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The Corporate Exit Taxes and the EU. A special  
reference to the Portuguese regime

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# ***Corporate Exit Taxes and the EU. A Special Reference to the Portuguese Regime***

## **LIST OF ABBREVIATIONS**

|        |   |
|--------|---|
| EEA    | European Economic Area                          |
| ET     | Exit Taxation                                   |
| FoE    | Freedom of Establishment                        |
| MS     | Member State                                    |
| OECDMC | OECD Model Tax Convention 2010                  |
| TFEU   | Treaty on the Functioning of the European Union |
| DTC    | Double Tax Convention                           |
| CFC    | Controlled Foreign Corporation                  |

## 1. Introduction. Origin and purpose of ET\*

### 1.1. Protecting the tax borders beyond the scope of *de jure* transfers of assets and companies. The principles of *territoriality*, *benefit* and *ability-to-pay*

In today's modern states, income taxes<sup>1</sup> are undoubtedly the main tool for redistribution of income among citizens. In order to really be *redistributive*, they must lie on foundations of equity and fairness<sup>2</sup>, ie., they must identify and target situations where real income arises, while being based on criteria common to all taxpayers. In effect, states under the *rule of law* are required by their citizens not only to define, but also, and principally, to legitimize tax policy choices, such as *personal* and *objective* scope, *territorial* reach, and also the relevant chargeable *income manifestations*.

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\* Right after this dissertation was finished, the Opinion of Advocate-General Kokott in Case C-371/10 *National Grid Indus* was published. Its main conclusions do not differ much from those that are anticipated in chapter 6, namely as regards the imposition of a deferral of ET to ensure proportionality and the ancillary obligations thereon, but we dissent in regard to some positions taken by the AG, such as accepting *coherence* as a justification (see para.97) or endorsing an indefinite ET deferral. We also cover issues which are not dealt with in the AG's Opinion. No change has been made to this work following such Opinion.

<sup>1</sup> Where not expressed otherwise, the references to "income taxes" include capital gains taxation.

<sup>2</sup> Roy Rohatgi (*Basic International Taxation: Principles of International Taxation*, 2005, 2<sup>nd</sup> Ed Richmond Law & Tax Ltd 23) refers to *horizontal equity*, requiring equal taxation on equal income, ie., an *ability-to-pay*, and to *vertical equity*, which expresses the need to tax progressively higher those who earn income above certain levels. See, also on this subject, Adam Zalasinski, 'The limits of the EC concept of 'Direct Tax Restriction on Free Movement Rights', The Principles of Equality and Ability to Pay and the Interstate Fiscal Equity' (2009) 37 5 Intertax 292.

The interaction of such national tax policies has led to the emergence of what some authors call the “international tax regime”<sup>3</sup>. Even those who hold that a true ‘regime’ requires *coercion* - which is not currently in place - will not find it hard to acknowledge that in today’s international tax arena principles like *non-discrimination*, the *arm’s length standard* and the *avoidance of double taxation*<sup>4</sup>, are almost like a pre-condition to a state’s entry into the developed world. Jurisdiction to tax cross-border income flows or gains is, hence, not limitless; on the contrary, it is understood that fiscal jurisdiction essentially stems from two main connecting factors, *residence* and *source*<sup>5</sup>, and from three basic principles: *territoriality*, *ability-to-pay* and *benefit*. In its tax shape, *territoriality* is not more than an emanation of an international public law principle with the same name which confines countries’ jurisdictions to their own borders. Its EU relevance has been many times acknowledged by the CJ, as in *Marks and Spencer*<sup>6</sup>: “*In accordance with the principle of territoriality, applicable both in international law and Community law, the MS in which the parent company is established has no tax jurisdiction over non-resident subsidiaries*”.

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<sup>3</sup> Reuven Avi-Yonah (‘Tax Competition, Tax Arbitrage and the International Tax Regime’ [2007] April BIT 130) sustains that there is, in fact, an international tax regime characterized by a set of principles “*embodied both in the tax treaty network and in domestic laws and that it forms (the international tax regime) part of international law (both treaty based and customary)*”.

<sup>4</sup> *Idem*, 132. According to this author, international legal instruments like DTCs are the culmination of the international consensus on what he calls the “single tax principle”, which he sees as the universal paradigm for cross-border transactions. In his own words: “*the single tax principle thus incorporates the traditional goal of avoiding double taxation, which was the main motive for setting up the international tax regime in the 1920s and 1930s.*”

<sup>5</sup> Wolfgang Schön, (‘International Tax Coordination for a Second-Best World (Part I)’ [2009] October ET 67) argues that both source and residence are being wore down by the corporate and personal mobility brought about by globalization, stating in particular that “the factual basis for the identification of corporate residence is gradually eroding” (p. 69). However, if an international tax regime indeed exists, allocation of source and of residence still appears to be the only route to ascribe tax jurisdiction, outside the domain of arguably extra-territorial anti-abuse mechanisms as CFC rules.

<sup>6</sup> C- 446/03, para. 36.

However, even though aiming to circumscribe the state's power to tax, this principle offers no clues on *how much* income should be taxed and *when* taxation may take place.

In general, both these issues are dealt with in the light of the other two principles, which steer the states' income tax policy options. The *ability-to-pay* principle, as noted by Schön<sup>7</sup>, is an expression of the “solidarity among members of a society”, and lies at the very heart of the *social contract*. States have come up with concepts like *nationality* and *residence* as decisive factors to impose tax on a person's worldwide income – that is, on a person's whole *ability-to-pay* - irrespective of their origin. *Source* location, however, appears to be largely irrelevant from the ability-to-pay standpoint, because purchasing capacity may derive from the state of residence, nationality or elsewhere<sup>8</sup>. Differently, the *effective realization* of income and the ensuing purchasing capacity is the cornerstone of the ability-to-pay philosophy, especially in a time when borrowing for purchasing capacity based on *potential income* or *gains* has seen better days.

The significance of *source* originates on the principle of *benefit*. It is understood that the countries where the payer or the subsidiary are domiciled have a claim to tax the interest, or the dividend because they provide the conditions for the income to arise. Ideally, for source countries there should be a direct proportion between the benefits they provide locally – from infrastructure to the purchasing power and/or productive capacity of their inhabitants - and the amount of tax they charge for income obtained in their territory. But *benefit* and *ability-to-pay* are

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<sup>7</sup> Op. cit., p.71.

<sup>8</sup> The link between residence and taxing on ability-to-pay basis must be viewed *cum grano sallis* in an EU setting, following the *Schumacker* jurisprudence (Case C-279/93). The country of residence of Mr. Schumacker, Belgium, as he earned almost no income from Belgian sources, could not tax him under the ability-to-pay principle, and, thus, allow him to benefit from personal deductions and allowances. As a result of the fact that he earned almost the totality of his income in Germany, the CJ held that he had to be treated as a German resident, despite his internal *non-resident* legal status.

by no means opposite concepts: the quantity of *benefits* provided by a State should play a part in legitimizing taxation based on the ability-to-pay, and, thus, on residence, but the idea that *benefit* alone – which is very difficult to measure – should be the sole motivation for source taxation fails to adhere to economic reality<sup>9</sup>, especially when there are substantial benefits provided by countries other than the source country.

As obvious as it may be, the context we have just outlined is, nonetheless, essential to understanding the motivations and the boundaries of ET, especially in the EU, where the protection ensured to the mobility of residents and nationals of the MSs by the fundamental freedoms, namely the FoE, is a clear obstacle to their taxing prerogatives. Though exit taxes may fall upon persons as well as corporate bodies and PEs, we will mainly focus on ET of the latter group, an area where, as we will see, there is currently more uncertainty and complexity. Our main priority will be, on a different note from much of the work in this area we have come across<sup>10</sup>, to analyze ET from a principled perspective, with a view

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<sup>9</sup> The mutability of all these concepts and principles is quite manifest in the taxation of PEs. From an ability-to-pay and tax status perspective, PEs are comparable to resident companies and, in general, are subject to the same tax rules. At an international level, OECD-based Conventions ensure, via non-discrimination provisions (OECD Model Convention, article 24), that PEs are treated in the same way as companies, and, at an EU level, such identity of tax status is preserved by the freedom of establishment, as upheld by the CJ in C-307/97 *Saint Gobain* and C-311/97 *Royal Bank of Scotland*.

<sup>10</sup> Many authors have published works on ET in EU and EEA states like Germany [Schneeweiss (*ET after Cartesio: The European Fundamental Freedom's Impact on Taxing Migrating Companies* (2009) 37 6/7 Intertax 363), Seitz (*Notional Income from the Cross-Border Internal Transfer of Assets – Why the Amendments to the German Income Tax Act Violate the Freedom of Establishment* (2008) 36 2 Intertax 44), Fuhrich (*ET and ECJ Case Law* [2008]) ET 10, Daiber and Offermans (*What's Going On In... Germany: German Exit Tax Provisions, Substantial Shareholdings and Incompatibility with EC Law* [2005] ET 579) France [Kotavidis (*What's Going On In... European Union: French Exit Tax Incompatible with the Freedom of Establishment: Case C-9/02* (2004) ET 375)], The Netherlands [Weber (*European Union: Exit Taxes on the Transfer of Seat and the Applicability of the Freedom of Establishment after Überseering* [2003] ET 350), Van den Hurk and Korving (*The ECJ's Judgement in the N Case against the Netherlands and its Consequences for Exit Taxes in the European Union*

to ascertaining whether it can coexist with the EU freedoms and also with the relevant international tax principles. We will not dedicate much time to discussing whether national company laws can prevent company emigration (as discussed in cases like *Daily Mail*<sup>11</sup>, *Uberseering*<sup>12</sup> or *Cartesio*<sup>13</sup>) but rather assume that in some countries (eg., Portugal<sup>14</sup>) such emigration is allowed, that in the same or other countries the subsequent immigration is also allowed (eg. in Luxembourg), and, finally, that European Companies (SEs) are, under certain conditions, free to migrate within the EU.

