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The Distribution Tax Regime Paradox

Compatibility of Estonian Tax Treatment of Non-Residents' Capital Gains from Alienation of Immovable Property with European Law

by

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Abstract

The four fundamental freedoms granted to residents in the Community have become the pillars for fairness between economic operators and persons within the internal market. The aim of the freedoms is to prohibit any restriction or discrimination toward residents of another Member State and endorse equal treatment. Subsequently, tax laws of Member States have been scrutinised before the Court of Justice of the European Union on many occasions in this regard. However, the jurisprudence of the Court clearly indicates that there is a line, although often subjective and circumstantially contingent on specifics such as purpose and aim of the legislation.

Likewise, the Estonian income tax legislation can be inspected in this regard as it confers resident companies the incentive to indefinitely defer their profits, including capital gains from sale of immovables, whereas non-resident corporate taxpayers are subject to immediate taxation. At first glance, the situation seems to constitute a textbook fundamental freedoms infringement case, whereby different rules are applied to the same, comparable situation. However, many nuances are relevant in this regard, which are discussed in more detail in the analysis conducted herein.

Although, with careful and supervised planning, corporate non-residents might not always suffer from the disadvantage, a restriction is nonetheless present. Despite the need to protect the balanced allocation of taxing rights might be a valid justification for such national provisions, especially considering that most bilateral double tax conventions confer the Contracting States the right to tax gains realised by economic operators from sale of immovable property located on their territory. Nevertheless, the Court has thus far been reluctant in finding similar measures to be proportional. Correspondingly, due to the availability of less restrictive methods, it is difficult to deem the Estonian rule for taxation of non-residents on real estate income to be proportional in attaining the aim and purpose of the provision.

Preface

This thesis is written in loving memory of my late grandmother, who passed shortly after my departure to Sweden to pursue my Master's degree. I will be forever grateful for showing me how fortunate I am to be part of a generation that gets to pursue higher education freely and internationally, an opportunity that should never be taken for granted.

I would like to extend my deepest appreciation to my professor, Cécile, for her devoted supervision and guidance throughout the programme as well as during the writing of this thesis. I admire her unparalleled curiosity and enthusiasm toward tax law, which has truly inspired me. I recall the first fundamental freedom cases *Bachmann* and *Columbus Container Services* I ever read and presented during the fundamental freedoms case-law seminars that spanned over two weeks. These weeks were exceptionally captivating and insightful, which sparked the interest in me to devote my research to this area of European tax law. I would also like to express my sincerest gratitude to Sigrid Hemels, Giorgio Beretta, Mariya Senyk for their dedication and contribution in introducing me to other areas of international taxation and providing a diverse, profound proficiency in their respective fields.

Finally, I am truly thankful to my family for the support and confidence in me on this journey. Moreover, I am glad to share the cherished memories of beloved professors, classmates and friends as well as leave Lund with a curious mind and a fair share of knowledge.

Abbreviation list

AG	Advocate General
CIT	Corporate Income Tax
DAC	Directive on Administrative Cooperation
DTT	Treaty for the Avoidance of Double Taxation
CJEU	European Court of Justice
EEC Treaty	Treaty Establishing the European Economic Community
ETCB	Estonian Tax and Customs Board
ETR	Effective Tax Rate
EU	European Union
ITA	Estonian Income Tax Act
MAP	Mutual Agreement Procedure
MTC	Model Tax Convention
OECD	Organisation for Economic Cooperation and Development
PE	Permanent Establishment
P&L	Profit & loss
SPV	Special Purpose Vehicle
TFEU	Treaty on the Functioning of the European Union
WHT	Withholding Tax

1. Introduction

1.1. Background

This dissertation focuses on different tax treatment of capital gains realised by non-resident companies with respect to transactions involving transfer of immovable property. The difference in treatment derives from the peculiarities of the Estonian CIT system, often referred to as the distribution tax regime, the main rule of which regarding taxation of resident companies is laid out in paragraph 50(1), (2) and (2^2) ITA. Generally, corporate taxation in Estonia is postponed until distribution of dividends or reductions in share capital inasmuch they exceed the contributions made into equity as well as liquidation proceeds, this also includes capital gains.[1] For non-resident companies, however, paragraph 29(4)(i) or (v) ITA applies, according to which they are subject to special capital gains tax on gains realised from alienation of immovable property located in Estonia, disposal of shares in a real estate company established in Estonia or receipt of liquidation proceeds of such company.[2] The applicable provisions in ITA are described in more detail in comparability analysis undertaken in Chapter 3.3.1. This dissertation seeks to establish whether application of different rules for residents and non-residents constitutes a restriction on fundamental freedoms as the different treatment results in a cash flow disadvantage for non-resident operators.

The issue has received attention from Estonian domestic courts on two occasions. First, in 2012 when the Tallinn District Court ruled in an appeal 3-10-25[3] that liquidation proceeds earned by a non-resident shareholder, which consist mainly of gains from alienation of immovable property, shall be considered as capital gains and thereby Article 13(1) (capital gains from alienation of immovable property) of the DTT between Estonia and Austria applies rather than Article 21 (other income). The applicant had also sought protection from EU law, sustaining that paragraph 29(4)(v) ITA is contrary to freedom of establishment and free movement of capital, but the Court disagreed. The Court's assessment on the potential breach of EU law is regardless ambiguous to a certain extent and some questions were left unanswered. The topic has also been touched upon in more detail from EU law perspective in an article written by Uustalu[4] in 2011, when the case was still pending before Tallinn District Court.

[1] Income Tax Act (*Tulumaksuseadus*), 1999, consolidated version in force from 06.04.2022, paras 50(1); 50(1); 50(2^2), (Estonian Income Tax Act).
[2] ibid., para 29(4)(i) and (v).
[3] *ImmoEast Beteiligungs GmbH v Estonian Tax and Customs Board* [2012], 3-10-25/61, Tallinn District Court.
[4] Uustalu, E., 'The Compatibility of the Estonian Tax Treatment of Real Estate Income with EU Law' (2011), Intertax, volume 39, issue 8/9, 449.

Second, another District Court ruling 3-14-26[5] was rendered 3 years later in 2015, which reflected rather on civil law aspects to extend paragraph 29(4)(v) of ITA to the taxpayer's situation. The District Court ruled that to the extent immovable property is designed and constructed to operate as a heat and power plant, heavy machinery and equipment that is an integral part of the property, form one singular unit and should thereby be included in the same tax base. The emphasis was placed on the fact that where the absence of the machinery would significantly undermine the function of that property, it should be considered as one single unit, regardless of whether the machinery could theoretically be removed and sold separately.[6]

Neither of the cases would have been brought before the Court had the applicant been a resident company as they enjoy indefinite deferral of CIT until such profits are distributed irrespective of the source of income. It is irrelevant whether the gains are earned from alienation of immovable or movable property – it is still considered as business income for resident companies. Moreover, the matter has surprisingly managed to escape the attention of CJEU despite the significance of the problem and neither have the Estonian domestic courts thus far recognised any discriminatory tax treatment of non-resident companies in dealings with immovable property located in Estonia.

It is noteworthy that, according to tax practitioners at PwC, similar problem might exist in Latvia, where a similar model for corporate taxation was adopted in 2018. Similarly to the Estonian system, corporate profits, including capital gains from alienation of securities and shares can be deferred until distribution by both residents and non-residents with exception to transfer or sale of immovable property by non-residents.[7]

1.2. Aim

This research is intended to update the findings of Uustalu with the outcome of both the case 3-10-25 and the infringement procedure against Estonia, which he mentioned in his article as well as provide an update in the light of recent advancements in the CJEU case-law. Further, his contribution is supplemented with analysis from the perspective of double tax conventions. This dissertation carries out an assessment of the tax treatment of non-residents in Estonia with regard to alienation of real estate/immovable property and compatibility of the corresponding provisions in ITA with the fundamental freedoms set out in TFEU.[8] The purpose of this thesis is to

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[5] *Dalkia International S.A. v Estonian Tax and Customs Board* [2015], 3-14-26/40, Tallinn District Court. For case overview in English see also 'Estonia - Case 3-14-26' IBFD.

[6] ibid, para 15.

[7] PriceWaterhouseCooper, 'Latvia, Corporate – Taxes on corporate income' (Wordlwide Tax Summaries, 12 January 2022) < https://taxsummaries.pwc.com/latvia/corporate/taxes-on-corporate-income > accessed 20 May 2022.

[8] Consolidated version of the Treaty on the Functioning of the European Union, [2012] OJ C 326/01.

evaluate on whether ITA discriminates against non-residents in treatment of capital gains realised from disposal of real estate or shares in a real estate company.

The leading research question for this dissertation is therefore: *Does paragraph 29(4) of the Estonian Income Tax Act constitute a restriction of Articles 49 and 63 of the TFEU*?

1.3. Methodology and material

This research paper follows the legal dogmatic method to examine the current state of Estonian tax legislation, including two rulings rendered by Tallinn Circuit Court. Moreover, bilateral DTTs concluded by Estonia alongside with European primary and secondary law as well as jurisprudence of CJEU on free movement in corporate taxation is assessed. The aim of this research is to determine whether the tax treatment of non-residents in conjunction with the Estonian peculiar CIT regime constitutes a restriction on Articles 49 and 63 TFEU.[9] It must be noted that upon the delivery of facts and arguments of the rulings produced by Estonian domestic courts, the authentic text is, first and foremost, relied on, which is generally not translated into English as opposed to most Estonian legal acts such as ITA or the General Part of the Civil Code Act. Nonetheless, although limited in substance, some publications reflecting on these rulings exist in English and thereby a reference is made also to the secondary sources (i.e., publication which reflects on the ruling) in addition to the primary source (i.e., the authentic text of the ruling).

The assessment is supported by legal literature such as articles, research papers, books as well as soft law publications and commentaries to provide a broad spectrum of considerations and arguments complementing the dissertation. The underlying analysis then delivers assessment whether the restriction on free movement of capital is justified, proportional and does not go beyond what is necessary to obtain its purpose.

