 30f(18) PITA.

[43] *See* Art. 24a(3) point 1 in conjunction with (8) CITA and Art. 30f (3) point 1 in conjunction with (9) PITA.

[44] *See* more in L. Hinnekens, *Basis and Scope of Public Interest Justification of National Tax Measures Infringing Fundamental Treaty Freedoms*, in *EU Freedoms and Taxation* 91 (F. Vanistendael ed., Amsterdam: IBFD 2005); B. J. M. Terra & P. J. Wattel, *European Tax Law* 59–64 (6th ed., Alphen aan den Rijn: Wolters Kluwer Law & Business 2012).

[45] *See* Art. 52(1) of the TFEU: 'grounds of public policy, public security or public health'. *See also* justification applicable solely to the discrimination under the free movement of capital in Arts 64 (1), 65(1)(a), 65(1)(b) and 65(3) of the TFEU. Arts 64(1) of the TFEU ('grandfathering clause') is relevant to the application of domestic law which restricts the free movement of capital in relations with third countries only if such restrictions existed on 31 Dec. 1993. The Polish CFC rules are in force from 1 Jan. 2015. Hence, Art. 64(1) of the TFUE does not apply to the restrictions triggered by the Polish CFC rules. Art. 65(1)(a)(b) and (3) of the TFEU, in turn, justify the discriminative tax treatment, which infringes the free movement of capital, only if the discriminative domestic law applies to situations which are not objectively comparable. *See Verkooijen*, C-35/98, para. 43. The Polish CFC rules, as other CFC rules, apply to comparable situations, since situation of a resident company having shares in another resident company is comparable to a situation of a resident company having shares in a non-resident company. *See Cadbury Schweppes*, C-196/04, para. 43–45; *Commission v. United Kingdom*, C-112/14, para. 18–23. *See also* the opinion of AG P. Léger in the *Cadbury Schweppes*, C-196/04, paras 77–78. Consequently, an infringement of the free movement of the capital by an application of the Polish CFC rules cannot be justified under Art. 65(1)(a)(b) and (3) of the TFEU.

[46] *See* more on this issue with respect to domestic anti-avoidance measures in Weber, *supra* n. 15, at 250–278; L. De Broe, *International Tax Planning and Prevention of Abuse: A Study Under Domestic Tax Law, Tax Treaties and EC Law in Relation to Conduit and Base Companies* vol. 14, 880–902 (Doctoral Series IBFD – Academic Council, Amsterdam: IBFD 2008).

[47] *See Cadbury Schweppes*, C-196/04, para. 47 and the opinion of AG P. Léger in the *Cadbury Schweppes*, C-196/04, paras 62–64 and 83–86.

[48] *See Commission v. United Kingdom*, C-112/14, para. 23.

[49] More generally, restrictive domestic measures can be justified under the principle of territoriality or the need to ensure the effective collection of tax, but these justifications are of scant relevance in case of CFC rules or other anti-tax avoidance rules, *see* De Broe, *supra* n. 46, at 883. For a wider analysis of all overriding reasons of general interest, *see* Smit, *supra* n. 17, at 250–278. There are four arguments that at first glance are relevant when justifying the restrictive effect of applying CFC rules: (1) to prevent

important type of justification, one of vital interest to the purpose of CFC rules regardless of their territorial scope, i.e. prevention of wholly artificial arrangements (section 5.3). The author then turn to a justification for CFC rules quite recently recommended by the OECD in Base Erosion Profit Shifting (BEPS) Action 3, i.e. prevention of tax avoidance together with a balanced allocation of taxing power (section 5.4). Next, the attention will be given to a justification of relevance to the enforcement of CFC rules in cases typical for relations between Member States with third countries, the justification here being the need to ensure effective fiscal supervision (section 5.4). Finally, a relevance and effect of the prohibition against irrefutable presumptions of tax avoidance or tax evasion will be analysed (section 5.5).

5.2 Prevention of Tax Avoidance Via Wholly Artificial Arrangements

In referring to its own previous case law, the CJEU in the *Cadbury Schweppes* case[50] and in the *Commission vs. the UK* case[51] concluded that the restriction of the freedom of establishment and the free movement of capital entailed by applying the contested UK legislation may be justified and proportionate if it is applied only to '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'.

This means that only the prevention of tax avoidance through the use of wholly artificial arrangements constitutes an autonomous and separate justification to restrict fundamental freedoms by the application of domestic anti-avoidance measures such as CFC rules. Simply counteracting a tax avoidance scheme does not amount to such a justification.[52] This is confirmed moreover by the fact that the CJEU did not refer to 'tax avoidance' in its judgment in the *Cadbury Schweppes* case.[53] However, the CJEU did make reference to 'wholly artificial arrangements' that are used for 'escaping the tax normally due'. For the sake of coherence and simplicity, the author uses the phrase 'tax avoidance' hereafter rather than the more cumbersome 'escaping the tax normally due' since, in the author's view, the two terms can be identified in terms of their linguistic meaning and the context of the *Cadbury Schweppes* case. Indeed, AG P. Léger himself, in his opinion on the *Cadbury Schweppes* case, used the phrase 'tax avoidance'.[54]

In the opinion of this author, the CJEU's judgments in the *Cadbury Schweppes* and *Commission vs. the UK* cases imply that the restrictive effect of CFC rules (and other domestic anti-avoidance measures with similar effect) on freedom of establishment and free movement of capital can be justified exclusively by their capacity to prevent wholly artificial arrangements used for tax avoidance purposes even though these freedoms have different substantive and territorial scopes of application.[55]

Furthermore, the CJEU did not offer an alternative definition of wholly artificial arrangement under the free movement of capital in its judgment in the *Commission vs. the UK* case to that provided earlier by it in its judgment in the *Cadbury Schweppes* case. The CJEU did not in fact analyse the meaning of wholly artificial arrangement for the purpose of justifying the restriction on the free movement of capital,

erosion of tax base; (2) to prevent harmful tax regimes; (3) to secure tax system coherence; and (4) capital export neutrality (CEN), *see* A. M. Jiménez, *Towards Corporate Tax Harmonisation in the European Community*, Chs 1 and 2 (Series on International Taxation, London: Kluwer Law International 1999); R. Fontana, *The Uncertain Future of CFC Regimes in the Member States of the European Union – Part 2*, 6 Eur. Tax'n 2006, at 323–330; M. Helminen, *Is There a Future for CFC-Regimes in the EU?*, 33(3) Intertax 120–122 (2005); Aigner & Scheuerle, *supra* n. 12, at 43–48. However, some of them, such as preventing erosion of tax base, have been rejected by the CJEU as justifications in general, *see Glaxo Wellcome*, C-182/08, para. 82 and *Cadbury Schweppes*, C-196/04, para. 49, as well as its earlier and later case law: *Meilicke and Others*, C-292/04, para. 44; *Meyn*, C-9/02, para. 60; *Skandia and Ramstedt*, C-422/01, para. 53; *Danner*, C-136/00, para. 56; *X and Y*, C-436/00, para. 61; *Verkooijen*, C-35/98, para. 59; *Metallgesellschaft and Others*, C-397/98 and C-410/98, para. 59; *Eurowings Luftverkehr*, C-294/97, paras 44–45 and *CIBA*, C-96/08, para. 38; *ICI*, C-264/96, para. 28; *Asscher*, C-107/94, para. 53; and *Commission v. France*, 270/83, para. 21. Preventing harmful tax completion was explicitly rejected as a justification in the AG Opinion on *Cadbury Schweppes*, C-196/04, paras 56–60. One could even infer from the *Cadbury Schweppes* case that such an argument was rejected as a justification, paras 49–50. Concurring: De Broe, *supra* n. 46, at 927. Securing CEN has never been considered explicitly as justification by the CJEU, Terra & Wattel, *supra* n. 44, at 210–217. *See Kerckhaert and Morres*, C-513/04, paras 16–17. It should be also stated that identifying the application of CFC rules with an achievement of CEN is not entirely correct, since the scope of the former is much narrower than that of the latter. *See* M. Lang, *CFC Legislation and Community Law*, 9 Eur. Tax'n 377–378 (2002); Aigner & Scheuerle, *supra* n. 12, at 46–47; B. Kuźniacki, *Norway's Recent Efforts to Prevent International Tax Avoidance*, Tax Notes Int'l 776 (29 Feb. 2016). There are also arguments, in particular securing the coherence of the tax system, that are not relevant for justifying CFC rules that are currently in force: for criteria where this argument can be used as a justification, *see* in *Bachmann*, C-204/90, para. 26; *Laboratoires Fournier*, C-39/04, para. 20. *See also* Helminen, *supra* n. 49, at 121; Fontana, *supra* n. 49, at 324. *See* however the reasoning used in the proposal of amendment of the German CFC rules in Rust, *supra* n. 12, at 497–500.