## 1.2. ET in light of the principles of international income taxation

In general, ET aims at levying the potential or latent gains (also called “hidden reserves”) related with the assets that an individual, a company or a PE located in a given country, economically (eg., through allocation to a foreign PE of a

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[2007] BIT 150]. Other authors like O’Shea [*Cartesio: Moving a Company’s Seat Now Easier in the EU* (2009) March 23 TNI 1072] Panayi [*Corporate Mobility in the European Union and Exit Taxes* (2009) BIT 459] Szudoczki [*How does the European Court of Justice Treat Precedents in its Case Law? Cartesio and Damseaux from a Different Perspective: Part I* (2009) 37 6/7 Intertax 346], Gusmeroli [*The Conversion of a Branch into a Subsidiary under the EC Merger Directive: Still “Rarely Pure and Never Simple* (2009) ET 567] and Cerioni, [*Cross-Border Mobility of Companies in the European Union: Tax Competition and Increased Scope for the CCCTB following Cartesio* (2010) BIT 636] have mainly focused on the company law issues regarding the migration of companies and their impact on exit taxes. Finally, some articles by authors like Rivolta [*Transfer of Residence within the European Union: The Treatment of Pre-Existing Losses – Part 1* (2010) 50 IBFD], have dealt with some specific aspects of ET like the treatment of pre-recorded losses.

<sup>11</sup> C-81/87.

<sup>12</sup> C-208/00.

<sup>13</sup> C-210/06.

<sup>14</sup> For an accurate analysis on the wide possibilities offered by Portuguese Company law for company emigration and immigration, see Karsten Sorensen, Mette Neville, ‘Corporate Migration in the European Union’ (2000) 6 Columbia Journal of European Law 181.

trademark or a shareholding), or physically transfer to another tax jurisdiction<sup>15</sup>. A first feature of ET is, thus, related with the fact that it is imposed when no asset disposal takes place, and no revenue is generated. At the outset, this leaves much room for uncertainty vis-à-vis the ability-to-pay: the taxpayer may not be solvent enough<sup>16</sup> and even if he is, he is put in a disadvantageous situation when compared with (i) a person<sup>17</sup> that has really disposed of similar assets, with the ensuing revenue, and (ii) a non-migrant person with the same unrealized gains. So, the potential for discrimination or restriction in this field is considerable. That is even more so when the migrating assets are ultimately taxed in the host state at a rate comparable to that of the origin country and on a similar base value. However, from a *benefit* standpoint, States imposing ET may claim that, since they provided to the migrant person the same *benefits* available to the non-migrant their right to a payback in the form of a tax similar to that which would be charged in the case of a disposal of the relevant assets is undeniable.

A first conclusion can, then, be drawn at this stage: ET may arguably be justified not as a way to treat similarly taxpayers who are in similar conditions to pay tax (equal ability-to-pay), but as a way to give a similar treatment to taxpayers who benefited from similar conditions provided by the State (equal benefit). This appears evident, as the migrant person may suffer the same or heavier tax burden on gains realized in the host country, or realize gains lower than those appraised at the time of emigration, and the origin state may take none of these

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<sup>15</sup> As we will see, some states have confined ET to transfers of corporate residence and local PEs of foreign entities (Portugal, for instance) while other states adopt a broader spectrum by imposing exit taxes on virtually all outward transfers of assets within the same entity (Germany and Norway).

<sup>16</sup> Herman Schneeweiss (op. cit.,363), accurately refers to “liquidity constraints”.

<sup>17</sup> Where not expressed otherwise, the references to “persons” encompass both natural and legal persons.



circumstances into account<sup>18</sup>. Even in this last case, one may discuss whether it makes sense to draw, on an ability-to-pay basis, a parallel between a person staying under one country's jurisdiction and another leaving it without triggering no actual income manifestation.

The second feature of ET is its *temporal* and *quantitative* disparity in relation the actual realization of the underlying potential income. It may so happen that after emigration, a company's assets, which had potential gains of € 1M, and suffered ET of m€ 300, devalue steadily for three years and are sold at a loss in the host country. The way this devaluation is taken into account in the origin country, should also come into play when we examine the compatibility of ET with the aforesaid principles. A possible consideration of the time differences in terms of tax in the origin state seems to derive from a concern by this state to mitigate the blow to the ability-to-pay principle when taxation is imposed on pure potential gains, and underlines what has been said about the principle of *benefit* as being the main foundation of ET, principles-wise.

If we come down to the concrete provisions of international tax law, namely to DTCs, we may also find that ET is not neutral in terms of the actual allocation of the taxing powers<sup>19</sup> normally established thereby<sup>20</sup>. Take for instance, a company

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<sup>18</sup> Zalasinski (op. cit., p. 292) sees that "using a combination of real and fictitious factors for determining a taxpayer's tax ability may serve two main purposes: to respect the principle of ability to pay and also to facilitate other, usually policy, reasons". As regards the fictitious gains targeted by ET we consider, as expanded further ahead, that ET fundamentally serves those other policy reasons, namely, on a more pragmatic level, the protection of tax revenues and also, on the level of principles, the retribution of the benefits provided by the origin country.

<sup>19</sup> See, in regard to DTCs, C-336/96 *Gilly*.

<sup>20</sup> This problem is addressed by Van Den Hurk (op. cit, p. 154). This author raises the issue of the compatibility with the tax treaties entered into by The Netherlands of the taxation of fictitious transfers. He claims that, having been granted to one of the states or to both states but with limitation, tax

in the Source State (S) that decides to transfer its domicile to the Residence State (R) and possesses movable assets which are transferred from the former state to the latter. State S' internal tax law provides for ET of the potential gains on those assets and the emigration is allowed as per company law. The two countries have a DTC in force which follows closely the OECDMC. Article 13 provides no solution to this case, as there is no pre-existing company resident of R holding assets in S. On the other hand, the taxable event is simultaneous to the change of tax residence. As a result, the issue of allocation of taxing rights between the two countries does not seem to arise under the DTC provisions.

However, there is no doubt that a problem of double taxation may emerge, especially when the tax base value of the assets transferred is lower in R than its deemed value in S. It can be assumed, though, that except where there is *goodwill*, the result deriving from the mentioned company emigration is equal to that which would originate from the sale of the movable assets that another company already resident in R would have in S, provided those assets did not form a PE in S. In this last case, no taxation would be due in State S even in the case of an effective alienation of the assets, let alone in the event of a fictitious one<sup>21</sup>. Therefore, it is fair to ask whether an interpretation in good faith of the DTC would not determine the same treatment of both situations, especially if we consider that in the case at issue no "real" gain is obtained. Some prominent scholars<sup>22</sup> sustain that no provision in the OECDMC, including its Commentaries, disallows the inclusion of the taxation of fictitious income, like ET, in the "other income" article (21), which allocates full taxation to the country

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jurisdiction cannot be changed by way of purchases or alienations that did not occur. This may amount to an infringement of the tax treaty and of the Vienna Convention on the Law of Treaties.

<sup>21</sup> The solution would not be alike if the assets sold were held by a PE of R in S. See Commentary to article 7 of the OECDMC (2010), para. 21.

<sup>22</sup> See Peter Wattel, Otto Marres, 'Characterization of Fictitious Income under OECD-Patterned Tax Treaties' (2003) March ET 66.

of residence. For the reasons already pointed out, we follow this reasoning, which results from a *purposive* interpretation of the OECDMC. As a result, whenever the actual transfer of residence is the tax triggering event, it can be argued that residence should be ascribed to the host country, with the consequent application of article 13 or article 21, which block *source* taxation<sup>23</sup>, except where there is an asset alienation by a PE in the source state.

## 2. Relevant analogies and differences between various forms of cross-border migrations of companies and assets

### 2.1. Transfers of legal seat or place of effective management

In general, levying a transfer of assets requires their effective disposal or, at least, a transfer of a *right in rem* against a payment or an obligation to pay. This will not happen with the mere transfer of the legal seat or place of management, unless the origin state attaches to such a transfer the wind-up and/or liquidation of the company, as a consequence, for instance, of an ensuing loss of *nationality*. In this event, the transfer of the assets to the shareholders upon liquidation entails a change of ownership on which a gain or a loss is triggered. Absent such event, the imposition of ET originates on an exceptional *taxable fact*, which, in most cases, represents an enlargement of the *normal* tax base. That is to say, as opposed to the general rule of income *realization*<sup>24</sup> following a disposal, ET will usually assume one of two legal characters:

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<sup>23</sup> Wattel/Marres raise this issue of the triggering event in ET, urging the OECD to include a provision on fictitious income in the Model (*Ibidem*, 79).

<sup>24</sup> In accounting, the *fair value* paradigm has largely replaced *realization*. IAS 16 (Tangible Assets), 38 (Intangible Assets) and 39 (Financial Instruments: recognition and measurement), foresee, as a general principle, that when the fair value of a tangible, intangible asset or financial asset can be measured

- i. A special taxable fact in its own right;
- ii. A legal fiction of a disposal of assets.

This distinction, although apparently superfluous, may be relevant, eg., in the interpretation of the scope of ET<sup>25</sup>. Differently, the origin state may prescribe that ET on migration is deferred if the migrant’s assets remain wholly connected to a PE in that State. If, in such a case, the origin state taxes such PE on the basis of the profits attributable to it (and not just those that arise in the origin state), its jurisdiction to tax the gains accumulated up to exit may remain unaffected, provided the assets thereof keep their value.

## 2.2. Mergers, divisions and asset transfers

Business reorganizations tend to assume the legal status of mergers, divisions or asset transfers when the consideration of the business(es) transferred thereby are shares of the company(ies) acquiring them.

In the EU context, mergers are operations whereby one or more companies (the “transferring company(ies)”) transfer all their assets and liabilities to an already existing company or to a company set up for the purpose (the “receiving company”)<sup>26</sup>. The loss that the shareholders record upon extinction of their shares of the transferring company is balanced by a share subscription of the receiving company. A division takes place whenever a company transfers of one

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reliably, it should be booked accordingly. For an in-depth study on tax and fair value, see Tomás Tavares (*IRC e Contabilidade - Da Realização ao Justo Valor*, [Almedina 2011]).

<sup>25</sup> For example, the prevailing hermeneutical principles in a certain jurisdiction may determine that where taxation is based on a legal fiction, its scope is to be interpreted restrictively. This may be relevant, for example, to ascertain to what extent should the tax measurement of the potential gains or losses upon exit follow the guidelines applicable to disposals of assets between related entities, ie., if transfer pricing rules also cover company migrations.

