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Company migration-A study on the European corporate exit taxation

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Table of Contents

Summary

The corporate exit taxation concerns the taxes levied by the Member States (MSs) of the European Union (EU) on the companies wishing to transfer their seat of management or assets outside their state of origin. The role of exit taxation is to give MSs the opportunity to protect their tax revenues and to avoid artificial transfers meant to take advantage of various tax systems.

Taxation in Europe is harmonized to a limited extent, which means that exit taxation is regarded differently in the EU MSs. Some of them treat exit taxation as a domestic transaction, while others include it in the tax treaties concluded with the MSs. The Court of Justice of the European Union (ECJ) interpreted the provisions under which exit taxation falls as well as it gave judgements which made the concept of exit taxation clearer. Therefore, the case law of the ECJ represents a very important source of law with the help of which it is intended to give a better understanding of the meaning and the implications of the TFEU provisions.

Moreover, EU MSs concluded tax treaties in order to provide their citizens with the legal certainty needed. The model followed by the MSs in drafting their tax treaties is the OECD Model Tax Convention. The OECD Model Tax Convention is not legally binding, thus it only serves as a model, giving the MSs the liberty to adapt the provisions to the requirements of their own tax systems. Exit taxation is not mentioned per se in the OECD Model Tax Convention; however, parallels have been drawn to the concept in article 7 that deals with the treatment of tax connected to assets transferred from a permanent establishment to a parent company abroad and in article 13 regarding capital gains.

The concern with exit taxation, raised in several occasions by the ECJ, is that the MSs tend to include in their tax legislation provisions that require immediate payment of taxes that result from migration of companies. Therefore, the judgements that arrived before the ECJ along the time focused on changing such provisions in the MSs' legislation. At this point, following the case law on exit taxation, the individuals have the possibility to choose either immediate payment or deferment of exit tax, given that immediate taxation of accrued but unrealised capital gains constitutes a restriction on the freedom of establishment and/or free movement of capital, as granted by the TFEU.

Preface

This Master Thesis marks the end of a very important stage of my life and opens the way to a new phase that, hopefully, will be at least as fruitful as this one. Thus, I would like to address my most sincere thanks to everyone who passed my way and contributed to the creation of unforgettable memories during these two years of European Business Law Master studies.

I would also like to thank my supervisor, associate prof. Maria Hilling, for the assistance, guidance and encouragement she provided throughout the writing of this thesis. I am truly grateful for your support.

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Abbreviations

AG	Advocate General
Ch.	Chapter
DEM	Deutsche Marks (currency)
ECJ	Court of Justice of the European Union
EEA	European Economic Area
EU	European Union
MC	Migrating Company
MS	Member State
OECD Model Convention	Organisation for Economic Co-operation and Development Model Convention
p.	Page
Para.	Paragraph
PE	Permanent establishment
prof.	Professor
SE	Societas Europaea
Sect.	Section
TFEU	Treaty on the Functioning of the European Union
vol.	Volume

1. Introduction

This chapter covers the background, the purpose that this thesis is intended to achieve, the material that helped with the realisation of this study and the outline which presents the structure of the present paper.

1.1. Background

The freedom of establishment is one of the fundamental freedoms provided by EU law. It allows EU nationals to set up undertakings, and take up and pursue self-employed activities in the territory of other MSs than the MS of origin, on the same conditions as nationals of those new MSs. The freedom of establishment entitles companies established in the EU to set up agencies, branches or subsidiaries in other MSs.

An automatic prohibition interfering with the very essence of the right to move and to establish in another MS is precluded by Union law. However, the transfer of residence can bring into force different tax rules that can lead to different tax consequences.

When a company incorporated under the laws of a MS wishes to transfer its seat of management or assets to another MS, a tax (exit/emigration tax) on the unrealised but accrued capital gains might be imposed on the migrating company with the scope of protecting the tax revenues of the home MS.

Exit tax provisions are provisions that cause tax consequences at the moment when a taxpayer moves to another country.[1] The provisions may subject, for example, unrealized income or capital gains to taxation or tax-exempt income to taxation or recapture a tax deduction at the moment when the taxpayer leaves the country.

A series of cases where addressed to the ECJ on the matter and until today it has been discussed that the exit taxes levied by MSs at the time when the company leaves its jurisdiction, is contrary to the freedom of establishment.[2] Furthermore, exit taxation often leads to double taxation, which can generally be defined as the imposition of comparable taxes in two or more states with regard to the same taxpayer, in respect of the same subject matter and concerning the same period.[3]

It follows that MSs need to have concluded double tax treaties between themselves in order to deal with the double taxation arising from the imposition of exit taxes. If the tax treaties manage to eliminate double taxation or double non-taxation is to be answered further in this paper.

Moreover, the cases that arrived before the ECJ are used by all MSs as guidelines on how the exit taxes should be levied without them being contrary to EU law.

Thus, the court first stated that companies are creatures of national law, which means that it is for the MSs to decide upon the requirements of incorporation, functioning and dissolution of their companies. Another statement of the court

[1] See Chapter 6 of the present paper for case law judgements that deal with the MSs exit tax provisions applied on companies wishing to migrate.
[2] Ibid.
[3] The OECD Model Tax Convention on Income and on Capital, Introduction, 2010.

refers to the different legal treatment applied to companies wishing to migrate abroad compared to the companies that move their seat or assets within the state of origin. Furthermore, it has been ruled that immediate taxation of latent capital gains acquired upon transfer of a company's seat or assets to another MS infringes the principle of freedom of establishment.[4]

It follows that the MSs have to keep account of the ECJ's decisions and apply the exit tax measures without making it difficult for the companies to avail of the freedom of establishment provided to them under the TFEU.

1.2. Purpose

This paper's purpose is to analyse the conditions on which a company incorporated under the laws of a MS can emigrate to another MS in order to streamline corporate group structures or to avail of more favourable tax systems than those offered by their State of origin.

Furthermore, in order to make possible the better understanding of the exit taxation matter, a series of questions will be answered: Can EU companies freely migrate? Can emigration taxes on capital gains be justified? Are emigration taxes restrictive?