1.4. Delimitation

The analysis carried out herein reflects partly on the findings of the article written by Uustalu in 2011, with extension of the scope of the analysis to the OECD 2017 MTC and bilateral tax treaties concluded by Estonia as well as inclusion of another case from 2015 rendered by the Tallinn District Court. It must be recalled that at the time of writing his article, both case 3-10-25 and infringement procedure case no. 2008/4851 initiated by the European Commission against Estonia were still pending. Therefore, the tax rate disadvantage incurred by non-residents is excluded from the analysis, which was investigated by Uustalu in his article, as Estonia changed its legislation

[9] Sjoerd Douma, *Legal Research in International and EU Law* (Wolters Kluwer, 2014), 18.

in this regard.[10] Furthermore, the analysis undertaken herein reflects only on the cash flow disadvantage stemming from granting indefinite CIT deferral to residents and not to non-resident companies. The arguments presented herein rebut and override the findings of Uustalu to certain extent with regard to e.g., the choice of fundamental freedom applicable to the case, the comparability analysis and proportionality analysis.

Given the special corporate tax regime in Estonia, which also is the core for the problems discussed herein as well as the relevant disputes brought to Estonian domestic courts, the analysis carried out herein omits taxation of natural persons and is directed only toward legal persons transferring or alienating immovable property or shares in a company located in Estonia whose assets consist mainly of immovables.

Moreover, this thesis will not take into consideration state aid implications arising from preferable tax treatment and granting of a tax incentive to resident operators in the real estate sector that nevertheless remain relevant to the situation. Inclusion of such topic entails an extensive research and discussion revolving around case-law and infringement procedures in the field of state aid that exceeds the scope of this research.

1.5. Outline

Free movement and the concept of non-discrimination are at the centre of this dissertation. The research is therefore structured accordingly: firstly, a general framework is described in Chapter 2 giving insight to previous contributions on the topic followed by overview of the two domestic cases including tax treaty interpretation as well as commentary and remarks on the two domestic cases. In Chapter 3, the research paper reflects on the issue from EU law perspective by establishing which of the four fundamental freedoms is applicable, whether there is difference in treatment and conducting a comparability analysis between resident and non-resident companies with the aim of determining presence of discrimination and restriction on free movement of capital and freedom of establishment, including analysis of possible justifications as well as a proportionality test following the arguments and methods used in the jurisprudence of CJEU.

[10] European Commission, 'Taxation: Commission requests Estonia to amend discriminatory tax rules for non-resident investment funds' (press release, IP/11/718, 16 June 2011).

2. General framework

2.1. Previous contributions to the research

Uustalu essentially raised three questions with respect to taxation of real estate income of non-residents in Estonia. He firstly examined whether the cause of different tax treatment is borne by application of different tax rates to resident and non-resident investment funds. Although one can no longer build a case on the fact that non-resident investment funds have a higher tax burden as the legislation was amended following an infringement procedure initiated by the Commission.[11] Secondly, Uustalu contends that different computation of the taxable base whereby taxation of non-residents on gross and residents on net tax basis results in unequal treatment. Thirdly, cash flow disadvantage arising from specific features of Estonian corporate tax regime conferring indefinite tax deferral to resident companies was analysed.[12]

The problem in 2022 therefore appears to be two-fold and the rest of Uustalu's concerns seem to prevail. First, there is the difference in tax computation and deductions, i.e., where a non-resident earns rental income from real estate, withholding tax at 20% is borne on the gross amount. Analogously, if a non-resident disposes of real estate or a holding in a real estate company as well as upon liquidation of such company, only acquisition cost of that immovable property shall be taken into account in computation of the tax base. This means that deductions of expenses, such as debt and interest expenses related to acquisition of the property, insurance premiums, administrative fees and taxes such as property/land taxes borne by non-residents in Estonia are precluded or severely limited. On the contrary, resident companies are subject to net tax basis, whereby they are entitled to deduct any expenses incurred throughout their economic activity, including expenses and losses from other sources and business activities.[13] Net and gross tax basis is however an issue of general nature. On the one hand, the principle of territoriality foresees that tax deductions can be made by non-residents only with regard to the costs that have a direct link with the income in the host state.[14] This means that, in principle the non-resident could demand to make relevant deductions and thus be subject to taxation on a net tax base. On the other hand, this issue is likely to fall under the *Marks and Spencer* line of case-law, whereby the expenses will have already been deducted in the other state, giving rise to the need to prevent double deduction of losses.[15] Moreover, when it comes to alienation

[11] ibid. (press release, IP/11/718, 16 June 2011).
[12] Uustalu, E., 'The Compatibility of the Estonian Tax Treatment of Real Estate Income with EU Law' (2011), Intertax, volume 39, issue 8/9, 449, 449.
[13] ibid., 453.
[14] M. Helminen, 'Chapter 2: Non-Discrimination and Basic Freedoms in EU Tax Law' in *Direct Taxation – 2021* (2021 Edition, IBFD), Books IBFD, chapter 2.3.6., 172.
[15] Case C-446/03 *Marks and Spencer* [2005] EU:C:2005:763, paras 43; 47.

of shares in a real estate company located in Estonia, related expenses and deductions are highly likely already taken into account in the valuation conducted by financial, tax and legal advisers as well as accountants and should thus be reflected in the sale price. Likewise, in case of liquidation proceeds of an Estonian real estate company, these losses are already deducted on the accounts of the resident company and are thereby reflected in the calculations of liquidation proceeds to be transferred to the parent. For these purposes, the analysis conducted herein reflects only on the cash flow advantage, as already mentioned in Chapter 1.4.

Therefore, the most important issue to be discussed is the cash flow disadvantage borne from the peculiarities of Estonian tax regime, according to which resident companies enjoy an option of unlimited deferral of CIT. Non-resident companies, however, are unqualified to benefit from the preferential regime unless they conduct their business in Estonia through a permanent establishment or a subsidiary. Although occasions where the former is not exercised are somewhat rare, the disadvantage is clearly present and appears in set-ups involving real estate income. It must be noted that presence of a subsidiary or PE may still result in the occurrence of the disadvantage to reappear with respect to liquidation proceeds or disposal of shares in such subsidiary and cessation of PE's activity such as that in the *ImmoEast* proceedings.

2.2. Tallinn District Court rulings

2.2.1. *ImnoEast Beteiligungs GmbH v ETCB*

The case concerns an Austrian company ImmoEast Beteiligungs GmbH (hereinafter ImmoEast) that held 45% of capital in an Estonian private limited company Robbins OÜ (hereinafter Robbins) that undertook the development of an apartment complex capable of accommodating 800 families. For the purposes of the construction, Robbins acquired immovable property in 2006 yet was forced to dispose of the land in August of 2007 due to the downtrend in the real estate market. Amidst the global financial crisis that shortly followed, the shareholders of Robbins decided to liquidate the company in January of 2008. It must be noted that at the time of the decision to liquidate, the company did not possess any immovable property. Nonetheless, Robbins had realised capital gains from the alienation of the plot of land, which superseded substantially the income from other sources. The liquidation proceeds were transferred to ImmoEast in April of 2008, and the gains were declared in 2009. Request for a refund followed shortly thereafter by reference to the DTT between Austria and Estonia as well as Articles 43 and

56 of the EEC Treaty (current Articles 49 and 63 TFEU) for which the taxpayer got a negative response from the tax authorities.[16]

The conflict was essentially the interpretation of the tax treaty between Austria and Estonia: the applicant argued that liquidation proceeds should be treated pursuant to Article 21(1) of the treaty (other income), whereas the tax authorities considered it a gain from alienation of property, i.e., Article 13(1) of the treaty. The correct application of either article was detrimental as the taxpayer sought to have the income taxed in Austria via application of Article 21(1), whilst the tax authorities contended the application of Article 13(1), which allocates taxing rights to Estonia.[17] In terms of DTT interpretation, the Court held that the applicant had linked Article 21 of DTT between Austria and Estonia with whether liquidation of a company can be considered alienation of property according to Estonian national law without providing any arguments on income categorisation of its own. The Court found that paragraph 15(3) ITA, according to which liquidation proceeds are subject to income tax inasmuch it exceeds acquisition cost, is systematically placed into paragraph titled "gains from transfer of property" and it is thus self-explanatory that liquidation proceeds shall be interpreted as such.[18]

The Court continued that it is crucial to assess whether the criteria in Article 13(1) of the Estonian-Austrian DTT allows paragraph 29(4)(v) of ITA to be taken into consideration. Essentially, the question was as to whether liquidation proceeds can be taxed as capital gains from immovable property in a situation where, although before the initiation of liquidation proceedings, but at some point, during the period of two years preceding the liquidation, the assets of the company consisted mainly of immovable property located in Estonia. The answer was found within Article 3(2) of the DTT between Austria and Estonia, which stipulates that, where a Contracting State employs a term upon application of the treaty that is not defined therein, national law of the Contracting State shall be applied. Further, inasmuch paragraph 29(4)(v) ITA applies to the situation of the taxpayer and no MAP is initiated between the Contracting States in regard to the interpretation of the treaty, one shall take guidance from the domestic law of the source state. The Court continued that it is unfounded to interpret Article 13(1) of the treaty narrowly in a way where Estonian tax authorities are entitled to tax the income as gains from immovable property only where the alienation of said property takes place during the liquidation proceedings.[19]

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[16] *ImmoEast Beteiligungs GmbH v Estonian Tax and Customs Board* [2012], 3-10-25/61, Tallinn District Court, para 1. For introduction to the case and proceedings before the Tallinn Administrative Court in English, see also Helen Pahapill 'Estonia: ImmoEast Beteiligungs GmbH' in Michael Lang and others (eds), *Tax Treaty Case Law around the Globe – 2011* (Wolters Kluwer 2012) 255-264.
[17] Convention between the Republic of Austria and the Republic of Estonia for the avoidance of double taxation with respect to taxes on income and capital [2001], Articles 13(1) and 21(1), (Estonian-Austrian DTT).
[18] ibid., para 11.
[19] ibid., para 12.

Finally, the Tallinn District Court upheld the tax authorities' appeal and revoked the applicant's claims related to breach of Articles 43 and 56 EEC Treaty. The Court maintained that the Estonian CIT regime does not proceed from different tax treatment based on residence but rather from the right of Estonia to exercise its power to tax gains realised from immovable property, a right that is assigned to Estonia in DTTs concluded with other states. The Court explained that the adverse disparities in tax treatment based on residency is borne from the need to prevent economic double-taxation because the DTT between Estonia and Austria prescribes the application of exemption method for income taxed in Estonia and double-taxation is thereby eliminated. When it comes to Articles 43 and 56 of the EEC Treaty, the Court answered that non-residents are not treated unfavourably, sustaining that by conferring the option for indefinite tax deferral, the taxation of residents is merely postponed until distribution of profits and the only difference in treatment between residents and non-residents is the taxable event. Concluding that, with reference to Article 58(1)(a) and (3) EEC Treaty (current Article 65(1)(a) and (3) TFEU), the relevant provisions are not contradicting Articles 43 and 56 of the EEC Treaty as the discrepancies are not arbitrary and derive directly from the peculiarities of the Estonian income tax regime.[20] Thereby, the Court ruled in favour of the tax authorities and deemed application of Article 13(1) of the DTT appropriate nor did it consider paragraph 29(4)(v) to be discriminatory toward non-residents.