[50] C-196/04, para. 55.

[51] C-112/14, para. 25.

[52] *See SCA Group Holding and Others*, C-39/13, C-40/13 and C-41/13, para. 42 and AG J. Kokott in her opinion delivered on 12 Sept. 2006 in *Oy AA*, C-231/05, para. 62.

[53] Reference to this phrase was only made by the national court (para. 27) and the United Kingdom Government, supported by the Danish, German, French, Portuguese, Finnish and Swedish Governments (para. 48).

[54] *See* AG Opinion in *Cadbury Schweppes*, C-196/04, para. 92.

[55] Cf. F. Zimmer, *Norway: The. Olsen Cases, in ECJ – Recent Developments in Direct Taxation 2014*, 117 (M. Lang ed., Vienna: Linde 2014). *See* however A. B. Scapa Passalacqua & L. Henie, *The Norwegian CFC Rules After the Cadbury Schweppes Case*, 36(8/9) Intertax 385–386 (2008).

referring instead to its previous case law,[56] where no exhaustive definition of this concept is to be found either, although certain guidelines are provided for doing so. Since the concept of wholly artificial arrangement was developed by the CJEU in the context of justifying the restriction of the freedom of establishment[57] and there is no case law giving a different meaning to it under the free movement of capital, even though the Court had an opportunity to do so in the *Commission vs. the UK* case, one can conclude that there is no more room for a different understanding of this concept under the free movement of capital than there is under the freedom of establishment. The opinion of AGs,[58] the case of European Free Trade Association (EFTA) Court,[59] and the European Commission[60] confirm that viewpoint.

It is therefore rational to examine whether the restriction of the free movement of capital by the Polish CFC rules could be justified by the prevention of tax avoidance via wholly artificial arrangement, as follows from the CJEU case law concerning CFC rules. This examination appears to be very easy: the Polish CFC rules cannot be justified insofar as they allow to tax the whole income of the CFC from a tax haven: (1) irrespective of existence of any tax avoidance factors otherwise applied to CFCs outside tax havens – control over the CFC, passive income of the CFC, and actual low taxation of the CFC's income; and (2) irrespective of the actual activity of the CFC – it may be even engaged in a significant economic activity and the CFC rules still apply to tax its income; and (3) without a legal way to establish by a Polish taxpayer who participates in the CFC that their participation has nothing to do with tax avoidance via wholly artificial arrangements.

What about other justifications?

5.3 Ensuring a Balanced Allocation of Taxing Power

One may infer, as OECD under BEPS Action 3 did,[61] from the CJEU's judgment of 21 January 2010 in the *SGI* case[62] that ensuring a balanced allocation of taxing power may exclusively justify the restrictive effect of CFC rules instead of preventing wholly artificial arrangements. Such an understanding seems to be in the view of this author inappropriate.

The *SGI* case does not indicate that the need for safeguarding a balanced allocation of taxing rights between Member States constitutes a separate, autonomous justification.[63] This judgment, as well as other examples of case law from the CJEU, rather implies that the balanced allocation of taxing rights can be used for justification in combination *with* other reasons, e.g. tax avoidance or coherence of tax system.[64] The only exception in that regard in CJEU case law occurs in relation to preventing the free transfer of profits in the form of tax deductible expenses/losses at the choice of a taxpayer since, in the CJEU's view, it may undermine a balanced allocation of the power to impose taxes between the Member States via increasing the taxable base in the low-tax Member State and reducing it in the high-tax Member State to the extent of the losses that will be transferred.[65] Thus, in such cases, safeguarding the balanced allocation of taxing powers between Member States can be considered a separate autonomous justification.[66] This does not include cases dealing with CFC rules insofar as applying these rules, including the Polish CFC rules, is not limited exclusively to cases regarding free transfers of profits in the form of tax deductible expenses/losses at the choice of a taxpayer. There are also other reasons to reject the OECD's recommendation on which this author elaborated in the other publications.[67]

[56] *See Itelcar*, C-282/12, para. 37; *Test Claimants in the Thin Cap Group Litigation*, C-524/04, para. 82 and *SIAT*, C-318/10, para. 50.

[57] *See ICI*, C-264/96, paras 24 and 26; *Lankhorst-Hohorst*, C-324/00, paras 32 and 37; *Mayn*, C-9/02, paras 48 and 50; *Marks & Spencer*, C-446/03, paras 34 and 57 and *Cadbury Schweppes*,C-196/04, paras 46 and 57.

[58] *See* AG opinion on *Oy AA*, C-231/05, para. 72 and AG opinion on *SGI*, C-311/08, para. 37.

[59] *See ratio decidendi* of the EFTA Court's judgment in the *Olsen* case, E-3/13 and E-20/13, point 5 at para. 234.

[60] *See* Room Document # 4 Working Party on Tax Questions – Direct Taxation Anti-Tax Avoidance Directive (ATAD) 18 Mar. 2016, Origin: DG TAXUD, at 4, https://www.asktheeu.org/en/request/2720/response/9485/attach/6/16%2003%2018%204%20ATAD%20Minimum%20Standards.pdf.

[61] *See* OECD, *Designing Effective Controlled Foreign Company Rules, Action 3 – Final Report*, (Paris: OECD 5 Oct. 2015) para. 22, fourth indent.

[62] C-311/08. A similar point can be made based on the *OY AA*, C-231/05, para. 63.

[63] Concurring: P. Pistone, *Public Discussion Draft BEPS Action 3: Strengthening CFC Rules Comments by Prof. Dr Pasquale Pistone*, in *Public comments received on discussion draft on Action 3 (Strengthening CFC Rules) of the BEPS Action Plan – Part 2,* 445–446 (5 May 2015), http://www.oecd.org/tax/aggressive/public-comments-beps-action-3-strengthening-cfc-rules-part2.pdf.

[64] Cf. Smit, *supra* n. 17, at 266–269. This issue is debatable. *See* more in literature P. J. Wattel, *Fiscal Cohesion, Fiscal Territoriality and Preservation of the (Balanced) Allocation of Taxing Power; What Is the Difference?*, in *The Influence of European Law on Direct Taxation* 156 (D. Weber ed., Alphen aan den Rijn: Kluwer Law International 2007); M. Isenbaert, *EC Law and the Sovereignty of the Member States in Direct Taxation*, vol. 19, 726–727 (Doctoral Series IBFD – Academic Council, Amsterdam: IBFD 2010); S. Van Thiel & M. Vascega, *X Holding: Why Ulysses Should Stop Listening to the Siren*, 8 Eur. Tax'n 338 (2010).