<sup>26</sup> See article 2, Council Directive 1990/434/EEC of 23 July 1990 (‘Merger Directive’).

if its branches of activity to one or more existing companies (partial division) or to a new company (also a partial division) or, it is totally divided into one or more parts forming two or more companies (total division). Finally, asset transfers resemble partial divisions, with the difference that the shares received as consideration for the transfer of the branch of activity are received by the transferor and not by its shareholders.

In all these operations, the ownership of the assets being transferred changes hands, from the transferring company to the receiving company. Under most, if not all of the EU jurisdictions, absent the harmonized neutrality regime<sup>27</sup>, they will typically give rise to taxation on the difference between the arm's length value of the assets (or the face value of the shares subscribed plus, subject to a cap, a possible cash amount) and their acquisition cost (less possible depreciation or amortization, and inflation coefficient adjustment). Seen from an ability-to-pay viewpoint, these operations cause the potential gain underlying the assets to become effective and, as a rule, will produce revenue, for accounting purposes<sup>28</sup>. Therefore, they are intrinsically different from the operations focused in 2.1. above; because they involve a legal transmission, their tax relevance will not typically depend on any territorial factor, given that taxation will arise irrespective of where the assets transferred are located. Nonetheless, on an EU cross-border scenario, reorganizations are protected from the underlying gains on the asset transfers they entail via three distinct mechanisms<sup>29</sup>:

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<sup>27</sup> Despite the obligation to apply the Merger Directive neutrality regime to cross-border reorganizations, a reverse discrimination of purely internal operations, although implausible, would not infringe EU Law. In this respect, see C-513/03 *Van Hilten*.

<sup>28</sup> See IAS 18 "Revenue".

<sup>29</sup> For a detailed analysis on the subject see Guglielmo Maisto, 'Shaping EU Company Tax Policy: Amending the Tax Directives' [2002] ET 287, Russo R., Offermanns R., 'European Union: The 2005 Amendments to the EC Merger Directive' [2006] ET 250.

- i. Carry-over of the tax values of the transferred assets and liabilities (a concept defined in article 4 (1) (a) of the Merger Directive) by the receiving company until disposal;
- ii. Carry-over, by the shareholders the transferring company, of the tax value of the shares which are exchanged by shares of the receiving company (article 8);
- iii. Effective connection of any assets transferred, to a PE of the receiving company in the Member State of the transferring company (or, in the case of a migrating SE, of a PE in the origin state) liable to tax in the latter state (article 10b).

### 2.3. Cross-border transfers of assets within the same entity

Internal transfers between PE and head-office or between PEs will not give rise, by definition, to a change of title of the assets transferred either internally or cross-border. Being, by and large, an economic concept, a PE is not legally autonomous from the head-office or another PE of the same entity. However, sometimes a PE in the origin state may be deemed to be an independent person in the host state or vice-versa. That may be the case when, for example, a Portuguese company transfers assets to an UK-based partnership as its contribution as a member. A partnership will typically not be recognized in Portugal as an independent person, but that may not be the case in the UK with, for instance, an LLP (*limited liability partnership*). The inverse situation is equally possible. This conflict of qualification may have significant consequences in the case of ET imposed on assets transferred as a contribution to a partnership formed in the host state, where this state does not recognize such partnership as being independent from its partners. In particular, if the origin state taxes the hidden reserves upon exit of the assets, it is likely that if the partnership is deemed to have a PE in the host state, this state will not consider as tax base

value on a subsequent transfer the arm's length amount taken into account in the prior computation of the ET.

### 3. The Portuguese ET regime and some features of the sophisticated Norwegian and German ET regimes.

#### 3.1. Portugal

Portuguese corporate ET rules were first enacted in 2006, following the publication of Law 60-A/2005, of 30 December (Portuguese State Budget for 2006), which introduced the current articles 83 to 85 of the Portuguese Corporate Tax Code ('IRC'). Exit taxes are covered at three different levels: (i) article 83 is directed at the corporate migrations (transfers of tax residence) by a company domiciled in Portugal, including a *Societas Europaea*<sup>30</sup> ('SE') or a *Societas Cooperativa Europaea*<sup>31</sup> ('SCE'), (ii) article 84 covers ET of a Portuguese PE of a non-resident company and, finally, (iii) article 85 deals with the taxation of the shareholders of a migrating company as per article 83. A common feature of the three provisions is that not only latent gains are liable to IRC upon exit, but also any potential losses are taken into account for the computation of the exit result.

#### *Corporate migrations*

Firstly, under article 83 IRC<sup>32</sup>, ET will only be due on a change of both of the relevant IRC *residence* connecting factors<sup>33</sup>: place of the *legal seat* and of *effective*

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<sup>30</sup> See Council Regulation (EC) 2157/2001 of 8 October 2001 ('RegSE').

<sup>31</sup> See Council Regulation (EC) 1435/2003 of 22 July 2003.

<sup>32</sup> From here onwards, references to any pieces of law will contain the number of the respective article plus the abbreviation thereof (eg. 67 IRC).

<sup>33</sup> See, 2 (3) IRC.

*management*<sup>34</sup>. The measurement of the tax *quantum* is done by subtracting to the market value of the asset elements<sup>35</sup> their accounting value deemed relevant for tax purposes. In the author's opinion, this explicit rule shows that the Legislature is perfectly aware that a corporate migration cannot be viewed as a transaction between 'related entities' under the Portuguese IRC transfer pricing rule (62 IRC), even when the migrant company allocates its assets totally or partially to a Portuguese PE<sup>36</sup>. Otherwise, it would have simply referred to the arm's length value definition contained in 62 IRC.

However, insofar as the assets of the migrant entity remain connected to a PE situated in Portuguese territory and exposed to IRC (eg. not benefiting from an exclusion or tax exemption), no liability to tax will arise, provided the tax valuation of the relevant assets is done in accordance with the IRC neutrality regime for cross-border reorganizations, which follows very closely the Merger Directive. A first paradox of this regime is that a migrant entity may, indeed, become worse off than it was prior to the migration, in terms of its Portuguese tax position. That outcome is made possible by the circumstance that, despite maintaining full tax jurisdiction over all the assets of the migrant entity, Portuguese law may not treat the PE in the same way as a resident corporate body<sup>37</sup>. Furthermore, as noted by Ricardo Borges and Pedro Ribeiro de Sousa in the most detailed study on Portuguese cross-border business restructurings

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<sup>34</sup> The change of the legal seat or of the place of effective management causes an automatic cessation of activities under 8 (5) (a) IRC.

<sup>35</sup> Free translation of the Portuguese wording "*elementos patrimoniais*".

<sup>36</sup> 63 (9) IRC deems as transactions between related entities any operations between a non-resident entity and its Portuguese PE and between the latter and other foreign PEs of the former.

<sup>37</sup> However, it is noteworthy that this *prima facie* less favorable treatment infringes free establishment, as seen in *Saint-Gobain* and *Royal Bank of Scotland*, or may infringe, on an international level, the rule of PE non-discrimination [OECDMC, article 24 (3)].



available<sup>38</sup>, this regime does not take into account “*any asset devaluation after tax emigration of the Portuguese company*”, in stark contrast to the immediate taxation of all potential gains<sup>39</sup>. Furthermore, the same rule does not provide for special relief when assets previously taxed upon migration of the company are eventually sold, for instance, through a PE set up by the Portuguese PE in another country, thus generating gains taxable in both countries. In this case, a mismatch in the relevant tax base values attached to those assets may give rise to double taxation<sup>40</sup>.

This lack of balance of the regime and the hardship of the alternative to the immediate taxation of the hidden reserves – eg., the connection of all assets to a Portuguese PE – will be examined further ahead, but, *prima facie*, it can be said that this regime is far from ensuring that corporate migrations are not restrained by tax reasons.

#### ***Asset transfers from Portuguese PEs of non-resident companies***

This other type of ET (article 84 CIRC), where no change in the *residence* connecting factor occurs, comprises solely two types of exit situations, although only one of them can be truly classified as an “exit”.

A first instance of taxation will take place when the PE of a non-resident entity ceases its activity. The intention here is obvious: when the assets no longer form

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<sup>38</sup> See ‘Cross-Border Business Restructurings: Portuguese Branch Report’ (2011) IFA Cahiers 621.

<sup>39</sup> Borges and Sousa reckon that the regime does not provide for a deferral of tax until the hidden reserves are realized in clear infringement of the CJ’s *dicta* in C-470/04 *N* and C-9/02 *Lasteyrie du Saillant*. This assumption is not entirely correct in relation to IRC ET, as such deferral is guaranteed where a PE-connection of the migrant entity’s assets is kept, but is accurate in relation to the special ET on individuals under article 10(9) of the Personal Income Tax (‘IRS’) Code.

<sup>40</sup> If both countries involved are bound by a tax treaty and agree to follow the wording and Commentaries of the OECD Model 2010 version it is likely that, by virtue of the recognition of the arm’s length character of the transactions between PE and head office, the base value in the host state should, more or less, correspond to the exit value in the origin state, as per article 7 (2).

part of a PE, any capital gains on a subsequent disposal thereof will escape Portuguese tax jurisdiction if Portugal and the state where the head office is situated have signed a DTC<sup>41</sup>; it is a way to tackle possible *abuse* by neutralizing the tax effect that would derive from an indirect sale of the PE via its cessation followed by a sale of all its assets. It follows that the assets may physically stay in Portugal, but will be taxed when the PE is dismantled. This corresponds to a double fiction: the fiction of a sale fiction (the “exit”). ET will also be levied on outward transfers of assets attributable to the PE, by any means (*legal* and/or *material*). Here, the assets transferred lose their territorial connection with Portugal and, so, escape its tax jurisdiction. Borges and Sousa<sup>42</sup> share a particular view in regard to this provision with which we do not agree. They hold that article 84(2) IRC aims at taxing “*isolated transfers of assets that are not already covered by the transfer pricing rule of article 63(9) of the IRC Code*”<sup>43</sup>, namely partial winding-ups of businesses (not included in 84(1)) or terminations of use of part of the PE’s assets. Otherwise, the authors claim, there would be an overlap between the two provisions.