Finally, an analysis on the insight of the ECJ's jurisprudence will be provided with the aim to find out whether the possibility of cross-border migration is possible and if not, where do we stand today when we discuss exit taxation.

1.3. Method and materials

The method used in the present paper is the traditional legal method, which consists in analysing a certain matter through relying on the existing legal sources. The main legal sources that are relevant for this paper are the Treaty on the Function of the European Union (TFEU) and the case law of the ECJ.

As corporate exit taxation has been harmonized among MSs to a very limited extent, the case law of the ECJ is put as a central legal source for the purpose of the present paper. The ECJ's interpretation of the primary law and its case law has the same legal value as the provisions of the TFEU. Thus, the study of relevant case law represents a very important source of law with the help of which it is intended to give a better understanding of the meaning and the implications of the TFEU provisions. The case law of the ECJ on exit taxation is outlined in Chapter 6 of the present paper and it is chronologically structured from the early 80's until present (2013). The selection of the cases was made by focusing on the important changes brought by the relevant judgments to exit taxation. Advocates General (AGs) opinions are also brought up, even though they do not have, as such, legal standing.

The OECD Model Convention, even if not legally binding, has been intensively used as a source in the present paper. The reasoning is that the OECD Model Convention proposes guidelines that are meant to reach common grounds between MSs with regard to the companies' ability to move or internationally expand. Even if the exit taxation is not dealt with thoroughly, the OECD Model Convention covers the matter in the sense that it deals with the treatment of tax

[4] See Chapter 6 of the present paper for case law judgements that deal with exit taxation.

connected to assets transferred from a permanent establishment to a parent company abroad as well as with capital gains. The extent to which the OECD Model Convention affects exit taxation is outlined in Chapter 3 of this paper.

The research covered only material written in English in the form of EU legislation, case law, tax treaties, literature and articles available until 23 May 2013. All the material used for the purpose of writing this thesis is listed in the bibliography of the present paper.

1.4. Outline

This paper has as first chapter, the introduction, covering the background, the purpose that this paper is set to achieve and the method and materials used in order to get to the result expected. The second chapter is under the name 'Point of departure' and it is meant to give a picture on what exit taxation represents, the objectives of tax treaties and their relationship with national law as well as the provisions under the primary and secondary legislation of the EU under which the exit taxation falls. Furthermore, it explains the circumstances under which exit taxation arises. Chapter three answers the questions regarding companies' possibility to migrate while the fourth chapter emphasises the effects of exit taxation. Chapter five describes the justifications used by EU MSs for the restrictive measures imposed on the MCs. Chapter six is based on the case law of the Court of Justice and the following chapter provides with an analysis of the cases in chapter six. Chapter eight concludes the present study by highlighting its main points.

2. Point of departure

This chapter is intended to introduce the reader with the matter of exit taxation. Thus, the following will comprise the definition of the term, the overview of EU law and the legislation that concerns exit taxation. Lastly, the description of the circumstances under which exit taxation can appear, is provided.

2.1. Defining exit taxation

Exit tax provisions are rules that cause tax consequences at the moment when a taxpayer moves to another country than that of origin. The provisions may subject, for example, unrealized income, capital gains, tax-exempt income or they can recapture a tax deduction at the moment when the taxpayer leaves the country. Exit taxation can concern both individuals and legal persons. [5]

Corporate exit taxes can be defined as all types of charges imposed by the State of origin on the company transferring its centre of management or assets to another State. The rationale behind exit taxation is that the home State preserves its taxing rights over gains accruing but not yet realized on its territory. This is understandable if regarded from the State of origin perspective whose intention is to protect tax revenues and avoid artificial transfers designed to take advantage of different tax systems, where such transfers are driven by tax rather than commercial motives. The ECJ, however, is of the opinion that MSs cannot prohibit companies to exit and establish in a new MS that offers less restrictive tax measures.[6]

The exit tax provisions included in the tax systems of many EU MSs are very questionable from the perspective of the right of EU nationals to leave a country. They may be in conflict with the TFEU if they are applied on a EU national moving from the country concerned to another MS or on a EU national moving assets to another MS, regardless of whether the person is an individual or a legal entity. This type of exit tax provisions may constitute restrictions on the freedom of establishment and free movement of capital.[7]

Even though there would be a justification for an EU MS to levy exit taxes in order to ensure that it can tax the accrued but unrealized income of a taxpayer moving to another MS, the treatment is often not in accordance with the principle of proportionality of EU law because a less restrictive measure is usually

[5] Marjaana Helminen, 'EU Tax law- Direct Taxation- 2012', Ch. 2.2- Basic Freedoms, IBFD Tax Research Platform; See also Peter Jacob Wattèl & B. J. M. Terra, 'European Tax Law', Sixth Edition, 2012, Kluwer, Amsterdam, p. 956-962 on emigration of individuals and p. 962-972 on emigration of companies.

[6] See chapter 6, C-212/97 Centros Ltd v Erhvervs- og Selskabsstyrelsen, 1999, ECR I-01459 and C-208/00 Überseering BV v Nordic Construction Company Baumanagement GmbH (NCC), 2002, ECR I-09919.

