Are the Days of Exit Taxes in the EU Numbered?

By Daniel Smit

Daniel Smit ponders whether exit taxation in the EU is compatible with the freedom of establishment granted in the EC Treaty. Daniel Smit is a tax manager with International Tax Services’ EU Competency Group of Ernst & Young Belastingadviseurs LLP in Rotterdam and a researcher at the Fiscal Institute of Tilburg University in the Netherlands.

On July 15, 2010, the Amsterdam Court of Appeal referred a question to the European Court of Justice regarding the compatibility with the freedom of establishment of the Dutch corporate exit taxation on the transfer of seat of a company. In this case, the Dutch limited liability company National Grid Indus BV transferred its effective place of management to the United Kingdom. At the moment of transfer, the company owned a substantial loan receivable denominated in British pounds. Because of an increase of the British pound compared with the Dutch currency (the guilder at the time of litigation), the value of the receivable had increased and a substantial unrealized currency gain rested on the loan receivable. On the transfer of seat, Dutch tax inspectors assessed the unrealized currency result based on the exit tax provisions incorporated in the Dutch corporate income tax act. The company appealed, arguing that the Dutch corporate exit taxation provision infringes on the freedom of establishment under article 49 of the Treaty on the Functioning of the European Union (TFEU). The Amsterdam Court of Appeal did not consider this issue acte clair and therefore referred the case to the ECJ.

Interestingly, in March 2010 the European Commission had already questioned the Dutch exit taxation provisions in the Dutch personal income tax act and the Dutch corporate income tax act. In the view of the commission, the current Dutch provisions are forbidden by the freedom of establishment under article 49 of the TFEU. The commission believes the Netherlands must defer the collection of its taxes until the moment of actual realization of the capital gains rather than on the transfer of seat.
The commission, therefore, may ask the ECJ to declare that the Dutch exit tax rules are contrary to article 49 of the TFEU. Given these developments, I will consider the exit taxes in light of EU law in some more detail.

Two Benchmark Cases

Two cases decided by the ECJ are of particular relevance in this regard: Daily Mail and Lasteyrie. Daily Mail concerned a U.K. company that wished to relocate its actual management abroad without receiving the required consent of the relevant U.K. authorities. At that time, U.K. company law provided that a company could relocate its actual management to another country without being liquidated or dissolved. However, U.K. company tax law prohibited companies resident for tax purposes in the United Kingdom from ceasing to be so resident without the consent of the Treasury. Daily Mail argued that the U.K. rule was in conflict with the freedom of establishment. The ECJ, however, rejected the taxpayer’s claim, holding that whether (and if so, how) the registered office or real head office of a company incorporated under national law may be transferred from one member state to another is not resolved by the rules concerning the right of establishment but must be dealt with by future legislation or conventions. Although Daily Mail concerned taxation on the transfer of seat, it seems that, essentially, the ECJ decided the case as a matter of civil law rather than as a matter of tax law. Contrary to the ECJ’s supposition in the Daily Mail judgment, the tax settlement obligation did not form a precondition for the continued existence of the company. Hence, the decision in this case is not conclusive.

The Lasteyrie case provides further interesting insights. Lasteyrie concerned a French individual who moved his place of residence from France to Belgium. The French individual held 25 percent of the shares in a French company. Under the French rules, the emigration of the individual was subject to immediate taxation calculated based on the difference between the fair market value acquisition price of the shares. Deferral of payment was possible, but subject to very strict conditions; one condition was that the taxpayer had a fiscal representative established in France and that the taxpayer had a guarantee sufficient to ensure the recovery of the tax debt by the French tax authorities. Subject to conditions, a waiver of debt was available five years after emigration. The question was whether this emigration tax constituted a discriminatory restriction of the freedom of establishment, and the ECJ answered this question in the affirmative. A taxpayer wishing to transfer his tax residence outside French territory was subject to less favorable tax treatment in comparison to a person who maintained his residence in France. Under the French rules, a taxpayer became liable, simply by reason of a transfer of residence, to tax on income that had not yet been realized and that the taxpayer therefore did not have. If the taxpayer had stayed in France, however, increases in value would become taxable only when they were actually realized (for instance, by means of an actual disposal). This difference in treatment concerning the taxation of increases in value was, according to the ECJ, contrary to the freedom of establishment.

It can be defended that the interpretation of the freedom of establishment given by the ECJ in the Lasteyrie case regarding exit tax rules on individuals is also valid for exit tax rules on companies applied by member states. The most appealing argument can be derived from the TFEU itself. In article 54 of the TFEU, companies established under the laws of a member state and having their central management within the EU will be treated in the same way as individuals. As in 1986 in the Avoir Fiscal case, the ECJ made it clear that regarding the principle of nondiscrimination there is no objective difference between a corporate entity and an individual.

Is There a Valid Justification?

The question, nevertheless, is whether an emigration tax on transfer of seat can be justified, in particular on the basis of the principle of territoriality and by the need to guarantee the fiscal coherence of the tax system. In the Dutch N case, which is comparable to Lasteyrie, the ECJ accepted the principle of territoriality as a valid justification for an exit tax levied on the emigration of individuals. The ECJ ruled that the contested
Dutch exit tax provisions provide for the charging of tax on increases in value recorded in the Netherlands.

The final question, however, is whether such a rule is also proportionate. It could be argued that the goal of territoriality and the need to guarantee the fiscal coherence of the tax system can be achieved by a less far-reaching rule other than immediate taxation. In \(X\ AB\ and\ Y\ AB\), the ECJ found that an immediate final settlement in the case of emigration would be disproportionate. \(X\ AB\ and\ Y\ AB\), concerned a Swedish tax rule for share-for-share mergers that provided that share transfers to a foreign company were liable to immediate taxation, whereas a deferment of tax liability was granted for share transfers to a Swedish company. The ECJ held that the cohesion of the tax rule could be guaranteed by less restrictive measures focused on the risk of a definitive emigration of the taxpayer. The ECJ suggested, in such an eventuality, that the member state create a system of securities or other necessary guarantees to ensure the payment of tax in case the transferor relocated permanently to another country. This conclusion can also be drawn from the \(N\) case, in which the ECJ accepted a less far-reaching system of a protective assessment, provided that such system is not conditional on the provision of guarantees and takes full account of reductions in value capable of arising after the transfer of residence by the taxpayer that were not taken into account by the host member state.

**Position of the European Commission**

The European Commission believes that immediate taxation on the transfer of seat of a company, although justified, is not proportionate. In March 2010 the European Commission questioned the Dutch exit taxation provisions in the Dutch personal income tax act and the Dutch corporate income tax act. The commission believes the current provisions are forbidden by the freedom of establishment under article 49 of the EC Treaty. The commission believes that the Netherlands must defer the collection of its taxes until the moment of actual realization of the capital gains rather than on the transfer of seat. The commission may ask the ECJ to declare that the Dutch exit tax rules are contrary to article 49 of the TFEU. Similar infringement procedures are pending against Belgium, Denmark, Portugal, and Spain. Here too, the commission believes that member states must defer the collection of their taxes until the moment of actual realization of the capital gains.

**Final Remarks**

It is questionable whether the Dutch exit tax on the transfer of seat is compatible with the freedom of establishment. The ECJ now has the final word. The ultimate outcome of this interesting case will affect not only the Netherlands, but also other EU member states that have exit taxation provisions in force.

**Endnotes**

1. Decision by Amsterdam Court of Appeal No. 08/00135, dated July 15, 2010.
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