First of all, neither the wording of article 84(2), nor the systematic insertion of article 63(9), point to this interpretation. Article 84(2) refers to “transfers of elements” and omits any specific mention to “certain” assets or functions. Secondly, article 63(9) is not a rule on *tax incidence* or *recognition* but only on *tax measurement*, which applies the *arm’s length* principle to transactions that are, beforehand, *recognized* for IRC purposes. The rule for *tax recognition* in the IRC is still that of *realization* (See Articles 21 (1) (h)), ie., potential gains, such as those underlying assets transferred outwards within the same company are only taxed on a subsequent realization. That is the case, for instance, of assets held by a

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<sup>41</sup> See article 14 (5) OECDMC.

<sup>42</sup> Op. Cit., p.611.

<sup>43</sup> This rule applies the arm’s length principle to transfers between a Portuguese PE of a non-resident entity or between other non-resident PEs of the same entity.

Portuguese company which are transferred to a PE situated abroad. Article 63(9) is no exception to the rule of *realization*, but article 84(2) IRC clearly is, no “deemed sale” taking place under the former but only under the latter.

However, if this is so, does article 63(9) IRC still have a function? It certainly does. Before the entry into force of article 84(2) IRC, it ensured that, where no CDT applied or where articles 13(2) and 7(2) of the Portuguese OECD-type CDTs did apply, Portugal would keep exclusive jurisdiction to tax, on an eventual sale of the asset previously transferred outwards within the same company or in other internal operations between the Portuguese PE and the head office or other PEs (e.g., notional loans or industrial property licensing) the part of the realized gain corresponding to an *arm’s length* value of the assets at the time of the prior exit, irrespective of the relevant tax value in the head office state or of those other PEs. While it is clear that, after the entry into force of Article 84(2), the scope of article 63(9) has been narrowed, it is not less evident that this provision still ensures the domestic application of the arm’s length principle to those *notional* intra-company operations. Therefore, the mentioned overlap between the two provisions, being merely partial, is the obvious outcome of a more recent tax policy guideline to ensure not only an arm’s length tax base in Portugal, but also the effectiveness in the tax collection achieved through ET. This solution is coherent with the previously commented *benefit* approach to the issue of ET.

### *Taxation of the shareholders*

In addition to taxing the migrant companies or PEs, article 85 IRC also levies shareholders, on the difference between the market value of the shares of the migrant company and its acquisition cost. If the shareholder is a company, the gain will, in most cases, be taxed as dividend, pursuant to article 85(1) IRC whereas if it is an individual, any gains shall be qualified either as income from capital or as capital gains. In the conditions set out in article 10b. of the Merger Directive, no tax will be due in the event the migrant company is an SE. One interesting point is the fact that, from the shareholders’ standpoint, taxation will

occur irrespective of the size of the shareholding<sup>44</sup>, meaning that free movement of capital rather than FoE will be at issue in the ET of the shareholders and, thus, freedom protection may encompass third countries' shareholders.

### 3.2. Some important features of the sophisticated Norwegian and German ET regimes

#### *Norway*

The corporate ET regime in Norway, an EEA state<sup>45</sup>, constitutes a real case-study on the complexity and variability of such regimes<sup>46</sup>.

Apparently in order to avoid possible doubts on the exercise of territoriality, ET on a residence transfer is deemed to be triggered in the day prior that in which it occurs. That means that the migrant company is still a resident when the fictitious sale takes place. Norwegian law is silent on whether ET will apply even when the assets of the migrant company remain connected to a local PE; thus, the maintenance of a PE-connection is not an ET safe-harbour. Furthermore, no ET deferral is available for migrant companies, contrary to what is foreseen for individuals and asset transfers within the same entity. With regard to asset transfers, taxation will arise as soon as the assets leave Norwegian tax jurisdiction even if no territorial transfer takes place<sup>47</sup>. However, assets other than intangibles

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<sup>44</sup> See, *inter alia*, C-157/05 *Hölbock* and Joined Cases C-436/08 and C-437/08 *Haribo* and *Sallinen*. See also, from the author, 'The ECJ jurisprudence on third countries' movement of capital rights: is a conspiracy in place?' (2010) 11 EC Tax Journal 73.

<sup>45</sup> Though an EEA State, Norway is bound by the FoE (see article 31 EEA Agreement).

<sup>46</sup> See Zimmer F., 'Exit Taxes in Norway' [2009] WTI] 115.

<sup>47</sup> Curiously, as noted by Zimmer (*ibidem*, 139) a transfer to a state which DTC with Norway foresees the credit method for PE profits is deemed not to constitute an "exit", which, in our opinion, may

and inventories benefit from a deferral with guarantee, and will escape ET if the assets are not sold within five years. In addition, a *reverse credit* may be available where the gain subject to ET is taxed twice due to the adoption of historic cost for the sold asset in the host state. Another curious rule taxes the latent gains on the assets of a CFC in a low-tax country when control by a resident company is lost. It is really ET in the most extreme form: a tax applied on foreign assets of a non-resident which do not move<sup>48</sup>.

### *Germany*

The German ET system shares some of the features of the Norwegian one – eg. it taxes virtually all operations which entail a limitation or a loss in German tax jurisdiction, including company migrations and cross-border relocations of assets. Two peculiarities deserve special attention<sup>49</sup>. First, the concept of *operating functions*, introduced in 2008, arguably the most important *object* of German ET. According to the German rules, where *operating functions* are transferred outwards or reduced, an exit charge is imposed, the value of which will correspond to the profit potential of the functions. Such profit potential is measured to the largest extent possible: it encompasses the loss in profit potential of the transferor and the gain in profit potential of the transferee, thus targeting totally or partially tax-driven relocations. Second, transfers of assets (including *functions*, it is presumed) within the EU may benefit from a five-year deferral of exit tax, whereby the tax ends up being paid in 20% instalments in each of the five years subsequent to the transfer. Unlike in Norway and France (at least before *de Lasteyrie*), no definitive exclusion of tax is foreseen.

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support Norway's claim of an anti-abuse purpose to the rule (if the assets are sold further ahead, the final tax rate on the gain will always be the Norwegian one).

<sup>48</sup> *Ibidem*, 140.

<sup>49</sup> Hartmut Wolter 'Cross-border business restructuring: German Report' (2011) 96A IFA Cahiers 349 and Seitz, *op. cit.*, 47.

## 4. Synopsis of the CJ jurisprudence on intra-EU migrations of individuals and companies

### 4.1. The tension between company migrations and company law: *Daily Mail* and *Cartesio*

The CJ dealt with the issue of the compatibility with the FoE of restrictions to company migrations, from the origin state's perspective, in the two widely debated cases *Daily Mail* and *Cartesio*.

In *Daily Mail*, two UK-incorporated companies (Daily Mail and General Trust PLC) intended to transfer their place of central management and control from the UK to the Netherlands in order to benefit from a lower taxation on a subsequent sale of a part of their assets, which would be provided by the consequent change of tax residence. Under UK law, the outbound transfer of the management and control did not entail the loss of legal personality; however, a tax provision prohibited companies from ceasing to be tax residents without consent of the Treasury. The Treasury denied such consent and the issue was referred to the CJ for a decision, among other less relevant issues, on the conformity of the need for a consent with the FoE. The Court began by affirming that the FoE comprised the setting up of an investment management office in The Netherlands by a UK company. However, it stressed that, by that time, companies were “creatures of national law” and national law was sovereign in determining how and when the loss of connection with the territory could generate their winding-up and liquidation, such piece of competence not being affected by free establishment. Thus, companies had not been conferred the right to retain national status in the origin state while transferring their central management to another jurisdiction.

*Cartesio* was, in the author's opinion, not a departure from *Daily Mail*, but rather a refined development, where the added complexity of the background allowed the

CJ to shed more light into the issue of company migrations. In this judgement, an Hungarian company, *Cartesio*, intended to transfer its seat to Italy while retaining its status as a company governed by Hungarian law. The Hungarian authorities refused to register the change of seat, as that would entail the loss of national status, and the matter ended up being referred to the CJ. In the judgement, the principles in *Daily Mail* were reaffirmed in the sense that it was stated that Hungary retained the power not to allow a company therein incorporated to transfer its seat and still require national status. However, and this is the main corollary of *Cartesio*, free establishment did impede Hungary to require the winding-up of a national company in the event the same company intended to convert itself into a company national of another EU state which domestic company law provided for such conversion<sup>50</sup>.

#### 4.2. The individuals tax cases

##### *De Lasteyrie*

Upon emigration to Belgium, Mr. de Lasteyrie, a French resident, became subject to French income tax on hidden gains in regard to a substantial shareholding of a French company, and was able to defer such tax only in case he appointed a fiscal representative, provided a guarantee and filed annual tax declarations. Mr. de Lasteyrie reacted against an assessment based on this regime and the case ended up being referred to the CJ on the grounds of incompatibility with the FoE.

In its decision, the CJ reminded that the fact that the ET regime at issue allowed tax deferral was irrelevant to ensure FoE compliance given that such deferral had been made conditional to the fulfilment of administrative and financial requirements which were not present in internal migrations. This regime entailed a restriction to the FoE which could not be justified on grounds of (i) *tax*

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<sup>50</sup> See landmark paragraphs 112 and 113.

*avoidance* – as it did not exclusively target artificial arrangements -, (ii) *fiscal coherence* - it was clearly not aimed at ensuring the compensation of a tax benefit (no direct link), (iii) *balanced allocation of taxing powers* (“BATP”) – the allocation of tax to France was not at stake, and (iv) *loss of tax revenue* - it is not an acceptable justification. Finally, the Court also acknowledged that the underlying presumption that the measure was aimed at tackling abuse was not reflected in the scale of the measures in question, which exceeded the necessary to achieve that goal.

## *N*

As *Cartesio* did in relation to *Daily Mail*, *N* brought about a much needed enlightenment on some aspects of the CJ’s stance on ET. The case concerned a Dutch individual who emigrated to the UK in 1997 and had, at that time, the totality of the share capital of three Dutch companies. In the same year, the Dutch Tax Administration assessed exit tax on the deemed disposal, but Mr. *N* provided a security foreseen in law at the time to ensure deferment of the tax. In the aftermath of *de Lasteyrie*, the security was released by ministerial order, but Mr. *N* went to court to ask for a damage compensation and the case was referred to the CJ.