[7] See case C-9/02 Hughes de Lasteyrie du Saillant v Ministère de l'Économie, des Finances et de l'Industrie, 2004, ECR I-02409 and case C-470/04 N v Inspecteur van de Belastingdienst Oost/kantoor Almelo, 2006, ECR I-07409.

available.[8] It thus, depends on the details of the national exit tax provision whether it can be accepted under EU law or not.[9]

It is important that the MSs have included in their legislation provision for exit taxation. In the absence of such legislation, the MS of origin is likely to lose the right to tax the gains accrued but not realised on its territory. That becomes problematic and can lead to tax avoidance when the company migrates to a State where such gains are subject to little or no tax.[10]

Exit taxes follow different patterns, as there are different ways in which they are imposed. Some countries include exit taxation in the tax treaties signed with the MSs and others can treat it as a domestic transaction to which tax treaties do not apply, given that the deemed disposal occurs just before emigration.[11]

2.2. Tax Treaties and exit taxation on capital gains

Tax treaties in EU are mainly following the OECD Model Tax Convention.[12] I say mainly, because MSs sometimes take the freedom to deviate from the OECD's guidelines in order to adapt the provisions of the tax treaties concluded between themselves to their own tax systems. [13] Moreover, the OECD Model does not cover exit taxation in particular, but I will further describe the provisions under which exit taxation is analysed. A short description of the U.N. Tax Convention is also provided in order to show the similarities and differences with the OECD Model.[14]

2.2.1. Tax Treaties

Tax treaties are international agreements meant to address and reduce the extent of double taxation.[15] Consequently, individual states enter into tax treaties with the aim to overcome the issue of double taxation by reciprocally agreeing to restrict their substantive tax law.[16]

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[8] See the ECJ's decisions in chapter 6 of this paper. See also Peter Jacob Wattèl & B. J. M. Terra, 'European Tax Law', Sixth Edition, 2012, Kluwer, Amsterdam, p. 955-974.

[9] Marjaana Helminen,'EU Tax law- Direct Taxation- 2012', Ch. 2.2- Basic Freedoms- Exit taxes, IBFD Tax Research Platform.

[10] Hji Panayi Christiana , 'Exit Taxation as an Obstacle to Corporate Emigration from the Spectre of EU Tax Law' (March 24, 2011). Cambridge Yearbook of European Legal Studies, Vol. 13, 2010-2011, p. 246. Available at SSRN: http://ssrn.com/abstract=1809566.

[11] Hji Panayi Christiana , 'Exit Taxation as an Obstacle to Corporate Emigration from the Spectre of EU Tax Law' (March 24, 2011). Cambridge Yearbook of European Legal Studies, Vol. 13, 2010-2011, p. 247. Available at SSRN: http://ssrn.com/abstract=1809566.

[12] See See for that matter Maria Hilling, 'Free Movement and Tax Treaties in the Internal Market', 2005, Iustus Förlag AB, Uppsala, p. 32.

[13] Ibid, p. 49.

[14] The U.S. Model Tax Convention is also mentioned but it is not treated separately because the purpose of the present paper is to cover exit taxes' treatment within Europe.

[15] Klaus Vogel, 'Double Tax Treaties and Their Interpretation', 2012, p.4. See also Maria Hilling, 'Free Movement and Tax Treaties in the Internal Market', 2005, Iustus Förlag AB, Uppsala, p. 50.

[16] Ibid, p. 10.

There is no uniform system of conflicts law; each state has its own rules so that differing results and imperfect legal relationships are unavoidable. The norms that determine which law applies are traditionally referred to as conflict rules.[17] In situations in which an overlapping of substantive tax law is expected to occur, states that are parties to tax treaties decide which of them shall be bound to withdraw its tax claim.[18] Article 23 of the OECD and UN Model Tax Conventions provides an alternative for the relief of double taxation; the contracting states in drafting their particular treaty may choose between the exemption and credit methods.[19]

The international treaties concluded by MSs do not form part of the EU law in its narrow meaning. The provisions agreed by two or more MSs in the treaties do not regard or bind the MSs that are not part to that agreement. The residents of the signatory countries are the ones affected by the treaty provisions.[20]

However, the tax treaties fall within the competence of EU law due to them having a direct impact on the functioning of the internal market.[21] Accordingly, tax treaties concluded for the purpose of eliminating double taxation and double non-taxation must, under EU law, comply with the internal market requirements on non-discrimination and the basic freedoms laid down in the TFEU.[22] Tax treaties have to be concluded, applied and interpreted in accordance with EU law.[23]

Moreover, when a conflict arises between EU law and tax treaties, the first one prevails. The supremacy of EU law over tax treaties has been made explicit by the ECJ in the Avoir Fiscal case.[24]

EU MSs can conclude agreements with third-countries on most matters concerning direct taxation.[25] Tax treaties concluded by MSs with non-EU MSs are acceptable to the extent that they do not prevent or restrict the effective attainment

[17] Ibid, p. 13.

[18] Ibid, p. 22. Tax treaties, in other words, do not just introduce international "source rules"; In addition, they usually establish an independent mechanism to avoid double taxation through the division of tax claims.

[19] See Maria Hilling, 'Free Movement and Tax Treaties in the Internal Market', 2005, Iustus Förlag AB, Uppsala, p. 61 on the importance of article 23 OECD Model Convention.

[20] The OECD Model Convention states in its 1st article that the persons covered by the convention are those of one or both of the Contracting States.

[21] Maria Hilling, 'Free Movement and Tax Treaties in the Internal Market', 2005, Iustus Förlag AB, Uppsala, p. 49-53.

[22] See e.g. C-270/83 Commission of the European Communities v French Republic (Avoir Fiscal), 1986, ECR 00273, para 26 : "the rights conferred by article [43] of the Treaty are unconditional and a MS cannot make respect for them subject to the contents of an agreement concluded with another MS."

[23] See e.g. C-307/97 Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v Finanzamt Aachen-Innenstadt, 1999, ECR I-06161., Para. 57 and C-279/93 Finanzamt Köln-Altstadt v Roland Schumacker, 1995, ECR I-00225, Para. 21 for examples of treaty rules that are contrary to EU law.

[24] C-270/83 Commission of the European Communities v French Republic (Avoir Fiscal), 1986, ECR 00273, para.24.

