EJTN Judicial Training on EU Direct Taxation

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Topics to be addressed

• Companies: exit taxation
• Companies: cross-border loss release (Marks & Spencer-doctrine)
• Abuse of tax law
Exit taxation

• Theoretical background

• Taxation when tax residence of an individual/company is moved to another (member) state;

• Income tax / corporation tax on fiscal reserves, hidden reserves, goodwill etc.

• Immediate taxation while there is no realisation (yet).
Exit taxation

• Relevant ECJ case law / infringement procedures

• Individuals:

• De Lasteyrie du Saillant, 11 March 2004, (C-9/02)

• N., 7 September 2006 (C-470/04)

• Commission vs Spain, 12 July 2012 (C-269/09)
Exit taxation

• De Lasteyrie du Saillant (C-9/02)

• French individual emigrated to Belgium;
• He was taxed on the increase in value of shares in a French company

• ECJ: freedom of establishment → no immediate tax on emigration
Exit taxation

• N (C-470/04)

• Dutch resident individual emigrated to Belgium
• He was taxed on the increase in value of shares in a Dutch company

• ECJ: freedom of establishment → Guarantees not allowed as a condition for tax deferral.
• Future depreciation of value must be taken into consideration.
Exit taxation

• Commission vs Spain (C-269/09)

• Infringement procedure general Spanish taxation rules for individuals emigrating from Spain

• ECJ: freedom of establishment → not allowed to impose immediate taxation, for which a domestic extension of payment was granted, at the moment of exit.
Exit taxation

• Companies:

• National Grid Indus, 29 November 2011 (C-371/10)

• Commission vs Portugal, 6 September 2012 (C-38/10)

• Arcade Drilling AS, 3 October 2012 (E-15/11)
National Grid Indus (C-371-10)

• National Grid Indus (C-371-10)
• Dutch BV

• ECJ: freedom of establishment → determination of the taxes due at moment of exit is allowed.
• immediate collection of the taxes due is not allowed without the possibility of postponement of payment of taxes upon request;
• Request for guarantees is allowed;
• Imposing interest on deferred payment is allowed based on domestic regulations
Commission vs Portugal (C-38/10)

- Infringement procedure
- Advocate General:
  - National Grid determined that interest may be imposed
  - Bank guarantee could be excessive in case of limited risks for non collection (in case a p.e. remains)
- ECJ: National Grid has general effect on all exit taxation situations regarding companies (no specific comments on interest and bank guarantees) and is also relevant for transfer of assets from and to a p.e.
Arcade Drilling AS (E-15/11)

- Norway: Upon transferring place of effective management in principal liquidation, in practice not: anti-abuse legislation -> immediate exit taxation upon transfer

- EVA-Court: → Immediate taxation is not allowed, guarantees only allowed genuine and proven risk of non-recovery

- (Will the same apply for the ECJ?)
Article 63 TFEU must be interpreted as meaning that the objective of preserving the balanced allocation of the power to impose taxes between Member States may justify the legislation of a Member State which requires assets in a limited partnership contributed to the capital of a capital company with its registered office in the territory of that Member State to be assessed at their value as part of a going concern, thus giving rise to the taxation, before they are actually realised, of the capital gains relating to those assets generated in that territory, if it will in fact be impossible for that Member State to exercise its powers of taxation in relation to those gains when they are in fact realised, which is a matter for the national court to determine.
DMC Beteiligungsgesellschaft C-164/12

• The national legislation of a Member State which provides for the immediate taxation of unrealised capital gains generated in its territory does not go beyond what is necessary to attain the objective of the preservation of the balanced allocation of the power to impose taxes between Member States, provided that, where the taxable person elects for deferred payment, the requirement to provide a bank guarantee is imposed on the basis of the actual risk of non-recovery of the tax.
DMC Beteiligungsgesellschaft
C-164/12

• In the present case, the combined provisions of Paragraph 20(6) and the third to sixth sentences of Paragraph 21(2) of the UmwStG 1995 enable a taxable person to spread over a period of **five years**, without being required to pay interest, payment of the tax due in respect of the transfer of the shares which that person holds.

• Accordingly, by giving the tax payer the choice between immediate recovery or recovery spread over a period of **five years**, the legislation at issue in the main action does not go beyond what is necessary to attain the objective of the preservation of the balanced allocation of the power to impose taxes between Member States.
Remaining questions according to ECJ case law regarding companies

• Which conditions for postponement of payment are allowed based on EU law?
  - Bank guarantee?
  - Interest (from which moment)?
  - Payment in installments?