2.2.2. *Dalkia International S.A. v ETCB*

The underlying case departs partly from the issues discussed herein and rather examines the issue from civil law perspective, limited language is provided for the national tax legislation as well as the applicable DTT, thus providing limited value to the research. The case nonetheless illustrates the excessive burden inflicted on non-residents and is therefore worth reflecting on. The dispute focused on whether, machinery and equipment, that is essential for the functioning of a combined heat and powerplant, should be considered immovable property for the purposes of extending paragraph 29(4)(v) ITA also to that equipment and machinery. The events building up to the case date to 2011, when Dalkia International S.A., a French company, sold its 85% shareholding in TEJ Valdus AS, an Estonian resident company, and duly paid EUR 4,9 million in corporate taxes pursuant to the same paragraph of ITA as discussed in the *ImmoEast* proceedings. It had applied for an advance ruling asking for exclusion of machinery and equipment from the tax base, which the tax authorities disagreed with.[21]

In appeal, the Tallinn District Court held that inasmuch the term "immovable property" is not defined within tax legislation, civil law shall be the basis for

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[20] ibid., para 13.

[21] *Dalkia International S.A. v Estonian Tax and Customs Board* [2015], 3-14-26/40, Tallinn District Court, para 1. For case overview in English see also 'Estonia – Case 3-14-26' IBFD.

the assessment and observed that the DTT between France and Estonia[22] does not state otherwise but rather provides even broader interpretation for immovable property. Furthermore, Article 6(2) of the treaty draws the definition of immovable property from laws of the Contracting State where such property is located. It continued that pursuant to the Civil Code, subjects such as equipment and machinery are considered essential parts of immovable property where they cannot be removed from the property without destroying or substantially damaging the equipment. The same applies to the property itself – the equipment and machinery are considered essential parts of immovable property where they are permanently connected to the property, the removal of which, would destroy or damage the property.[23] Moreover, the Court maintained that it is of little importance that it is theoretically possible to use the buildings of the plant for other purposes after removal of the equipment and machinery but rather that the underlying buildings are designed and constructed to operate as a power plant thereby forming one whole functional unit.[24]

2.3. Interpretation of double tax treaties

Unarguably, one important aspect is the application and interpretation of DTTs. There is often debate on the application procedure for the treaties as to which law needs to be examined first, the treaty law or domestic law. Regardless, it requires little effort to acknowledge that one arrives at the same outcome irrespective of which method is applied first. The order of preference in application of a DTT can be decided reasonably on a case-by-case basis, despite the treaty being considered as *lex specialis* in relation to the domestic law. For instance, Vogel's interpretation of tax treaty law suggests that a DTT is applied on top of domestic law as a stencil thereby covering or overriding certain parts of the domestic legislation.[25]

In regard to the *ImmoEast* case, Arnold[26] maintains in his article that the assessment of Tallinn District Court of Appeal, in relation to DTTs, is wrong because at the time of liquidation of the Estonian subsidiary, its assets did not primarily consist of immovable property located in Estonia – it had disposed of its immovable asset shortly prior to the commencement of the liquidation proceedings. He argues that Article 13(1) of the Estonian-Austrian tax treaty does not provide any requirement for holding period and it is unacceptable for a domestic court to extend such requirement to that article where the Contracting States did not include such text in the article. Therefore, the

[22] Convention between the Government of the Republic of Estonia and the Government of the French Republic for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital [1997].
[23] ibid., para 11. See also paras 53-55 General Part of the Civil Code Act.
[24] ibid., para 15.
[25] Klaus Vogel, *Klaus Vogel on Double Taxation Conventions* (Ekkehart Reimer and Alexander Rust eds, 5th edn, Wolters Kluwer 2022), 62.
[26] Brian J., Arnold, 'Tax Treaty Case Law News' (2012), IBFD, volume 66, issue: Bulletin for International Taxation, 481, 481.

underlying article of the DTT cannot be deduced to give taxing rights to Estonia regarding a resident subsidiary whose assets consisted of, at some point prior to the alienation of the shares, immovable property but did not so at the time of the disposal of the shares.[27]

On the other hand, Arnold's analysis of the case is the perfect reflection of Vogel's stencil theory and provides a comprehensive illustration of the relation between tax treaties and domestic laws. Indeed, the Austrian-Estonian treaty in no way provides for any holding requirement, however, this is included in paragraph 29(4)(v) of ITA, which includes holding requirement of 10% in the Estonian company as well as provides a threshold for the ratio between the company's assets and immovable property, i.e., the company's assets must have consisted at least 50% of immovable property at some point during 2 years prior to the alienation of the shares.[28] Since the treaty does not provide for any criteria of such kind, the 'stencil' allows the application of domestic law on this particular aspect, the same applies to *Dalkia* case.

Nonetheless, there is a way for non-residents to circumvent the issue by a way of a loophole in DTTs. Namely, relief can be found in the DTT signed between Estonia and the Netherlands[29], whereby only gains from transfer of immovable property becomes taxable in Estonia and not disposal of shares in a real estate company, which means that the former shall be then taxable in the resident state, i.e., the Netherlands – a country known for its tax treatment of capital gains under the *Herinvesteringsreserve*[30], a special tax deferral reinvestment reserve system, despite the transaction being also subject to a transfer tax at 8%.[31] To illustrate this, the text of Estonian-Dutch[32] and Estonian-Austrian treaty[33] is compared. Article 13(1) of the latter states that gains derived from alienation of immovable property located in the other state as well as shares in an establishment whose assets consist mainly of immovable property shall be taxable in the other state (i.e., Estonia in our case), whereas Article 13(1) of the Estonian-Dutch treaty provides that the gains realised by a resident of a Contracting State from transfer of immovable property located in the other State may be taxed in that other state. It can clearly be seen that text surrounding the tax treatment of capital gains from transfer of shares in an Estonian real estate company is missing in the

[27] ibid., 481, 483.
[28] Estonian Income Tax Act, para 29(4).
[29] Convention between the Republic of Estonia and the Kingdom of the Netherlands for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital [1997], (Estonian-Dutch DTT).
[30] Dutch Income Tax Act (Wet op de Inkomstenbelasting), 2001, Article 3.54. For English explanation, see PriceWaterhouseCooper, 'Netherlands, Corporate – Income determination' (Wordlwide Tax Summaries, 28 December 2021) < https://taxsummaries.pwc.com/netherlands/corporate/income-determination > accessed 9 May 2022.
[31] Dutch Real Estate Transfer Tax Act (Wet op Belastingen van Rechtsverkeer), 1970, Article 14. For English explanation, see PriceWaterhouseCooper, 'Netherlands, Corporate – Income determination' (Wordlwide Tax Summaries, 28 December 2021) < https://taxsummaries.pwc.com/netherlands/corporate/other-taxes > accessed 9 May 2022.
[32] Estonian-Dutch DTT, Article 13(1) and (4).
[33] Estonian-Austrian DTT, Article 13(1).

Estonian-Dutch treaty. For that reason, those capital gains trigger application of paragraph 4 of the article dealing with capital gains not referred to in paragraphs 1, 2 and 3 that will be taxable in the state where the alienator is resident. Interestingly enough, with little research in the Estonian Ministry of Finance database of the bilateral tax treaties concluded by Estonia, one can ascertain that Estonian-Dutch treaty is the only one that allocates capital gains from disposal of shares in an Estonian real estate company to the resident state rather than source state.[34]

Although this might raise questions of its own regarding ethics and abusive practices, the Court has regardless held, on multiple occasions, that it is not contrary to EU law for a taxpayer to seek a tax regime that is most favourable for him/her. It cannot, by itself, raise general presumptions and speculations around fraud or abuse and cannot thereby constitute an illegitimate purpose.[35] The taxpayer can only be deprived of enjoying tax advantages by relying on EU law in instances, where the taxpayer lacks economic substance and participates in wholly artificial arrangements intended for escaping from a Member State's laws.[36] Meaning that a Dutch SPV owning shares in an Estonian real estate holding company cannot be considered to be a conduit company as long as it satisfies the requirements of having sufficient substance based on the criteria of having e.g., an active management board, staff and premises, equipment as well as balance sheet and P&L statement reflecting genuine economic activities such as income and expenditure.[37]

It can only be assumed that most well-advised multinational companies have sought to set up a SPV real estate holding in the Netherlands, little research into Estonian companies is required to establish that most of them owning immovable property in Estonia have a Dutch parent. This is perhaps the reason why the issue has been brought before domestic courts only on two occasions, both of which were somewhat exceptional.

It must be recalled that tax treaties shall allocate but not discriminate.[38] Although, one can assume that paragraph 29(4) of ITA protects Estonia's right to tax capital gains from immovable property located in Estonia where there is no DTT concluded with the other state where the non-resident alienator has its economic seat. Particularly considering that the content of paragraph 29(4) is similar to that of Article 13 OECD MTC that is generally present in most tax treaties, i.e., conferring the taxing rights on such gains to the state where the immovable property is located. Nevertheless, it can be

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[34] Rahandusministeerium (Minstry of Finance), 'Overview of Estonian bilateral Conventions for Avoidance of Double Taxation and Prevention of Fiscal Evasion' (*Riigiteataja*, 22 October 2021).

[35] C-371/10 *National Grid Indus* [2011] EU:C:2011:786, para 84; Joined Cases C-116/16 and C-117/16 *T Denmark and Y Denmark Aps* [2019] EU:C:2019:135, para 81.

[36] Case C-322/11 *K* [2013] EU:C:2013:716, para 61; C-106/16 *Polbud – Wykonawstwo* [2017] EU:C:2017:804, paras 61-63.

[37] Joined cases C-116/16 and C-117/16 *T Denmark and Y Denmark Aps* [2019] EU:C:2019:135, para 104.