[25] See e.g. C-469/98 Commission of the European Communities v République de Finlande, 2002, ECR I-09627,C-471/98 Commission of the European Communities v Kingdom of Belgium, 2002, ECR I-0968, C- 472/98 Commission of the European Communities v Grand Duchy of Luxemburg, 2002, ECR I-09741, C-475/98 Commission of the European Communities v Republic of Austria, 2002, ECR I-09797, C-476/98 Commission of the European Communities v Federal Republic of Germany, 2002, ECR I-09855.

of the objectives of the EU treaties, the directives on direct taxes or other EU law provisions and principles.[26]

2.2.2. The OECD Model Tax Convention

The OECD Model Tax Convention was founded in the 1950s and took over the work of developing a model tax treaty. One of the principal aims of the OECD Model Tax Convention is to promote trade between its MSs. An important aspect of its work is to assist in removing barriers to trade posed by taxation issues.[27]

The OECD Model Tax Convention is not binding upon any state but it is often used as a template for tax treaties, with its detailed Commentary on each of the Articles being used as supplementary data to aid interpretation. Nearly all treaties are based on the OECD Model Tax Convention, except the US's treaties, which use an alternative model (the US Model Income Tax Convention, which is broadly similar to the OECD Model in many respects). However, the OECD Model Tax Convention has been very widely used for a long time.[28]

The real importance of the OECD Model Tax Convention is that it provides a degree of certainty to the tax implications of international business, which makes international expansion less risky for enterprises. If two states have entered into a double tax treaty based on the OECD Model Tax Convention, then a company resident in one state, can have a reasonable degree of certainty as to how it will be treated for tax purposes if it expands its operations into the other state.[29]

Furthermore, the connection between exit taxation and tax treaties is not entirely clear. The OECD Model Tax Convention does not further deal with exit taxation. However, parallels have been drawn to the OECD Model Tax Convention on article 7 that deals with the treatment of tax connected to assets transferred from a permanent establishment to a parent company abroad and on article 13 OECD regarding capital gains.

The term ‘permanent establishment’ is very important for the host state’s taxation of business profits made by non-residents. Article 7 writes that: '… profits of an enterprise of State A shall be taxable only in State A unless the enterprise carries on business in State B through a "permanent establishment" situated therein'.

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[26] Marjaana Helminen,’EU Tax law- Direct Taxation- 2012’, ch. 1.5.3. 1., IBFD Tax Research Platform.

[27] For further information on the historical development of the OECD, read the Introduction in the OECD Model Convention (2010). See also regarding the OECD Model Tax Convention, Maria Hilling, ‘Free Movement and Tax Treaties in the Internal Market’, 2005, Iustus Förlag AB, Uppsala, p. 54-66.

[28] In general, this model allocates the primary right to tax to the country from which capital investment originates (i.e., the home, or resident country) rather than the country in which the investment is made (the host, or source country). As a result, the model convention is most effective as between two countries with reciprocal investment flows (such as among the OECD member countries), but can be very unbalanced when one of the signatory countries is economically weaker than the other (such as between OECD and non-OECD pairings).

[29] There is also the comfort that should double taxation occur, the taxpayer has the right, under the double tax treaty, to require the tax authorities of the signatory countries concerned to consult together in situations not expressly covered by the treaty to ensure that the enterprise is not subject to double taxation. Read further, Angharad Miller and Lynne Oats, ‘Principles of International Taxation’ , 3rd Edition, Ch. 7.

A typical example of the circumstances under which article 7 applies can be described as follows: Company X, resident of state A has a branch in state B where company X is a non-resident. State B is entitled to tax only the profits arsing in the branch located in state B and state A can tax the entire profits made by company X. [30]

Moreover if dividends, interest or royalties are received via a permanent establishment in the other contracting state, and if the right in respect of which such payments are made is an asset of that permanent establishment, then their taxation is determined pursuant to Article 7 of the OECD Model Tax Convention.[31]

The ground rules for deciding how much of the total profits of the company are attributable to the permanent establishment are laid down in article 7 of the OECD Model Tax Convention.

Furthermore, the way in which capital gains[32] are taxed varies from state to state. It follows that some MS tax capital gains as ordinary income, some may give capital gains a special treatment, while in other states may not be taxed at all. The basic rule is that the capital gains are taxable only in the state where the company is resident. That does not mean, however, that the State of residence has the obligation to tax the capital gains concerned. [33]

Article 13 of the OECD Model Tax Convention concerns alienations of property and it includes normal disposals of assets, for example by sale and also events such as exchange of assets.[34] Not all states levy tax in all these situations, but the meaning of the term 'alienation' is sufficiently wide to give them the right to do so if their domestic law provides for a charge to tax in a particular situation.[35]

Two provisions are found in most tax treaties[36]:

First, a state is permitted to tax gains from the alienation (e.g. sale) of immovable property (land and buildings) situated in that state. This is due to the very close link between the gain and the state in which the property is located.

Secondly, gains on alienation of movable property forming part of the assets of a permanent establishment may be taxed by the state where the permanent establishment is situated, including gains from the alienation of the permanent establishment, whether or not as part of the alienation of the whole enterprise. Thus, for example, the sale of a company resident in State A and owned by a

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[30] Angharad Miller and Lynne Oats, 'Principles of International Taxation', 3rd Edition, Ch. 7, sect. 7.22.

[31] Klaus Vogel, 'Double Tax Treaties and Their Interpretation',2012, Vol. 4, p.29.

[32] Article 13 of the OECD Model Tax Convention

[33] Angharad Miller and Lynne Oats, 'Principles of International Taxation' , 3rd Edition, Ch. 7. The OECD Model does not attempt to deal with these different approaches and does not specify to what kind of tax it applies.

[34] It includes also expropriation, gifts and the passing of assets to another on death.

[35] Angharad Miller and Lynne Oats, 'Principles of International Taxation' , 3rd Edition, Ch. 7, sect. 7.28.

[36] Art. 13.3 Gains on the alienation of ships or aircraft used in international traffic businesses are invariably taxable only in the state in which the place of effective management is located. This is sensible in that an international transport firm will have assets located around the world, with the locations of those ships and aircraft changing daily. In the absence of this rule, an international transport firm could find itself liable to a capital gains tax charge in whatever state the ship or aircraft happened to be at the time the sale took place.

resident of State A could give rise to a tax charge in State B if that company has a permanent establishment in State B.