• What is the moment of realisation (sale, depreciation)?

• Does the EC treaty require a step up? Perhaps depending on the original home state?
Treatment of Losses

Overview

• Development of ECJ judgements re. treatment of losses - from M&S to A Oy ... to M&S?
  • Where do we stand 7 years after M&S?
  • Has there been a development or are we back to where it all started?
  • Latest developments: ECJ case K

• ECJ judgement re. double loss relief
  • Philips Electronics
Treatment of Losses
Marks & Spencer (C-446/03), 13 December 2005

• **Justification** – three justifications taken together
  • Allocation of taxation rights
  • Risk of double utilization of losses
    – But: Double taxation no problem?
  • Risk of tax avoidance
    – Proportionality
    – Measure not proportional if:
      • Final Losses
      • Proof of finality of losses
Marks & Spencer (C-446/03), 13 December 2005

- As Community law now stands, Articles 43 EC and 48 EC do not preclude provisions of a Member State which generally prevent a resident parent company from deducting from its taxable profits losses incurred in another Member State by a subsidiary established in that Member State although they allow it to deduct losses incurred by a resident subsidiary.

- However, it is contrary to Articles 43 EC and 48 EC to prevent the resident parent company from doing so where the non-resident subsidiary has exhausted the possibilities available in its State of residence of having the losses taken into account for the accounting period concerned by the claim for relief and also for previous accounting periods and where there are no possibilities for those losses to be taken into account in its State of residence for future periods either by the subsidiary itself or by a third party, in particular where the subsidiary has been sold to that third party.
Treatment of Losses
Oy AA (C-231/05), 18 July 2007

• Facts

• Decision
  – The ECJ held the contribution non-deductible. HMRC asserted contribution received not taxable in UK.
  – Justification - two justifications taken together
    • Allocation of taxation rights
    • Risk of tax avoidance
Facts
- German partnership with loss-making Luxembourg branch. Since profits were treaty exempt, Germany denied losses.

Decision
- The ECJ held that the denial of German loss relief for EC branches was not discriminatory. Per Marks & Spencer, loss was not terminal, but would have been deductible if terminal.

Justifications: two justifications taken together
  - Allocation of taxation rights
  - Risk of double utilization of losses
  - Proportionality
    - Measure not proportional if:
      - Final losses
      - Proof of finality of losses
Treatment of Losses
X Holding (C-337/08), 25 February 2010

• Facts
  – X Holding, a Netherlands company, was the sole shareholder of a company resident in Belgium. Both companies requested to be treated as a group (tax entity) for Netherlands tax purposes.
  – The Netherlands Tax Authorities rejected that request on this basis that the Belgian company was not established in the Netherlands.

• Decision
• The ECJ decided that the Dutch group taxation system, which gives a resident company the option to form a tax group with its domestic subsidiaries but not with its non-resident subsidiaries is in conformity with EU law.
• The Netherlands are not obliged to open their group taxation system for cross-border situations within the EU.
Treatment of Losses
X Holding (C-337/08), 25 February 2010

Justifications: only one justification
• Allocation of taxation rights

– Proportionality
• Foreign subsidiary is not comparable with a foreign PE; the Netherlands need not permit the temporary offsetting of losses incurred by foreign PE to non-resident subsidiaries.
• The Netherlands group taxation system is optional and gives the possibility to every individual group company to dissolve the group taxation scheme from one year to the next.
• In a cross-border situation this flexibility would open the doors for tax optimization by giving the parent company the chance to “choose freely the Member State in which the losses of that subsidiary are to be taken into account”.

Treatment of Losses
A Oy (C-123/11), 21 February 2013

• Facts
  • The Finnish company A Oy holds all the shares in the Swedish company B AB. This subsidiary company has in the meantime ceased trading after previously operating three retail stores in Sweden.
  • However, it still has liabilities arising from two long-term leases of business premises. In the Swedish taxation procedure the subsidiary’s resultant losses for the period 2001 to 2007 were found to be SEK 44.8 million, approximately EUR 5 million.
  • The Finnish company A Oy plans a merger with its Swedish subsidiary, which would result in the dissolution of the subsidiary and the acquisition of all its assets by A Oy.
  • B AB has no PE in Finland, neither A Oy in Sweden.
  • Under Finnish law the receiving company may deduct losses of the merged company only if the latter is a resident company.
Treatment of Losses
A Oy (C-123/11), 21 February 2013

Opinion of AG Kokott (19 July 2012) + expectations

• AG Kokott raised doubts regarding the necessity of transfer of final losses in general, and especially with regard to a merger operation between two companies situated in two Member States.

