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(E)merging value decreases in transferred assets - A study on tax aspects regarding post-merger value decreases in assets transferred upon merger

by

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Abstract

The objective of this thesis has been twofold. Firstly, the purpose has been to examine how the outcomes for tax purposes, at the company level, differ depending on whether the assets transferred in a merger remain attributable to a P.E. in the state of the transferring company, when those assets are subsequently realised with a loss after having decreased in value, post-merger, to a level below their book value. Secondly, the purpose has also been to investigate to what extent a step-up in tax base mechanism, the one in ATAD as well as a conceivable step-up in tax base mechanism inserted in the Merger directive or tax treaties, could be suitable to mitigate any discrepancies. In examining the first part of the purpose a legal-dogmatic research method was applied, analysing the law as it positively stands. For the second part of the purpose a normative approach was applied.

The study shows that there are discrepancies in the outcomes for tax purposes, depending on whether the assets transferred in a merger remain attributable to a P.E. in the state of the transferring company, when those assets are subsequently realised with a loss. Furthermore, the study shows that the step-up in tax base mechanism included in the exit tax rule in the ATAD is not sufficient for mitigating the highlighted discrepancies. Nor would it be sufficient for member states to extend these rules to merger situations by unilateral means. Moreover, inserting a rule with similar characteristics into the Merger directive would end up with a choice having to be made between the objective of the directive to safeguard the financial interest of the member state of the transferring company and aligning the rule with the one in the ATAD. The later would be desirable for reasons of legal certainty. A more suitable solution would be to insert an exit rule, with similar characteristics to the exit tax rule in the ATAD, into tax treaties. Any disagreements on what constitutes an appropriate market value at the time of the merger or exit could be resolved by the contracting states under the mutual agreement procedure article.

Key words: ATAD, Exit Tax, Merger, Merger Directive, Realised Tax Loss, Step-Up in Tax Base, Transferred Assets

Preface

This thesis has been written during studies at Lund University, School of Economics and Management, Department of Business Law. As I write these last couple of lines, my adventure at the Master's Programme in European and International Tax Law will come to an end. Hence, I would like to dedicate a few words to those who have supported and inspired me along the way.

Those who contributed to making this a fun, educative and memorable journey deserves a special thanks. This includes my dear classmates, passionate teachers and superb guest lecturers. On top of that I would like to thank my supervisor Prof. Cécile Brokelind for her brilliant feedback on my thesis, her tireless enthusiasm and her humour that can ease the mood in the most tense of situations. You are both appreciated and highly respected. Not to be forgotten is Assoc. Prof. Axel Hilling, who enlightened me of this programme and encouraged me to apply. For that, I am grateful. Lastly, a heartfelt thanks goes out to my friends and family, wherever in the world you may be. Thank you for listening, motivating me and taking the thesis of my mind, whenever needed.

While writing this thesis during the ongoing covid-19 pandemic, the world has at times felt (socially) distant. One might be excused for thinking that the lack of other activities to spend time on would do wonders for my productivity when it comes to writing the thesis. However, that was not the case. At one point I even felt like finishing the thesis would be nothing short of impossible, yet here we are. As the, by many, beloved Walt Disney once said:

It is kind of fun to do the impossible.
-Walter Elias Disney

Abbreviation list

ATAD	Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market
CJEU	European Court of Justice
EU	European union
EU law	The European union's legal order
Member states	Member states of the European union
Merger directive	Council directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States
OECD	Organisation for Economic Co-operation and Development
-model tax convention	Tax Convention on Income and on Capital
P.E.	Permanent establishment
TEU	Treaty on the European Union
TFEU	Treaty on the Functioning of the European Union
t_x	A given point in time
v_x	Market value at a given point in time

1 Introduction

1.1 Background

The former vice-president of the European commission, Tugendhat, sent a communication to the council on January 17 1984, underlining the necessity for tax measures designed to increase "[…] cooperation between undertakings across intra-Community frontiers […]".[1] Inter alia, this led to the adoption of the original Merger directive in 1990.[2] After being amended numerous times, the directive was re-casted in 2009 to achieve added rationality and clarity.[3]

The purpose of the Merger directive is twofold. On the one hand, it strives to neutralise the tax disadvantages from member state's domestic provisions that may render cross border, intra-community, mergers[4], partial divisions and divisions, exchange of shares and transfer of assets less favourable for enterprises and hence harm the functioning of the internal market.[5] On the other hand, the directive shall simultaneously safeguard the financial interest of the member state of the company that is on the transferring side of the merger.[6] At the company level, the directive strives to unite these two objectives through a carry-over of balance sheet values and relief of taxation.[7] However, the Merger directive only expresses that taxation of gains from transferred assets shall not occur as a direct consequence of the merger.[8] It is silent on the matter of taxation of the gains from the ultimate disposal or transfer of these assets, subsequent to the merger. Furthermore, the directive is also silent on the treatment of losses that are realised when

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[1] Commission, 'Communication from the Commission to the Council. Fiscal measures aimed at encouraging cooperation between undertakings of different member states' COM(85) 360 final, p. 1.

[2] Council directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office, of an SE or SCE, between Member States [1990] OJ L 225/1.

[3] Council directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States [2009] OJ L 310/34, preamble, recital 1. In the following, this directive will be referred to as "Merger directive" or simply "the directive".

[4] Hereinafter, 'merger' will be used to refer to the cross-border restructuring operations covered by the Merger directive, article 4. Likewise, the term 'restructuring operation' may be used for the same purpose.

[5] Merger directive (n. 3), preamble, recital 2.

[6] ibid., preamble, recital 5.

[7] See ibid., article 4; ibid., preamble, recital 5. See also Boulogne, 'Tax, Time, and the Merger Directive' in Haslehner, Kofler & Rust, *Time and Tax: Issues in International, EU, and Constitutional Law* (Wolters Kluwer Alphen aan den Rijn 2019), pp. 183, 190.

[8] See Merger directive (n. 3), article 4 and the preamble, recital 5. See also Boulogne in Haslehner, Kofler & Rust (2019) (n. 7), pp. 191, 195.

assets are subsequently sold after having decreased in value to a level below their book value, post-merger. The latter is of particular interest in the context of the different situations that may arise depending on whether a Permanent establishment[9], connected to the transferred assets, remains in the member state of the transferring company after the merger. If the transferred assets are connected to a P.E. that remains in the member state of the transferring company after the merger, article 4 of the directive prevents that member state from taxing any hidden values in the transferred assets at the moment of the merger. On the other hand, if the transferred assets are not linked to a P.E. remaining in the state of the transferring company, there may be an exit tax situation arising instead.

According to the principle of territoriality, linked to a temporal component, member states should tax gains and, by the principle of symmetry, take into account losses arising in their territory.[10] In exit scenarios, this calls for a value to be determined at the time when the fiscal connection to the transferred tax subject or tax object shifts from one member state to the other. The reason for this is because the value at the time of exit from the transferring state should act as the starting value for tax purposes in the receiving state. In other cases, the internal market may suffer from tax deficiencies.[11] However, institutional differences and disparities between member states and their tax systems may result in different perceptions of such a market value of transferred assets. In turn, this could potentially lead to losses, realised after a cross-border merger, not being taken into account fully. In certain exit situations, the Anti-tax-avoidance directive mitigates this problem through its exit tax rule, which includes a step-up in tax base mechanism.[12] However, the purposes of the Merger directive and the ATAD are not the same. The merger directive, as explained above, concerns temporal relief of taxation and strives to achieve mergers that are neutral for tax purposes.[13] The ATAD, on the other hand, strives to prevent aggressive tax planning and avoidance, which concerns final tax relief.[14] How do these two directives interact? Could the exit tax rule in the ATAD be relied on by the member states to reach an agreement on the market value of assets transferred in a cross-border merger? Could a step-up in tax base mechanism, similar to the one in the ATAD, be inserted into the Merger directive or potentially tax treaties, in order to mitigate any discrepancies in

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[9] Hereinafter referred to as P.E.

[10] See to that end, e.g. Judgment of 29 November 2011, *National Grid Indus*, C-371/10, EU:C:2011:785, para 58.

[11] Which, in relation to mergers, is unwanted. See to that end e.g. Merger directive (n. 3), preamble, recital 2.

[12] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market [2016] OJ L 193/1, article 5. This directive will hereinafter be referred to as ATAD or the directive.

[13] Merger directive (n. 3), article 4; Merger directive (n. 3), preamble, recital 5, 7.

[14] ATAD (n. 12), preamble, recitals 1-3.

the outcomes for tax purposes, based on whether or not a P.E., connected to the transferred assets, remains in the member state of the transferring company after the merger?

As seen from this pluralism of sources of law, this has the potential of leading to vastly different tax consequences even though, in both the situation where the transferred assets remains attributable to a P.E. in the state of the transferring company after the merger and where an exit tax situation may arise, the restructuring operations covered by the Merger directive have been utilised by the taxpayer in order to exercise the freedom of establishment.[15]

1.2 Purpose

In the light of the above, the purpose of this study is to examine how the outcomes for tax purposes, at the company level, differ depending on whether the assets transferred in a merger remain attributable to a P.E. in the state of the transferring company, when those assets are subsequently realised with a loss after having decreased in value, post-merger, to a level below their book value. Furthermore, the purpose is also to investigate to what extent a step-up in tax base mechanism, the one in ATAD as well as a conceivable step-up in tax base mechanism inserted in the Merger directive or tax treaties, could be suitable to mitigate any discrepancies.

In order to fulfil the purpose of the study, the following questions will be examined and answered:

- What is the outcome for tax purposes when assets transferred in a merger remain attributable to a P.E. in the state of the transferring company and those assets are subsequently realised with a loss after having decreased in value, post-merger, to a level below their book value?
- What is the outcome for tax purposes described above, if the transferred assets do not become attributable to a P.E. in the state of the transferring company?
- Could a step-up in tax base mechanism, either the one in ATAD or a conceivable step-up in tax base mechanism inserted in the Merger directive or tax treaties, be an appropriate tool to mitigate any discrepancies?