[65] *See Marks & Spencer*, C-446/03, para. 46; *Oy AA*, C-231/05, paras 54–56 and *X Holding*, C-337/08, paras 32–33.

[66] Concurring: Smit, *supra* n. 17, at 269. Dennis Weber stated in that regard that Member States have more scope to apply domestic anti-avoidance provisions within the EU for excluding cross-border offsetting of losses and profits than to apply other types of anti-avoidance provisions, *see* D. Weber, *Abuse of Law in European Tax Law: An Overview and Some Recent Trends in the Direct and Indirect Tax Case Law of the ECJ – Part 1*, 6 Eur. Tax'n 320–322 (2013).

[67] *See* B. Kuźniacki, *Strengthening CFC Rules in a Compatible Way with EU Law Under BEPS Action 3 in Light of the European Commission's Proposal – A Critical Evaluation*, in *Base Erosion and Profit Shifting*

Accordingly, in this author's opinion, if CFC rules apply under the entity approach, as the UK CFC rules did in the *Cadbury Schweppes* case,[68] and the Polish CFC rules do,[69] prevention of wholly artificial arrangements is the only autonomous justification to cases in which a country which applies CFC rules has in force a legal instrument allowing for exchange of tax information.[70] This follows from the fact that the application of such CFC rules leads to taxation of the whole of the CFC's income. Hence, they clearly target the existence of tax avoidance structures altogether and therefore their justification relies entirely on the concept of 'wholly artificial arrangement'.[71]

Accordingly, time to examine the possibility to justify the restriction of the free movement of capital by the need to ensure the effectiveness of fiscal supervision.

5.4 The Need to Ensure the Effectiveness of Fiscal Supervision

As follows from the CJEU settled case law,[72] the justification based on the need to ensure the effectiveness of fiscal supervision:

> can only be accepted where the legislation of a Member State makes entitlement to a tax advantage dependent on the satisfaction of conditions compliance with which can be verified only by obtaining information from the competent authorities of a non-Member State and where, because that non-Member State is not bound under an agreement to provide information, it proves impossible to obtain that information from it.[73]

This reveals one of the most significant differences between EU Member States and third countries in a legal context: Directive 2011/16/EU on administrative cooperation in the field of taxation, which allows for exchanging of tax information, applies only between the EU Member States. In the CJEU's view, this means that the case law regarding restrictions on fundamental freedoms within the EU cannot be applied in its entirety to cases involving EU Member States and third states and that the need to ensure the effectiveness of fiscal supervision may be a relevant justification only in respect of the application of Member States' domestic laws to third countries.[74,75]

Moreover, the CJEU's case law[76] indicates that ensuring the effectiveness of fiscal supervision may be achieved by other means than Directive 2011/16/EU, i.e. other international legal instruments, such as tax treaties, Tax Information Exchange Agreement (TIEAs) or the MAATM Convention.[77] What should matter is whether the legal instrument in question is functional, i.e. it is suitable for obtaining the information required for the effective application of the domestic tax law provisions.[78] The important thing is not nature of the legal instrument enabling the exchange of tax information but its capacity to enable tax authorities to verify the information provided by a CFC and/or its participants in order to apply CFC rules.[79] That is to say, the function prevails over the form.

All this means that ensuring the effectiveness of fiscal supervision may only constitute a suitable justification with respect to a restriction of the free movement of capital in relation to third countries with which the Member State applying CFC rules lacks the legal basis enabling the effective exchange of tax information. For instance, an application of the Polish CFC to a CFC established in a third state may be justified by the need to ensure effective fiscal supervision rather than the prevention of wholly artificial arrangements if there is no legal basis for exchanging of tax information between Poland and that third state.

It is worth noting on this point that since the legal measures facilitating an effective exchange of tax information are required in order to prevent tax

(BEPS): Impact for European and International Tax Policy 144–154 (R. Danon ed., Zürich: Schulthess 2016); B. Kuźniacki, *Tax Avoidance through Controlled Foreign Companies Under European Union Law with Specific Reference to Poland*, in *Accounting, Economics, and Law: A Convivium (AEL)* 23 (R. S. Avi-Yonah, Y. Biondi, & S. Sunder eds), https://doi.org/10.1515/ael-2015-0018.

[68] *See Cadbury Schweppes*, C-196/04, para. 6. Cf. D. Friel, *UK – National Report: Limits on the Use of Low-Tax Regimes by Multinational Businesses: Current Measures and Emerging Trends* 881 (86b Cahiers de droit fiscal international, IFA Congress in San Francisco 2001).

[69] *See* Kuźniacki, *supra* n. 2, ss 7.3.3.2 and 9.4.1.

[70] *See* more the section immediately below in this article.

[71] *See* more Kuźniacki, *supra* n. 2, Ch. 18, in particular ss 18.4 and 18.6.

[72] *See Haribo*, C-436/08 and C-437/08, para. 67 and case law cited.

[73] *See Emerging-Markets*, C-190/12, para. 84.

[74] *See* in relation to EU Member States and third states belonging to the EEA: *Rimbaud*, C-72/09, paras 40–41 and 50–51. *See* the same reasoning in relation to a third state outside the EEA (Switzerland) in *Skatteverket v. A*, C-101/05, paras 60–61. *See* critically on the CJEU's reasoning in the *Rimbaud*, C-72/09, in M. Lang, *The Legal and Political Context of ECJ Case Law on Mutual Assistance*, 5 Eur. Tax'n 201 (2012). A comprehensive and systematic overview of this case law before 2009 is presented in S. J. C. Hemels, *References to the Mutual Assistance Directive in the Case Law of the ECJ: A Systematic Approach*, 12 Eur. Tax'n 583–591 (2009).

[75] Hence, the need to ensure effective fiscal supervision as a justification has been rejected by the CJEU when the tax authorities of a Member State could rely, in a concrete case, precisely on Directive 2011/16/EU. *See Skandia*, C-422/01, para. 42. *See also Wielockx*, C-80/94, para. 26 and *Danner*, C-136/00, para. 49.

[76] For instance, the *Cadbury Schweppes* case (para. 31) referred to the Directive 77/799/EEC [now: the Directive 2011/16/EU] and to the tax treaty between the UK and Ireland as for legal instruments providing access to the necessary information on the CFC's real situation without indicating any distinction between them. Cf. the *Olsen* case, E-3/13 and E-20/13, para. 216.

[77] Convention of the OECD and the Council of Europe on mutual administrative assistance in tax matters Signed in Strasbourg on 25 Jan. 1988, as amended by the 2010 Protocol.

[78] *See Emerging Markets*, C-190/12, para. 105.

[79] Cf. Smit, *supra* n. 17, at 571 and the cited case law.

evasion and tax avoidance by Member States,[80,81] there is a link between the effective exchange of tax information to enable (1) effective fiscal supervision and (2) the effective application of anti-avoidance provisions, such as the Polish CFC rules, required for preventing tax avoidance. When the tax authorities are unable to verify whether a taxpayer is exploiting wholly artificial arrangement for tax avoidance purposes in a third state or not, they may justify the restriction of the free movement of capital by invoking the need to ensure effective fiscal supervision rather than the prevention of tax avoidance via wholly artificial arrangements. This is the main difference in justifying the restrictive effect of CFC rules within and outside the EU.

Accordingly, the Polish CFC rules could be justified solely by the need to ensure the effectiveness of fiscal supervision to the extent of their application to CFCs established in tax havens with which Poland lacks the legal basis to pursue an effective exchange of tax information.