The CJ began to confirm that, in such an exit, the FoE was involved, as the provision at issue had the potential of restricting the movement of a person who substantially influenced the participated company’s activities. It then went on to assess whether the French tax entailed a restriction on the FoE and, if so, whether such restriction was justified<sup>51</sup>. Differently to *de Lasteyrie*, in *N* the CJ upheld that *territoriality* and the BATP were, as reasons of public interest, at issue in the case; as the ET in question was a form of exercise of Netherlands’ power

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<sup>51</sup> The additional issue of whether compensation was due for damages emerging from the obligation to provide a guarantee is out of this work’s scope.



to define the criteria for tax allocation<sup>52</sup> and as such allocation could determine local taxation of the gains accrued during residence therein, the restriction was justified. However, requiring a guarantee to ensure the fulfilment of the tax assessment in The Netherlands on a subsequent disposal of the assets exiting Dutch tax jurisdiction was not proportionate to the aim of preserving taxing powers. Such aim could be attained, nonetheless, through the less burdensome and proportionate obligation of filing a tax declaration at the time of exit. Proportionality of such an ET regime would also require that it took into account any reductions in value of the shareholding.

## 5. The protection of the mobility (freedom) of the primary establishment

### 5.1. Company migrations and reorganizations: comparability analysis under the FoE

#### *Migrations of “national” companies*

Under article 49 TFEU,

restrictions on the freedom of establishment of nationals of a MS in the territory of another MS shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any MS established in the territory of any MS.

Free establishment thus comprises, *expressis verbis*, the setting-up of the so-called *secondary establishment* in another MS and prohibits any discrimination, overt or covert<sup>53</sup>, thereon, by the origin state<sup>54</sup> as well as by the host state<sup>55</sup>.

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<sup>52</sup> See para.41.

<sup>53</sup> See Cases C-152/73 *Sotgiu* and C-107/94 *Asscher*.

Even though not in such unequivocal terms, the FoE also encompasses the freedom to move the *primary establishment*, ie., the legal seat or the place of central management of a company<sup>56 57</sup>. Yet, *prima facie*, primary establishment mobility seems not to reach the breadth acknowledged by the Court to secondary establishment mobility. As we see it, it all depends on the perspective from which look at the concrete transfer of the primary establishment<sup>58</sup>. Experience from past jurisprudence tells us that, when a discrimination or restriction is being imposed by the host state based on its national law or administrative practice, it is found to infringe the FoE<sup>59</sup>. In *Überseering* a Dutch incorporated company which had moved its place of central management to Germany was impeded to exercise its legal rights in a court of law because it lacked legal personality recognition in Germany, under this country's company law. The relevant question addressed by the Court was not whether *Überseering* could retain its Dutch national status if it transferred its legal seat or place of central management to Germany, but whether Germany could require *Überseering* to reincorporate under its internal law. In both cases, the Court did not deny the prevalence, in the absence of harmonization, of national laws in determining the relevant connecting factor to ascribe nationality for corporate bodies. The difference is that in *Überseering*, the principle of *national treatment* was at stake: it was all about comparing the legal status of a company considered "German" (incorporated and with its legal seat therein) with that of a company considered "national" in another MS, but a

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<sup>54</sup> See C-168/01 *Bosal*, and *Marks and Spencer*.

<sup>55</sup> See C-1/93 *Halliburton*, C-330/91 *Commerzbank*.

<sup>56</sup> See, on this subject, Catherine Barnard, *The Substantive Law of the EU – The four freedoms* (2007 2<sup>nd</sup> Ed. OUP 332).

<sup>57</sup> See, for an earlier view, Dennis Weber, (n10) 353.

<sup>58</sup> See O' Shea, 'Hungarian Tax Rule Violates EC Treaty Advocate General Says' (2008) August 4 TNI 4.

<sup>59</sup> C-208/00 *Überseering*, C-212/97 *Centros*.

“foreign” company in Germany. For the author, this was a true case of discrimination on the basis of *nationality*<sup>60</sup>, and nothing of the sort was seen in *Daily Mail*.

Notwithstanding, the existence of a minimum scope for the FoE in the origin state in the case of the transfer a primary establishment, is undeniable since *Cartesio*<sup>61</sup>. In effect, where the host state facilitates the conversion of a company migrating from the origin state into a company governed by its own law, the imposition of a prior winding-up or liquidation is seen by the CJ as a restriction on the FoE only to be acceptable if justified by “*overriding requirements in the public interest*”. Therefore, the origin state cannot hinder the migrating company’s right to become a “national” of the host state by suppressing its legal existence and forcing it to reincorporate in the latter state. Such power is retained only when the migrant company, while not seeking to be converted into a national company of another MS, intends to preserve its status as a national of the origin state.

### *Migration of an SE*

The principles laid down in *Cartesio* can be transposed, *a fortiori*, to a migrant SE situation. This type of company is, by contrast to national companies, a “creature” of European Law, whose connecting factor to a jurisdiction of a MS – the place of its registered office – cannot be altered through any of the internal legislative procedures of the MSs. The prerogative of an SE to transfer its registered office from one MS to another is expressly provided for by the RegSE and not by any internal law of the MSs. Therefore, no MS is entitled to create an obstacle to the exit of an SE by requiring its liquidation or winding-up or, in the

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<sup>60</sup> The CJ refers to a mere restriction (para. 82), but seems to convey the idea of an actual discrimination on nationality when it states that “*the location of their registered office, central administration or principal place of business constitutes the connecting factor with the legal system of a particular MS in the same way as does nationality in the case of a natural person*” (para. 57).

<sup>61</sup> See Schneeweiss, op cit., p.372.

case of a host state, its reincorporation into a new legal person<sup>62</sup>, beyond that of requiring that the exit (transfer of the registered office) be accompanied by the transfer of the head-office<sup>63</sup>. With its corporate continuance safeguarded upon exit, an SE may, thus, rely on the FoE to oppose any tax barriers that may be lifted by the origin or host states.

### *Cross-border reorganizations*

At the outset, this issue seems of little or no significance, as EU companies enjoy a harmonized tax regime which largely facilitates cross-border mergers (the Merger Directive) by deferring tax on cross-border asset transfers. Nonetheless, one has to bear in mind that even a harmonized tax regime may ensure less protection than the fundamental freedoms in cross-border movements. Consequently, it becomes important to ascertain whether any restrictive conditions laid down in the Merger Directive for tax neutrality are justified and proportional to the goal of preserving the origin state's tax jurisdiction, should FoE apply.

The issue of free establishment in cross-border mergers was addressed in *SEVIC Systems*<sup>64</sup>, an origin state case. *SEVIC Systems*, a German company, sought to merge with a Luxembourg company and was deterred from completing the operation by a German court on the grounds that only mergers between German companies were recognized under German internal law. In this case, the loss of the connecting factor of the company to the German territory and the ensuing tax consequences were not at stake, as *SEVIC Systems* would cease to exist by virtue of the merger. The Court, contrasting mergers among German companies

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<sup>62</sup> See article 8 RegSE.

<sup>63</sup> See article 7 RegSE.

<sup>64</sup> C-411/03 *SEVIC Systems*.

and cross-border mergers, held that legal non-recognition of the latter amounted to a restriction on “particular methods of exercise of the freedom of establishment, important for the proper functioning of the internal market”. The Court went on to remark that, although a number of overriding motives in the public interest could justify said restriction, the measure in question went beyond what was necessary to safeguard such public interest.

### *Comparability analysis of mergers and migrations under the FoE.*

In order to determine whether a certain measure with impact on tax is in breach of the FoE (or any other of the fundamental freedoms) it does not suffice to assess the particular restrictiveness of such a measure. A pre-condition to establish a discrimination or a discriminatory restriction is to define what some authors call a “comparison standard to establish whether the two positions (the cross-border and the merely internal) are, in fact and legally, comparable”<sup>65</sup> and others, more synthetically, a “migrant/non-migrant” test<sup>66</sup>. Whatever name this task assumes, it is always essential to find the correct comparator so as to assess *national treatment*. Since the paradigm underlying the fundamental freedoms is the *internal market*, the comparator to a potentially restrictive measure in a cross-border situation is an *objectively* parallel purely internal situation<sup>67</sup>. Comparability has been characterized in broad terms by the CJ in cases like *Saint-Gobain*, where the parallel between a PE of a non-resident and a resident company was held to encompass even benefits which arose to the latter by virtue of a DTC.

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<sup>65</sup> See Terra/Wattel, *op. cit.*, 727. By adding factual and legal comparability, these two authors seem to align with Prof. Michael Lang’s thoughts in his widely discussed article ‘Recent Case Law of the ECJ in Direct Taxation: Trends, Tensions, and Contradictions’ (2009) 3 EC Tax Rev. 101, in particular with respect to the issue of comparability, where he expresses his disagreement with the CJ’s choice of *factual comparability* in *Schumacker*, which culminates in the attribution to Mr. Schumacker of allowances accessible only to residents of Germany.

<sup>66</sup> See Tom O’Shea, *EU Tax Law and Double Tax Conventions*, (Avoir Fiscal Limited 2008) 42.

<sup>67</sup> See C-319/02 *Maninnen*, 39.

The choice of the right comparator for the situations under analysis is apparently uncontroversial. In *N*<sup>68</sup> and *de Lasteyrie du Saillant*<sup>69</sup>, the Court explicitly said that national treatment would only be observed if a non-migrant in the same conditions of the migrant suffered the same tax burden<sup>70</sup>. Hence, in relation to exit taxes on a company migration, it must be ascertained whether a non-migrant company in the same conditions would be taxed on its latent gains. To be comparable, both companies should have the same tax liability to income tax in the origin state, which is normally the case of resident companies. However, one could hypothesize a scenario where an internal migration from one state to the other – eg. in federal states like Germany – would suffer ET in the same way as a cross-border one. In that scenario, it would be difficult to sustain that the principle of *national treatment* was being infringed. But even with such an even-handed rule, a restriction to free establishment within the EU would still emerge, prompting the question of whether the *Bosman*<sup>71</sup> jurisprudence should be applied. In turn, the tax treatment of transfers of assets from the head-office to PEs situated in another MS should be contrasted with analogous internal transfers. For example, the tax consequences of assets forming a PE of a Portuguese

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<sup>68</sup> See, para.38, where the CJ explicitly states that “the tax declaration (...) is an additional formality likely further to hinder the departure of the person concerned, and which is imposed on taxpayers continuing to reside in that MS only when they actually dispose of their holdings”.