[15] Operations covered by the Merger directive are specific methods to exercise the freedom of establishment. To that end, see e.g. Judgement of 13 December 2005, *SEVIC Systems*, C-411/03, EU:C:2005:762, para 19.

1.3 Method and material

1.3.1 Methods applied

In order to answer the first two research questions and to fulfil the corresponding part of the purpose of the study, a legal-dogmatic research method will be applied. This method is a tool through which the legal issue at hand will be examined using the legal sources available in the area of positive EU law.[16] In other words, this type of positivistic research explores the law as it stands.

When investigating the third research question and the corresponding part of the purpose, a normative research method will be applied. While positivistic research examines the law as it stands, normative research strives to improve the law and understand how it should be.[17] When studying how the law could advance, under the normative research approach, the rules and arguments put forward must be evaluated for how well they fit into the legal system in which they would apply.[18] This is a way of determining the strength of the arguments.[19] In order to assess how well a normative argument suits the legal system in which it would apply, the same legal sources as for the positivistic research will be observed.

These legal sources, which together make up the material fundaments of the study, are primary law, secondary law, supplementary sources of law, in the form of case law from the Court of justice of the European union[20], soft law from the OECD and legal literature.[21] The material used in this study will be described more in-depth in section 1.3.2 below.

1.3.2 Material used

The core of EU's primary law comprises of the Treaty on the European union alongside the Treaty on the functioning of the European union.[22] The latter is the source of primary law relevant for this paper. In tax matters, member states domestic provisions have been tested against the fundamental freedoms of the TFEU ever since the case of Avoir Fiscal[23] in the 1980s.[24]

[16] Douma, *Legal Research in International and EU Tax Law* (Kluwer Deventer 2014), pp. 17-20, 35. Vranken, 'Exciting Times for Legal Scholarship' (2012) vol. 2(2) Law and Method, 42, p. 43.
[17] Douma (2014) (n. 16), pp. 32-33, 43-44.
[18] ibid., pp. 33, 44.
[19] ibid.
[20] Hereinafter referred to as CJEU.
[21] Vranken (2012) (n. 16), p. 43.
[22] Consolidated Version of the Treaty on the European Union [2016] OJ C202/13; Consolidated Version of the Treaty on the Functioning of the European Union [2012] OJ C326/47, hereinafter referred to as TEU and TFEU, respectively.
[23] Judgment of 28 January 1986, *Commission v France (Avoir Fiscal),* Case 270/83, EU:C:1986:37.

The specific fundamental freedom applicable for this study is the freedom of establishment, which precludes any restrictions from a member state on nationals of another member state's right to establish in the territory of the first mentioned state.[25] By virtue of article 54 TFEU, the freedom of establishment extends to companies.

Secondary law are sources of law that are based on EU treaties. These legal instruments cover unilateral acts.[26] One example is directives, which is the source of secondary law relevant for this paper. A directive is a way through which the competence of the EU is exercised.[27] Member states are obligated to conform with the directives in a way that fulfils their purpose but the means through which this is achieved is left to be decided by each member state.[28] Specifically, one of the relevant directives for this study is the Merger directive. The aim of the Merger directive is to, on the one hand, neutralize tax effects of intra-community cross border mergers, while, on the other hand, safeguard the financial interests of the member states.[29] One of the reasons and starting points for this paper is the articles of the Merger directive. In particular article 4, which concerns the prohibition to tax, at the company level, capital gains arising from a merger, at the time of the merger. In addition to the Merger directive, the ATAD is of relevance for the third research question presented in this study. Specifically, the exit tax rule in article 5 of ATAD and the step-up in tax base mechanism incorporated in that provision.

Occasionally, the question arises whether national provisions are in line with EU's primary and secondary law or if the legal sources of EU law preclude the exercises of specific provisions in the member state's domestic legislation. In those situations, it is the mission of the CJEU to clarify how EU law shall be interpreted.[30] Hence, it is of essence to consider the CJEU's case law when examining legal issues related to EU law. The CJEU has, in several cases, ruled on whether or not national provisions are in line with the Merger directive or the freedom of establishment.[31] One of the cornerstones of this paper is to analyse such cases in order to strengthen the legal argumentation being put forward. The cases referred to in this study are applied on one of two grounds. Firstly, cases may be relied upon to substantiate the reasoning and the arguments made throughout the paper.

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[24] For cases tested against other fundamental freedoms, see e.g. Judgment of 5 July 2012, *SIAT,* C-318/10, EU:C:2012:415; Judgment of 26 February 2019, *X GmbH,* C-135/17, EU:C:2019:136.
[25] TFEU (n. 22), article 49.
[26] See ibid., article 288; see also Douma (2014) (n. 16), p. 21.
[27] TFEU (n. 22), article 288.
[28] ibid.
[29] Merger directive (n. 3), preamble, recital 2 and 5.
[30] TEU (n. 22), article 19; see also Douma (2014) (n. 16), pp. 20-21.
[31] See for example Judgment of 22 March 2018, *Jacob and Lassus*, joined cases C-327/16 and C-421/16, EU:C:2018:210.

However, these cases may only deal with the issues in this paper to a limited extent. Secondly, the case law of the CJEU may be used to form a body for analysis. In addition to the case law of the CJEU, opinions of Advocates General are referred to for their clarifying and elaborated elements. The Advocates General are supposed to give reasoned submissions to cases in an independent manner.[32] However, in this regard it shall be stated, for the purpose of clarity, that opinions of Advocates General have no binding effect and, in itself, do not compose the law as it stands.[33] Likewise, soft law from the OECD will be used to some extent.

In this study legal doctrinal research and literature will serve as a complement to the other sources of law. It is not uncommon for legal issues, that are yet to be clarified by the CJEU, to already have been subject for debate in the legal research and literature.[34] For this reason it is relevant to study the literature when conducting legal research. However, when legal doctrinal literature is used as a source for legal research, it is important to consciously asses the reliability of the text. Literature that has been peer-reviewed by independent parties and that are composed by reputable and experienced academic authors is to some extent a mark of quality.[35] Notwithstanding the above, the value of the legal doctrinal literature as a source in legal research is never greater than the strength of the arguments presented therein.[36] Legal doctrinal research and literature will be used for two reasons in this study. Firstly, literature will be used as a steppingstone to find other sources of law that may be of interest for the study, primarily case law. Secondly, ideas presented in legal research will be used to assure and contribute to a nuanced legal argumentation in the study.

The material, on which this study is built upon, has been found and collected using both chain searches and systematic searches. Chain searches means reading, from the outset, texts that are general or introductory to the topic, for example in the legal literature. Through the references made in this text, other relevant materials, that goes more in-depth on the topic, will be found.[37] This procedure is repeated in the newly found texts, in order to find further material of interest. The chain is reiterated until no new material relevant for the study can be found. Systematic searches, on the other hand, is a way of finding material for the study using subject-related words.[38] The combination of these methods simplifies selection of material, for instance

[32] TFEU (n. 22), article 252.
[33] Mańko, *Role of Advocates General at the CJEU* (European Parliament 2019), p. 2.
[34] Vranken (2012) (n. 16), pp. 43-44.
[35] van Gestel & Vranken, 'Assessing Legal Research: Sense and Nonsense of Peer Review versus Bibliometrics and the Need for a European Approach' (2011) vol. 12(3) German Law Journal, 901, pp. 902-904.
[36] Vranken (2012) (n. 16), pp. 55-56.
[37] Bell, Bryman & Harley, *Business research methods* (5th edition, Oxford University Press Oxford 2019), pp. 98 et seq.
[38] ibid.

because texts frequently quoted or referred to will recur in the search results.[39] As a result, widely accepted legal literature may, for example, be found that way.

1.4 Delimitation

Article 4 of the Merger directive governs the tax neutrality on the company level with regards to the transfer of both assets and liabilities in a merger. Both assets and liabilities may be subject to value fluctuations, which could potentially lead to realised losses.[40] However, for the sake of simplicity, this study will solely focus on assets. Similarly, depreciation of assets will not be considered as a value decreasing factor in the study. The reason being that depreciations could be seen as partial and gradual disposal of the assets, hence, adding an extra element of complexity when it comes to clarifying relevant scenarios and examples, without necessarily leading to different end results. Consequently, non-depreciable assets are intended when referring to 'assets' in this study.

The term 'permanent establishment' is not defined in the Merger directive.[41] This may raise questions as to how to interpret the term permanent establishment in the directive. According to the CJEU in Punch Graphix, the definitions in one directive on corporate income taxation can be used to understand the terms in other directives on corporate income taxation.[42] By that reasoning, the definition of a P.E. in the Parent-subsidiary directive[43] could be used to understand how the term should be interpreted in the Merger directive. Nonetheless, the definition of a P.E. is of smaller relevance when it comes to fulfilling the purpose of this study. Therefore, this question will not be investigated further. Instead will the criteria for an existing P.E. be assumed to be satisfied, when necessary, in this paper.[44]

By the same token, the requirements to fulfil the personal scope of the Merger directive will not be discussed. Instead will these criteria for being qualified as a 'company from a member state' be assumed to be met when referring to the term 'company' in this paper.[45]

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[39] ibid.
[40] Liabilities my fluctuate in value due to exchange rate changes.
[41] cf. Boulogne, *Shortcomings in the EU Merger Directive* (Kluwer Law International Alphen Aan Den Rijn 2016a), p. 306; van den Broek, *Cross-Border Mergers within the EU proposals to remove the remaining tax obstacles* (Wolters Kluwer Law & Business Alphen Aan Den Rijn 2012), p. 205.
[42] Judgment of 18 October 2012, *Punch Graphix*, C-371/11, EU:C:2012:647, para 34.
[43] Council directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (recast) [2011] OJ L 345/8, article 2(b).
[44] More on the definition of a P.E. in the Merger directive can be found in Boulogne (2016a) (n. 41), pp. 150 et seq., 306.
[45] These criteria can be found in the Merger directive (n. 3), article 3, read in conjunction with annex I.