Of the current list of twenty-six tax havens, Poland has only ratified TIEAs with the Andorra and the BVI,[82] but Polish tax authorities may also obtain tax information pursuant to Article 4 MAATM from the following signatories: Andorra, the Bahrain, the Marshall Islands, Mauritius, Nauru, Niue, Saint Lucia, Seychelles, Cook Islands and Dominica.[83] Thus, the application of the Polish CFC rules to companies from the above-mentioned eleven tax havens cannot be justified solely by the need to ensure effective fiscal supervision, because, in the CJEU's view, such supervision could be ensured by exchange of tax information. The only possible justification in such cases remains the prevention of wholly artificial arrangements, which is not relevant to the Polish CFC rules in the analysed scope. To this extent, the Polish CFC rules seem therefore incompatible with the free movement of capital.

In addition, the EU has ratified the agreements which constitute the basis for the automatic exchange of information on bank accounts with several tax havens and they are on the list of the Polish Ministry of Finance regarding the reporting obligations of the banks where the accounts are held for the years 2016 and 2017.[84] These jurisdictions are: Anguilla, Antigua and Barbuda, Curaçao and Sint-Maarten, Monaco, Samoa, Niue, Mauritius, Nauru, Seychelles, Marshall Islands, Saint Lucia and the Cook Islands. These jurisdictions are also signatories of The Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information.[85] Grenada and Bahrain have figured on this list too as of 2018. This list therefore includes six tax havens that are not covered by the above-mentioned TIEAs and MAATM: Anguilla, Antigua and Barbuda, Curaçao and Sint-Maarten, Grenada, Monaco, and Samoa.

This shows Poland has the legal basis to request tax information from eleven out of twenty-six tax havens. In addition, Poland has the legal basis to obtain information automatically about the bank accounts of Polish taxpayers kept in the other six tax havens. Consequently, Poland lacks the legal basis enabling the exchange of tax information and information on bank accounts from only nine of twenty-six tax havens: Sark, Hong Kong, Liberia, Macau, Maldives, Panama, Tonga, the US Virgin Islands, and Vanuatu. The restriction of the free movement of capital seems therefore to be justified by the need to ensure the effectiveness of fiscal supervision exclusively in relation to the application of the Polish CFC rules to companies established in these nine jurisdictions. This justification also seems valid, albeit debatable,[86] in respect of the six above-mentioned tax havens with which Poland may automatically obtain information on bank accounts of Polish taxpayers kept in these tax havens insofar as this type of information may not be suitable for the correct application of the Polish CFC rules.

Before finishing this section, it is worth noting *de lege ferenda* that the need to ensure effective fiscal supervision should constitute a valid justification to restrict the free movement of capital whenever an actual exchange of tax information does not take a place, despite there being a legal basis to do so with tax authorities in a tax haven. For instance, the Polish tax authority requests information from the tax authorities of the BVI regarding the type and scope of the activity of the BVI company, insofar as the Polish authority suspects the Polish taxpayer of holding shares in it. However, the BVI's tax authorities do not provide such information even though they are obliged to do so under the TIEA in force between Poland and the BVI. The actual ineffectiveness of the TIEA should be the decisive factor when assessing the

[80] *See* AG Bot's opinion delivered on 11 Sept. 2007 in *A* case, C-101/05, paras 150–151.

[81] More generally, cf. P. Baker, *Improper Use of Tax Treaties, Tax Avoidance and Tax Evasion*, in *Papers on Selected Topics in Administration of Tax Treaties for Developing Countries* 4 (Paper No. 9-A, UN, May 2013), http://www.un.org/esa/ffd/wp-content/uploads/2013/05/20130530_Paper9A_Baker.pdf; F. Zimmer, *Skatteparadis – noen skatterettslige problemstillinger*, 50(4) Lov og Rett 239 (2011); M. Orlov, *The Concept of Tax Haven: A Legal Analysis*, 32(2) Intertax 111 (2004).

[82] *See* the Poland's Ministry of Finance, *Wykaz umów o wymianie informacji w sprawach podatkowych*, http://www.finanse.mf.gov.pl/abc-podatkow/umowy-miedzynarodowe/wykaz-umow-o-wymianie-informacji-w-sprawach-podatkowych.

[83] *See* the full list of the MAATM's signatories as published at the website of the Poland's Ministry of Finance http://www.finanse.mf.gov.pl/abc-podatkow/umowy-miedzynarodowe/konwencja-o-wzajemnej-pomocy-administracyjnej.

[84] *See* Art. 99(3) and Art. 24(1) point 25 letter b and c of the Act of 9 Mar. 2017 on the exchange of tax information with other countries (Dz.U. 2017, item 648).

[85] *See* the full list at: http://www.oecd.org/tax/exchange-of-tax-information/MCAA-Signatories.pdf.

[86] *See* the analysis in the next section.

validity of the justification in question. Nevertheless, the CJEU implies that it is not the case. Paras. 94–96 of the CJEU's judgment in the *ELISA* case (C-451/05) and the cited case law are apposite in this regard:

> [A]lthough Article 8(1) of Directive 77/799 [now: the Directive 2011/16/EU] does not oblige the tax authorities of the Member States to cooperate when the competent authorities are prevented by their laws or administrative practices from conducting enquiries or from collecting or using information for those States' own purposes, *the fact that it may be impossible to request that cooperation cannot justify refusal of a tax benefit.* [emphasis added]
>
> There is no reason why the tax authorities concerned should not request from the taxpayer the evidence that they consider they need to effect a correct assessment of the taxes and duties concerned and, where appropriate, refuse the exemption applied for if that evidence is not supplied (see Commission v Denmark [C-150/04], paragraph 54 and case law cited there).
>
> Thus, the taxpayer should not be excluded 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 (see, to that effect, Case C-254/97 Baxter and Others [1999] ECR I-4809, paragraphs 19 and 20, and Case C-39/04 Laboratoires Fournier [2005] ECR I-2057, paragraph 25).

However, in this author's opinion, the CJEU's position is not entirely correct insofar it is inconsistent with the CJEU case law which implies that what matters for ensuring effective fiscal supervision is the suitability of the legal basis for exchanging tax information.[87] This legal basis must be functional in the sense that such exchanges actually take place and are not merely illusory, i.e. a legal basis exists without its effective application. Moreover, without actually obtaining information from foreign tax authorities, irrespective of their location (inside or outside the EU), the tax authorities of the Member States cannot effectively supervise their tax residents in respect of their foreign activities. Nor can they apply their anti-avoidance legislation effectively.

Accordingly, the effective exchange of tax information, i.e. the way that is suitable and necessary for the application of national tax regulations such as the CFC rules, are decisive to ensure effective fiscal supervision, not just the existence of such opportunities based on TIEAs or other legal facilities. The same follows from the effective exchange of tax information without there being a legal basis for such exchange, e.g. a voluntary agreement on the exchange of information between foreign tax authorities upon the request of tax authorities of a Member State or a voluntary verification of documentation submitted by taxpayers by foreign tax authorities. In either case, the effective exchange of tax information or the effective verification of the taxpayer's documentation by the foreign tax authorities will cancel the necessity of providing a justification of the restriction of free movement of capital with reference to the need to ensure the effective fiscal supervision.

The approach proposed by this author should improve consistency and symmetry of CJEU case law in relation to the need to ensure effective fiscal supervision – the effective (functional) exchange of tax information matters enabling efficient fiscal supervision as much as between Member States as between Member States and third countries, including tax havens. This approach also fits the purposes of the ATAD and the BEPS Project insofar as the effective exchange of tax information, irrespective of the existence of a legal basis – which is far better than an ineffective exchange practice with a legal basis – is indispensable for the effective application of anti-avoidance measures, including CFC rules.[88] Perhaps in the light of the ATAD and the BEPS Project, the CJEU will modify its position in the near future in light of these proposals.