[38] Cases C-265/04 *Bouanich* [2006] EU:C:2006:51, para 28; C-374/04 *Test Claimants in Class IV of the ACT Group Litigation* [2006] EU:C:2006:773, para 36.

concluded that element of discrimination exists in most cases irrespective of what stands in the convention, because while it rightfully retains Estonia's power to tax capital gains from immovable property located within its territory, non-resident companies are, unlike resident establishments, deprived from the freedom to postpone their tax liability until distribution. Meaning that the problem does not lie within the DTTs. Obviously with an exception to Dutch residents as the DTT between Estonia and Netherlands that stipulates that where immovable property is transferred as a share deal rather than an asset deal, the gains will be taxed in the Netherlands. Consequently, although the tax treaty rightfully allocates, it does so in most cases together with disadvantages in conjunction with paragraph 29(4)(i) and (v) ITA, however, the treaty does not itself discriminate but rather the corresponding provision of ITA.

2.3.1. OECD Model Tax Convention

The provisions in the 2017 OECD MTC, that are relevant for the purposes of the analysis undertaken herein, include Article 6 defining the term 'immovable property' and Article 13 (particularly paragraphs 1 and 4) laying out the rules for tax treatment of capital gains from immovable property as well as Article 22.

With respect to tax treatment of capital gains, the 2017 OECD MTC provides in paragraph 1 of Article 13 that gains derived from immovable property defined in Article 6 of the Convention, are generally taxed in the host state. Paragraph 4 of the article complements paragraph 1 by extending taxing rights mentioned therein to the host state in instances where a resident of one of the Contracting States disposes of shares or equal interests in an establishment, the value of which originated either directly or indirectly, at any time during a calendar year preceding to the transaction, at least 50% from immovable property. Lastly, paragraph 5 of Article 13 allocates taxing rights to the residence state on gains derived from alienation of any other property that is not listed in paragraphs 1-4 of the article. Article 22 paragraph 1 applies the above also to immovable property that forms a substantial part of the assets of an establishment. [39]

In the Commentary on Article 13, the OECD emphasises that taxation of capital gains differs from country to country: e.g., some countries do not consider capital gains as taxable income at all, other countries treat companies and individuals differently when realising gains and some may even have special rules for instances where assets are purchased with the intention to resell at a gain. Furthermore, in some OECD countries capital gains are regarded as ordinary income and included in common tax base with other income from different sources, particularly in the case of gains from disposal of assets of a company. In other OECD Member States, capital gains are treated with a special tax, often at different rates, that is withheld on each gain

[39] Organisation for Economic Co-operation and Development, *Model Tax Convention on Income and on Capital* (Volume I and II, 2017) Articles 6, 13 and 22.

occurred and separated from other income thereby also limiting deductions. These kinds of taxes may include e.g., tax on capital gains derived from disposal of immovable property, capital appreciation tax, general capital gain tax etc.[40]

The OECD comments illustrated above in conjunction with the current situation in Estonia demonstrate quite clearly the problem and allows one to conclude that capital gains derived from immovable property in Estonia by non-residents are subject to a form of the abovementioned special capital gains tax, whereas Estonian resident companies can include such gains in their business income, which may also have other sources. Meaning that two different ways of tax treatment of capital gains from alienation of immovable property exist simultaneously depending on where the taxpayer has its residence, not to mention that the taxable amount and taxable event may substantially vary for residents to non-residents.

However, a nuance is provided in Article 10 paragraphs 1 and 3 of the Convention when it comes to tax treatment of liquidation proceeds, according to which jouissance shares or rights and other rights for participation in a company's profits with exclusion to debt claims may be taxed in the host state.[41] The Commentary on the underlying article mentions that other payments such as bonus shares and bonuses, liquidation proceeds as well as share redemptions and hidden profit distributions may be regarded as dividends in addition to mere distribution of profits.[42] This is also supported by the commentary on Article 13, which states that where the shareholder disposes of its shares with respect to liquidation of the company, redemption of shares or reductions in share capital of that company, the difference between the proceeds gained and the nominal value of these shares may be treated as a distribution of profits and not as capital gain.[43]

2.4. Observations on the cases

It is clear from the text in both rulings that the disputes essentially revolve around the principle of territoriality, a concept that in essence confers states the right to adopt laws within limits of its own territory.[44] As seen in the previous chapters, the same notion can be found within the text of DTTs. In tax matters, the principle of territoriality is primarily invoked by Member States in disputes before the CJEU on application of fundamental freedoms to restrictive direct tax measures that subject residents and non-residents to different tax treatment.[45] Namely, pursuant to the concept of territoriality in

[40] ibid., C(13)-1, paras 1-2.
[41] ibid., Article 10.
[42] ibid., C(10)-13, para 28.
[43] ibid., C(13)-14, para 31.
[44] S. Kingston, 'Chapter 2: Territoriality in EU (Tax) Law: A Sacred Principle, or Dépassé?' in J. Englisch (ed), *International Tax Law: New Challenges to and from Constitutional and Legal Pluralism* (IBFD 2016), IBFD, chapter 2.1.
[45] Ibid., Chapter 2.4.

international tax law, states are entitled to only tax non-resident income where a nexus between the territory and the income can be established.[46] It can be seen that the arguments submitted by the tax authorities in both rulings effectively were intended to protect these rights.

However, some remarks on the cases can still be made. Firstly, it is difficult to understand with respect to the *ImmoEast* case as to why a state, that employs the so-called distribution tax regime for companies, treats liquidation proceeds as capital gains rather than a distribution. Especially when the proceeds would have been treated as a distribution had it been a resident company. This might therefore bring one to conclude that neither the taxpayer nor the tax authorities were right regarding categorisation of the income in this regard. Unarguably, the element of immovable property is clearly present in the case and Estonia indeed has the right to tax gains from alienation of immovable property located on its territory. The categorisation is thus understandable but there is undeniably conflict between DTTs and national law, it seems that distribution tax regimes simply do not work well in cross-border situations such as that of *ImmoEast* and Estonia has failed to accommodate such situations in its tax laws without eliminating any adverse effects. Therefore, although the Court was not wrong in application of the Estonian-Austrian DTT as, unlike the Estonian-Dutch DTT, it did not provide for an exclusion of capital gains from disposal of shares in a real estate company located in Estonia. The ruling nevertheless lacks deeper analysis of EU law. Especially with regard to interpretation of paragraph 29(4)(v) ITA in light of fundamental freedoms and leaves loose ends in that sense as not enough attention was paid on the discrimination even though the taxpayer had requested in the appeal to refer the question to CJEU.[47] The Court made reference to Article 58(1)(a) and (3) of the EEC Treaty when denying the existence of potential restriction on fundamental freedoms without conducting a thorough analysis and providing assessment on whether Article 43 or 56 of the EEC Treaty applies. Undoubtedly, justification provided in Article 58(1)(a) and (3) or Article 65(1)(a) and (3) TFEU can only be relied on when Article 56 of the EEC Treaty or 63 TFEU, i.e., free movement of capital is applied. The latter becomes detrimental in application and choice of fundamental freedoms considering that this line of argumentation cannot be applied where freedom of establishment is applied.

Secondly, the Court's arguments in the *ImmoEast* proceedings raise further questions regarding the comment about systematic placement of provisions related to tax treatment of liquidation proceeds under paragraph 15 (gains from alienation of property). It must be pointed out that paragraph 15 is included in Chapter 3 of the Act, which is titled 'Taxation of Income of Resident Natural Persons', meaning that the paragraph lays out taxation of liquidation proceeds at the level of shareholder that is a natural person, making the Court's statement seem particularly controversial. Considering

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[46] M. Helminen, 'Chapter 2: Non-Discrimination and Basic Freedoms in EU Tax Law' in *Direct Taxation – 2021* (2021 Edition, IBFD), Books IBFD, chapter 2.3.6., 172.
[47] *ImmoEast Beteiligungs GmbH v Estonian Tax and Customs Board* [2012], 3-10-25/61, Tallinn District Court, para 7.

the predominantly literal view taken by the Court in interpreting ITA, it can be questioned whether it should not be obvious that these provisions apply to natural persons and not legal persons, not to mention the term ‘resident natural persons’ being in the title of the section. By making such statement, it appears as if the Court started rushing and searching for the first provision in ITA that mentions liquidation proceeds and apply it to the case, resulting in same tax treatment between non-resident legal and resident natural persons.

When it comes to *Dalkia* case, it is first and foremost, unexpected that the Court ignored the applicant’s argument that Eesti Energia AS, an Estonian state-owned power plant, had sold its real estate and machinery separately.[48] Particularly because this clearly demonstrates the discriminating treatment between residents and non-residents since Eesti Energia was not liable for tax unless it distributes the profits earned from the transfer of both movable and immovable property. On the one hand, it seems as if the Court avoids commenting on different tax treatment of residents and non-residents, but on the other, the applicant had not put forward enough concerns nor arguments in connection with the discrimination. Regardless, the applicant’s argument that upon application of civil law, every production plant owned by a non-resident should be rather considered as real estate company following the logic of this ruling, is convincingly profound. This is supported by opinion of AG Hogan in *Veronsaajien oikeudenvalvontayksikkö,* whereby it is important to stress that tax law is often distinct from other fields of law, meaning that legal definitions employed in a particular situation for the purposes of civil or commercial law may not be applicable in tax matters. For example, the definition of residence is likely different in the context of family law and tax law.[49] Again, since it does not make any difference for resident companies regarding taxation, the argument lacks emphasis on discrimination and should have rather been formed in a way where distinction of characterising manufacturing plants is made between resident and non-resident companies.

[48] *Dalkia International S.A. v Estonian Tax and Customs Board* [2015], 3-14-26/40, Tallinn District Court, para 15.
[49] Case C-480/19 *Veronsaajien oikeudenvalvontayksikkö* [2021] EU:C:2021:334, Opinion of AG Hogan, para 45.