1.5 Previously conducted research

Cross-border restructuring operations and the Merger directive have been described by multiple academics.[46] Some studies are more extensive and take a problematising position.[47] For example, examining the interrelationship between the Merger directive and the fundamental freedoms provided for in the TFEU.[48] Most of the tax research conducted in the field of cross-border corporate restructuring operations examine the taxation of gains, at either the shareholder level, the company level or both.[49] Although, some research has been performed on the treatment of losses.[50] Still, that research has mostly been related to losses from previous tax years, i.e. losses that arose before the merger. In particular, the Merger directive's takeover rule[51] for non-exhausted losses and the recapture rule[52] for losses that have been set off against profits previous years, have been of interest for researchers.[53] However, that is not the nature of the losses relevant for this study. Instead, as is stated in the purpose, this study examines how the outcomes for tax purposes, at the company level, differ depending on whether the assets transferred in a merger remain attributable to a P.E. in the state of the transferring company, when those assets are subsequently realised with a loss after having decreased in value, post-merger, to a level below their book value.

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[46] See e.g. Helminen, *EU Tax Law – Direct Taxation* (2019 edn, IBFD 2019), sec. 3.3; Matsos 'Tax Mergers Directive: Basic Conceptualisation' in Papadopoulos (ed), *Cross-Border Mergers: EU Perspectives and National Experiences* (Springer e-source 2019), pp. 193-208; Boulogne 'The Tax Merger Directive' in Terra & Wattel, *European tax law Volume I General topics and direct taxation* (7th abridged student ed., Wolters Kluwer Deventer 2018), pp. 151-174; Hofstätter & Hohenwarter-Mayr 'The Merger Directive' in Lang et al. (eds), *Introduction to European tax law on direct taxation* (4th ed Linde Wien 2016), pp. 157-182; Werbrouck, 'Tax Rules Applicable to Cross-Border Mergers' in Van Gerven (ed), *Cross-Border Mergers in Europe*, vol 1 (Cambridge University Press 2010), pp. 44-53.

[47] See e.g. Boulogne (2016a) (n. 41); van den Broek (2012) (n. 41).

[48] For the examination of the interrelationship between the Merger directive and the CJEU's case law on exit taxation, see e.g. Boulogne (2016a) (n. 41), pp. 159-172; Jiménez-Valladolid de L´Hotellerie-Fallois, 'The Permanent Establishment: Still a (Permanent) Requirement?' (2014) vol. 23(1) EC Tax Review, 4, pp. 4-15; van den Broek (2012) (n. 41), pp. 345-368.

[49] See e.g. Boulogne in Haslehner, Kofler & Rust (2019) (n. 7), pp. 190-195; Boulogne, 'Shortcomings in the European Union Merger Directive: Lessons for Future Harmonization' (2016b) vol. 44(11) Intertax, 810, pp. 810-814; Jiménez-Valladolid de L´Hotellerie-Fallois (2014) (n. 48), pp. 4-15.

[50] See e.g. Boulogne in Haslehner, Kofler & Rust (2019) (n. 7), pp. 190-195; Vande Velde, 'How Does the CJEU's Case Law on Cross-Border Loss Relief Apply to Cross-Border Mergers and Divisions?' (2016) vol. 25(3) EC Tax Review, 132, pp. 132-145; Bezzina, 'The Treatment of Losses under the EC Merger Directive 1990' (2002) vol. 42(2) European Taxation, 57, pp. 57-71.

[51] Merger directive (n. 3), article 6.

[52] ibid., article 10.

[53] See e.g. Vande Velde (2016) (n. 50), pp. 139-144; Boulogne, 'A Proposal to Expand and Improve Article 6 of the EU Merger Directive' (2014) vol. 42(2) Intertax, 70, pp. 70-91; Bezzina (2002) (n. 50), pp. 57-63.

1.6 Outline

As the name implies, chapter 2 will set the scene for this study. This will be done through the constructing of a hypothetical scenario, which will be explained both written and visually. The chapter will also give a brief explanation of the interrelationship between domestic law, the Merger directive and primary EU law. Once out of the starting blocks, chapter 3 will examine the outcomes for tax purposes of the scenario established in chapter 2, depending on if the assets transferred in a merger are effectively connected to a remaining P.E. in the member state of the transferring company (section 3.1), or not (section 3.2.2). Section 3.2.1 explores the case law relevant for the exit-like scenario illustrated in section 3.2.2. Chapter 4 will follow up on the discrepancies highlighted between the different scenarios in chapter 3. The exit tax rule in the ATAD and its step-up in tax base mechanism, as well as a conceivable step-up in tax base mechanism, potentially, inserted into the Merger directive or into tax treaties will be scrutinised for their potential strengths and limitations when it comes to reassuring that the taxpayer will have losses, realised after the merger, taken into account. The thesis is concluded with a fifth and final chapter, were the findings of the study will be summarised.

2 Setting the scene

2.1 A hypothetical restructuring scenario

At the outset, a few words should be dedicated to clarifying and elaborate on the situation at hand in this study. The example described below highlights a hypothetical restructuring operation where assets transferred in a cross-border merger are subsequently sold with a loss due to those assets decreasing in value after the merger, to a level below their book value. This scenario forms the basis on which this study is founded. It reads as follows:

Picture that company A of member state A acquires assets for the value v_2, at a specific point in time (t_1). The value of the acquired assets will be their book value, i.e. their balance sheet value. Furthermore, at a later point in time (t_2), company A merge into company B of member state B. While the balance sheet values of the transferred assets are carried over to Company B, their market value have increased to v_3 at this point in time. Eventually, the time comes when the transferred assets are sold by company B (t_3). Between the merger and the time of the ultimate disposal, the transferred assets have decreased in value to a level below their balance sheet value (v_1). Hence, the assets transferred in the merger are realised with a tax loss. A visual presentation of the example can be found in *Image 1. Hypothetical scenario* below.

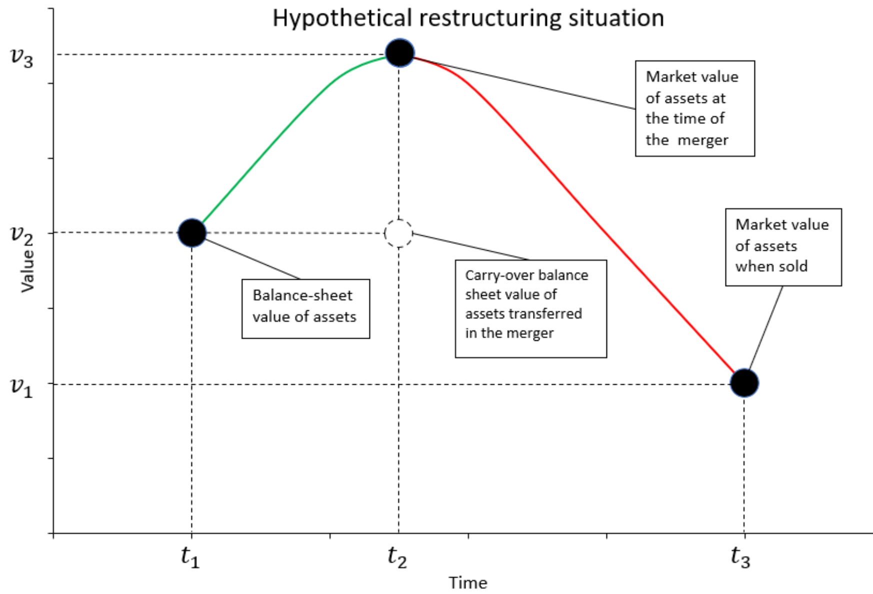

Image 1. Hypothetical scenario

Chapter 3 of this study will examine the consequences for tax purposes in the situation described above, depending on whether the transferred assets remain attributable to a P.E. of company B in member state A between the time of merger and the time of the ultimate disposal of the assets. The different scenarios can, in a simplified way, be pictured as below in *Image 2. Before and after the merger, with and without a remaining P.E.*

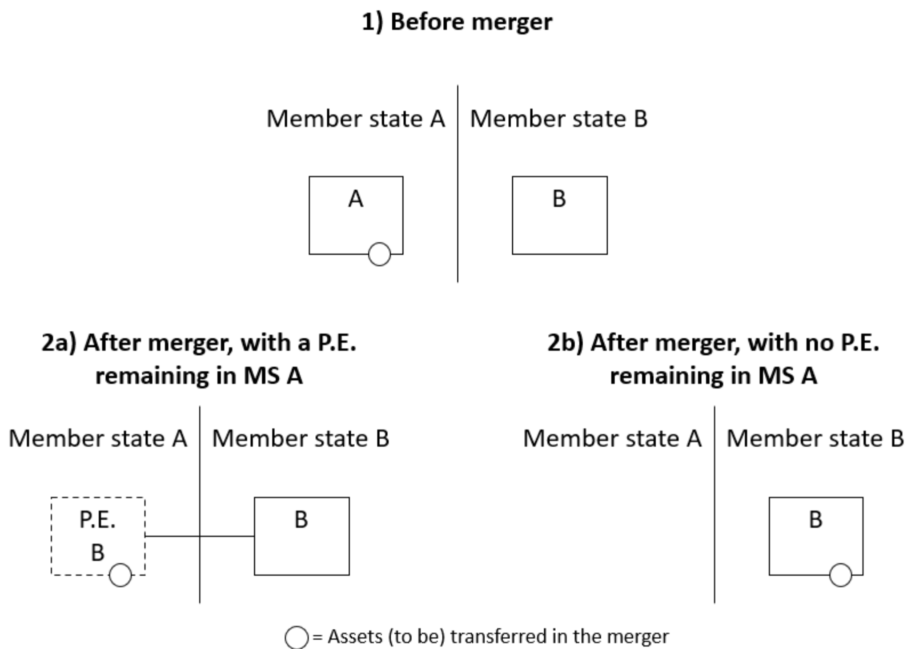

Image 2. Before and after the merger, with and without a remaining P.E.