OECD Model Tax Convention also contains a more detailed rule which provides that the gains on the alienation of shares deriving more than 50% of their value, directly or indirectly from immovable property situated in the other state, may be taxed in the other state.[37]

Some bilateral tax treaties include provisions regarding the change of residence from one Contracting State to another.[38] For instance, where an individual changes residence from one State A (either of which he is a national or of which he has been a resident for at least 10 years) to the other state B, State A retains the right to tax any gains made in the five years following the change of residence. State B retains the same right regarding individuals who move to State A (this is the anti-avoidance rule). Furthermore, where an individual who ceases to be a resident of State A, and immediately after becomes a resident of the State B, is treated for the purposes of taxation in the State A as having alienated a property and is taxed in that State A by that reason. The individual, however, may choose to be treated for the purposes of taxation in the other State B as if the individual had, immediately before becoming a resident of that State, sold and repurchased the property for an amount equal to its fair market value at that time. In other words, if one state imposes a capital gains exit charge, the other state will permit an uplift in the base cost of the assets involved.[39]

2.2.3. The U.N. Tax Convention

The UN Model Tax Convention[40] (UN Model), developed in 1980, favours capital importing states as opposed to capital exporting states and was developed for use between a developing state and an already developed state. Although it is based on the OECD Model Tax Convention, more scope is afforded for the taxation of the foreign investor by the source state. The UN Model is designed to aid developing states to tax a larger part of the overseas investor's income than the OECD Model Tax Convention and the US Model[41]. It permits double tax relief by exemption and includes tax-sparing clauses.[42]

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[37] Art. 13.4. OECD Model Tax Convention.

[38] See, for instance, The Convention between Canada and the Republic of Austria for the avoidance of Double Taxation and the prevention of fiscal evasion with respect to taxes on income and on capital.

[39] Angharad Miller and Lynne Oats, 'Principles of International Taxation' , 3rd Edition, Ch. 7, sect. 7.28. See also the Convention between Canada and the Republic of Austria for the avoidance of Double Taxation and the prevention of fiscal evasion with respect to taxes on income and on capital.

[40] United Nations Model Double Taxation Convention between Developed and Developing Countries, New York, 2011.

[41] United States Model Income Tax Convention of November 15, 2006 – 'Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income'.

[42] See, Angharad Miller and Lynne Oats, 'Principles of International Taxation', 3rd Edition, Ch. 7, sect. 7.14.

2.3. EU Treaties and secondary legislation

Even if expected to cover the issues arising under the free movement of companies, the EU legislation and case law is rather limited, due to the lack of harmonization between MSs in the field of exit taxation.

In the absence of harmonized measures within the EU, MSs remain free to define the criteria for allocating their taxing powers by treaty or unilaterally, particularly with a view to eliminating double taxation.[43]

Furthermore, the articles concerning the basic freedoms prohibit not only the discrimination of EU nationals of other MSs compared to those of a country's own nationals, but also a country's tax treatment that results in a restriction on the use of the basic freedoms by its own nationals.[44] The freedom of establishment gives an EU national the right to move from a MS to another and the MSs are prohibited to apply laws that make it difficult for the EU nationals to take advantage of this right.[45]

Secondary legislation also failed to bring concise measures that would solve the problems of migration. Several attempts were made to provide legislative measures that would enhance corporate migration but they did not entirely, or in a clear manner, provide for solutions to these issues.[46]

2.3.1. The concept of establishment

The right of establishment is set in articles 49 and 54 of the TFEU and it has a substantial importance in the effective functioning of the Internal Market.[47] This freedom has direct effect, which means that it can be relied on before national courts whenever a rule that is contrary to it arises in national law.[48] The national

[43] Judit Jancsa-Pék 'The impact of Article 39 EC on exit taxation concerning deferred remunerations'.

[44] Marjaana Helminen, 'EU Tax Law- Direct Taxation- 2012', IBFD Tax Research Platform, Sect. 2.2.5.2.2.

[45] See e.g. C-251/98 C. Baars v Inspecteur der Belastingen Particulieren/Ondernemingen Gorinchem, 2000, ECR I-02787, Para. 28, Case 81/87 The Queen v H. M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc, 1988, ECR 05483, C-208/00 Überseering BV v Nordic Construction Company Baumanagement GmbH (NCC), 2002, ECR I-09919, Case C-210/06 Cartesio Oktató és Szolgáltató bt, 2008, ECR I-09641, Paras. 112-113, C-209/01Theodor Schilling and Angelica Fleck-Schilling v Finanzamt Nürnberg-Süd, 2003, ECR I-13389, Case C-200/98 X AB and Y AB v Riksskatteverket, 1999, ECR I-08261, C-107/94 P. H. Asscher v Staatssecretaris van Financiën, 1996, ECR I-03089, C-264/96 Imperial Chemical Industries plc (ICI) v Kenneth Hall Colmer (Her Majesty's Inspector of Taxes), 1998, ECR I-04695, C-224/02 Heikki Antero Pusa v Osuuspankkien Keskinäinen Vakuutusyhtiö, 2004, ECR I-05763, Para. 19, Case C-268/03 Jean-Claude De Baeck v Belgische Staat, 2004, ECR I - 5963 and C-520/04 Pirkko Marjatta Turpeinen, 2006, ECR I-10685, Para. 22.

[46] Hji Panayi Christiana , 'Exit Taxation as an Obstacle to Corporate Emigration from the Spectre of EU Tax Law' (March 24, 2011). Cambridge Yearbook of European Legal Studies, Vol. 13, 2010-2011, p. 263. Available at SSRN: http://ssrn.com/abstract=1809566.

[47] Se also Maria Hilling, 'Free Movement and Tax Treaties in the Internal Market', 2005, Iustus Förlag AB, Uppsala, p. 124-125.