3. Fundamental freedoms

3.1. Preliminary considerations

CJEU case-law on direct taxation is rich and vast, recently marking a 35-year anniversary. Zalasiński convincingly presents a perspective on the freedoms granted to persons active in the private sector, which, although subjective in writing, accord residents of Member States two basic rights. Firstly, the privilege to move freely between Member States and secondly, freedom to exercise their economic activity in those states whilst being accorded to national treatment in the host Member State.[50] The latter shall be particularly emphasised in the context of the aim pursued within this research paper. One could argue that Member States retain their sovereignty to design their direct tax systems according to their will. Nevertheless, the implementation of such laws shall be compliant with EU law, meaning that treatment of cross-border transaction in a less favourable fashion compared to a comparable internal transaction is prohibited.[51]

Despite the element of DTT application in the issues related to the underlying provisions of ITA and the Court's limited competence when it comes to tax treaties,[52] it can be systematically argued that the questions raised in both disputes before Estonian court's should have instead gotten more attention from EU law perspective in addition to treaty law. Especially since the difference in treatment does not derive from bilateral DTTs but from Estonian national legislation. The question as to whether the non-residents must at least be granted the option for tax deferral is yet unanswered. As already mentioned in Chapter 2.2.1, although raised in the *ImmoEeast* proceedings, the Tallinn District Court's comments on potential restrictions on free movement of capital amounts to one single sentence and no further insight is provided nor are the questions referred to the CJEU. It remains unknown whether the Supreme Court would have had a different opinion or would have even referred the questions to CJEU. For these purposes, the following chapters provide insight to jurisprudence of CJEU on fundamental freedoms and follows the framework undertaken by the Court in free movement cases.

Therefore, the analysis conducted herein seeks to establish whether Articles 49 and 63 TFEU must be interpreted as precluding a national legislation of a Member State whereby, non-resident companies are liable for WHT on gains

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[50] Adam Zalasiński, '35 Years of CJEU Direct Tax Case Law: An Historical Overview on the Occasion of the 60th Anniversary of European Taxation' (2021) volume 61, issue: European Taxation, 2021, No.12, IBFD, 542, 542.
[51] Moritz Scherleitner*, 'E, *Veronsaajien Oikeudenvalvontayksikkö* C-480/19: A Remarkable Case' (2022) Intertax volume 50, issue 4, Wolters Kluwer, 367, 368.
[52] Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation* [2006] EU:C:2006:139, para 52.

realised from sale of immovable property or shares of a company, whose assets consisted mainly of immovable property during the period of two years prior to the transfer or receipt of liquidation proceeds from such company, where a resident company enjoys indefinite deferral of taxes until profit distribution.

Although with some disparities, *Commission v Portugal* comes relatively close to the problems discussed herein regarding the facts and circumstances. Essentially, the case concerned Portuguese national provisions on exit taxation, whereby a company becomes liable for immediate taxation of unrealised capital gains (i.e., the company's assets) upon transfer of its economic activities and seat of effective management from Portugal to another Member State, whilst transfer of such assets within Portuguese territory would not result in such tax consequences.[53] The Commission argued that this cannot result in imposition of tax earlier or greater in amount compared to that of applicable to a resident transferring its activities within Portuguese territory.[54] The Court found that, indeed, such national provision restricts the freedom of establishment.[55] Although the case concerns exit taxation, a connection between *Commission v Portugal* and *ImmoEast* and *Dalkia* can be established as it might bring one to wonder, by way of analogy, as to whether the arguments presented therein could be extended to the current situation in Estonia as non-residents are financially penalised in a similar way as the deferral of CIT is conferred only upon resident companies. Estonia's right to tax capital gains from transfers of immovable property located on its territory is not criticised nor undermined, it is rather sought to establish whether the option for tax deferral should be extended to non-residents or alternatively deny resident companies from postponing their CIT liability with regard to this particular source of income.

3.2. Applicable freedom

Firstly, it is crucial to establish which of the four freedoms applies as there might be an overlap between the freedom of establishment and free movement of capital making it unclear which freedom really applies. Although irrelevant in most instances because the four fundamental freedoms serve the same purpose and the interpretation by CJEU in this regard is identical. Even more so considering that capital movement and payments are completely liberalised since 1994.[56] Discrepancies do however exist in the case of Third Countries, because free movement of capital takes precedence also in situations involving Third Countries, it being the only one of the four

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[53] Case C-38/10 *Commission v Portugal* [2012] EU:C:2012:521, paras 27-28.
[54] ibid., para 22.
[55] ibid., para 35.
[56] Peter J. Wattel, Ben Terra, *European Tax Law, Volume I – General Topics and Direct Taxation* (Peter J. Wattel, O.C.R. Marres and H. Vermeulen eds, Student edition, Wolters Kluwer, 2018), chapter 3.2.5., 47.

to extend outside of the Community.[57] Moreover, as observed in Chapter 2.4, Article 65(1)(a) and (3) TFEU can only applied to free movement of capital. Therefore, the distinction between freedom of establishment (Article 49 TFEU) and free movement of capital (Article 63 TFEU) is even more important.

The overlap between freedom of establishment and free movement of capital is especially apparent in situations involving immovable property. Nonetheless, the Court has acted in that regard and complemented its interpretation on the two freedoms over time. For instance, in *Commission v Greece*, one of the earliest cases on the matter, the Court held that the right to acquire, utilise, or dispose of immovable property in another Member State falls within the scope of freedom of establishment.[58] However, in *Commission v Portugal* the Court expanded on the previous that these activities nevertheless generate capital movements.[59] The latter include investments in real estate on the territory of a Member State by non-resident, a language that, for the purposes of defining the notion of movements of capital, has not changed.[60] Consequently, in a situation where a non-resident acquires property in another Member State, such cross-border transaction shall undoubtedly be considered as movement of capital within the meaning of that terminology.[61] This is supported by the nomenclature provided for capital movements in Annex I of the Council Directive 88/361/EEC.[62] Furthermore, the Court has held, on the one hand, that where a legislation has restrictive effects also *vis-à-vis* free movement of capital, they should be considered an unavoidable outcome of restriction on freedom of establishment and do not warrant additional examination and testing the national provisions against free movement of capital.[63] On the other, any restriction on freedom of establishment could also be viewed as an inevitable consequence of free movement of capital, meaning that two freedoms are generally not applied simultaneously.[64]

At first glance, one might wish to disregard the freedom of establishment and limit the scope to free movement of capital, especially considering that the situation that is being analysed herein concerns a situation whereby a non-resident legal person, without any substantial nor ancillary services performed in Estonia, realises capital gains from liquidation proceeds, disposal of immovable property or shares in a real estate company in Estonia (i.e., direct and indirect investment in immovable property). It must be noted that

[57] Consolidated version of the Treaty on the Functioning of the European Union, [2012] OJ C 326/01, art 63(2).
[58] Case C-305/87 *Commission v Greece* [1989] EU:C:1989:218, para 22.
[59] Case C-267/09 *Commission v Portugal* [2011] EU:C:2011:273, para 34.
[60] Case C-113/16 *SEGRO and Horváth* [2018] EU:C:2018:157, para 52.
[61] Cases C-376/03 *D* [2005] EU:C:2005:424, para 24; C-451/05 *ELISA* [2007] EU:C:2007:594, para 60.
[62] Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty [1988] OJ L178/5.
[63] Case C-524/04 *Test Claimants in the Thin Cap Group Litigation* [2007] EU:C:2007:161, para 34.
[64] Cases C-182/08 *Glaxo Wellcome* [2009] EU:C:2009:559, para 51; Joined cases C-52/16 and C-113/16 *SEGRO and Horváth* [2018] EU:C:2018:157, para 55.

application of the freedom of establishment would require an element of permanent presence in the host state (i.e., Estonia), meaning that an intermediary, a separate legal person, must exist that has acquired the immovable property, thereby holding the rights to that property and participates actively in the management of that property.[65]

Notwithstanding the above, one could argue, bearing in mind the *ImmoEast Beteiligungs* case, that situations such as those in these proceedings concerning taxation of liquidation proceeds of a real estate company, and disposal of shares in a real estate company, triggers freedom of establishment, seeing as resident and non-resident companies are treated differently and the criteria of presence in the host state is fulfilled. This is supported by the arguments of the Court in *Oy AA* and *Commission v Germany*, where the Court maintained that a national provision targeting residents of a Member State holding capital in a company that is a resident of another Member State, whereby having definite influence on decision making and control over its economic activity, falls within the scope of EU provisions on freedom of establishment.[66]

On the other hand, where such provisions apply to shareholdings that are acquired with the sole purpose of making a financial investment rather than business expansion, whereby the taxpayer does not intend to participate in the management and control of the company, shall be scrutinised in view of free movement of capital.[67] Moreover, the Court has held that a 10% shareholding or voting rights in a company does not necessarily mean that the owner of such holding exercises definite influence and control of that company.[68] However, holding of 45% of the shares or voting rights in an undertaking may already be deemed to suggest the presence of the element of control.[69] It must be noted that paragraph 29(4)(v) ITA provides *de minimis* exclusion for shareholding in a real estate company or interest in an immovable asset that is 10% or less and subsequently it can be established that the purpose of the national provision should fall in scope of freedom of establishment.[70] It is, however, yet unclear as to whether the same logic can be applied to direct investment and ownership of immovable property by non-resident establishments as paragraph 29(4)(i) does not provide such *de minimis* criteria. Regardless, from the explanatory notes in Directive 88/361/EEC seem to indicate that direct investments in real estate generate capital movements only for private persons.[71] Moreover, considering that this research is limited to tax treatment of companies, it seems inappropriate to apply Article 63 TFEU.

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[65] Case C-386/04 *Centro di Musicologia Walter Stauffer* [2006] EU:C:2006:568, para 19.
[66] Cases C-231/05 *Oy AA* [2007] EU:C:2007:439, para 20; C-112/05 *Commission v Germany* [2007] EU:C:2007:623, para 13.
[67] Case C.257/20 *Viva Telecom Bulgaria* [2022] EU:C:2022:125, para 80.
[68] Case C-686/13 *X AB* [2015] EU:C:2015:375, paras 21-22.
[69] ibid., para 24.
[70] Estonian Income Tax Act, para 29(4)(v).
[71] Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty [1988] OJ L178/5.

Unquestionably, it can be established that although both Articles 49 and 63 TFEU might be considered applicable when it comes to paragraph 29(4)(i) and (v) ITA. Nevertheless, application of free movement of capital seems inappropriate in the issue at hand, as it could only be applied where a company has acquired a property or a shareholding in a real estate company as a financial investment, consequently not exercising definite influence and control over the property or the company. The *de minimis* exclusion provided in paragraph 29(4)(v) for holdings or interests in the property that is less than 10% quite clearly illustrates that the provision is not meant for portfolio investments and for that reason Article 63 TFEU should, in essence, be rejected. Thereby, it should be concluded that Article 49 is applicable to situations concerning capital gains realised by non-resident establishments from transfer of immovable property, disposal of shares or liquidation proceeds of a real estate company such as that in the proceedings of *ImmoEast Beteiligungs* and *Dalkia*, where the taxpayer is in control of the management of such undertaking or the property.