2.2 Briefly on the relationship between domestic legislation, the Merger directive and primary EU law

The freedom of establishment is one of the fundamental freedoms, laid down in the TFEU, that shall not be prohibited by the member state's domestic law.[54] It is established case law that cross-border mergers and other restructuring operations covered by the Merger directive constitute specific ways for companies and shareholders to exercise the freedom of establishment, which is essential for the internal markets proper functioning.[55] The fact that the field of direct taxation is not fully harmonised simultaneously means that if situations are not explicitly covered by the Merger directive, the matter falls within the national laws of the member states.[56] However, it is clear from the case law that EU law takes precedence over national law.[57] This holds true even though direct taxation is not a fully harmonised field of EU law and, hence, the member states are left with room to exercise their fiscal powers through domestic legislation.[58] For the same reason, when member states implement provisions in directives into domestic law, they should do so in a way that respects EU law e.g. the freedom of establishment and the principle of proportionality.[59] Consequently, national laws of the member states must comply with EU law and cross-border mergers must be treated in the same way as domestic mergers for tax purposes.[60]

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[54] TFEU (n. 22), article 49.

[55] C-411/03 *SEVIC Systems* (n. 15), para 19; Judgment of 8 March 2017, *Euro Park Service,* C-14/16, EU:C:2017:177, para 28; Judgment of 23 November 2017, *A Oy,* C-292/16, EU:C:2017:888, para 23; Joined cases C-327/16 and C-421/16 *Jacob and Lassus* (n. 31), para 71.

[56] Joined cases C-327/16 and C-421/16 *Jacob and Lassus* (n. 31), para 72; Judgment of 18 September 2019, *AQ and DN,* joined cases C-662/18 and C-672/18, EU:C:2019:750, para 41; Opinion of Advocate General Wathelet delivered on 15 November 2017, *Jacob and Lassus,* joined cases C-327/16 and C-421/16, EU:C:2017:865, paras 100-101; see also Boulogne in Haslehner, Kofler & Rust (2019) (n. 7), p. 190.

[57] See e.g. Judgment of 15 July 1964, *Costa v. ENEL,* Case 6/64, EU:C:1964:66, sec. "On the submission that the court was obliged to apply the national law", p. 594.

[58] See e.g. Case 270/83 *Commission v France (Avoir Fiscal)* (n. 23), para 24.

[59] Judgment of 17 July 1997, *Leur-Bloem,* C-28/95, EU:C:1997:369, para 43; Judgment of 18 September 2003, *Bosal Holding,* C-168/01, EU:C:2003:479, para 26; Joined cases C-662/18 and C-672/18 *AQ and DN* (n. 56), para 41; see also Boulogne (2016a) (n. 41), p. 190.

[60] For more on this, see e.g. Boulogne (2016b) (n. 49), p. 812.

3 Outcomes for tax purposes depending on whether the transferred assets become attributable to a remaining P.E. in the member state of the transferring company after the merger

3.1 Outcomes for tax purposes if the transferred assets become attributable to a P.E. in the member state of the transferring company

From the example depicted in section 2.1 it is recalled that in the time between the acquiring of the assets (t_1) and the merger (t_2) their market value increases from v_2 to v_3. Hence, at the time of the merger (t_2), when company A ceases to exist in member state A, the transferred assets have a hidden, not yet realised, value of $v_3 - v_2$. A loss is later realised when the transferred assets are subsequently sold by company B (t_3), after having decreased in value to v_1.

Article 4(1) of the Merger directive states that a merger "[…] shall not give rise to any taxation of capital gains calculated by reference to the difference between the real values of the assets and liabilities transferred and their values for tax purposes".[61] Notwithstanding the, from a time perspective, imprecise wording of the provision, it is not suggested that any potential tax claim shall be abolished altogether. It simply means that any gains shall not be taxed at the time of the merger but rather shall gains be taxed when the transferred assets are ultimately disposed.[62] In addition, this is in accordance with the aims of the directive to avoid taxation in connection with the merger while simultaneously safeguard the taxing rights of the member state of the transferring company at the date of the ultimate disposal of the transferred assets.[63]

If the transferred assets are effectively connected to a P.E. of company B in member state A following the merger and those assets "[…] play a part in generating the profits or losses taken into account for tax purposes"[64],

[61] Merger directive (n. 3), article 4(1).
[62] Judgment of 5 July 2007, *Kofoed,* C-321/05, EU:C:2007:408, para 32; Judgment of 11 December 2008, *A.T.,* C-285/07, EU:C:2008:705, para 28; Judgment of 20 May 2010, *Modehuis A. Zwijnenburg,* C-352/08, EU:C:2010:282, para 39; Judgment of 19 December 2012, *3D I Srl*, C-207/11, EU:C:2012:818, para 28; Opinion of Advocate General Jääskinen delivered on 10 July 2012, *3D I Srl,* C-207/11, EU:C:2012:433, para 39.
[63] See Merger directive (n. 3), preamble, recital 5 and 7.
[64] ibid., article 4(2)(b). All the requirements stated in this provision will in the following be referred to together as: the assets being attributable to, or effectively connected with, a remaining P.E. in the state of the transferring company.

member state A must refrain from taxing the hidden values of the assets at the time of the merger, provided that company B carries over the balance sheet values of the transferred assets.[65] Furthermore, article 4(4) of the Merger directive stipulates that company B shall compute any gains or losses related to the transferred assets in line with the rules that would have applied if the merger would not have taken place.[66] In addition, assuming that member states A and B have concluded a tax treaty equivalent to the OECD model tax convention on income and capital[67], the taxing right of member state A has been protected with regards to both profits from the P.E.'s business and the alienation of the transferred assets.[68] Likewise, by relying on the principle of symmetry, losses corresponding to the aforementioned profits should be accounted for in that very same member state.[69] As a result, company B will incur a loss of $v_1 - v_2$ in member state A at the time of t_3, when the assets are ultimately disposed.

Thus, not only will member state A be prevented from taxing a hidden gain of $v_3 - v_2$ at the time of the merger (t_2), but member state A will also be faced with a loss of $v_1 - v_2$ when the assets are subsequently sold (t_3). However, this indicates that article 4 of the Merger directive is successful in reassuring a continuance in the tax treatment of the transferred assets, before and after the merger. The two objectives of the directive are, therefore, achieved. On the one hand because the cross-border merger itself is tax neutral and on the other hand because the member state of the transferring company kept their fiscal competence with regards to the assets unrealised values generated within its territory.[70] In this specific case, though, the ultimate disposal of the transferred assets would result in a loss rather than a gain.

[65] Merger directive (n. 3), article 4(1) read in conjunction with article 4(2) and 4(4).
[66] ibid., article 4(4); see also Boulogne in Haslehner, Kofler & Rust (2019) (n. 7), p. 192.
[67] OECD, *Model tax convention on income and on capital*, (Condensed version 21 November 2017, OECD Publishing Paris 2017). In the forthgoing referred to as OCED model tax convention.
[68] ibid., article 7(1) and article 13(2).
[69] On the principle of symmetry, see e.g. C-371/10 *National Grid Indus* (n. 10), para 58; Opinion of Advocate General Kokott delivered on 17 October 2019, *Aures,* C-405/18, EU:C:2019:879, paras 40-42.
[70] See Merger directive (n. 3), preamble, recital 5, as well as recital 7.

3.2 Outcomes for tax purposes if the transferred assets do not become attributable to a P.E. in the member state of the transferring company

3.2.1 Case law applicable for the situation in which no P.E. remains in the state of the transferring company

Before examining the outcomes for tax purposes if no P.E. remains in the state of the transferring company, which will be the gist of section 3.2.2, a section will be dedicated to exploring the case law from the CJEU that could be of relevance for understanding the outcomes for tax purposes in such an exit-like scenario. Ever since the first adopted version of the Merger directive, granting a carry-over relief if a P.E. remains in the member state of the transferring company has been the solution opted for in article 4.[71] When no P.E. remains, article 4(1) of the Merger directive does not prevent the member state of the transferring company from taxing the hidden values of the transferred assets when the transferring company ceases to exist in that member state.[72] In fact, the Merger directive itself remains completely silent on the taxation at the time of the merger if the transferred assets do not become attributable to a P.E. remaining in the state of the transferring company.[73] As is described in section 2.2, when a situation is not explicitly covered by the directive, member states retains discretionary power in shaping their domestic tax laws. Nevertheless, member states must do so in a way that complies with EU law.[74] Moreover, not until the CJEU's judgement in the case of National Grid Indus[75] was some light shed on the tax treatment, under EU law, of hidden values when no P.E. remains in the state of the transferring company.[76]

National Grid Indus concerned a Dutch company transferring its place of effective management to the UK, all while holding a receivable which corresponded to an unrealised currency gain. As the Netherlands were to lose their taxing rights under the applicable tax treaty after the transfer, they imposed an immediate exit tax on the unrealised gain.[77] CJEU found that this exit tax constituted a restriction to the freedom of establishment since it created a cash flow disadvantage for the taxpayer.[78] However, this

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[71] See Council directive 90/434/EEC of 23 July 1990, preamble and article 4.
[72] See Boulogne in Haslehner, Kofler & Rust (2019) (n. 7), pp. 191-192; van den Broek (2012) (n. 41), p. 204.
[73] See Boulogne in Haslehner, Kofler & Rust (2019) (n. 7), pp. 191-192; Jiménez-Valladolid de L´Hotellerie-Fallois (2014) (n. 48), pp. 5-6.
[74] See e.g. joined cases C-327/16 and C-421/16 *Jacob and Lassus* (n. 31), para 72; joined cases C-662/18 and C-672/18 *AQ and DN* (n. 56), para 41.
[75] C-371/10 *National Grid Indus* (n. 10).
[76] Boulogne (2016a) (n. 41), p.160; Boulogne (2016b) (n. 49), p. 813.
[77] C-371/10 *National Grid Indus* (n. 10), paras 10-14.
[78] ibid., paras 37-41.