• “One” remaining justification as in X Holding (i.e. symmetry of profit and loss consideration) leads to the consequence that “final losses” become “outdated” or at least should be interpreted in a very restrictive manner.

• A “free choice” of the taxpayer in case of a merger or cessation of trading cannot be allowed.

• Regulations of the Tax Merger Directive does not provide for the situation in the case at hand.
ECJ Decision

– As expected, the ECJ holds that Tax Merger Directive is not applicable at the case at hand.

Infringement of Freedom of Establishment

• ECJ holds that the fact that a merger is motivated solely by tax considerations is not itself capable of making the freedom of establishment inapplicable.

– Justification

• ECJ considers all three justifications, but very superficially
• Allocation of taxation rights
• Risk of double utilization of losses
  – But: Double taxation no problem?
• Risk of tax avoidance
Treatment of Losses

A Oy (C-123/11), 21 February 2013

ECJ Decision
Proportionality
– Measure not proportional if:
• Final Losses
• Proof of finality of losses

According to the ECJ, it is for the national court to determine whether A Oy has proven that B AB has exhausted all possibilities of taking account of the losses which exist in Sweden.

If such proof has been produced, it would be contrary to the freedom of establishment to deny the possibility of deducting losses of its non-resident subsidiary from its taxable profits.
Treatment of Losses
K (C-322/11), AG opinion, 21 March 2013

Facts

– K, a natural person with unlimited liability to tax in Finland, requested the deduction of a loss incurred in connection with the sale of immovable property in France from gains on the transfer of shares taxable in Finland.

– This was denied by the Finnish tax authorities:
  • Pursuant with the applicable double taxation treaty (DTT), income arising from immovable property in France is only taxable there.
  • According to the principle of symmetry, a loss incurred on the transfer of immovable property situated in France is not deductible in Finland.

According to Finnish law, a person with general liability to tax in Finland may on certain conditions deduct a loss on the transfer of equivalent immovable property situated in Finland from gains on the transfer of shares.
Opinion of AG Mengozzi

– The AG finds that the Finnish rules impose a restriction on the free movement of capital because they differentiate between taxpayers based on the location of their capital investment within the EU and are thus capable of deterring persons resident in Finland from acquiring immovable property in another Member State than Finland.

– **Can the restriction be justified?**
  
  • With the balanced allocation of taxation rights, which may be reflected in the regulations of a DTT, the symmetry between the right to tax profits and the possibility to deduct losses is supposed to be upheld.
  
  • The AG concludes that this approach, which is taken with regard to companies, is also applicable to individual taxpayers.
Treatment of Losses
K (C-322/11), AG opinion, 21 March 2013

Can the restriction be justified?

- In the end, the restriction may be justified by the need for balanced allocation of taxation rights – as a stand-alone justification.
- Were Finland forced to surpass the balanced allocation of taxation rights, as agreed within the DTT, this decision would – according to the AG - call into question the case law of the ECJ, with which it recognized that this balanced allocation is reserved to the Member States.
Treatment of Losses
K (C-322/11), AG opinion, 21 March 2013

– Consequence
  If this method was applied, Finland’s denial of deduction would be proportionate.

– The only drawback ...
The AG points out that this solution is not in accordance with the current ECJ case law!

Therefore, the AG asks the ECJ to (please!) use this chance to explain the applicability of the Marks & Spencer exception and to tell us its sense and purpose!
ECJ 7 November 2013, K-case

- Articles 63 TFEU and 65 TFEU do not preclude national tax legislation such as that at issue in the main proceedings, which does not allow a taxpayer who resides in the Member State concerned and is fully liable to income tax there to deduct the losses arising on the transfer of immovable property situated in another Member State from the income from moveable assets which is taxable in the first Member State, although that would have been possible, on certain conditions, if the immovable property had been situated in the first Member State.

- This falls under the disparity approach!
Treatment of Losses
Philips Electronics (C-18/11), 6 September 2012

Background

– In the UK, companies in the same group may surrender losses by way of “group relief” to other profitable companies. Such surrender can take place between UK-resident companies and also in respect of UK PEs of non-resident companies.