<sup>69</sup> See para.46.

<sup>70</sup> For the CJ, differences in treatment of minor importance do not qualify as “same or similar treatment” (See *N*, para. 43). Being itself defined in a positive way, as a subjective right of EU persons, the FoE does not allow comparability to be framed negatively, as non-discrimination in article 24 (3) of the Model, by virtue of which taxation of a PE of a non-resident shall not be more burdensome than that of a resident company. As flows from the 2010 Commentary to this article, taxation may be *different* insofar as it is *not more burdensome*. The same principle is not admissible under the FoE, where the *same* treatment must be assured. This is particularly noticeable in C-250/95 *Futura* (para.26) and, of course, in *N*.

<sup>71</sup> See, C-415/93 *Bosman*, paras. 98 and 99.

Group moving into Spain should be compared with the same move within Portuguese territory. Having established the comparator, we should then check if the cross-border situation is being disadvantaged<sup>72</sup>. Safe for the possible “federal state” issue mentioned earlier, no tax jurisdiction is lost in a purely internal transfer to a PE, and, thus, the outward transfer would be worse-off than its internal comparable. In both cases analyzed, a discriminatory restriction for cross-border EU movements clearly arises, thus contravening article 49 TFEU, absent a possible justification. This migrant/non-migrant distinction was particularly notorious in origin state cases, like *Keller Holding*<sup>73</sup>, *Cadbury Schweppes*<sup>74</sup> or *Rene*<sup>75</sup>.

With cross-border reorganizations, though, comparability will not achieve the same results. As they involve changes in ownership – that is, *income realization* -, internal transfers will, as a rule, be taxed in the same way as their cross-border equals. Therefore, if there had been no tax harmonization at this level, a MS with no internal neutrality regime for reorganizations could tax gains emerging from cross-border operations<sup>76</sup>. Nonetheless, even the harmonized regime of the Merger Directive, may be restrictive in a way we see as potentially discriminatory. Indeed, it may be argued that the requirement set out in article 4 (1) (b) of the Merger Directive, ie., the need to effectively connect the transferred assets and liabilities in a reorganization to a PE of the receiving company in the origin state, infringes the FoE. Two companies may merge in the origin state and the

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<sup>72</sup> On the particular issue of discrimination of PE cross-border movements, see Georg Kofler, Servaas Van Thiel, ‘The “Authorized OECD Approach” and EU Tax’ (2011) August ET 327

<sup>73</sup> C-471/04.

<sup>74</sup> C-196/04

<sup>75</sup> C-347/04.

<sup>76</sup> However, this restriction may be so burdensome that the very core of the right of establishment may be at stake. In that case, despite the inexistence of *overt* or *covert* discrimination, the sheer gravity of the restriction could, again, justify a *Bosman*-like approach.

receiving company will not be burdened with the need to preserve a fixed installation to which the assets of the transferring company remain attached to. Those assets may be physically transferred to the premises of the receiving company and tax neutrality will endure. The same cannot be said in relation to a cross-border merger when, for instance, the receiving company intends to dismantle a production plant in the origin state and move it to the host state. Unlike in a domestic merger, the PE tax neutrality requirement may well end up having a negative impact on operational decisions in a cross-border merger.

## 5.2. The Commission's position on corporate ET: a first step in the right direction

The central problem in the current debate is whether exit taxes like those in force in Portugal, Germany or Norway restrict free establishment in a way which, unless justified by imperative reasons of public interest, infringes article 49 TFEU. This outcome has already been acknowledged by both the Council<sup>77</sup> and the Commission<sup>78</sup> in two Communications issued in the aftermath of *de Lasteyrie du Saillant* and *N*. In its Communication, the Commission goes more in-depth into the subject, by reflecting on the problems and distortions that may be caused by ET – such as mismatches in the tax bases of the relevant assets in the origin and host states and the need for administrative cooperation – as well as by drawing important conclusions from the *de Lasteyrie* judgment in the domain of company ET. Categorically, the Commission acknowledges that:

It follows from *de Lasteyrie* that taxpayers who exercise their right to freedom of establishment by moving to another MS may not be subject to an earlier or higher tax charge than taxpayers who remain in one and the same MS. If a MS allows tax deferral for transfers of

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<sup>77</sup> Council Resolution on coordinating ET, 2911<sup>th</sup> Economic and Financial Affairs, of 2 December 2008.

<sup>78</sup> Commission of the European Communities, Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee: ET and the need for co-ordination of MSs' tax policies, COM(2006) 825 final, 19 December 2006



assets between locations of a company resident in that MS, then any immediate taxation in respect of a transfer of assets to another MS is likely to be contrary to the EC Treaty freedoms.

The Commission goes on to define the scope of the cross-border movements that would be exposed to those restrictions on the FoE. Curiously, it begins by remarking that, following the transfer of an SE's registered office, only assets which did not remain connected to a PE in the origin state would require protection under the FoE, as the 2005 amendments to the Merger Directive already ensured a tax deferral on gains and losses relating to assets so connected. Furthermore, the Commission identifies another type of situation worthy of protection under the FoE:

However, assets and liabilities which are transferred by a company's head office to its PE situated in another MS are, under the current tax rules of most MSs, considered as 'alienated' and gains accrued while the assets were effectively connected with the company resident in their territory are usually taxed immediately upon transfer of the assets.

In regard to either situation, the Commission holds, without hesitation, that the *de Lasteyrie* principles should apply to companies<sup>79</sup>. This implies that it recognizes the existence of a discriminatory restriction, but also that it accepts that origin state jurisdiction within the period in which the gains (and also losses) have accrued may justify a tax claim, insofar as the respective exercise does not go beyond what is necessary to fulfil such claim.

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<sup>79</sup> In a pre-*Cartesio* article, Öttmar Thomes sustains that even in the case where the host state would recognize an SE intending to transfer its registered office to its territory, "*the state of original incorporation would not be prohibited from applying liquidation treatment to the SE in the absence of its compliance with articles 7 and 64 of the SE Statute*", ie. in the event the transfer would not encompass a concomitant transfer of the head-office ('EC Law Aspects of the Transfer of Seat of an SE' [2004] ET 22). We do not aim to analyse this exception, but the most likely hypothesis of a company transferring its head office along with the registered office. The Commission's reasoning also seems to be premised on this most likely event.

Yet, the Commission fails to address two issues, which, for the author, should be central in this debate. First, it remains silent on its position regarding companies which are not SEs or SCEs, namely on whether origin states should apply, in migrations of “national” companies, the (i) the solution adopted in the Merger Directive for SEs, ie., a PE-connection requirement for the assets transferred and (ii) the solution described above – that is, an ET deferral - for assets that fail to keep such connection. This omission is understandable, if we take into account that, by the time the Communication was issued, *Cartesio* had just been referred for a preliminary ruling and, thus, the Commission had not been provided with a clearer picture on the framework for national companies’ emigration within the EU. Second, the Commission appears to see no problem in the PE-connection requirement laid down in the Merger Directive for tax deferral of the underlying gains on the assets of an SE, vis-à-vis the FoE. It views it as a warranty for tax neutrality and not as an onerous condition on the migrant SE, which cannot choose to move its assets to another jurisdiction and be taxed according to the rules therein and thus avoid being levied on unrealized gains in the origin state, even if it is recognized that the latter state may keep its claim to tax the gains accrued during the period the assets concerned remained in its territory.

We submit that in most or at least in some cases the freedom offered by article 49 TFEU to a migrant SE is wider than that which is provided by the Merger Directive<sup>80</sup>. That is because, presently, taxation of the local assets of a resident company and of a PE of a non-resident in the origin state tends to be exactly the same<sup>81</sup>. A simple example may illustrate the paradox of the PE-connection

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<sup>80</sup> While it is true that such requirement is enshrined in a binding legal act of the EU – a Directive – it is equally true that Directives have to comply with the fundamental freedoms (an example of a Directive infringing its formal boundaries can be found in the landmark *Tobacco Advertising Case C-376/98*).

<sup>81</sup> That is why the origin state would never find a justification to tax a migrant company on potential gains accrued on its domestic assets if those assets remained connected to a local PE. Nothing relevant would happen from a tax point of view, as no material loss of tax jurisdiction would emerge. ET would,

requirement. An SE wishing to transfer its registered office from State A to State B, intends, as well, to relocate all its resources, which include registered trademarks, industrial property, a marketing infrastructure, *back-office* activities, and the respective human and material resources (computers, furniture, etc.). This relocation serves operational purposes, but the SE also pursues a higher level of tax efficiency by taking advantage of special regimes for IP companies in the host state. Under the Merger Directive, the PE-connection requirement [article 10b (1) (b)] will not be met, and the consequent liability to tax in the origin state may deter the SE from moving abroad. However, if it may avail itself of the *de Lasteyrie* jurisprudence – a hypothesis not yet confirmed by the CJ - the SE will be able to defer ET, albeit with a possible array of administrative obligations imposed by the origin state to ensure its share of the accrued gain in the eventual disposal of the transferred assets. As a result, it will be able to benefit, for instance, from tax incentives applicable to income from IP licensing activities in the origin state, thus improving its overall efficiency and competitiveness.