restriction could be justified by the need to preserve the balanced allocation of the power to impose taxes between the member states, linked to a temporal component.[79] Furthermore, the CJEU held that immediate recovery of the tax was not proportional but allowing the transferring company to choose between immediate and deferred payment would be.[80] Nor is definitively fixing the tax claim at the time of the exit disproportionate.[81] What was further concluded was that it is proportional for the state of the transferring company to not take decreases in value into account after losing its fiscal connection to the exiting company, because those decreases in value will, in principle, be considered in the host state.[82] If not, this would, simply, be the result of disparities between the member states tax legislation.[83]

The fact that the member state of the transferring company does not have to take account of value decreases emerging after the transfer of the company's place of effective management could also hold for a future decrease in value of assets transferred in a merger.[84] In certain cases, however, discrimination may still result from not taking losses into account after an exit. Joined cases Jacob and Lassus[85] highlights such a scenario. These cases, even though not specifically concerning exit taxation, makes for an interesting point of comparison. In exchange for shares in a Luxembourg company, Mr Lassus, tax resident in the UK, transferred shares in a French company to the first mentioned company. A capital gain relating to the transfer of the shares in the French company was established but taxation was deferred according to the French rules implementing article 8 of the Merger directive. When the shares received upon the exchange were subsequently sold with a loss, the capital gain relating to the exchange of shares was taxed, without taking account to the arisen loss. This was possible under the applicable tax treaty next to French legislation.[86] The court held that the freedom of establishment prevents member states from exploiting a legal mechanism which:

> […] in a situation where the subsequent transfer of securities received in exchange does not fall within the fiscal competence of that Member State, provides for taxation of the capital gain that is subject to tax deferral upon that transfer without taking into account any capital loss occurring at that time, whereas

[79] ibid., paras 45-48.
[80] ibid., paras 73, 85.
[81] ibid., paras 52, 64.
[82] ibid., paras 56-59, 61, 64.
[83] ibid., paras 61-62.
[84] Boulogne in Haslehner, Kofler & Rust (2019) (n. 7), p. 192.
[85] Joined cases C-327/16 and C-421/16 *Jacob and Lassus* (n. 31).
[86] ibid., paras 21-29.

> account is taken of such a capital loss when the taxpayer holding the securities is resident for tax purposes in that Member State on the date of the transfer.[87]

The important distinction between the situation in this case and the one in National Grid Indus is that in the latter, the state of origin had exercised all possibilities to tax the hidden gains of the transferred assets, generated within its territory, when the transfer occurred.[88] In the former case, the state of origin, who at the time of the exchange of shares was not entitled to tax the gain that arose in that exchange, deferred the taxation of that gain until the subsequent transfer of the received shares.[89] Thus, that state exercised its fiscal power when the subsequent transfer occurred, even though any gain from that subsequent transfer was outside its fiscal competence.[90] In other words, in the case of Lassus, the state of origin had the power to tax when the loss arose, unlike the situation in National Grid Indus.[91] Furthermore, the obstacle in Lassus could not be justified by the need to preserve the allocation of fiscal powers, because only tax competence of the state of origin was at stake.[92]

Regarding the non-necessity to take account for value decreases after the migration of the exiting company, it is noteworthy that the CJEU deviated from its earlier decision in the N case.[93] In N the court held that the member state of origin:

> […] would have to *take full account of reductions in value capable of arising after the transfer* of residence by the taxpayer concerned, unless such reductions have already been taken into account in the host Member State.[94] (emphasis added, ed.)

This discrepancy can be explained by reasoning that the court has developed separate lines of case law when it comes to exit taxation of individuals, on

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[87] ibid., para 84.
[88] C-371/10 *National Grid Indus* (n. 10), para 61.
[89] Joined cases C-327/16 and C-421/16 *Jacob and Lassus* (n. 31), para 82; Opinion of Advocate General Wathelet in joined cases C-327/16 and C-421/16 *Jacob and Lassus* (n. 56), para 90.
[90] Joined cases C-327/16 and C-421/16 *Jacob and Lassus* (n. 31), para 83; Opinion of Advocate General Wathelet in joined cases C-327/16 and C-421/16 *Jacob and Lassus* (n. 56), para 91.
[91] Joined cases C-327/16 and C-421/16 *Jacob and Lassus* (n. 31), paras 82-83; Opinion of Advocate General Wathelet in joined cases C-327/16 and C-421/16 *Jacob and Lassus* (n. 56), para 92. The Advocate General adds to this, in para 90, e.g. that the tax rate and the tax payable are only determined on the date of the subsequent transfer of the received shares.
[92] Joined cases C-327/16 and C-421/16 *Jacob and Lassus* (n. 31), para 81; Opinion of Advocate General Wathelet in joined cases C-327/16 and C-421/16 *Jacob and Lassus* (n. 56), para 93.
[93] Judgment of 7 September 2006, *N*, C-470/04, EU:C:2006:525.
[94] ibid., para 54 (emphasis added, ed.).

the one hand, and exit taxation of corporations, on the other hand.[95] However, in Commission v. Portugal[96] the CJEU, seemingly, attempted to align the exit tax case law for individuals with the National Grid Indus doctrine.[97] Inter alia, the court states that, with regards to unrealised gains, there is no objective reason to distinguish individuals from legal persons.[98] Notwithstanding the application of the National Grid Indus doctrine in this case, one may argue that, since the case concerned exit taxation in relation to exchange of shares and transfer of assets linked to the conducting of a business undertaking, it did not, per se, overrule the reasoning in the N case.[99] Instead, there is an argument to be made that the court expanded the National Grid Indus doctrine to all professional undertakings, incorporated as well as non-incorporated.[100]

In numerous cases fallowing National Grid Indus has the court confirmed the ruling of that case, both in regards to the disproportionality of immediate collection of the exit tax[101] and the proportionality of fixing the tax claim at the time of exit and to not take account for subsequent decreases in value[102]. CJEU further developed the National Grid Indus doctrine in the decisions of DMC[103] and Verder LabTech[104]. In DMC the court extended the reasoning in National Grid Indus[105] and held that offering the taxpayer the options of immediate taxation or recovery in instalments over a five year period is proportionate to safeguard the balanced allocation of the power to impose taxes between member states.[106] The court found this mechanism to be a satisfactory measure to counter the risk of non-recovery of the taxes, which increases as time passes.[107] In Verder LabTech, the court considered even less leeway left for the taxpayer to be in line with EU law. Verder LabTech

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[95] van Thiel 'Exit Taxes' in Terra & Wattel, *European tax law Volume I General topics and direct taxation* (7th abridged student ed., Wolters Kluwer Deventer 2018), pp. 429-441.
[96] Judgment of 21 December 2016, *Commission v. Portugal,* C-503/14, EU:C:2016:979.
[97] van Thiel in Terra & Wattel (2018) (n. 95), pp. 440-441.
[98] C-503/14 *Commission v. Portugal* (n. 96), para 56.
[99] van Thiel in Terra & Wattel (2018) (n. 95), pp. 440-441.
[100] ibid.
[101] See to that extent Judgment of 6 September 2012, *Commission v Portugal,* C-38/10, EU:C:2012:521, paras 27-32; Judgment of 31 January 2013, *Commission v Netherlands,* C-301/11, EU:C:2013:47, para 16; Judgment of 25 April 2013, *Commission v Spain,* C-64/11, EU:C:2013:264, paras 27-32; Judgment of 18 July 2013, *Commission v Denmark,* C-261/11, EU:C:2013:480, paras 29-32; Judgment of 16 April 2015, *Commission v Germany,* C-591/13, EU:C:2015:230, para 67; Judgment of 14 September 2017, *Panayi,* C-646/15, EU:C:2017:682, paras 57, 59; C-292/16 *A Oy* (n. 55), para 37.
[102] See to that extent C-64/11 *Commission v Spain* (n. 101), para 31; C-301/11 *Commission v Netherlands* (n. 101), para 16; C-646/15 *Panayi* (n. 101), para 58.
[103] Judgment of 23 January 2014, *DMC*, C-164/12, EU:C:2014:20.
[104] Judgment of 21 May 2015, *Verder LabTech,* C-657/13, EU:C:2015:331.
[105] That it is proportional to give the taxpayer the option to choose between immediate and deferred payment of the tax due on the hidden values of assets upon exit.
[106] C-164/12 *DMC* (n. 103), para 64.
[107] ibid., para 62.

transferred intellectual property to its P.E. in another member state.[108] The hidden values of these assets were taxed upon their exit from the state of origin, but the tax was collected in instalments over ten years, without the option of immediate recovery of the tax.[109] The Advocate General stated in his opinion that the reason that immediate taxation is prohibited under EU law is because it creates a cashflow disadvantage[110] for the taxpayer and that a schematic recovery of the tax can mitigate this problem if the recovery period is sufficiently long.[111] The CJEU followed this reasoning and stated that, since the schematic recovery in DMC of five annual instalments was appropriate, the recovery of tax in ten annual instalments must be proportionate.[112]

3.2.2 The outcomes for tax purposes if no P.E. remains in the state of the transferring company

How would the case law described in section 3.2.1 affect the scenario illustrated in section 2.1, where no P.E. remains in the state of the transferring company? Recall, from section 2.1, that in the time between the acquiring of the assets (t_1) and the merger (t_2) their market value increases from v_2 to v_3. Hence, at the time of the merger (t_2), when company A ceases to exist in member state A, the transferred assets have a hidden, not yet realised, value of $v_3 - v_2$. In the time following the merger, the transferred assets decrease in value to v_1, at which point they are sold by company B (t_3). Consequently, upon this ultimate disposal of the transferred assets, a capital loss is realised.