– However, the surrender of UK PEs’ losses is denied in cases where, at the time of the claim, there is any possibility that the loss can be used outside the UK.

– Is this a restriction and, if yes, can it be justified by the need to prevent double use of losses or the preserve the balanced allocation of taxation rights between Member States?
Treatment of Losses
Philips Electronics (C-18/11), 6 September 2012

Facts

– A UK company claimed group relief in respect of losses incurred by the UK PE of a non-resident group company in the Netherlands.

– The tax authorities denied this claim on the grounds that there was a possibility that the same losses could also be used outside the UK, e.g. the Netherlands.

– Decision

– The ECJ held that a UK subsidiary and a UK PE of a foreign company were in a comparable situation:

  • While the subsidiary can surrender losses by way of group relief without any restriction involving the potential use of the loss outside the UK, a UK PE would be subject to such a restriction.

– This restriction is contrary to the freedom of establishment.
Can the restriction be justified?

– The ECJ held that neither of the proposed justifications could apply to the situation in question, either alone or when taken together.

– The right of the taxpayer to obtain relief for losses of a UK PE against profits of a UK-resident company does not infringe the right of the UK to tax the profits of that PE.

– Similarly, the possibility that the loss might also be utilized in another Member State, e.g. the Netherlands, does not affect the UK’s position.
Treatment of Losses
Philips Electronics (C-18/11), 6 September 2012

• Consequences
  – EU law does not prevent a situation of double loss relief.
  – A domestic loss relief in the country where the PE is situated is possible by deducting the losses from domestic profits of a domestic group company, and at the same time, cross border loss relief in the country where the company (head office) with the PE is situated is also possible.

  – Who may benefit from this decision?
  – Companies may benefit if the tax legislation in their State of residence permits the deduction of foreign PE losses.

  ➢ Result: In certain cross-border situations double loss relief which is caused by a disparity, i.e. a difference in the tax legislation of the Member States, arises and cannot be “healed” by invoking EU law.
Abuse: Cadbury Schweppes, ECJ 12 September 2006, C-196/04

• Articles 43 EC and 48 EC must be interpreted as precluding the inclusion in the tax base of a resident company established in a Member State of profits made by a controlled foreign company in another Member State, where those profits are subject in that State to a lower level of taxation than that applicable in the first State, unless such inclusion relates only to wholly artificial arrangements intended to escape the national tax normally payable.

• Accordingly, such a tax measure must not be applied where it is proven, on the basis of objective factors which are ascertainable by third parties, that despite the existence of tax motives that controlled company is actually established in the host Member State and carries on genuine economic activities there.
Foggia, ECJ 10 November 2011, C-126/10

• It is incumbent on the national court to verify, in the light of all the circumstances of the dispute on which it is required to rule, whether the constituent elements of the presumption of tax evasion or avoidance, within the meaning of that provision, are present in the context of that dispute.
SGI, ECJ 21 January 2010, C-311/08

- At arms’ length dispute
- Corrective assessment is only made up in a cross-border situation, not in a domestic situation
- According to the Belgian Government, the burden of proof as to the existence of an ‘unusual’ or ‘gratuitous’ advantage within the meaning of the legislation at issue in the main proceeding rests with the national tax authorities. It states that when those authorities apply that legislation, the taxpayer is given an opportunity to provide evidence of any commercial justification that there may have been for the transaction in question. The taxpayer has a month, a period which may be extended, within which to establish that no unusual or gratuitous advantage is involved, having regard to the circumstances in which the transaction was effected. If, however, those authorities persist in their intention of issuing a revised assessment and do not accept the taxpayer’s arguments, the latter can challenge the assessment to tax before the national courts.
SGI, ECJ 21 January 2010, C-311/08

• Article 43 EC, read in conjunction with Article 48 EC, must be interpreted as not precluding, in principle, legislation of a Member State, such as that at issue in the main proceedings, under which a resident company is taxed in respect of an unusual or gratuitous advantage where the advantage has been granted to a company established in another Member State with which it has, directly or indirectly, a relationship of interdependence, whereas a resident company cannot be taxed on such an advantage where the advantage has been granted to another resident company with which it has such a relationship.

• However, it is for the referring court to verify whether the legislation at issue in the main proceedings goes beyond what is necessary to attain the objectives pursued by the legislation, taken together.