5.5 The Prohibition Against Irrefutable Presumptions of Tax Avoidance or Tax Evasion

The analysis in the previous section implies that the need to ensure effective fiscal supervision is a relevant justification in respect of an application of the Polish CFC rules to companies from fifteen tax havens (or only nine if one assumes that the exchange of information for bank account matters) with which Poland does not have the legal bases for the exchange of tax information. To that extent, the Polish CFC rules are therefore compatible with EU law.

This conclusion, however, seems to be debatable in the light of the prohibition against irrefutable presumption of tax avoidance or tax evasion stemming from the settled CJEU case law[89] and the position of the European Commission.[90] That is to say, domestic anti-avoidance and/or anti-treaty havens provisions that include irrefutable presumptions of tax avoidance and/or tax evasion are prohibited under EU law because they are neither proportionate to the prevention of tax avoidance via wholly artificial arrangements nor combating tax evasion via effective fiscal supervision.[91] So even when there is no legal basis enabling the exchange of tax information,

[87] *See supra* n. 77–82.

[88] Cf. *supra* n. 81

[89] *See Leur-Bloem*, C-28/95, para. 44; *Commission of the European Communities v. Kingdom of Belgium*, C-478/98, para. 45; *Commission of the European Communities v. French Republic*, C-334/02, para. 27; and *Rewe*, C-347/04, paras 50–53.

[90] *See Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee – The Application of Anti-abuse Measures in the Area of Direct Taxation – Within the EU and in Relation to Third Countries* 5 (COM/2007/785 final, Brussels, 10 Dec. 2007).

[91] *See Leur-Bloem*, C-28/95, para. 44; *Commission of the European Communities v. Kingdom of Belgium*, C-478/98, para. 45 and *Zentralfinanz*, C-347/04, paras 50–53.

the irrefutable presumptions of tax avoidance or tax evasion appear to be incompatible with EU law.

Although the findings noted above conform to case law in intra-EU situations, according to which there is nothing to prevent tax authorities from requiring a taxpayer to produce such proof as they consider necessary to assess whether to grant the requested tax benefit (e.g. non-taxation of the CFC's income),[92] the juxtaposition of the judgments in the *Rimbaud* and *ELISA* cases renders these findings questionable with respect to relations between the Member States and third countries, especially tax havens.

In the *Rimbaud* case, the fact that the French tax authorities had no opportunity to obtain from the Liechtenstein tax authorities the information needed to exercise effective supervision was enough for the CJEU to consider the French tax legislation restricting the free movement of capital as justified by the need to ensure effective fiscal supervision (prevent tax evasion).[93] In contrast, in the *ELISA* case, the CJEU did not consider the lack of an option to obtain tax information by the French tax authorities from the Luxemburgish tax authorities under the mutual assistance directive or France–Luxembourg tax treaty[94] as having a significant bearing on justifying the restrictive French tax legislation by the need to ensure effective fiscal supervision (prevent tax evasion), i.e. the CJEU concluded that the French legislation cannot be justified by the mentioned justification and hence its application is precluded by the free movement of capital.[95]

Consequently, the CJEU treats the same or similar fact patterns (the lack of possibility to exchange of tax information) in terms of relations between EU States with third countries (especially those which may be considered tax havens such as Liechtenstein) less favourably as compared to relations between Member States. That is to say, the lack of actual possibility to exchange of tax information can justify the irrefutable presumptions of tax avoidance or tax evasion by the need to ensure effective fiscal supervision only in respect to the relations between the Member States and third countries.[96]

In addition to the criticism expressed by this author in the last paragraphs of the previous section, the approach of the CJEU is not to be commended because, as M. Lang has so aptly put it,:

> it would then be within the legally non-reviewable discretion of that Member State to decide whether and in relation to which third countries discrimination would be permissible under national tax law. By refusing to conclude mutual assistance treaties or by cancelling existing agreements, every Member State would have the option of sustaining or reviving discriminatory rules in relation to specific countries. If Member States were essentially able to determine the scope of application of the free movement of capital in relation to third countries by concluding and cancelling mutual assistance agreements, this freedom would be deprived of most of its significance.[97]

Hence, the CJEU's approach is clearly asymmetrical by allowing Member States to apply disproportionately restrictive anti-avoidance and anti-tax havens provisions to companies from third countries (as the analysed Polish CFC rules) in line with the EU law. The lack of symmetry constitutes an example of hidden tax protectionism by Member States at the expense of non-Member States (third countries).[98,99] Unfortunately, this hidden tax protectionism also follows from the ATAD's CFC rules, since the option under Article 7(1)(a) leaves the decision regarding the exemption from taxation of the CFC's income if a CFC is located outside the EU/EEA and carries on a substantive genuine business activity there to Member States. This means that under CJEU case law and the ATAD, Member States are free to discriminate against third countries via their CFC rules as they see fit.[100,101]

[92] *See Vestergaard*, C-55/98, para. 26; *Bachmann*, C-204/90, paras 18 and 20; *Commission of the European Communities v. Kingdom of Belgium*, C-300/90, paras 11 and 13; *Twoh*, C-184/05, para. 37 and *ELISA*, C-451/05, paras 13, 51–53, and 95–96.

[93] *See Rimbaud*, C-72/09, paras 43–44 and 53.

[94] *See ELISA*, C-451/05, paras 10, 47–53.

[95] *See ELISA*, C-451/05, paras 97–99.

[96] This justification becomes valid again simply by the existence of a legal basis for exchanging of tax information between the Member States and the third countries, although it may not lead in practice to exchanging of tax information.

[97] *See* Lang, *supra* n. 74, p. 201.

[98] Cf. P. Pistone, *BEPS, Capital Export Neutrality and the Risk of Hidden Tax Protectionism. Selected Remarks from an EU Perspective*, in *Base Erosion and Profit Shifting (BEPS): Impact for European and International Tax Policy* 360–361 (R. Danon ed., Zurich: Schulthess 2016).

[99] The author acknowledges the arguments of AG Bot in his opinion delivered on 11 Sept. 2007 in *A* case, C-101/05, paras 150–151, according to which the mentioned approach of the CJEU is justified by and required by the need for the EU and Member States to exert pressure on third countries to commit themselves to entering into mutual tax information exchange agreements. If this fails, combating tax evasion will be more difficult, unfair and possibly detrimental to the EU. Having said that, the author finds the CJEU approach to be inappropriate by rendering Art. 63(1) of the TFUE steadily less meaningful. The inappropriateness of the CJEU's case law also follows from the fact that it does not emphasize the importance of the actual exchange of tax information, although this matters a great deal for the effective prevention of tax avoidance and tax evasion. *See supra* last paragraphs of 5.4.

[100] *See* the remarks made by P. Pistone & R. Danon at a meeting of tax practitioners and lawyers for the International Fiscal Association congress in Madrid 2018. *See* P. Sukhraj, *EU's Take on CFC Rules Could Trip up Multinationals*, Bloomberg BNA (29 Sept. 2016), https://www.bloomberg.com/professional/blog/eus-take-cfc-rules-trip-multinationals/.

[101] The another example of the hidden protectionism follows from Art. 7(1) of the ATAD according to which CFC rules of a Member States may apply to a PE the profits of which are not subject to tax or are exempt from tax in that Member State of a taxpayer. Such exemption will typically takes a place under tax treaties. e.g. 73 of 81 Polish tax treaties exempt foreign sourced PE's income from taxation in Poland. Hence, the approach under Art. 7(1) of the ATAD is highly undesirable as it is likely to worsen commercial relations

No matter how debatable the CJEU approach (and this under the ATAD) is, however, it also implies that the Polish CFC rules seem to be compatible with EU law insofar of their application to companies established in the fifteen tax havens without an information exchange agreement with Poland. This is so because the prohibition against irrefutable presumptions of tax avoidance or tax evasion does not apply in such situations even though the tax authorities in the tax havens could exchange relevant tax information with the Polish tax authorities upon request if they so desired.