If the transferred assets do not become effectively connected to a remaining P.E. of company B in member state A after the merger, article 4(1) of the Merger directive does not preclude taxation of any hidden gain.[113] Thus, at the time of the restructuring operation, the Merger directive does not prevent member state A from taxing the unrealised gain of $v_3 - v_2$, hidden in the transferred assets, when no P.E. remains in member state A. As seen from the case law above[114], however, discrimination may arise with regards to the freedom of establishment if domestic mergers, within member state A, would not result in taxation of unrealised gains.[115] Such a restriction may, nonetheless, be justified by the need to preserve the balanced allocation of

[108] C-657/13 *Verder LabTech* (n. 104), para 18.
[109] ibid., paras 20-27, 31.
[110] As seen in C-371/10 *National Grid Indus* (n. 10), para 37.
[111] Opinion of Advocate General Jääskinen delivered on 26 February 2015, *Verder LabTech*, C-657/13, EU:C:2015:132, para 72.
[112] C-657/13 *Verder LabTech* (n. 104), para 52.
[113] cf. Merger directive (n. 3), article 4(2)(b).
[114] See subsection 3.2.1.
[115] See e.g. C-371/10 *National Grid Indus* (n. 10), paras 37-41.

the power to impose taxes between member states.[116] That being said, member state A would still be permitted to settle the tax claim at the time of the cross-border restructuring operation, given that the taxpayer is either faced with the option of the tax being collected at the time of realisation or the tax being collected in annual instalments over five[117] or ten[118] years.[119]

Following the reasoning above, if no P.E. remains in the transferring state after the merger, member state A could e.g. fix the tax claim pertaining to the unrealised gains in the transferred assets, at the time of the restructuring operation and collect that tax over five or ten years. Assuming these deemed instalments would all be collected before the loss is realised at the time of the ultimate disposal of the transferred assets (t_3), this would result in member state A levying the tax pertaining to the unrealised gain of $v_3 - v_2$ fully. This would hold true even though the assets are eventually realised with a loss, possibly not taken into account in member state B where company B received those assets in the merger.[120] The fact that member state A would not take the subsequently realised loss into account is reasonable as that member state would have no fiscal power left in relation to the transferred assets at this point in time (t_3).

Would member state A have to take the value decrease into account if the transferred assets were sold and the loss became realised before the last deemed instalments were collected? Or if, simply, the market value of the transferred assets has fallen below the balance sheet value (v_2) before the last deemed instalment was collected, thus, creating an unrealised loss? Seeing that the court, in Verder LabTech[121], accepted taxation of hidden values in instalments over ten years, without offering immediate payment or payment upon realisation, it is not unreasonable to expect that a state which schematically recovers the tax due in instalments would not be obligated to take into account value decreases or losses emerging after that state lost its fiscal competence, since it methodically diverges from systems that tax when the hidden gains related to the transferred assets are realised.[122] This was later confirmed by the court in Lassus, where the matter was the member state's deferral of taxation, while keeping the possibility to exercise its fiscal competence, rather than definitively setting a tax claim at the time

[116] See e.g. ibid., paras 45-48.
[117] C-164/12 *DMC* (n. 103), para 64.
[118] C-657/13 *Verder LabTech* (n. 104), para 52.
[119] See also C-371/10 *National Grid Indus* (n. 10), paras 52, 73.
[120] See to that extent ibid., paras 61-62.
[121] C-657/13 *Verder LabTech* (n. 104), paras 52-53.
[122] Boulogne in Haslehner, Kofler & Rust (2019) (n. 7), p. 192.

when the taxpayer ceases to be subject to tax in that member state.[123] The latter was the case in National Grid Indus.[124]

To sum up, if no P.E., to which the transferred assets are attributable, remains in member state A after the merger, the outcomes for tax purposes would be the following. At the time of the merger (t_2), when company A ceases to exist and to be subject to tax in member state A, the unrealised gain of $v_3 - v_2$ can fully be levied through annual instalments collected by member state A over a number of years. The subsequently realised loss (t_3), deriving from decreases in value of the transferred assets to v_1, do not have to be taken into account in member state A and may or may not, due to disparities between tax systems, be taken into account in member state B.[125]

3.3 Intermediate conclusion

Whether a P.E., to which the transferred assets become attributable, remains in the member state of the transferring company after the merger, makes all the difference as to whether the situation falls within the ambit of the Merger directive or is considered an exit situation from the point of view of the member state of the transferring company. In the first mentioned scenario, where the transferred assets do become effectively connected to a P.E. in the state of the transferring company at the time of the merger, the Merger directive's carry-over relief mechanism will apply and the member state of the transferring company will be prevented from taxing the unrealised gain pertaining to the assets transferred in the cross-border restructuring operation. In the example this was shown as the hidden gain of $v_3 - v_2$ at the time of t_2. Instead there will be a continuance for tax purposes established in the form of the P.E. As a consequence, the member state of the transferring company will be faced with a loss when the transferred assets are subsequently sold after having decreased in value since the time of the merger. In the example, this was displayed as the realised loss of $v_1 - v_2$ at the time of t_3.

In the second scenario, when no P.E. remains in the member state of the transferring company, the Merger directive does not apply and the member state of the transferring company is able to settle a tax claim and levy the tax due in instalments collected over a number of years. For example, over five or ten years. Hence, in the example provided, the unrealised gain of $v_3 - v_2$, at the time of t_2, can be taxed fully. Additionally, the member state of the transferring company would not have to take into account any losses arising after that member state lost its fiscal competence pertaining to the

[123] Joined cases C-327/16 and C-421/16 *Jacob and Lassus* (n. 31), paras 82-83.
[124] See to that extent C-371/10 *National Grid Indus* (n. 10), para 61.
[125] A situation partly dealt with in the ATAD's exit tax rule. Chapter 4 comes back to this.

transferred assets. Accordingly, the realised loss of $v_1 - v_2$ at the time of t_3 in the example will not have to be considered in the state of the transferring company and may or may not, due to disparities between tax systems, be accounted for in the member state of the receiving company.

In short, the first scenario will lead to the member state of the transferring company being faced with a loss that could potentially be offset against profits in group companies. In the other scenario, that state may through instalments fully tax the hidden gain that is unrealised at the time of the merger, whereas the subsequently realised loss may possibly not be taken into account fully anywhere. Despite the different outcomes, in both scenarios have the taxpayer utilised cross-border restructuring operations covered by the Merger directive in order to exercise the freedom of establishment. Moreover, the discrepancy between these two scenarios disclose the main issue of a system that tax unrealised gains but does not require following value decreases to be taken into account.[126]

4 The value of a step-up in tax base mechanism for transferred assets in order to mitigate the different outcomes for tax purposes

4.1 Scrutinising the exit tax rule and the step up in tax base mechanism in ATAD

This chapter will follow up on the discrepancy highlighted in chapter 3. The potential value of a step-up in tax base mechanism, for assets transferred in a merger, will be scrutinised with the aim to mitigate the different outcomes for tax purposes in a scenario where no P.E. remains in the member state of the transferring company after the merger, compared to when the transferred assets are effectively connected to a P.E. in the member state of the transferring company. One solution to ensure that the taxpayer will have losses, resulting from value decreases arising after the exit, taken into account while simultaneously safeguarding the principle of territoriality linked to a temporal component, is the exit tax rule provided for in the ATAD. The ATAD's main objective is to combat tax avoidance but also to avoid double taxation in achieving its goal.[127] Article 5 of the ATAD establishes a rule for exit taxation of unrealised gains in a few defined

[126] To the very same extent, see Boulogne in Haslehner, Kofler & Rust (2019) (n. 7), p. 193.
[127] ATAD (n. 12), preamble, recital 5.

scenarios.[128] Furthermore, the provision requires the receiving member state to grant a step-up in tax base for the assets transferred into its territory, corresponding to the market value established by the transferring state upon exit.[129] In addition, the provision also offers deferred payment of the unrealised gains, collected in instalments over five years.[130] This right to spread the recovery of the tax due over a period of five years follows the National Grid Indus doctrine, as further advanced in the cases of DMC[131] and Verder LabTech[132]. The directive was likely drafted with heed taken to these cases.[133]

In theory this tax base step-up mechanism seems solid in the way it ensures that the taxpayer will be able to have value decreases, arising after the exit, taken into account. Nevertheless, this system does leave some issues untouched. As mentioned above, the step-up in tax base mechanism does require the member state of the receiving company to grant, as the starting value for tax purposes, the market value established by the member state of the transferring company.[134] However, the member state of the receiving company is not obliged to do so if it considers the established value not to be the correct market value.[135] From article 5(6) of the ATAD, read in conjunction with the preamble, it is understood that the correct market value is the value at arm's length.[136] The member states are advised to rely on the existing dispute resolution mechanisms to solve that kind of issues.[137] But agreement on the valuation of the transferred assets is, thus, not to be taken for granted. As Smit puts it: "Accepting the principle of mutual recognition when it comes to the valuation apparently was a bridge too far for Member States."[138] That being said, there are established methods for calculating and establishing market values at arms' length.[139] Notwithstanding those methods, it is not necessarily uncomplicated for different parties to agree on what the correct value is. The application of different methods may result in different perceptions of what is the market value at arm's length. This has

[128] ibid., article 5(1).
[129] ibid., article 5(5).
[130] ibid., article 5(2).
[131] C-164/12 *DMC* (n. 103).
[132] C-657/13 *Verder LabTech* (n. 104).
[133] See ATAD (n. 12), preamble, recital 10; Smit 'The Anti-Tax-Avoidance Directive (ATAD)' in Terra & Wattel, *European tax law Volume I General topics and direct taxation* (7th abridged student ed., Wolters Kluwer Deventer 2018), pp. 255, 257; van Thiel in Terra & Wattel (2018) (n. 95), pp. 438-439.
[134] ATAD (n. 12), article 5.
[135] ibid., article 5(5).
[136] ibid., articles 5(6); see also ibid., preamble, recital 10.
[137] ibid., preamble, recital 10.
[138] Smit in Terra & Wattel (2018) (n. 133), p. 255.
[139] To that end, see e.g. OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017*, (OECD Publishing Paris 2017), chapter II.