[48] The principle of direct effect was created and developed throughout the years by the ECJ. See case C-26/62 NV Algemene Transport- en Expeditie Onderneming van Gend & Loos v Netherlands Inland Revenue Administration 1963, ECR 00001; Case C- 41/74, Yvonne van Duyn v Home Office 1974, ECR 01337; Case C-43/75, Gabrielle Defrenne v Société anonyme belge de navigation aérienne Sabena, 1976, ECR 00455, that deal with this principle. Case C- 2/74, Jean Reyners v. Belgian State, 1974, ECR 00631; Case C-71/76, Jean Thieffry v Conseil de l'ordre des avocats à la cour de Paris, 1977, ECR 00765; confirmed that art 49 TFEU is directly effective.

law of a MS that restricts the freedom of establishment must be modified, except for the case where the restriction can be justified by overriding reasons of general interest; and where the restriction is proportionate.[49]

This concept of establishment is far reaching, allowing EU nationals to participate on a continuous and stable basis to the economic development of a MS, other than their state of origin, thus contributing to the economic and social interpenetration within the Union in the field covering the area of self-employed persons.[50]

The freedom of establishment also allows the carrying on of undertakings (market access) and the right to treatment as an entrepreneur in the MS of establishment (market equality). It includes the right to set up a new undertaking (primary establishment), as well as the right to set up agencies, branches or subsidiaries of already existing undertakings (secondary establishment). It addresses both the departure state and the state where the management seat is transferred or in which a primary or secondary establishment has been set.[51]

Art 49 TFEU is prohibiting both direct and indirect discrimination on ground of nationality.[52] For instance, two EU nationals from two different countries that are found to be in a comparable situation should be treated in the same way, otherwise, the national legislation may be in conflict with the Treaty provisions. [53]

A restriction on the freedom of establishment also occurs when the national rules of a MS are capable to restrict the exercise of that freedom by companies established in another MS, meaning that it is not required that the legislation in question actually had the consequence of making companies refrain from transferring their seat of management or their assets abroad.[54]

2.3.2. The concept of free movement of capital

Within the Internal Market, we are not only referring to the free movement of workers and companies but also to the free movement of capital. In most of the cases where a company wishes to transfer its management seat to another MS, it also transfers its capital (assets). Thus articles 63-68 of the TFEU ensure the free movement of capital and freedom of payments.

[49] The principle of proportionality is found under article 5.4 TEU and it writes that ‘the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties.’ The justification test was developed by the ECJ in its judgements. On this matter, see chapter 6 ‘Case law of the ECJ on exit taxation’ bellow.

[50] Case C-55/94 Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano, 1995, ECR I-04165, para 25; Case C-97/09 Ingrid Schmelz v Finanzamt Waldviertel, 2010, ECR I-10465, para 37.

[51] Peter Jacob Wattèl & B. J. M. Terra, ‘European Tax Law’, Sixth Edition, 2012, Kluwer Law International, Amsterdam, p. 68.

[52] See C-55/94 Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano, 1995, ECR I-04165.

[53] Case C-270/83 Commission of the European Communities v French Republic (Avoir Fiscal), 1986, ECR 00273, Para. 14, C-374/04 Test Claimants in Class IV of the ACT Group Litigation v Commissioners of Inland Revenue, 2006, ECR I-11673, Para. 43 C-231/05 Oy AA, 2007, ECR I-06373, Para. 30, C-307/97 Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v Finanzamt Aachen-Innenstadt, 1999, ECR I-06161, para. 35 and C-524/04 Test Claimants in the Thin Cap Group Litigation v Commissioners of Inland Revenue, 2007, ECR I-02107, Para. 37.

[54] C-524/04 Test Claimants in the Thin Cap Group Litigation, 2007, ECR I-02107, Para. 62 and C-231/05 Oy AA, 2007, ECR I-06373, para. 42.

The provisions regarding the freedom of movement of capital and payments have direct effect, which means that it is directly applicable before national courts and administrations.[55] The mere change of state residence does not fall under the free movement of capital unless transfer of capital or payments is involved.[56]

The rules that impose restrictions on the free movement of capital and payments are prohibited. The prohibited restrictions include measures of a MS that are likely to discourage non-residents from making investments in the MS or to discourage the MS's residents from doing so in other states.[57] In some cases, however, the restrictions on free movement of capital can be accepted provided that they have as objective the protection of public interest and that they pass the proportionality test.[58]

2.4. Tax triggering event

In order for exit taxation to take place, a cross-border event must occur. Thus, a company wishing to migrate is likely to face exit taxation when transferring its tax residence or assets outside the MS under which laws it has been incorporated. The present sub-chapter is meant to capture the moment when and the circumstances under which exit taxation is triggered.

2.4.1. Transfer of tax residence

First and foremost, the term 'resident of a Contracting State ', as described by the OECD Model Tax Convention, refers to the concept of residence adopted in the domestic laws and includes 'any person that is liable to tax by reason of his domicile, residence, place of management or any other criterion of a similar nature'.[59] On the other hand, where a legal entity is 'a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated'[60]. Two well-known theories are used in order to determine a company's residency: the incorporation theory and the real-seat theory.[61]

The transfer of tax residence entails the desire of a legal entity to migrate from its state of origin to another MS for reasons that vary from case to case. For instance, some companies may choose to migrate due to high tax regimes applied in their country of origin, while other companies migrate in order to take advantage of the available tax treaties in the new place of residency.[62]

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[55] See case Case C-101/05 Skatteverket v A, 2007, ECR I-11531.
[56] See e.g. C-513/03 Heirs of M. E. A. van Hilten-van der Heijden v Inspecteur van de Belastingdienst/Particulieren/Ondernemingen buitenland te Heerlen, 2006, ECR I-01957, para. 49.
[57] C-451/05 Européenne et Luxembourgeoise d'investissements SA (ELISA) v Directeur général des impôts and Ministère public, 2007, ECR I-08251., Para. 69.
[58] C-478/98 Commission of the European Communities v Kingdom of Belgium, 2000, ECR I-07587, paras. 38 and 39.
[59] OECD Model Tax Convetion on Income and on Capital, art 4.1.
[60] Ibid art 4.3.
[61] See chapter 3 on incorporation and real seat theories.
[62] See chapter 6 on case law of the ECJ.

Once the decision of transfer has been taken, an exit tax could be required by the MS of origin provided that the migration triggers a realisation event for the shareholders.