The reader may feel somewhat confused by the analysis in this section insofar as it has turned full circle. This confusion, however, is quite useful since it mirrors the confusion of the CJEU's approach to justifying the restriction of fundamental freedoms in respect of third countries. Moreover, despite previous observations, the author still considers it possible to eject oneself from the circle by launching an effective challenge against the Polish CFC rules before the CJEU to the extent of their application to companies established in the fifteen tax havens with no exchange agreements with Poland. This follows from the extreme restriction of the free movement of capital triggered by these rules.

This extreme restriction stems from the irrefutable presumption that any participation of a Polish taxpayer in a company in a tax haven is either associated with tax avoidance or/and harmful tax competition.[102] Such a presumption allows the tax authorities to tax the whole income of this company at the level of the Polish taxpayer irrespective of any factors otherwise implying tax avoidance, such as control over foreign companies, the passive nature of their income, and minimal or no actual taxation of this income. The factors indelibly associated with harmful tax competition (and thus tax evasion) are also ignored, since the existence of a legal basis for exchanging of tax information does not influence the result of an application of the Polish CFC rules. Companies in tax havens and other third countries with which Poland has and does not have legal bases for exchanging of tax information are treated alike, i.e. their entire income is taxed at the level of their Polish participant. Finally, the amount of the CFC's income subject to tax is not conditioned by the actual percentage of the participation in the CFC's profits by the Polish taxpayer.

All this demonstrates that the actual purpose of the analysed element of the Polish CFC rules and the only assured effect of their application is to prevent Polish taxpayers from participating in companies from tax havens rather than to prevent tax avoidance or combat harmful tax competition.[103] Even if one agrees that such rules enable the authorities to combat harmful tax competition of tax havens, as the Ministry of Finance has argued, this does not constitute a valid justification to restrict fundamental freedoms.[104] In fact, the actual purpose and effect of the Polish CFC rules seem best suited to preventing the erosion of the tax base in Poland. But this is not a valid justification either.[105]

Consequently, it cannot be ruled out that the CJEU may consider the Polish CFC rules to the extent of their application to companies from tax havens with which Poland has no legal basis to exchange tax information as incompatible with EU law. This is not unlikely especially since their extremely disproportional and restrictive effect may also be seen as incompatible with the constitutional principle of proportionality[106] and prohibition of discrimination in conjunction with protection of property under the European Convention of Human Rights.[107] Relying on the constitutional and international principles, in addition to EU law, could be an effective strategy for taxpayers seeking proportional tax treatment of their cross-border activities in or via tax havens.

6. Doubtful Justification of the Polish CFC Rules, Inconsistency Regarding List of Tax Havens, and Inappropriate Implementation of the ATAD

The very restrictive regulations contained in the Polish CFC rules have been justified by the Ministry of Finance by one of the purposes of these rules: to combat harmful

between Contracting States, especially when the state of PE's location is not a Member State and there is no symmetry in taxation of the PE's income, i.e. Member States may impose taxation via the ATAD while non-Member States may not. *See* B. Kuźniacki, *(In) Compatibility of the Polish CFC Rules with the Constitution Before and After the Implementation of ATAD – Part 2*, 4 Eur. Tax'n (2018), s. 2.4.

[102] Prevention of tax avoidance and harmful tax completion constitutes the bifurcated purpose of the Polish CFC rules, as articulated by the Ministry of Finance. *See* Governmental Bill of Act on amending Corporate Income Tax Act, Personal Income Tax Act and some other Acts of 14 Apr. 2014 (CFC Bill) (PL: *Rządowy projekt ustawy o zmianie ustawy o podatku dochodowym od osób prawnych, ustawy o podatku dochodowym od osób fizycznych oraz o zmianie niektórych innych ustaw*) at 1 and 6, *see* online at: http://www.sejm.gov.pl/sejm7.nsf/PrzebiegProc.xsp?nr=2330.

[103] Cf. C-347/04, *Rewe*, para. 42.

[104] *See supra* n. 49.

[105] *Ibid.*

[106] *See* Art. 31(3) in conjunction with Art. 22 and Art. 64 of the Constitution. *See* more in Kuźniacki, *supra* n. 101, s. 3.2.

[107] *See* Art. 14 of the European Convention of Human Rights in conjunction with Art. 1 of the additional Protocol to the Convention for the Protection of Human Rights and Fundamental Freedoms, Paris, 20 Mar. 1952. Cf. judgments of the *Conseil d'Etat* in the *SA Financière Labeyrie* case. 12 Apr. 2002, RJF 6/02, no 673. *See also* H. Kabbaj & E. R. Bletière, *National Report France*, in *CFC Legislation, Domestic Provisions, Tax Treaties and EC Law* 236 (M. Lang, et al. eds, Eucotax, The Hague: Kluwer Law International 2004).

tax competition exercised by tax havens.[108] The Ministry of Finance confirmed this by indicating that the irrefutable assumptions are justified because there is no means to determine the taxpayers' rights to participate in the profits of a foreign company located in a listed tax haven.[109] Moreover, the Ministry pointed out, these jurisdictions can be characterized as having no or very low taxation, restrictive provisions on banking and trade/commercial secrecy, a record of non-cooperation with Polish tax authorities and tax authorities of other states, and no or very small networks of tax treaties/TIEAs.[110]

This justification is doubtful.

The list of twenty-six tax havens in Poland currently includes eleven jurisdictions with which Poland has a legal basis to exchange legal information (TIEAs). Hence, contrary to the claim of the Ministry of Finance, taxpayers' rights to participate in the profits of a foreign company located in these tax havens can be determined. What the impossibility of obtaining tax information comprises, the Ministry could have provided evidence. But it has not. There is also a paradox here: the lack of any possibility to determine the taxpayers' rights to participate in the profits of a foreign company established in a listed tax haven would render impossible to apply the Polish CFC rules under the irrefutable presumption because such presumption works only if the tax authorities know of such participation. The tax authorities can either obtain the information voluntarily from the taxpayers concerned, by going through a third party (whistle-blower)[111] or through the tax authorities of tax havens. But this of course invalidates the Ministry's justification since it is clearly possible to obtain the necessary information on the taxpayers' rights to participate in the profits of a foreign company located in a listed tax haven.

Furthermore, only four out of twenty-six tax havens listed by Poland are on the EU black list: Bahrain, Marshall Islands, Saint Lucia, and Samoa.[112] The Polish black list diverges significantly from the EU's black list. Oddly enough, a taxpayer who participates in companies in jurisdictions which are not on the Polish black list but are on the EU black list, i.e. American Samoa, Guam, Namibia, Palau and Trinidad and Tobago, are immune from the irrefutable presumptions under the Polish CFC rules. Of course, there is no legal basis to exchange tax information between those jurisdictions and Poland or the EU. More generally, a taxpayer who participates in companies in all jurisdictions, which are not on the Polish black list, is shielded from the irrefutable presumptions, even when there is no legal basis for exchanging of tax information between those jurisdictions and Poland or the EU. By contrast, a taxpayer who participates in companies in jurisdictions on the Polish black list which are committed to exchanging tax information with Poland or the EU via relevant international agreements, i.e. the eleven jurisdictions named above, suffer from the irrefutable presumptions. In what way can the justification of the Ministry of Finance be considered rational now?