been shown in recent cases concerning, inter alia, transfer pricing, where the arm's length principle was at issue.[140]

Noteworthy is that article 5 of the ATAD does not explicitly cover mergers.[141] However, since the exit tax provision in the ATAD constitutes a minimum standard[142], member states are free to extend the scope of the directive to these operations as long as they comply with the case law on exit taxes and the rest of EU law.[143] Thus, extending the scope of the exit tax rule in the ATAD to cross-border restructuring operations covered by the Merger directive, where the transferred assets remain effectively connected to a P.E. in the member state of the transferring company, would not be allowed since it would not comply with the tax neutrality safeguarded by the Merger directive.[144] In theory member states could extend, by unilateral means, the exit tax rule in ATAD to those cross-border restructuring operations that fall outside the scope of the directive, provided the member state comply with EU law when doing so.[145] For example, an exit tax claim could be established when no P.E. remains in the member state of the transferring company. However, in such a scenario, since it would be enforced by unilateral means, there would be no requirement on the member state of the receiving company to grant a step-up in tax base of the transferred assets based on a market value established by the member state of the transferring company. Hence, the authority of the rule would not be as present as for the exit tax rule in the ATAD. Moreover, it would not respect the principle of fiscal territoriality, linked to a temporal component, if the member state of the transferring company could, by unilateral means, impose a step-up in tax base mechanism in another jurisdiction.

4.2 Scrutinising the potential use of a step up in tax base mechanism in the Merger directive

Could a step-up in tax basis mechanism be inserted into the Merger directive in order to neutralise the discrepancies emphasised in chapter 3? As stated above, in section 4.1, article 5 of the ATAD does not explicitly cover mergers. Nonetheless, taking a comparative view, looking at the broad definition 'taxpayer'[146] in the ATAD and a comparison of the rules in the

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[140] See e.g. Judgment of 24 September 2019, *Netherlands v Commission*, joined cases T-760/15 and T-636/16, EU:T:2019:669, para 53.
[141] Boulogne in Haslehner, Kofler & Rust (2019) (n. 7), p. 193; Smit in Terra & Wattel (2018) (n. 133), p. 257.
[142] ATAD (n. 12), article 3.
[143] Case 6/64 *Costa v. ENEL* (n. 57), sec. "On the submission that the court was obliged to apply the national law", p. 594; Smit in Terra & Wattel (2018) (n. 133), pp. 256-257.
[144] See Merger directive (n. 3), article 4.
[145] See e.g. Case 6/64 *Costa v. ENEL* (n. 57), sec. "On the submission that the court was obliged to apply the national law", p. 594.
[146] See ATAD (n. 12), article 1.

Merger directive and e.g. article 5(1)(c) of the ATAD, which states that exit tax shall not be levied on the transferred assets that remain effectively connected to a P.E. in the transferring state, one may infer that the provisions in article 5 of the ATAD were intended to complement the provisions of the Merger directive.[147] Moreover, regardless of whether the ATAD explicitly would cover mergers, it would, by reference to the principle of legal certainty, be desirable to have any provisions related to a step-up in tax base mechanism, concerning mergers, inserted into the Merger directive.[148]

A step-up in tax base mechanism with similar characteristics to the one in the ATAD could be adopted into the Merger directive. When the transferred assets would become attributable to a remaining P.E. in the member state of the transferring company, the step-up in tax base mechanism would not apply because the member state of the transferring company would retain their fiscal competence with regards to the transferred assets.[149] On the contrary, if the transferred assets would not be attributable to a remaining P.E. of the receiving company in the member state of the transferring company and the state of the transferring company would levy an exit tax[150], then the step-up in tax base mechanism would apply. Accordingly, the member state of the receiving company would have to grant a step-up in the tax base of the transferred assets, corresponding to the market value established by the state of the transferring company. As in the ATAD, the member state of the receiving company would be allowed to dispute the valuation if not considered to be the appropriate market value at arm's length. This would not be contradictory to the rules in article 4 of the Merger directive, nor any of its aims, since no taxation would occur at the time of the merger.[151] Likewise, there would be no conflict between the Merger directive and the CJEU's case law on exit taxation. It has been established, from the case law on exit taxation, that determining the amount of tax due at the time of exit and subsequently collecting the tax in annual instalments over a number of years is proportional since it ensures the balanced allocation of the power to impose taxes between the member states and it respects the principle of territoriality linked to a temporal

[147] Boulogne in Haslehner, Kofler & Rust (2019) (n. 7), p. 193.
[148] See Boulogne (2016b) (n. 49), pp. 812-813, who argues in a similar manner regarding the use for directives as codifications of the fundamental freedoms.
[149] Assuming the transferring and the receiving state has adopted a tax treaty equivalent to the OECD model tax convention, see n. 67.
[150] Naturally, such an exit tax would have to be in line with EU law. This could also be specified in the provision in the Merger directive, e.g. like the need for a tax claim to be settle, corresponding to the unrealised gains, and the option for tax to be collected in instalments over a number of years.
[151] See Merger directive (n. 3), article 4; Merger directive (n. 3), preamble, recital 2 and 5; see also C-207/11 *3D I Srl* (n. 62).

component.[152] This means that the right to tax profits and, by the principle of symmetry, also the requirement to take into account of the corresponding losses are respected.[153] Profits and losses derived in the territory of a member state will be accounted for in that member state.[154]

Adopting a step-up in tax base mechanism as described above would, nevertheless, leave the Merger directive with the same mutual recognition problem regarding market valuation of the transferred assets as is the case in ATAD.[155] As stated in section 4.1, even with the methods available for determining the market value of the transferred assets at arm's length, agreement is not guaranteed since the application of different methods may result in different perceptions of the correct market value.[156] If the market valuation of the transferring member state would not be accepted, then there is a risk of no step-up in tax base to the fair market value due to no agreement being reached between the member states. Moreover, there is also the possibility that a market value that is lower than the transferring state's valuation is mutually agreed. Both outcomes are troublesome in the light of the aims of the Merger directive.[157] In the former, the merger would not be neutral for tax purposes because of the risk for double taxation.[158] In the latter, the aim to safeguard the financial interests of the member states of the transferring company have not been achieved, due to a lower tax claim than accounted for by that state. In both of the above expressed outcomes will the financial interests of the receiving state be protected, rather than the aims expressed in the preamble of the Merger directive.[159] Since the only member state that the Merger directive expresses a will to safeguard is the member state of the transferring company, one potential alternative to align the step-up in tax base mechanism with the aims of the Merger directive would be to strip the member state of the receiving company of their right to not accept the market value established by the member state of the transferring company. However, this measure would not be in line with the rule in article 5(5) of the ATAD. Hence this approach would cause a loss of legal certainty within the field of exit taxation. In the light of the above, the approach suggested in the ATAD of relying on the existing dispute

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[152] See e.g. C-371/10 *National Grid Indus* (n. 10), paras 58 et seq.; C-657/13 *Verder LabTech* (n. 104), paras 52-53.
[153] See e.g. C-371/10 *National Grid Indus* (n. 10), para 58; Opinion of Advocate General Kokott in C-405/18 *Aures* (n. 69), paras 40-42.
[154] See e.g. C-371/10 *National Grid Indus* (n. 10), paras 46, 49, 58; Joined cases C-327/16 and C-421/16 *Jacob and Lassus* (n. 31), para 65; Opinion of Advocate General Kokott in C-405/18 *Aures* (n. 69), para 35.
[155] See to that extent ATAD (n. 12), article 5(5); ATAD (n. 12), preamble, recital 10; see also Smit in Terra & Wattel (2018) (n. 133), p. 256.
[156] As was the case in e.g. joined cases T-760/15 and T-636/16 *Netherlands v Commission* (n. 140), para 53.
[157] See Merger directive (n. 3), preamble, recitals 2 and 5.
[158] See e.g. van den Broek (2012) (n. 41), pp. 368-369.
[159] See Merger directive (n. 3), preamble, recitals 2 and 5.

resolution mechanisms or to otherwise reach mutual agreements in order to resolve any valuation disputes is, in the current state of EU law, as good as it gets.[160]

4.3 Scrutinising the potential use of a step up in tax base article in tax treaties

As seen in section 4.2, the main drawback of implementing a step-up in tax base mechanism into the Merger directive is the problem of achieving one of the purposes of the directive while, simultaneously, retaining the right of the member state of the receiving company to refuse the market value established by the member state of the transferring company, if the value would not correspond to the market value at arm's length. Put differently, the main shortcoming is to fulfil the purpose of safeguarding the financial interests of the transferring member state, while still keeping the provision in line with the exit tax rule in the ATAD, which would be desirable for reasons of legal certainty.

In contrast to the Merger directive, tax treaties do not have the same explicit objective of safeguarding only one of the involved states. on the contrary, tax treaties strive to, bilaterally or multilaterally, allocate the taxing power between the contracting states.[161] Following that, unlike what was discussed in section 4.1, regarding member states imposing, by unilateral means, a requirement of a step-up in tax base to a specific value, on another member state, tax treaties constitute bilateral or multilateral agreements.[162] Hence, the rules in a tax treaty have more authority on both sides of the agreement, compared to the situation where one state unilaterally tries to invoke rules.