When transferring their seat of management abroad, the companies might cease to be tax residents of the country under which rules they have been incorporated if the MS of exit and the host MS follow the provisions of OECD Model Tax Convention. *E contrario*, if the two MSs involved have not concluded a tax treaty that follows the OECD Model Tax Convention, the company incorporated in one MS having its place of management in another MS may be a dual resident subject to unlimited tax liability in both MSs. In a tax treaty shaped after the OECD Model Tax Convention, article 4.3 is allocating unlimited taxing rights to the MS where the company has established its place of effective management meaning that the exit MS will only tax the income of the MC which is sourced in that MS. Income sourced in the exit MS would include profits attributable to a permanent establishment (PE) maintained in the exit MS[63], gains derived from alienation of immovable property situated in the exit MS or movable property forming part of a PE maintained in the exit MS.[64]

Taxation may occur even if the transfer of the registered office and/or real seat does not lead to a change of tax residence. This may be the case when the MC, as a result of the migration, ceases to exist under company law of the exit MS. [65]

It is important to mention that companies are creatures of national law, which means that it is for the national legislation to determine the requirements for both the formation and the functioning of a company. Thus, a company incorporated under the laws of a MS may not be automatically recognized in other jurisdictions and therefore it is up to the host MS to recognize the existence of a corporate entity. Nowadays this issue may be overcome through use of a SE, which is a legal form regulated at EU level.[66]

2.4.2. Transfer of assets

MSs argue that the rules on transfer of assets are designed to prevent residents of a MS from avoiding tax on capital gains by sheltering them in closely held overseas companies.[67]

Transfer of assets entails an operation whereby a company transfers without being dissolved all, one or more branches of its activity to another company in exchange for the transfer of securities representing the capital of the company receiving the transfer.[68]

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[63] Art. 7(1) of the OECD Model Convention.

[64] Art. 13(1) and 13(2) of the OECD Model Convention.

[65] Daria Zernova, 'Exit Taxes on Companies in the Context of the EU Internal Market' (2011), KluwerLawOnline, 39 Intertax, Issue 10, pp. 472.

[66] Raffaele Russo "The Fundamentals of International Tax Planning", ch 5.4 'Substantive versus tax planning', p. 66-69.

[67] See the case law chapter 6, C-371/10 National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam, 2011, ECR Not yet published.

[68] Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different MSs, article 2.(c).

The transfer of assets between companies may still trigger immediate taxation of unrealised capital gains related to the assets concerned in some MSs. These transfers may be subject to exit taxation in the MS where the MC is resident if[69]:

1. The assets transferred become part of business property of the foreign company;
2. The MS where the MC is resident relieves double taxation by way of exception under domestic law or the applicable tax treaty.

This is the case of Norway and Austria. Austria, however, does not impose tax, if the assets are transferred within the EU/EEA. Although Art. 7 of the OECD Model Tax Convention does not preclude a MS from imposing tax with respect to such transfer[70], most MSs do not recognize this as a realization event, since under tax exemption method, capital gains derived through the PE will still be included in the worldwide income of the MC of the year when assets are actually realized.[71]

What the EU law stands against is not the taxation of the accrued but not yet realised capital gains as such but the immediate taxation of these gains.[72]

The bottom line is that, even if MSs consider necessary to apply exit taxes at the moment when a company transfers its assets, the ECJ held in its judgements that immediate taxation with regard to both, transfer of management seat or assets, is unlawful and such provisions that are contrary to this view should be modified.[73]

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[69] Ibid, article 10.2.

[70] See Commentary on the OECD Model Tax Convention on Income and on Capital, (2008), Art. 7, s. 21.

[71] Daria Zernova, 'Exit Taxes on Companies in the Context of the EU Internal Market', p. 472.

[72] See chapter 6case law of the ECJ bellow.

[73] See case C-371/10 National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam, bellow, where the ECJ held that a less restrictive measure with regard to immediate exit taxation, is to give the company wishing to transfer its seat of management or assets, the option to choose whether to do so or to defer the payment of such taxes until the actual realization of the gain.

3. Can EU companies freely migrate?

Before even considering exit taxes there are some other inherent limitations to the ability of a company to migrate that takes us back to the very basic freedom of establishment. This can be the result of substantive national laws or conflict of rules of the exit State or of the host State, upon which EU law has surprisingly little effect. The companies' ability to migrate is built on two important theories, namely the incorporation theory and the real seat theory. [74]

3.1. The incorporation theory

The incorporation theory[75] is the theory that connects the company to the jurisdiction where it was incorporated. Under this theory, the laws of the incorporation jurisdiction dictates the existence, internal affairs and dissolution of the company, irrespective of any activities carried out in other MSs.[76]

After the case law of *Segers*[77], *Daily Mail*[78] *and Centros*[79], it follows that the host MS has to respect the laws of the MS of origin. As long as the MC maintains its legal personality under the law of the MS of origin, the host MS is obliged to recognise the legal personality of that company.[80]

Generally, the incorporation states do not require companies that have been formed in another MS but hold their effective management in their jurisdiction, to reincorporate. There are, however, measures that MSs may take in order to protect the persons dealing with overseas companies that carry on business in their jurisdiction.[81]

[74] Hji Panayi Christiana , 'Exit Taxation as an Obstacle to Corporate Emigration from the Spectre of EU Tax Law' (March 24, 2011). Cambridge Yearbook of European Legal Studies, Vol. 13, 2010-2011, p. 259. Available at SSRN: http://ssrn.com/abstract=1809566.

[75] Also referred to as 'siège statuaire' in France or 'Gründungstheorie' in Germany. Countries such as the USA, the UK, Ireland, Switzerland, Denmark and the Netherlands subscribe to this theory.

[76] Hji Panayi Christiana , 'Exit Taxation as an Obstacle to Corporate Emigration from the Spectre of EU Tax Law' (March 24, 2011). Cambridge Yearbook of European Legal Studies, Vol. 13, 2010-2011, p. 259. Available at SSRN: http://ssrn.com/abstract=1809566

[77] C-79/85 D. H. M. Segers v Bestuur van de Bedrijfsvereniging voor Bank- en Verzekeringswezen, Groothandel en Vrije Beroepen, 1986, ECR 02375.