3.3. Comparability and discrimination

3.3.1. Whether there is a difference in treatment

First and foremost, it is necessary to establish, whether by treating the income received from sale of real estate by companies incorporated under Estonian law differently compared to income realised by non-resident companies, the former is treated less favourably.[72] It must be noted that discrimination regarding fiscal matters is generally borne where different rules are applied to comparable situations or *vice versa* – the same rule is being applied to different situations.[73] Meaning that comparable situations shall not be treated differently and different situations shall not be treated similarly unless another criteria that is impartial from the nationality applies, and it is proportional with regard to the objective and aim pursued by the national provision.[74]

Accordingly, relevant paragraphs of ITA on taxation of resident and non-resident companies shall be scrutinised. The tax treatment of residents is relatively simplistic: paragraph 50(1) stipulates that a resident company is subject to CIT upon profit distributions in the form of dividend payments or equal profit distributions in monetary or non-monetary form.[75] In addition, resident companies are liable for CIT on payments made from equity by way of reductions in share capital, share buybacks and redemption of contributions in capital inasmuch the payments exceed the monetary and non-monetary contributions to the equity.[76] For the purposes of this dissertation, another paragraph of ITA laying out the tax consequences borne upon deletion of a

[72] Case C-480/19 *Veronsaajien oikeudenvalvontayksikkö* [2021] EU:C:2021:334, para 34.
[73] Case C-279/93 *Schumacker* [1995] EU:C:1995:31, para 30.
[74] Case C-155/09 *Commission v Greece* [2011] EU:C:2011:22, para 68.
[75] Estonian Income Tax Act, para 50(1).
[76] ibid., para 50(2).

resident company from the Commercial Registry is applicable. Subparagraph (2^2) of paragraph 50 extends the latter to liquidation proceeds that exceed the contributions made into the company subject to liquidation inasmuch economic activity will not be continued in Estonia via another local company or a permanent establishment of a non-resident company.[77] The above applies irrespective of the source of income, including transfer of immovable property.

Non-resident companies, however, are liable to income tax on capital gains generated from transfer of immovable property located in Estonia as well as disposal of shares and holdings in a company, investment fund or equal vehicles, assets of which consisted of more than 50% either directly or indirectly, at the time of transfer or at some point during two years prior to the transaction, of immovable property located in Estonia. The provision provides for a *de minimis* exclusion for holdings lower than 10% at the time of the underlying transfer.[78]

Consequently, capital gains derived from transfer of immovable property by residents are taxed at the level of the resident company as dividends once these profits are distributed (if at all) and not reinvested, whereas non-resident companies are liable to immediate taxation as capital gains tax. It must be emphasised that retained profits of resident companies are exempt from tax until a decision to pay dividends is taken and residents may enjoy unlimited deferral of tax. It is therefore necessary to assess the implications raised in Chapter 2.1, i.e., whether the liberty to retain profits and indefinitely defer tax consequences puts non-resident companies in a disadvantageous situation resulting in deterring non-residents from investing in Estonia. Nonetheless, a comparability analysis must be first undertaken to establish whether non-resident companies are in an objectively comparable situations.

3.3.2. Whether the situations are objectively comparable

Secondly, it is necessary to examine whether the difference in treatment between a company registered under the laws of Estonia receiving income from alienation of immovable property located in Estonia and a non-resident company receiving income from transfer of immovable property located in Estonia, concern objectively comparable situations.[79] Whilst it is true that in regard to free movement of capital, Article 65(1)(a) confers Member States to apply provisions that differentiate between residents and non-residents. Meaning that they are not precluded from having regard to the place of residence of the taxpayer in forming their tax law, only where it is deemed relevant.[80] Regardless, this line of argumentation cannot be applied to Article 49 TFEU. However, Member States are nevertheless not precluded from

[77] ibid., para 50(2^2).
[78] ibid., para 29(4) 1) and (v).
[79] C-375/12 *Bouanich* [2014] EU:C:2014:138, para 46.
[80] Consolidated version of the Treaty on the Functioning of the European Union, [2012] OJ C 326/01, art 65(1)(a). See also Case C-480/19 *Veronsaajien oikeudenvalvontayksikkö* [2021] EU:C:2021:334, Opinion of AG Hogan, para 37.

denying non-residents certain tax benefits and advantages that it grants to residents where objective differences between the two are present – it cannot be automatically considered to be discriminatory.[81] It must also be borne in mind that residents and non-residents, in direct tax affairs, should not, as a rule, be automatically considered to be in comparable situations.[82]

Thirdly, the comparability analysis of a cross-border and an internal situation must be analysed in the light of the objective pursued as well as purpose and content of these provisions.[83] It follows that only the distinctive criteria that sets apart non-residents from residents in the national legislation shall be considered in ascertaining whether the adverse consequences resulting from the different tax treatment produces objectively different situations.[84]

In terms of comparability of the situations, it must be firstly noted that the taxation of the capital gains realised from transfer of immovable property concerns one category of taxable persons, i.e., legal persons regardless of whether they are residents or non-residents. Moreover, although the transfer of immovable property or shares in a company or liquidation proceeds of such company, assets of which consist mainly of immovable property, does not necessarily relate to the same type of income in the light of ITA. Bearing in mind that it is considered as capital gains for non-resident companies and business income for resident companies, but it nonetheless does concern the same categorisation of transaction. Last, the source state of the taxable income is Estonia on both occasions. Accordingly, it can be concluded that the circumstances do not produce objective differences between resident and non-resident companies capable of substantiating different tax treatment and the situations must be deemed comparable.[85] For example, in *Denkavit*, the Court held that whilst it is true that recipients of dividends that are residents are not necessarily in a comparable situation with non-resident shareholders. Nonetheless, residents and non-residents become comparable once a Member State imposes tax on income, either unilaterally or via application of a convention, to both residents and non-residents on the dividends received from resident company.[86] It is difficult to find a reason as to why this argument cannot be extended from dividends received by non-residents from a resident subsidiary (established in the source state) to capital gains realised by non-residents from alienation of immovable property located in Estonia (i.e., the source state).

[81] Case C-562/07 *Comission v Spain* [2009] EU:C:2009:614, para 47.
[82] Case C-279/93 *Schumacker* [1995] EU:C:1995:31, para 31.
[83] Cases C-39/10 *Commission v Estonia* [2012] EU:C:2012:282, para 51; C-252/14 *Pensioenfonds Metaal en Techniek* [2016] EU:C:2016:402; C-135/17 *X GmbH* [2019] EU:C:2019:136, para 64; C-565/18 *Société Générale* [2020] EU:C:2020:318, para 26.
[84] Case C-338/11 *Santander Asset Management SGIIC* [2012] EU:C:2012:286, para 28.
[85] Cases C-443/06 *Hollmann* [2007] EU:C:2007:600, paras 50-51; C-388/19 *Autoridade Tributária e Aduaneira (Impôt sur les plus-values immobilières)* [2021] EU:C:2021:212, paras 37-38.
[86] Case C-170/05 *Denkavit Internationaal and Denkavit France* [2006], EU:C:2006:783, paras 34-35.

3.3.3. Whether there is a restriction

It must be emphasised, with regard to determining whether there is a restriction, that the four fundamental freedoms set out in TFEU seek to ensure national treatment in the host Member State for foreign nationals and companies.[87] Any measure that prohibits, hinders, or renders exertion of these freedoms less attractive, shall be considered as a restriction of Article 49 TFEU.[88]

It can be established that the application of two different provisions for the assessment of tax on capital gains from alienation of the same immovable property located in Estonia is not the same for residents and non-residents. Although non-residents are not subject to a higher tax burden per se, they nevertheless suffer from a cash flow disadvantage, which indirectly increases the tax burden for non-residents thereby putting non-residents to a less favourable position. It follows from CJEU case-law that where residents may systematically benefit from deferral of their CIT liability and reinvest their gains without having to pay any tax in between is less favourable toward non-residents, regardless of the fact that for non-residents capital gains are subject to a WHT that is lower than the tax imposed on a resident on the whole of its income.[89] In this regard, it must be noted that non-residents are subject to a WHT of 20% on the capital gains whereas residents are taxed at the nominal CIT rate of 20%, which is calculated on a net basis, meaning that the net CIT rate on the dividends is 25% (the method for calculating the tax due is as follows: $dividend\ amount \times 20 \div 80$).[90] Further, to encourage companies to distribute their profits more frequently and consequently attract more tax revenues from corporate taxpayers to the State's budget, a reduced nominal tax rate of 14% (calculated following the same logic as with the standard rate, i.e., roughly 16,3% on net basis) for regularly distributed dividends was introduced in 2017, whereby the lower rate can be applied to dividends that is less or equal to the average dividends distributed during three previous fiscal years at the standard rate.[91]

Moreover, taking into consideration paragraph 50(2) ITA, which Uustalu also rightfully pointed out, resident companies may distribute the profits by way of reductions in equity, which means that they are able to choose their tax rate, which could also be 0% as long as the reduction does not exceed the contributions paid into equity. This would, of course, imply that tax credit on contributions into equity or capital is also reduced for future reductions or dividend payments. For that reason, the tax burden for resident companies should be considered to be lower, especially in light of the new concepts developed in the draft Council directive on ensuring a global minimum level of taxation for multinational groups in the Union, according to which the ETR

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[87] Case C-686/13 *X AB* [2015] EU:C:2015:375, para 27.

[88] Case C-375/12 *Bouanich* [2014] EU:C:2014:138, para 57.

[89] Case C-388/19 *Autoridade Tributária e Aduaneira (Impôt sur les plus-values immobilières)* [2021] EU:C:2021:212, paras 28-29.

[90] Estonian Income Tax Act, paras 4(1) and (1^1).

[91] ibid., paras 50^1 and 4((v)

should be calculated by a way of ratio between the tax paid and profits generated by the taxpayer, whereby the effective tax rate of resident companies is considered to be 0% unless dividends are distributed.[92] Considering the abovementioned, it can be established that there is a restriction of Article 49 TFEU.