In practice, a migration of an SE where all the assets located in the origin state remain attached to a local PE, is rather a formal cross-border movement than a new economic endeavour of the type that inspired FoE. Moreover, as the legal possibility to transfer the registered office of an SE had already been foreseen in the RegSE – that is, the *Daily Mail* type of problem never did arise -, the application of the FoE as per *de Lasteyrie*, in the absence of the Merger Directive, would always provide, as a minimum, the deferral of tax ensured by the PE-connection requirement. Therefore, the introduction in 2005 of the SE migration regime, looks now more like a strategic move by the Council to institute a new archetype for ET, by imposing an illusory limitation on the tax jurisdiction at

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in that case, amount to an act of pure tax violence. Unlike Luca Cerioni (op. cit. p. 641), and as explained, we do not find relevant to ensure exit relief to what this author calls “domestic converting companies” when all of those companies’ assets remain effectively connected to a PE at origin.

origin, thus avoiding having to face the main issue of how to really safeguard the FoE from ET on a cross-transfer of assets to another PE or to the head-office of the same company.

The scope of the Merger Directive in relation to SEs is, thus, very narrow and perhaps one of the reasons behind their scarce use<sup>82</sup>. However, at the level of the SE's shareholders, the Merger Directive clearly removes the second-level ET restriction, that is, the taxation of the migrant company's shareholders on the latent gains. In this domain, the Directive goes beyond *De Lasteyrie* and *N*, by stating that the migration shall not, by itself, generate ET on their shareholdings' potential gains (article 10b), and by, apparently, not giving room for the origin state to impose any formal requirements thereto, found to be proportional in *N*<sup>83</sup>.

### 5.3. The limits of the “Balanced Allocation of Taxing Powers” as justification for ET

It is a settled principle of EU Law that restrictions on any of the four freedoms, in order to be lawful, should be justified by *imperative requirements in the general interest*<sup>84</sup>. This *rule of reason* was firstly enunciated in *Cassis de Dijon*<sup>85</sup> and then refined in the landmark *Gebhard* case, establishing a hermeneutical methodology that has been used by the CJ ever since.

In all domestic ET regimes we have come across, taxation was not specifically targeted at strictly *abusive* situations, as opposed to other forms of taxation on

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<sup>82</sup> Up until 1 August 2011, only 871 SEs had been established (Source: <http://ecdb.worker-participation.eu/>).

<sup>83</sup> See para.49.

<sup>84</sup> See C-55/94, para.37.

<sup>85</sup> C-120/78.

unrealized income or gains<sup>86</sup>. Conversely, they enact general rules applicable to roughly all relevant limitations on or losses of tax jurisdiction in relation to unrealized gains on assets transferred outwards but not alienated. That is why in *De Lasteyrie* abuse as a justification was categorically dismissed<sup>87</sup>, and also because the French rules at issue foresaw that a person already domiciled abroad who sold at a gain a shareholding within five years after emigration, would pay capital gains tax in France, clearly evidencing that the purpose of the law was to secure the French “slice” of the gains “pie”.

We also do not see the use, as the debate now stands, in expanding much on other *justifications* for the restrictions posed by ET, not found to be pertinent by the CJ either in *De Lasteyrie* or in *N*. Some authors<sup>88</sup> have thoroughly examined the relevance of other justifications like *fiscal coherence*<sup>89</sup> or the *prevention of double use of losses*.<sup>90</sup>, and inferred that the two should be dismissed outright. In relation to the first one, no *direct link* can be found in ET between the tax on underlying gains and any deductions or allowances provided by the State<sup>91</sup>; as to the second, a double use of losses would be merely hypothetical and could only happen if the host state allowed the immigrant company to depreciate the assets entering its tax jurisdiction via migration at a value higher than their fiscal value in the origin state. The origin state could then argue that, in a certain way, ET neutralizes the advantage that the migrant company could derive from a step-up in the

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<sup>86</sup> Such as CFC regimes, judged in *Cadbury-Schweppes* and C-201/05 *CFC and Dividend Group Litigation*.

<sup>87</sup> Para.50.

<sup>88</sup> See Seitz, 60 et seq. and Terra/Wattel, (n65) 746 et seq.

<sup>89</sup> See C-204/90 *Bachmann*. Führich (n10) 12, and also Terra/Wattel (n65) 781, admit that ET may be legitimized by a *coherence* argument without, however, sustaining straightforwardly that it is sufficient justification.

<sup>90</sup> See *Marks and Spencer*, para.43.

<sup>91</sup> See, *inter alia*, C-287/10 *Tankreederei* (para.24) and C-233/09 *Dijkman* (para.55).

depreciable value of the transferred assets<sup>92</sup>. This is totally different from the relevant facts, for instance, in *Marks & Spencer* and *Oy AA*<sup>93</sup>, which dealt, respectively, with the use of the same losses in two jurisdictions and the transfer of profits to take advantage of the losses generated in a MS different from the one where the profits arose. Here, the issue is the double advantage of the same tax situation (use of losses) and the neutralization in the origin state of losses already realized via their offset with losses recorded in another state. In the ET situation, the tax advantage is merely hypothetical, the host state may not allow depreciation on the value on which the ET is computed in the origin state, and the asset depreciation in the latter state may have been offset by profits generated and taxed therein prior to the exit, in which case the origin state does not suffer any tax base erosion. In short, this situation clearly does not fit into the *prevention of double use of losses* justification.

As mentioned earlier, in relation to *justifications* the CJ has accepted that

MSs retain the power to define, by treaty or unilaterally the criteria for allocating their powers of taxation, particularly with a view to eliminating double taxation<sup>94</sup> and also that, “ (...) in accordance with that principle of fiscal territoriality, connected with a temporal component, namely residence within the territory during the period in which the taxable profit arises, that the national provisions in question provide for the charging of tax on increases in value (...)”<sup>95</sup>,

in order to conclude

it follows, first, that the measure at issue in the main proceedings pursues an objective in the public interest (...).

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<sup>92</sup> Seitz explains that this justification is upheld by the German Tax Administration (op. cit., p. 62).

<sup>93</sup> C-231/05.

<sup>94</sup> See *N*, para.44.

<sup>95</sup> *Idem*, para.45.

Thus, for the CJ, *fiscal territoriality* and the need to preserve the BATP – which the CJ appears to consider as two sides of one single justification<sup>96</sup> - may justify ET. Clearly, the *allocation of taxing powers* among states, which is put in place through DTCs or, in the EU context, through the income taxes Directives, is a corollary of those states' underlying territorial sovereignty and expresses an idea of *coordination* which is the main focus of the following analysis. As a justification for restrictions to the FoE, the BATP has been, in recent years, called upon by the CJ in a growing number of cases, relating to diverse income tax issues. It has, specifically, been tolerated as a motive to counter (i) the transfer of profits in the form of unusual or gratuitous advantages between related entities<sup>97</sup>, (ii) the transfer of profits to or the deduction of losses in one state that had been generated in another state, within the same Group scheme<sup>98</sup>, or (iii) the deduction of losses of a foreign PE by the head-office<sup>99</sup>. Unlike in *N*, in this group of cases the BATP argument was always applied in conjunction with anti abuse-type justifications, namely the *prevention of tax avoidance* and or the *prevention of the double use of losses*. This difference makes perfect sense, in view of the aforesaid character of most ET regimes in the EU and, in particular, of those examined in *N* and *de Lasteyrie*<sup>100</sup>. As previously noted, they aspire to create a general regime for all exit situations and, thus are specifically not targeted at abuse or distortions. Furthermore, and going back to the discussion of the first chapters of this work, it should be stressed that the three aforementioned cases revolved around the tax treatment of *effectively realized* profits or losses and the reflection of the ensuing increased or diminished *ability-to-pay* in the location found convenient, in

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<sup>96</sup> Terra/ Wattel (n65) 765 clearly underline the affinity between the two arguments.

<sup>97</sup> C-311/08 *SGL*.

<sup>98</sup> See *Oy AA, Marks and Spencer*.

<sup>99</sup> C-414/06 *Lidl Belgium*.

<sup>100</sup> It should be reminded that in *De Lasteyrie* the CJ did not address BATP as a justification to ET because the issue was not in dispute (para.68).

detriment of the state with which they were territorially linked (eg. in *SGI* and *Oy AA*), or the double consideration of a diminished *ability-to-pay* within a cross-border group of companies (*Marks and Spencer*). With ET not only is a mere *potential* ability-to-pay at stake, but also the most likely risk thereof is that of a double taxation and not the opposite. Hence, in the author's view, the restriction to the FoE posed by ET is, from a BATP standpoint, seemingly less justifiable than those spotted in the cases just mentioned.

Yet, in *X Holding*<sup>101</sup>, the BATP was singled out as the only justification susceptible of allowing the MSs to maintain their internal tax grouping schemes eligible solely for resident companies. Once more, the CJ adequately identified “the courses of action that are capable of jeopardising the right of the member states to exercise their taxing powers”<sup>102</sup>, by stating that

the possibility of including a non-resident subsidiary in the single tax entity would be tantamount to granting the parent company the freedom to choose the tax scheme applicable to the losses of that subsidiary and the place where those losses are taken into account.<sup>103</sup>

The main idea from this line of thinking is that the inclusion of a non-resident subsidiary would deprive the state granting the group relief from exercising its taxing powers in relation to the resident company's profits (one or more companies within the group) by allowing other foreign companies' losses – over which no control is exercised by the origin state – to offset those profits.

In our view, a ban on cross-border group taxation on the basis of the BATP coexists much better with the FoE than imposing ET on companies with no effective deferral possibilities. Such ban is targeted at cross-border transfers of losses which have the capability of *effectively* and *definitively* neutralizing the origin

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<sup>101</sup> C-338/08.

<sup>102</sup> See Tom O'Shea, *EU Tax Law* (...) 139.

<sup>103</sup> See para.31.



state's<sup>104</sup> power to tax in relation to *realized* local profits, whereas in ET the issue of *when* and *how* taxing powers are *exercised* - ie. the "exit" - arises prior the real *allocation* problem, ie. the imputation of the part of the gains/losses thereof (which are only potential upon exit) to the origin and host states prompted by the eventual disposal of the migrating assets. The CJ appears to have made this distinction in *N*<sup>105</sup>, by alluding to the charging of tax on disposal, and to a suspension of the right to tax of the Netherlands until that moment, which is the right taxing point also as per article 13(5) of the OECDMC. We submit, therefore, that ET regimes imposed upfront with no possibility of effective deferral are not worthy of being justified, unless they are only aimed at targeting *abusive* situations<sup>106</sup>.

