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Freedom of establishment can override free movement of capital

The ECJ has held that the freedom of establishment cannot always be extended to third states through the freedom of capital movement.

A German resident deceased left his German resident daughter the sole shareholding in a Canadian company. Had the company been established in a member state, the daughter would have been entitled to an Inheritance Tax Act provision now allowing a full waiver of the inheritance tax on the shareholding if the total wages paid during the next five years were at least 400% of the amount paid during the same period immediately prior to the date of death. The purpose of this relief was to encourage business continuity within the same family with the ultimate intention of preserving jobs.

Two fundamental freedoms were potentially involved. The first, the freedom of establishment, was directed at investments intended to assure the holder of an influence on the management of the company. Under German law this level could be taken at over 25% as such an investment would be sufficient for the holder to block a major resolution on future company development. This contrasted with the portfolio holding seen as a pure investment in the hope of dividend or capital gain income. Passive investments of this nature fell under the freedom of capital movement. The freedom of establishment ends at the community border, whereas the freedom of capital movement for EU citizens applies worldwide. Thus, in the case at issue, the daughter could base a claim on an infringement of the freedom of capital movement, but not of the freedom of establishment. The ECJ distinguished between the two freedoms according to the intention of the legislation. In this case, the German rule was clearly aimed at management influence. Thus, the freedom of establishment predominated. This freedom did not, however, extend to investments in Canada. A 100% shareholding entitled the holder to significant management influence. It therefore fell by its nature under the freedom of establishment. However, that freedom did not apply and that its breach necessarily led to a breach of the freedom of capital movement did not entitle the court to review the case in the light of that freedom alone.

The ECJ case reference is C-31/11 *Scheunemann*, judgment of July 19, 2012.

Keywords

free movement of capital, freedom of establishment