3.4. Justification

The Court has consistently held that an obstructive national measure that constitutes a restriction on free movement of capital may be permitted if it can be justified by overriding reasons in the public interest, on the condition that it attains the purpose it is intended to pursue and does not go beyond what is necessary to secure that objective.[93]

It must be recalled that although the Court agreed with the tax authorities in *ImmoEast* proceedings that difference in treatment derives from the need to ensure balanced allocation of taxing rights and the avoidance of double taxation, little to no arguments were put forward in support of this justification, despite the applicant relying on both Articles 49 and 63 TFEU in their documents filed to the Court as well as their request in the appellation proceedings to refer the questions to CJEU.[94] Neither was the issue assessed in detail from EU law perspective in *Dalkia Investments S.A.* proceedings.

It is settled case-law that Member States enjoy fiscal autonomy to a certain extent in the current level of harmonisation of tax laws within the Community. Consequently, where companies are free to choose between different States *vis-à-vis* the place of their establishment, Member States are in no way compelled to accommodate their tax regimes to tax systems of other States for the purposes of neutralising adverse consequences and disparities borne from peculiarities of tax laws of another Member State.[95] Neither are the tax laws of a Member State always neutral toward non-resident taxpayers exercising their freedom to establish or invest in another state.[96] Nevertheless, as mentioned in Chapter 2.4, it seems to be the other way around in this case and there seems to be an indication that distribution tax regimes are nothing but poorly suited for certain cross-border scenarios compared to traditional annual corporate tax systems. Moreover, especially in cases involving application of DTTs, where the Court has previously held that, in absence of unifying or harmonising measures adopted on Community level, Member

[92] Commission, 'Proposal for a Council Directive on ensuring global minimum level of taxation for multinational groups in the Union' COM (2021) 823 final, Article 25.
[93] Cases C-464/14 *SECIL* [2016] EU:C:2016:896, para 56; C-156/17 *Köln-Aktiefonds Deka* [2020] EU:C:2020:51, para 83.
[94] *ImmoEast Beteiligungs GmbH v Estonian Tax and Customs Board* [2012], 3-10-25/61, Tallinn District Court, para 13.
[95] Cases C-298/05 *Columbus Container Services* [2007] EU:C:2007:754, paras 44 and 51; C-293/06 *Deutsche Shell* [2008] EU:C:2008:129, paras 43 and 49; C-157/07 *Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt* [2008] EU:C:2008:588, paras 49-50; C-322/11 *K* [2013] EU:C:2013:716, para 79.
[96] Case C-372/20 *Finanzamt Österreich* [2021] EU:C:2021:962, para 80.

States retain the competence of defying the criteria for the purposes of income taxation and elimination of double taxation and double non-taxation by way of bilateral agreements.[97] Regardless, Member States are not relieved from exercising that competence consistently with EU law.[98]

3.4.1. Prevention of abusive practices

On the one hand, the relevant provisions in ITA may be justified by the need to prevent abusive tax practices. Especially considering that by extending the option for deferral of CIT to non-resident companies makes it more difficult for the tax authorities to recover the tax on the capital gains of the non-resident. On the other, CJEU has over time significantly limited the scope for a national measure to qualify for the justification. As seen in *Cadbury Schweppes and Cadbury Schweppes Overseas*, a restrictive measure can only be justified by the need to prevent abusive tax practices in wholly artificial arrangements whereby taxpayer's business conduct does not reflect economic reality and does not pursue genuine economic intentions, resulting in evading the tax that would have been due had the profits been earned via economic activity undertaken on the national territory.[99] Thereby, it cannot be generally assumed that a non-resident involved in investments in immovable property located in Estonia does not fulfil the former criteria and shall thus be deprived from treatment that is granted to resident companies in an equivalent situation on the grounds that the national measure combats tax avoidance and evasion. Moreover, establishment of an entity outside of the source state, cannot raise the presumption of tax avoidance because it will be taxable in that state.[100]

3.4.2. Protection of the cohesion of the tax system

Although the Court has been rather reluctant in justifying a restrictive measure by the need to preserve the coherence of a Member State's tax system and has sustained such argument on very limited occasions.[101] The concept concerns interrelation between tax base increases (e.g., profits) and matching reductions in tax base (e.g., losses) within the merits of a jurisdiction. Although the argument contains elements of the justification based on the need to preserve balanced allocation of taxing rights and the principle of fiscal territoriality, the Court has interpreted them altogether and acknowledged that

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[97] Cases C-307/97 *Saint Gobain ZN* [1999] EU:C:1999:438, para 57; C-290/04 *FKP Scorpio Konzertproduktionen* [2006] EU:C:2006:630, para 54; C-374/04 *Test Claimants in Class IV of the ACT Group Litigation* [2006] EU:C:2006:773, para 52.

[98] Cases C-265/04 *Bouanich* [2006] EU:C:2006:51, para 28; C-374/04 *Test Claimants in Class IV of the ACT Group Litigation* [2006] EU:C:2006:773, para 36.

[99] Case C-196/04 *Cadbury Schweppes and Cadbury Schweppes Overseas* [2006] EU:C:2006:544, para 51.

[100] Case C-324/00 *Lankhorst-Hohorst* [2002] EU:C:2002:545, Opinion of AG Mischo, para 90.

[101] See to that e.g., Case C-204/90 *Bachmann* [1992] EU:C:1992:35, para 21; C-157/07 *Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt* [2008] EU:C:2008:588, para 43; C-322/11 *K* [2013] EU:C:2013:716, para 71; C-418/07 *Papillon* [2008] EU:C:2008:659, para 51; C-388/14 *Timac Agro Deutschland* [2015] EU:C:2015:829, para 51.

these concepts may often coincide.[102] The Court's interpretation of the need to protect the coherence of the tax system thus far requires that a direct link is recognised between a particular tax advantage and a tax levy that compensates against that advantage. This shall be done by examining the aim and objective pursued by the national provision at hand.[103] However, this justification cannot be accepted in the case of paragraph 29(4)(i) and (v) ITA as the issue revolves around incentive for tax deferral granted to residents and not to non-residents rather than relation between a tax levy offsetting a particular advantage, the nexus between the two does not seem to exist in this instance.

3.4.3. Balanced allocation of taxing rights

Perhaps the argument of the need to preserve the balanced allocation of taxing rights is more convincing and applicable to the situation at hand. In this regard, CJEU has held that such justification is accepted in situations where the objective of the national legislation is to prevent practices which jeopardise Member State's right to exert its power to tax economic activities undertaken within its territory.[104] This means that Member States cannot be prohibited from taxing economic activity conducted on its territory and also extends to the need to prevent a State from being forced to surrender its taxing rights on income that is sourced within its territory by having to admit deductions of losses of foreign entity to which the state has not extended its taxing power.[105] Further, it must be noted that the justification regarding the need to safeguard the balanced allocation of taxing rights has been accepted by the Court in situations where the condition of residence is required for benefitting from a tax arrangement with the aim of preventing the taxpayer having the free choice of which Member State profits are taxed or losses are accounted.[106]

One could argue that tax deferral could be conferred to non-residents invested in immovable property located in Estonia on the condition of provision of a guarantee. This is reflected upon in *N v Inspecteur van de Belastingdienst* where the Court held, on the one hand, that Dutch exit tax measures that impose deferred assessment of tax, subject to a condition of a guarantee, on unrealised capital gains from value increases of assets accumulated throughout the period prior to the exit, is a restriction on freedom of establishment, where the resident taxpayer, that maintains its seat in the Netherlands, becomes taxable only upon realisation of those assets.[107] On the other, the Court accepted the justification of balanced allocation of taxing

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[102] Peter J. Wattel, Ben Terra, *European Tax Law, Volume I – General Topics and Direct Taxation* (Peter J. Wattel, O.C.R. Marres and H. Vermeulen eds, Student edition, Wolters Kluwer, 2018), 350-351.
[103] Case C-641/17 *College Pension Plan of British Columbia* [2019] EU:C:2019:960, para 86-87.
[104] Case C-545/19 *AllianzGI-Fonds AEVN* [2022] EU:C:2022:193, para 82.
[105] Case C-446/03 *Marks and Spencer* [2005] EU:C:2005:763, paras 43-46.
[106] Case C-484/19 *Lexel AB v Skatteverket* [2021] EU:C:2021:34, para 61.
[107] Case C-470/04 *N v Inspecteur van deBelastingdienst* [2006] EU:C:2006:525, para 55.

rights by referring to the principle of fiscal territoriality as there is a link between a temporal element of residence in the Netherlands and the time period at which the taxable gain arose. The Court contended that the exit tax provision aims to levy tax on the value increases recorded in the Netherlands during that particular period, which shall be subject to deferral until disposal of the assets. Neither was the national provision found to go beyond what is necessary to attain that objective.[108] Nonetheless, the Court stated that the obligation of providing guarantees in order for the taxpayer to be eligible for tax deferral goes beyond what is necessary to ensure functioning and effectiveness of the Dutch tax system as there are less restrictive methods available.[109]

Considering the above, it could be established that inasmuch the aim of paragraph 29(4)(i) and (v) is to ascertain such rights conferred to Estonia and make the recovery of taxes possible as well as minimise the probability of missing out on tax revenues. The adverse consequences of paragraph 29(4)(i) and (v) could therefore be justified by the need to ensure balanced allocation of taxing rights between Member States. The only issue with justifying the measure by the need to ensure balanced allocation of taxing rights lies within the fact that in *N v Inspecteur van de Belastingdienst* the deferral of taxes on the capital gains was, contrary to the situation in Estonia, granted to the taxpayer.