This reveals a broader picture: the Polish tax policy regarding tax havens is highly dubious. In fact, Polish law lacks a definition of tax haven and, additionally, clarification of the factors relevant to their identification.[113] Although some authors argue that the Ministry of Finance takes account of the relevant decisions of the OECD in the area of harmful tax competition when it prepares its list of tax havens,[114] the author cannot see much correlation between the current Polish black list and that published by the OECD. The OECD listed only three jurisdictions – Bahrain, Nauru, and Vanuatu – which may be considered tax havens due to the fact that they have not indicated a timeline or have not yet committed themselves to an effective implementation of a system for the automatic exchange of information.[115] Neither is it easy to find a consistent use of the criteria as recognized by the OECD[116] by which tax havens qualify for a place on the list,, by the Ministry of

[108] *See* CFC Bill, *supra* n. 102, at 1 and 6.

[109] *Ibid.*, at 93.

[110] *Ibid.*

[111] Cf. the way of obtaining information by the ICIJ in Panama Papers, https://offshoreleaks.icij.org.

[112] *See The EU List of Non-Cooperative Jurisdictions for Tax Purposes*, adopted by the Council (EU) on 5 Dec. 2017, Doc. 15429/17 FISC 345 ECOFIN 1088, http://www.consilium.europa.eu/media/31945/st15429en17.pdf. The EU black list currently contains the following nine jurisdictions: are American Samoa, Bahrain, Guam, Marshall Islands, Namibia, Palau, Saint Lucia, Samoa and Trinidad and Tobago. *See* The EU list of non-cooperative jurisdictions for tax purposes: *Report by the Code of Conduct Group (Business Taxation) Suggesting the De-Listing of Certain Jurisdictions*, (Doc. 15429/17 5086/18 FISC 9 ECOFIN 7), http://data.consilium.europa.eu/doc/document/ST-5086-2018-INIT/en/pdf. The decision pf the EU to publish so narrow black list has been considered by some experts as a 'joke' (*see* M. Carth, *EU Tax haven Blacklist Is a Whitewash*, 15 Dec. 2017, http://guengl-panamapapers.eu/eu-tax-haven-blacklist-is-a-whitewash/) and implying opaqueness and hypocrisy of the EU tax policy (*see* B. Smith-Mayer, 8 countries removed from EU tax haven blacklist, sparking criticism, Politico (23 Jan. 2018) https://www.politico.eu/article/8-countries-removed-from-eu-tax-haven-blacklist-sparking-criticism/).

[113] The above-mentioned factors follow merely from the justification to the Polish CFC rules, which is not a source of law.

[114] *See* Z. Kukulski & M. Sęk, *Poland –National Report: Tax Transparency* 17 (Zurich: EATLP Annual Congress 2018), http://www.eatlp.org/uploads/public/2018/National%20Report_Poland.pdf.

[115] *See* OECD, *Tax Transparency 2015: Report on Progress* 19 (Paris: OECD, 2015).

[116] Since 2001, the OECD officially uses only transparency and effective exchange of information as criteria for identifying jurisdictions as uncooperative tax havens. *See* OECD, *The OECD's Project on Harmful Tax Practices: The 2001 Progress Report* (Paris: OECD 2001), para. 28. Cf. Orlov, *supra* n. 81, at 95–111. However, it is noteworthy that the OECD under BEPS Action 5 does acknowledged that no or low effective taxation may be seen as a relevant factor for recognizing harmful tax regimes and regimes where artificial profit shifting is likely to occur. *See* OECD, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 – Final Report* 9 (Paris: OECD, 5 Oct. 2015) and paras 3, 17–18 and 142–47. Cf. Kuźniacki, *supra* n. 2, s. 1.6.2.1.

Finance. Accordingly, Polish tax policy concerning tax havens should be revisited.

The way the ATAD is implemented with respect to CFC rules also triggers doubts, and seems inappropriate.

The Minister of Development and Finance argued that the option under Article 7(2)(b) of the ATAD, i.e. only income artificially diverted to CFC can be taxed, would seem invalid in Poland due to the conceptual gap – the lack of the legal basis for exchanging of tax information with many jurisdictions considered as tax havens by Poland. This allegedly would render the Polish CFC rules inapplicable to companies established in tax havens. That is why an option under Article 7(2)(a) of the ATAD – a categorical approach – has been chosen by Poland.[117] This justification is not cogent due to the reasons provided in the above paragraphs. In brief, the lack of a legal basis for exchanging of tax information hinders the application of CFC rules not only under Article 7(2)(b) of the ATAD, but also under Article 7(2)(a) of the ATAD. Indeed, the tax authorities cannot effectively apply CFC rules, or other anti-tax avoidance measures, without obtaining relevant information about the relations between a taxpayer and a foreign company irrespective of the type of CFC rules.[118] This suggests that the only valid argument for choosing to adopt CFC rules under Article 7(2)(a) of the ATAD instead of Article 7(2)(b) of the ATAD was an administrative convenience on the side of the tax authorities, since the former is easier to apply than the latter.

The Minister of Development and Finance further pointed out that an implementation of the ATAD under a categorical approach would require the repeal of Article 30f (19) PITA and Article 24a(17) CITA, i.e. the two exemptions from taxation of the CFC's income: (1) *de minimis* and (2) the exemption based on CFC's genuine economic activity combined with 10% level of profitability – this exemption applies to CFCs having a residence in a third state outside the EEA with which Poland or the EU have an agreement on exchanging of tax information. As a result of this repeal, Polish taxpayers automatically and unconditionally have been deprived of any possibility to establish whether their participation in companies in tax havens is not related to tax avoidance and/or harmful tax competition. This situation, however, has not been mentioned by the Minister at all. Indeed, the responsibility for this restrictive result of the implementation of the ATAD has been exclusively attributed by the Minister to the Council (EU) due to the impossibility, in the Minister's view, of retaining the mentioned exemption in relation to companies from third countries, including tax havens.

The Ministry's view, in this author's opinion, does not appear to be entirely correct and most likely resulted from an inaccurate analysis of the ATAD.

Article 7(4) of the ATAD says that:

> Member States may exclude from the scope of point (b) of paragraph 2 an entity or permanent establishment: (a) with accounting profits of no more than EUR 750 000, and non-trading income of no more than EUR 75 000; or (b) of which the accounting profits amount to no more than 10 percent of its operating costs for the tax period.

It means that one of the above exemptions could be introduced only if a Member State implemented the option under Article 7(2)(b) of the ATAD, which is not the case with Poland. At first glance, it suggests that the Ministry's view is correct. But on closer inspection, this does not seem to be the case.

Article 7(4) of the ATAD excludes only two types of exemption in relation to the option under Article 7(2)(a) of the ATAD, as followed by Poland: (1) *de minimis* exemption and (2) 10% profitability exemption. Hence, this provision of the ATAD only required Poland to repeal the exemption under Article 30f (19) point 1) PITA and Article 24a(17) point 1) CITA – the *de minimis* exemption – while retaining the exemption under Article 30f (19) point 2) PITA and Article 24a(17) point 2) CITA – the combination of the 10% profitability with genuine economic activity. That is to say, the exemption of companies from third countries, if they are engaged in a substantive economic activity, could be applicable with regard to the option under Article 7(2)(a) of the ATAD, as chosen by Poland. Article 7(2)(a), *in fine*, confirms this observation, as it says that taxation under Article 7(2)(a) of the ATAD shall not take a place where:

> the controlled foreign company carries on a substantive economic activity supported by staff, equipment, assets and premises, as evidenced by relevant facts and circumstances. Where the controlled foreign company is resident or situated in a third country that is not party to the EEA Agreement, Member States *may decide* to refrain from applying the preceding subparagraph. [Emphasis added]

This means that the ATAD clearly allowed, but not required, Poland to exempt from taxation CFCs established third countries, including tax havens, which carry on substantive economic activities. Again, the Minister of Development and Finance did not ponder over that option. It is also worth noting that Article 7(4) of the ATAD refers to Article 7(2)(a) of the ATAD which, in turn, allows for taxation of the non-distributed passive income of the CFC, but not the whole income of the CFC (unless the CFC's entire income is the listed undistributed passive income). The Polish CFC rules, by contrast, allow for the taxation of the whole income of the CFC irrespective of its nature (e.g. be it passive, active, or some other

[117] *See* Justification to the ATAD, at 15, http://sejm.gov.pl/Sejm8.nsf/druk.xsp?nr=1878.