An exit tax rule, with similar characteristics to the one in the ATAD, could be inserted in the article of treaties concerning allocation of taxing rights with respect to capital gains.[163] From an EU perspective, the exit tax rule and the step-up in tax base mechanism could not be applicable for all the provisions in article 13 of the OECD model tax convention, which concerns capital gains. If the rule would be applicable to article 13(2) of the OECD model tax convention, it would target the disposal of assets transferred in a merger, when they are subsequently sold from the P.E. remaining in the state of the transferring company, to which they were attributable. This would not be in accordance with the Merger directive.[164] To align the rule with the Merger directive, which would be necessary from the point of EU

[160] See ATAD (n. 12), article 5(5) and ATAD (n. 12), preamble, recital 10.
[161] To that end, see e.g. the preamble of the OECD model tax convention (n. 67).
[162] To that end, see e.g. the preamble to the OECD model tax convention (n. 67), as well as the distributive rules in article 6-22.
[163] See OECD model tax convention (n. 67), article 13.
[164] See Merger directive (n. 3), article 4(1) and article 4(2).

law, the rule could be applied to article 13(5) of the OECD model tax convention. This provision governs the taxation of those capital gains not otherwise covered by that article.[165] The effect would be that there would be no exit tax on capital gains pertaining to P.E.'s and no requirement of a step-up in tax base for the transferred assets when they remain attributable to a P.E. in the member state of the transferring company after the merger. This is reasonable since the assets are not actually exiting the territory of the state of the transferring company. Likewise, the state of the transferring company retains their fiscal connection to the transferred assets through the P.E. after the merger.[166]

Similar to the exit tax rule in the ATAD, this exit rule would require the state of the receiving company to grant a step-up in tax base of the transferred assets. This would entail that the state of the receiving company accepts, as a starting point for tax purposes, a market value established by the state of the transferring company, at the time of the exit. This adoption would respect the principle of territoriality linked to a temporal component, since gains arising in the transferring state would be taxed there and subsequently realised gains arising in the receiving state would be taxed there.[167] By the principle symmetry, losses realised after the transfer would, likewise be taken into account in the receiving state.[168] Moreover, it would be desirable to define the term 'market value' in the treaties, e.g. as the price reached at arm's length.

Lastly, as in the ATAD, it would be possible for the receiving state to refuse to accept the market value established by the transferring state if it considers the value not to be at arm's length. Tax treaties drafted in accordance with the OECD model tax convention contains an article for dispute resolution.[169] If the receiving state would not accept the market value established by the transferring state, such a dispute could be resolved in a mutual agreement procedure under that article.

4.4 Intermediate conclusion

This chapter followed up on the discrepancy highlighted in chapter 3. The potential value of a step-up in tax base mechanism, for assets transferred in a merger, has been scrutinised with the aim to mitigate the different outcomes for tax purposes in a scenario where no P.E. remains in the member state of the transferring company after the merger, compared to when the transferred assets are effectively connected to a P.E. in the

[165] See OECD model tax convention (n. 67), article 13(5).
[166] ibid., article 7(1) and article 13(2).
[167] See C-371/10 *National Grid Indus* (n. 10), para 58.
[168] To that end, see ibid., para 58.
[169] See OECD model tax convention (n. 67), article 25.

member state of the transferring company. The exit tax rule in the ATAD and its step-up in tax base mechanism, as well as a conceivable step-up in tax base mechanism, potentially, inserted into the Merger directive or into tax treaties have been scrutinised for their potential benefits and drawbacks when it comes to reassuring that the taxpayer will have losses, realised after the merger, taken into account.

As shown in section 4.1, the exit tax rule in the ATAD does not explicitly cover cross-border mergers. Hence, the exit tax rule, in itself, is of limited use for reassuring that the starting value for tax purposes, in the member state of the receiving company, is the same as the market value established by the member state of the transferring company at the time of the merger. However, since the directive sets a minimum standard, member states are free to implement rules, similar to the exit tax rule in the ATAD, into their domestic legislation. This holds provided that the implemented rules comply with EU law. In order to comply with the Merger directive, the rule implemented by the member state would only allow for exit tax to be levied when the transferred assets are not attributable to a P.E. remaining in the member state of the transferring company. Notwithstanding the possibility of the member state to implement an exit tax rule in merger situations by unilateral means, such an exit tax rule would not have the same authority as the one in the ATAD. This is because the step-up in tax base mechanism would not be enforceable on the member state of the transferring company when the member state of the transferring company implements it unilaterally.

Another potential solution to mitigating the discrepancies highlighted in chapter 3, would be to insert, in the Merger directive, a step-up in tax base mechanism with similar characteristics as the one in the ATAD. Such a provision would only be active when the transferred assets do not remain connected to a P.E. in the member state of the transferring company after the merger and, simultaneously, that member state levies an exit tax related to the unrealised gains of the transferred assets. i.e. the step-up in tax base mechanism would not apply when the P.E. requirement in article 4 of the Merger directive is fulfilled. Furthermore, implementing such a rule would not cause any conflict between the Merger directive and the case law on exit taxation. It would, likewise, be in line with the exit tax rule in the ATAD, thus, contributing to legal certainty. However, this adoption would leave the Merger directive with the same mutual recognition issue as is present in the ATAD, regarding the market valuation of the transferred assets. That being said, the approach suggested in the ATAD, of relying on the existing dispute resolution mechanisms or to otherwise reach mutual agreements in order to resolve any valuation disputes is the most reassuring tool, presently available in the current state of EU law.

The last presented solution to mitigating the discrepancies highlighted in chapter 3, was to insert a step-up in tax base mechanism, with similar characteristics to the one in the ATAD, into article 13(5) of the OECD model tax convention. This would reassure that no tax would be levied when the transferred assets stay attributable to a P.E. remaining in the state of the transferring company after the merger. Likewise would this exit rule reassure an effective allocation of taxation of capital gains in a way that respects the principle of territoriality linked to a temporal component, while simultaneously assure that subsequently realised gains, as well as losses will be accounted for in the state of the receiving company. Disagreements on what the market value is at arm's length can be solved using the mutual agreement article in the treaty.

To sum up, all options presented have a mutual recognition problem. Since the ATAD does not explicitly cover mergers, it is of limited use to mitigating the discrepancies highlighted in chapter 3. To the same end would member states unilaterally extending the exit tax rule in the ATAD to mergers be of limited use since the step-up in tax base mechanism would lack authority. Inserting an exit tax rule into the Merger directive, that would only apply when the transferred assets are not attributable to a remaining P.E. in the state of the transferring company, seems, at first, like a desirable option for mitigating the discrepancies highlighted in chapter 3. However, allowing the receiving state to not accept the step-up value could lead to the objective of the directive, to safeguard the financial interests of the state of the transferring company, to not be achieved. On the other hand, stripping the receiving state of this right would create a disparity between the exit tax rule in the Merger directive and the ATAD. This would be undesirable for reasons of legal certainty within the field of exit taxation. Since tax treaties do not have the same explicit objective, as the Merger directive, of protecting one specific state involved, they make for a suitable alternative to insert an exit rule into. An exit rule, with similar characteristics to the one in the ATAD, could be inserted into article 13(5) of the OECD model convention and disputes concerning the market value for the step-up could be solved in a mutual agreement procedure under article 25.

5 Summary of findings

The objective of this study has been twofold. Firstly, the purpose has been to examine how the outcomes for tax purposes, at the company level, differ depending on whether the assets transferred in a merger remain attributable to a P.E. in the state of the transferring company, when those assets are subsequently realised with a loss after having decreased in value, post-merger, to a level below their book value. These situations were illustrated

in chapter 2 and subsequently examined in chapter 3. The findings show that in the first scenario, where the assets transferred in a merger remain attributable to a P.E. in the member state of the transferring company after the merger, will lead to that state being faced with a loss when the assets are ultimately disposed. Thus, in this scenario the Merger directive achieves a neutrality for tax purposes. In the other scenario, where the transferred assets or a P.E. do not remain in the member state of the transferring company, the story is different. Here, the findings show that the member state of the transferring company may, through instalments, fully tax the hidden gain that is unrealised at the time of the merger, whereas the subsequently realised loss may possibly not be taken into account fully anywhere. Thus, there is a discrepancy in the treatment of the realised loss in these two scenarios, depending on whether the transferred assets remain effectively connected to a P.E. in the member state of the transferring company after the merger. Despite the different outcomes for tax purposes, the cross-border restructuring operations covered by the objective scope of the Merger directive have been utilised to exercise the freedom of establishment in both scenarios.

Secondly, the purpose has also been to investigate to what extent a step-up in tax base mechanism, the one in ATAD as well as a conceivable step-up in tax base mechanism inserted in the Merger directive or tax treaties, could be suitable to mitigate these discrepancies. This was examined in chapter 4 and the findings show that all the presented options have a mutual recognition problem. Moreover, the ATAD does not explicitly cover mergers. Hence, it is of limited use in mitigating these discrepancies. The same goes for member states unilaterally extending the exit tax rule in the ATAD to mergers. The lack of authority that member state has in another jurisdiction, makes it impossible to impose the step-up value on the other state. Inserting an exit tax rule into the Merger directive, that would only apply when the transferred assets are not attributable to a remaining P.E. in the state of the transferring company, seems, at first, like a desirable option for mitigating the discrepancies. However, this would create a crossroad where one way leads to the receiving state having the option to refuse the step-up value established by the member state of the transferring company and the other way leads to the receiving member state being stripped of this option. The former would lead to the objective in the directive, of safeguarding the financial interests of the state of the transferring company, to not be fulfilled. The latter would create a disparity between the exit tax rule in the Merger directive and the ATAD, which would be undesirable for reasons of legal certainty within the field of exit taxation. None of these options would be preferable. Unlike the Merger directive, tax treaties do not have the explicit objective of protecting the interests of only one of the states involved. This makes tax treaties a more suitable alternative for eliminating the discrepancies. In short, an exit rule, with similar characteristics to the one in the ATAD, could be inserted into article 13(5) of the OECD model

convention and disputes concerning the market value for the step-up could be solved in a mutual agreement procedure under article 25. The fact that states may not always perceive the market value of the transferred assets in the same way is an issue that cannot be solved entirely. Luckily, there are mechanisms that strives to sort out this issue.

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