3.4.4. Effectiveness of fiscal supervision

Another compelling argument in favour of the tax authorities could be found in the need to ensure effective fiscal supervision and recovery of taxes. For example, pursuant to the logic behind the *X NV* ruling, it can be established that although the obligation on the non-resident alienator to withhold tax on capital gains generated from alienation of immovable property at source should be considered a restriction on freedom of establishment, where such tax is not withheld on a resident alienator and where the non-resident incurs additional administrative burden as well as affecting the cost of investing in immovable property in that State.[110] It can nonetheless be justified by the need to protect effective collection of taxes in cross-border arrangements and is, at the same time, found to be proportional in pursuit of the aim and objective of the measure, even in light of Directive 76/308 on mutual assistance in recovery of taxes. Although, the above applies only where the administrative obligations and formalities on the taxpayer would not be eliminated upon invocation of the Directive.[111]

Notwithstanding the above, the Court has been reluctant in accepting such justification in more recent case-law. Possible reasons behind rejection of the justification can be found in either that Member States could have applied a

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[108] ibid., paras 46-47.
[109] ibid., para 51.
[110] Case C-498/10 *X NV v Staatssecretaris van Financiën* [2012] EU:C:2012:635, paras 32-33.
[111] ibid., paras 49-53.

less restrictive measure where available or due to the fact that Directive 76/308[112] has been repealed and replaced by Directive 2011/16/EU[113] on administrative cooperation in the field of taxation. Further, Directive 2010/24/EU[114] concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures could be invoked. These two Directives imply that information relating to collection of taxes could easily be requested from the taxpayer by the tax authorities and can subsequently be exchanged between the authorities in different states.[115] For that reason, justification based on the need to ensure effectiveness of fiscal supervision is rejected.

3.5. Proportionality

Lastly, as mentioned in Chapter 3.4, where a restrictive national provision is justified by the overriding reasons in the public interest, it is necessary to establish whether it is proportional and does not go beyond what is necessary in attainment of the aim and objective pursued by the national rule.

One could argue that the aim and objective of paragraph 29(4)(i) and (v) is to protect Estonia's taxing rights within the merits of its territory as both the 2017 OECD MTC and most bilateral DTTs concluded by Estonia confer the taxing rights on capital gains on immovable property to Estonia. However, it is not disputed that the taxing rights should be reallocated to the resident state of the alienator. Rather, it is sought to establish as to whether the freedom to postpone taxable event until distribution of such profits takes place should be extended to non-resident companies. Especially considering that there could be options available that are less harmful to non-residents exercising their fundamental freedoms, e.g., an option between immediate taxation or tax deferral, the latter of which could be arranged via tax recovery account allowing the gains to be retained for either future investments in Estonia or until distribution. On the other hand, where there is an Estonian entity owning the rights to the immovable property, the taxpayer can still take advantage of the distribution tax system. For example, if the taxpayer wishes to reinvest the realised gains in Estonia without having to pay CIT in between, it can either retain the realised gains on the accounts of the Estonian entity and wait the two years or alternatively invest through the Estonian company. It seems that the disadvantageous treatment is triggered mostly in unique and exceptional cases.

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112 Council Directive 76/308/EEC of 15 March 1976 on mutual assistance for the recovery of claims related to certain levies, duties, taxes and other measures [1976] OJ L073/18.
113 Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC [2011] OJ L064/1 (DAC).
114 Council Directive 2010/24/EU of 16 March 2010 concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures [2010] OJ L084/1.
115 M. Helminen, 'Chapter 2: Non-Discrimination and Basic Freedoms' in *EU Tax Law – Direct Taxation – 2021* (2021 Edition, IBFD), Books IBFD), chapter 2.3.2., 156.

It is also settled CJEU case-law that where the tax legislation of a Member State offers the taxpayer a choice between immediate taxation, although creating a cash flow disadvantage but nevertheless relieves the taxpayer from administrative constraints in e.g., where deferral of tax payments is granted, often subject to interest on the unpaid amount, is considered appropriate in safeguarding balanced allocation of taxing rights and is less harmful in regard to fundamental freedoms compared to immediate taxation.[116] Nonetheless, it would be interesting to see what the Court would have to say about the issue related to paragraph 29(4)(i) and (v) ITA as to whether it would still be found to be acceptable in attaining its purpose, with emphasis on the fact that the tax deferral for Estonian resident companies is indefinite and, as rightfully pointed out by Uustalu, can usually be measured in years.[117] Contrary to the above, ITA as it stands now, does not provide for such option for non-resident companies, meaning that the legislation seems to go beyond what is objectively necessary.[118]

Further, it can be argued, on the one hand, that the direction of international taxation in the light of recent trends within the EU such as harmonisation, mutual recognition, administrative cooperation and advancements in technology should, in principle, enable to extend the benefits conferred upon resident companies also to non-resident companies without Estonia losing tax revenues. On the other, this would likely make recovery for taxes excessively difficult for Estonia when it comes to monitoring the non-resident companies concerned. The development of a system that is capable of sustaining the above is likely to require considerable investments and resources on the state's behalf that could potentially exceed what is necessary to attain the aim and purpose of paragraph 29(4)(i) and (v) and be disproportionate from the state's perspective. Although this kind of argumentation appears to be unconvincing. Instead, in relation to the issues revolving around recovery of taxes should the tax deferral be granted also to non-resident companies, increased relevance could be seen in invoking DAC and Directive concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures, considering that both Directives encourage cooperation between Member States in application of domestic tax laws, including recovery of tax claims, administration of documentation as well as penalties in regard to unduly paid taxes.[119]

Notwithstanding the above, it must be noted that in regard to tax return obligation, non-resident companies fall under paragraph 2(1) ITA, which stipulates that resident natural persons, common investment funds, public limited funds and non-resident companies shall declare and submit their income tax return reflecting the income and gains, including the taxes discussed herein, realised during a tax period by 30th April following the tax

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[116] Case C-292/16 *A Oy* [2017] EU:C:2017:888, para 35.
[117] Uustalu, E., 'The Compatibility of the Estonian Tax Treatment of Real Estate Income with EU Law' (2011), Intertax, volume 39, issue 8/9, 449, 455.
[118] Case C-292/16 *A Oy* [2017] EU:C:2017:888, para 37.
[119] Sigrid Hemels, 'Chapter 13: Administrative Cooperation in the Assessment and Recovery of Direct Tax Claims' in Peter J. Wattel, Ben Terra (Peter J. Wattel, Otto Marres and Hein Vermeulen eds), *European Tax Law*, (Kluwer Law International 2019), chapter 13.1.1., 281.

period, which shall be duly paid by 1st October of the calendar year following the tax period.[120] This means that the deadlines for submission of income tax return and payment of the tax coincide with a calendar year, which in conjunction with traditional corporate tax regimes such as that in most countries within the Community, whereby income taxation is based on an annual basis for each fiscal year, is less likely to pose administrative problems for non-residents concerned. However, it must be borne in mind that a national measure restricting a taxpayer to exercise freedom of establishment is prohibited regardless of whether the scope of the provision is narrow or immaterial in importance.[121] Moreover, the issue regarding tax deferral would still appear to be unsolved and not entirely eliminated, meaning that non-residents could nonetheless find themselves in a disadvantageous position compared to resident companies. It is difficult to understand as to why non-resident companies could not be allocated to a tax period of a calendar month such as resident companies, that declare their CIT returns, which also reflect dividend distributions, on a monthly basis on the tenth day of the following month.[122] Together with a tax recovery account, this seems to be a valid solution and for these reasons, it is hard to find paragraph 29(4)(i) and (v) proportional in attainment of the objective pursued.

[120] Estonian Income Tax Act, paras 2(1) and 44(1) and 46(3).
[121] Case C-498/10 *X NV v Staatssecretaris van Financiën* [2012] EU:C:2012:635, para 30.
[122] Estonian Income Tax Act, para 3(2).

4. Conclusion

Although the adverse consequences can be circumvented with careful and supervised tax planning, resulting in rare occurrence of situations where a non-resident owns real estate in Estonia without having a SPV established. Besides, one can assume that most well-advised non-resident taxpayers investing in Estonia have real estate holdings set up in the Netherlands. Additionally, considering that the deadline for declaration submission and payment of tax for non-residents is in correlation with a calendar year, which in some instances coincides with traditional annual corporate income tax systems, consequently mitigating the troubles and administrative burden for non-resident taxpayers to some extent. This, however, cannot mean that a restriction such as that is acceptable considering that, in principle, conferring the tax deferral to non-residents is acceptable.

ImmoEast Beteiligungs and *Dalkia Investments S.A.* illustrate quite clearly that Estonian tax laws continue to distress non-residents, but set a somewhat controversial precedent, which, in conjunction with low awareness on the fact that the incentive for CIT deferral should be available for non-resident companies, might be another reason why the issue at hand has not been brought before the court in the recent years. However, at some point another case comes along where a non-resident might wish or need to take advantage of the incentive despite not being eligible for it and the questions discussed herein will eventually end up getting referred to CJEU as the discrimination is clearly present. Moreover, it might bring one to wonder how long the 'lack of harmonisation' argument can be presented before a court, especially when taking into account that the disadvantageous treatment does not come from double tax treaties but from ITA. Moreover, administrative cooperation between Member States as well as advancements in technology and digitalisation of the economy should entail no problems in extending the option for deferral also to non-residents, consequently eliminating the discrimination that currently exists and encourage non-residents to invest in Estonia instead of discouraging.

Although the need to safeguard balanced allocation of taxing rights between Member States could be seen as a valid and proportionate justification, it is rather difficult to find affirmation from the jurisprudence of CJEU capable of supporting the arguments that would justify the different tax treatment of non-residents. Despite some of the cases on fundamental freedoms as well as on exit taxation rules and different tax treatment of non-residents fall relatively close to the issue discussed herein, the comparability between these cases and the problem relating to paragraph 29(4)(i) and (v) ITA is lacking in the most crucial parts of the proportionality analysis, i.e., the extent to which a restrictive measure amounts to toward non-residents. As for the rest of the arguments that could be applicable, e.g., the effectiveness of fiscal supervision, the analysis entails in that the justification supporting paragraph 29(4)(i) and (v) seems to be outdated.

As regards to the principle of territoriality, it is not disputed that the taxing rights of immovable property located in Estonia should be allocated to the state where the alienator is resident but rather finds that at least an option between immediate taxation of capital gains from transfer of immovable property and tax deferral should be extended to non-residents. Alternatively, ITA could be revised and changed in a way whereby the tax treatment of resident companies in regard to this specific category of income is excluded from the general corporate taxation conferring indefinite deferral and subjected to an universal capital gains tax instead in order to eliminate the discrimination. Undoubtedly, it is highly unlikely that the latter is favoured both by Estonian residents and the Government.

The research question as to whether the different tax treatment of resident and non-resident companies regarding real estate income constitutes a restriction on Articles 49 and 63 TFEU should therefore be answered as – Article 49 TFEU should be interpreted as precluding a national legislation of a Member State that subjects non-resident companies to immediate taxation on gains realised from alienation of immovable property, shares of a real estate company or liquidation proceeds of such company, where a resident company would be subject to indefinite deferral of such income.

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