It is, thus, fair to ask whether the solution in *N*, if switched to a corporate scenario, should not converge with the outcome of *Cadbury-Schweppes*<sup>107</sup> and *Test Claimants in the CFC and Dividend Group Litigation*, where, despite very different backgrounds, the decisive issue was the EU conformity of a tax on unrealized profits (a mere imputation) in the country of residence of a company which had exercised its right of secondary establishment by setting up a subsidiary in another EU state<sup>108</sup>. From an overall and substantive analysis, both situations can

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<sup>104</sup> In this context, and for the sake of this analysis, the origin state is the state which group taxation scheme's application is at issue.

<sup>105</sup> See para.46.

<sup>106</sup> Seitz (op. cit., p. 72) also holds that conformity with EU Law of the German ET regime will only be achieved through a regulation which ensures the profit attribution (to a German PE) only after disposal of the migrating assets.

<sup>107</sup> Case C-201/05.

<sup>108</sup> Terra/Wattel emphasize that the BATP was also involved as a justification to prevent "the type of conduct (...) such as to undermine the right of the Member States to exercise their tax jurisdiction in relation to the activities carried out in their territory" (op. cit., p.766)

indeed be compared<sup>109</sup>. By way of example, Group A sets up in its state of residence (A) company B to develop the market of state B and sell there through independent agents while, at the same time, incorporates company C in state C where it intends to develop a genuine new business. Under *Cadbury-Schweppes*, A would not be allowed to tax the undistributed profits generated by C even if the income tax rate in state C was substantially lower than that of state A. However, if company B migrates to state B, state A may, if the principles stated in *N* are enforced, tax any hidden reserves up to the moment of migration. It is beyond dispute that B's link to A's territory until the migration is stronger than C's, as it was domiciled therein. This is coherent with EU states' competence in direct taxation issues, including that of defining the tax connecting factors. Notwithstanding, *Cadbury-Schweppes* dealt with profits that, though undistributed, had been fully *realized*, and would only be *partially* allocated to the parent's state by way of imputation and credit.

The argument of equality between migrant and non-migrant companies, in terms of tax payable until migration, to justify deferred ET – we have already dismissed upfront ET as an FoE-abiding unilateral measure – is not very convincing when we observe that the court has ruled out CFC regimes that encompassed genuine economic activities. Indeed, in the above case, a similar situation (that of B and C) could have a different treatment, as C would be taxable as per the rules and rates of C, whereas B would always see its effective and potential profitability taxed in A. In addition, there are other arguments that are normally seen as clearly supportive of the case for ET, which, in our opinion, should not be taken as such. First, as already enunciated, the argument of ET as a compensation for the *benefits* provided by the origin state may prove to be a fallacy<sup>110</sup>:

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<sup>109</sup> See reference to Norwegian CFC ET regime, p. 18 *supra*.

<sup>110</sup> For Seitz, this appears to be a decisive argument (*op. cit.*, p. 72).

- i. Any tax deductions or use of public goods may have been compensated by taxes paid at origin within the life of a company prior to migration; ie., benefits and taxation may be temporally matched. A sign of such compensation may be the inexistence of carry-forward losses at the time of migration;
- ii. It is likely that the bulk of the potential gains on exit derive from a *discounted cash-flows* valuation, relating to cash-flows not only *future*, but also expected to be sourced outside the origin state.

Moreover, as recognized by authors like Schön, the residence bond is, nowadays “much more precarious when it comes to taxpayers”<sup>111</sup>. In his words,

the corporate income tax on the company’s profits works as a “source tax” on the operating profit before it is paid out as a dividend to the shareholders or the parent company in another country. This leads to the result that taxation with respect to the location of a corporate headquarters or the country of incorporation is a strange mixture of source and residence taxation at the same time.

This conclusion is perfectly consistent with the current international residence criteria for companies and individuals. While, in relation to the latter, notions like the “central of vital interests” tend to be effective tie-breakers, as regards the former, ascribing residence based on the *place of effective management* is increasingly difficult, as is evidenced by the international lack of consensus on the respective definition<sup>112</sup>. Therefore, in a corporate setting, ET may tend to have much more to do with avoiding a possible loss of tax revenue – not an accepted justification for a restriction<sup>113</sup> - than with the genuine exercise of territoriality as a principled attribution of the state (based on the *ability-to-pay* and *benefit* axioms). A symptom of that pragmatic approach is the circumstance that none of the ET regimes analysed

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<sup>111</sup> Op. Cit., p. 69.

<sup>112</sup> Cfr. Commentary on article 4 OECDMC.

<sup>113</sup> See, *inter alia*, C-35/98 *Verkoijen*.

works on a previous assessment of the contribution of the respective jurisdiction to the pursued hidden reserves.

The above arguments, taken together with the idea affirmed by the CJ, in *Cadbury-Schweppes*, that establishment can also be sought for tax reasons, as long as it corresponds to a genuine economic activity, raise important doubts on the susceptibility of ET being justifiable, let alone on the proportionality of many of the domestic regimes in force in the EU, a matter discussed in the next chapter.

## **6. Conclusion. Attempting to anticipate corporate ET from the CJ's standpoint.**

The CJ will soon decide whether some states of the EU may maintain their ET regimes unchanged. Presently, four cases are pending in the CJ against particular groups of States that have ET legislation found by the Commission to be in breach of the Court's *dicta* in *N* and *de Lasteyrie* and also in the aforementioned Commission's Communication: Portugal<sup>114</sup>, The Netherlands<sup>115</sup> and Spain<sup>116</sup>. Another case, brought against the Dutch Tax Authorities<sup>117</sup>, is also pending on the CJ, where, in addition to the issue of the overall lawfulness of exit tax, a decision on whether the BATP may justify an exit tax without any possibility of deferral and consideration for post-exit asset devaluations has been requested. The previous analysis may help us anticipate some of the solutions the CJ could adopt or, at least, identify the fundamental discussion topics.

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<sup>114</sup> Case C-38/10 *Commission v. Portugal*.

<sup>115</sup> Case C-301/11 *Commission v. Netherlands*.

<sup>116</sup> Case C-269/09 *Commission v. Spain*.

<sup>117</sup> Case C- 371/10 *National Grid Indus*.

Despite the serious doubts expressed in the previous paragraph about whether ET can really be justified in an EU setting, namely on the basis of BATP, we have to concede that company migration may be a domain considerably prone to abuse and also that some form of compensation of benefits provided by the origin state - or better put, a reward for the contribution of the origin state to the profitability of the migrant company up to exit - should be put in place. This would not amount to accepting a restriction without justification<sup>118</sup> but rather recognizing that such compensation is justified as a way to uphold the legitimate right of a state to quell tax base erosion schemes. That is to say, *prevention of tax abuse* as a justification legitimizes not only restrictions to the FoE to avert tax avoidance measures but also restrictions intended to avoid disruptions to ‘balanced and consistent interjurisdictional results’<sup>119</sup>. It is then highly likely that the Court’s decision on the pending cases will mainly focus on the *proportionality* of the measures at issue to attain their legitimate purpose. Such proportionality should be assessed in two different ways: through (i) quantification, in terms of *duration* and taxable amount, of the extent of the origin state’s taxing rights, so that the above consistency and compensation is achieved, and (ii) definition of the terms under which it will be considered that the restrictions to the FoE secure such compensation will not go beyond what is necessary (eg. ancillary obligations such as tax returns, guarantees).

In relation to compensation of the origin state, a first possible solution would be the Court disagreeing with the Commission and declaring that the Merger Directive SE regime which establishes potential gains deferral only for assets that remain connected to a PE in the origin state attains its full compensation and prevents abuse. For the reasons already pointed out and considering the evident lack of consistency with the corollaries of both *N* and *de Lasteyrie*, this solution does not seem likely. It is, therefore, expectable that the CJ will uphold the right for a deferral of gains upon exit

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<sup>118</sup> See below section 5.3. on the relevance of the BATP in exit situations as a single justification

<sup>119</sup> See Terra/Wattel (n65) 768.

both in corporate migrations and in cross-border asset transfers. Many other possibilities could be considered, but we could attempt to anticipate a few guidelines which, based on the principles and jurisprudence herein, may be hinted by the Court in the coming decisions:

- (i) Only a full and complete deferral of potential gains until disposal of the relevant assets, and not just a limited relief mechanism under which ET will be spread over four or five years (as in foreseen in the German regime), even if no disposal takes place, will be proportionate and, thus compatible with the FoE, while preserving the origin state's tax claim. For the author, this may be the dividing line between a legitimate anti base-erosion restriction and one strictly oriented to the protection of the revenue.
- (ii) As in the Norwegian regime, prevention of abuse may no longer be justifiable after a relevant number of years have passed from exit, in relation to assets unsold. After more than five years or so, it may become evident that the exit was not abusive and also that it becomes increasingly difficult to ascertain the origin state's contribution to any gains which may be realized thereafter on those assets. Therefore, to be proportional and balanced, ET regimes should, besides taking account of asset devaluations<sup>120</sup>, foresee phasing out schemes for the exit claim, thus reflecting the decreased benefit provided by the origin state.
- (iii) One important discussion point may be a possible compensation of the loss of the exit tax claim by the origin state, whenever the migration seeks simply to re-allocate the assets to a jurisdiction where the rents or royalties thereof are favourably taxed. Such importance lies in the fact that the *potential* value of most assets may be realized either through sale or through concession of their use, ie., licensing and leasing, and certain states may want to tax the part of the post-exit royalties or rents deriving from the value accrued in the origin state. In these or

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<sup>120</sup> See *N*, para.54.

in future cases, the CJ may consider that, also within a certain period, the origin state is, eg., allowed to claim the difference between the tax that would be charged on a rent on the migrating assets, had the exit not occurred, and tax effectively charged on the rent by the host state. This would place all other exit situations on an equal footing to that of a cross-border transfer of assets to a PE located in a state which DTC with the origin state applies the ordinary credit method.

Finally, in relation to reporting obligations and other ancillary duties which may be deemed necessary to ensure the origin state's taxing rights we do not see any reason why the Court would deviate from the guideline set forth in para.50 of *N*, namely the acceptance of an initial obligation to file a tax declaration computing the potential gain on the assets transferred and the maintenance of documentary evidence thereon while such gain remains taxable in the origin state.

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