[118] *See supra* last paragraphs of 5.4.

type of income). So also the strict literal interpretation of the Article 7(4) and Article 7(2)(a) of the ATAD which indicates that Poland was not required to repeal Article 30f (19) point 2) PITA and Article 24a(17) point 2) CITA.

Accordingly, the misinterpretation of the ATAD by the Minister of Development and Finance resulted in an inappropriate implementation of the ATAD by Poland in respect of the Polish CFC rules. The minimum level of protection and freedom of Member States to exempt CFCs from third countries under Articles 3 and 7(2)(a) of the ATAD, respectively, also seems to be an aspect of Poland's failure to appropriately implement the ATAD in respect of CFC rules. Indeed, the Ministry has repeatedly stated that the solutions under the Polish CFC rules, although more restrictive than those included in the ATAD, are permissible under the minimum level of protection.[119]

7 Conclusions

In light of the approach of the Minister of Development and Finance to the implementation of the ATAD's CFC rules described above, and the lack of a response by the legislator, the whole income of a CFC in a third country may be taxed in Poland, even if the CFC carries on a significant genuine economic activity and there is a legal basis to exchange tax information between Poland or the EU and the CFC's residence country exists. The analysis shows that such taxation can be considered incompatible with EU law due to an unjustified (disproportionate) restriction on free movement of capital. This article, however, focuses on companies from tax havens, because the companies from third countries other than tax havens, even if there is no agreement to exchange tax information between them and Poland or the EU and they are on the EU black list, may be considered CFCs only if a Polish taxpayer, alone or together with associated entities, has more than a 50% shareholding or similar voting right percentage in each of them. This, in principle, means that the free movement of capital is irrelevant in these circumstances. By contrast, it is enough to have a minimal shareholding in companies in tax havens listed by the Minister of Development and Finance to consider them CFCs, in which case, the free movement of capital may apply. An interesting observation follows from this: companies in tax havens are protected by EU law, while companies in third countries which are not recognized as tax havens by the Minister of Development and Finance, are not.

The above observation can be modified under the assumption that a taxpayer and associated entities if any with a shareholding of more than 50% may not necessarily control or exert a definitive influence over a foreign company.[120] In that situation, the free movement of capital may apply to companies from third countries other than tax havens. The Polish CFC rules could be here be seen as incompatible with EU primary law to the extent of their application to all companies from third countries. Thus, the analysis in this article is, *mutatis mutandis*, valid not only for companies in tax havens, but for all companies in third countries. However, only in respect of companies in tax havens do the Polish CFC rules seem to violate EU primary law so blatantly by allowing the taxation of the whole of the CFC's income at the level of a Polish taxpayer, regardless of their actual participation in the CFC's profits, the degree of their control over the CFC, the type of income derived by the CFC, the type of activities carried out by CFC, and the actual level of taxation of its income in comparison to corresponding taxation in Poland.

It will be interesting to see, therefore, how the administrative courts in Poland approach this problem and, in the event of a preliminary ruling, how the CJEU considers it. The author is reasonably certain that the administrative courts will entertain serious doubts about the compatibility of the Polish CFC rules with the free movement of capital. If they so request, the CJEU will most likely decide that the free movement of capital precludes taxation under the Polish CFC rules. In the author's view, a similar decision seems to have been delivered by the CJEU in the *X-GmbH* case (C-135/17), although the challenged German CFC rules are much less restrictive than the Polish. This decision is particularly instructive in relation to the problem regarding the Polish CFC rules.

More generally, the analysis reveals several incongruities related to the application of the domestic anti-avoidance rules to entities in third countries under the free movement of capital.

First, a framework whereby taxpayers can be shielded from domestic anti-avoidance rules under EU law is inversely proportional to the size of an investment in a third country because the free movement of capital does not apply in situations in which taxpayers exert definitive control over CFCs. This provides protection of portfolio investments, while it denies it direct investments, which seems to be unfair, economically counterproductive, and contradicts the

[119] For instance, the taxation of the whole CFC's income rather the non-distributed passive income, or not taking into account the losses of a CFC for tax purposes instead of allowing to offset such losses in the subsequent tax years of the CFC.

[120] E.g. facts of the case may reveal that the taxpayer does not control or has a definite influence on the company's activities, despites having more than 50% shares in that company together with associated entities.

historically greater importance attributed by EU law to the direct investments.[121] Moreover, it allows Member States to adjust their tax laws to explicitly target direct investments in third countries without being limited by Article 63(1) of the TFEU.[122] This seemingly enhances prevention of tax avoidance through the use of entities established in third countries insofar as Member States can apply very restrictive anti-avoidance rules, such as the Polish CFC rules, to discourage taxpayers from participating in the economies of third countries. At the same time, however, it makes Article 63(1) of the TFUE virtually and increasingly meaningless. The EU should ask itself whether it is not better to change the TFUE and explicitly limit the scope of the application of the free movement of capital to Member States, as prescribed under the EEA Agreement, than doing so via a hidden form of protectionism.

Second, the CJEU treats the same or similar fact pattern in terms of relations between Member States with third countries less favourably as compared to relations between Member States only, i.e. the lack of a factual possibility to exchange of tax information can justify the irrefutable presumptions of tax avoidance or tax evasion by reference to the need to ensure effective fiscal supervision only in respect of the relations between the Member States and third countries. Similar to the above observation, here we also face a hidden form of protectionism and an opening for Member States to render Article 63(1) of the Treaty on the Functioning of the European Union (TFEU) meaningless by not entering into or terminating existing tax information exchange arrangements. Hence, the question posed above is relevant to this observation as well. Moreover, it is quite paradoxical that the mere existence of a legal basis for exchanging tax information matters more to the CJEU than the actual effectiveness of such a mechanism. Ultimately, the actual exchange of tax information matters for the effective administration of fiscal supervision. It is also true regarding the effective application of domestic anti-avoidance measures. So to what degree are the purposes of the ATAD and BEPS project facilitated by CJEU case law? Not much, the author hazards to say.

Finally, enacting the minimum level of protection (Article 3 of the ATAD) and allowing Member States to refrain from applying CFC rules to companies in third countries when CFCs carry on genuine economic activities (second and third paragraph of Article 7(1)(a) of the ATAD) were both wrong, and have been rightly criticized by scholars.[123] Poland is an extreme example in that regard. The near future will show if this is a solitary example or just the beginning of a new, infamous trend.

[121] *See* P. Pistone, *European Direct Tax Law: Quo Vadis?*, in *A Vision of Taxes Within and Outside European Borders. Festschrift in Honor of Prof. Dr Frans Vanistendael* 726 (L. Hinnekens & Ph. Hinnekes eds, Alphen aan den Rijn 2008); Cordewener, Kofler & Schindler, *supra* n. 33, at 374.

[122] *See* Cordewener, Kofler & Schindler, *supra* n. 33.

[123] *See* J. Schönfeld Bonn, *CFC Rules and Anti-Tax Avoidance Directive*, 3 EC Tax Rev. 150 (2017); A. Dourado, *The Role of CFC Rules in the BEPS Initiative and in the EU*, 3 Brit. Tax Rev. 358 (2015); J. Wittendorf, *European Commission Anti-Tax-Avoidance Package: Unavoidably Flawed?*, 81 Tax Notes Int'l 857 (2016); Kuźniacki, *supra* n. 2, at 163–164. *See also* Pistone & Danon, *supra* n. 100.