[78] C-81/87 The Queen v H. M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc, 1988, ECR 05483.

79 C-212/97 Centros Ltd v Erhvervs- og Selskabsstyrelsen, 1999, ECR I-01459.

[80] Some exceptions may arise by reason of general interest protection or avoidance of abuse of law.

[81] For instance, the companies formed overseas that carry on significant business on the territory of UK and the Netherlands are under a certain reporting obligation. The information required is provided to the Company Registry and is meant to protect the persons entering in contact with these companies.

3.2. The real seat theory

The real seat theory[82] focuses on there being a substantial connection between a company and the legal system upon which it depends for formation and the establishment of legal personality. Under this theory, only the place where the company has registered its real seat (the actual centre of management) has the power to regulate the company's internal affairs. The company has to register or incorporate in the State where it has its centre of management.[83]

A company registered in one State having its centre of management in another State that follows the real seat theory may not be recognised in that real seat State as a legal entity[84], which means that a number of issues that may hinder cross-border corporate migration can arise. From an emigration perspective, the company may be required to dissolve before migrating while from an immigration perspective, the company may not be recognised in the host State as a foreign company, which can lead to the loss of protection of the limited liability status. In addition, the company may have to reincorporate under the host State or adjust part or its entire internal law.

3.3. Impact on the freedom of establishment

The incorporation doctrine has no negative impact on a company wishing to migrate from its state of origin to a new MS. The use of the incorporation theory allows companies to establish in the state that seems most advantageous for them.[85] The reasoning is that there is no requirement to reincorporate in the new MS, which can be time and costs saving for the MC.[86]

It cannot be argued in the same way about the real seat doctrine, which is known for making it difficult on the companies to migrate, since it requires the existence of a genuine link with the incorporation state. In other words, the addresses of central administration and place of incorporation have to coincide under the real seat theory.[87]

Suppose that company X incorporated under the laws of MS A (using incorporation theory) moves its real seat in MS B (using also the incorporation theory). As in *Centros*[88] case, company X will not face any problem to establish in the new MS. In the second scenario, company X wishing to move from MS A (incorporation theory) to MS B (real seat theory) will still have its company

[82] This theory is adopted by Germany, France, Italy, Spain, Portugal, Greece and Belgium, for example, and is commonly referred to as 'Sitztheorie' in Germany, 'siège réel' or 'siège social' in France.

[83] Hji Panayi Christiana , 'Exit Taxation as an Obstacle to Corporate Emigration from the Spectre of EU Tax Law' (March 24, 2011). Cambridge Yearbook of European Legal Studies, Vol. 13, 2010-2011, p. 260. Available at SSRN: http://ssrn.com/abstract=1809566

[84] Non-recognition can sometimes be mitigated by international conventions entered into by States, usually on a bilateral basis, which take precedence over their national rules.

[85] Chapter 6 of this paper on case law of the ECJ. See also Guglielmo Maisto, 'Residence of Companies under Tax Treaties and EC Law', IBFD, 2009, Asterdam, p. 20.

[86] Mattias Dahlberg, 'Direct Taxation in Relation to the Freedom of Establishment and the Free Movement of Capital', Kluwer Law International, 2005, Netherlands, p. 145.

[87] Guglielmo Maisto, 'Residence of Companies under Tax Treaties and EC Law', IBFD, 2009, Asterdam, p. 21.

[88] C-212/97 Centros Ltd v Erhvervs- og Selskabsstyrelsen, 1999, ECR I-01459, chapter 6 of this paper.

recognized by the state of origin, MS A, but MS B using the real seat theory, will require company X to comply with its laws, given that the company is located on is territory.[89] The final case, where company X wishes to move from MS A (real seat theory) to MS B (incorporation theory), shows that MS A will no longer recognize company X upon transfer, while MS B will not be able to recognize company X either, since the company is no longer existent in MS A or anywhere else for that matter.[90]

It follows from the foregoing that the companies' freedom to migrate is dependent on the MSs application of the incorporation or the real seat doctrines.

[89] See chapter 6 on case law of the ECJ C-208/00 Überseering BV v Nordic Construction Company Baumanagement GmbH (NCC), 2002, ECR I-09919.

[90] See for that matter in chapter 6 of this paper, C-210/06 Cartesio Oktató és Szolgáltató bt, 2008, ECR I-09641.

4. The harmful effects of exit taxes on business community

The adverse effects of exit taxation make it, most of the times, difficult for companies to pursue their initial plan of transferring their seat of management or assets abroad.[91] When finding out about the consequences that migration brings, companies enhance instead the idea of reincorporation upon dissolution.[92] The existence of exit taxes[93]:

i. Makes it more difficult for companies to restructure and adapt to changing economies in a globalized world. The taxation of unknown income can be an unbearable obstacle against reorganizations that would otherwise occur;
ii. They withdraw liquidity and net equity by taxation of unrealized gains or by an obligation to provide adequate security for such deemed gains;
iii. They create new burden of compliance and administration for both the public authorities and the companies. A primary difficulty constitutes the determination of the value of the transferred assets;
iv. Bring with, sometimes, double taxation. A number of states may completely ignore the fact that the assets have been taxed by the State of origin. In other cases where the host State provides for some sort of tax payment recognition, the excessive taxation may persist if the two States do not use the same form of valuation.

What is desirable with exit taxation is that it does not lead to double taxation or tax avoidance.[94] As there are countries that disregard the fact that a corporate gain has already been taxed in the former state, the exit taxes should be rethought, perhaps, as to be applied only in the cases where the MC is obviously intending to avoid tax or only where both countries provide for solutions against double taxation. With regard to the transfer of assets, one might say that it is more effective to think about cooperation between jurisdictions, exchange of information and bilateral tax conventions that secure the protection of the tax base belonging to the state of origin and the elimination of double taxation.[95]

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[91] The taxes applied due to migration can be unbearable for the company. Mattias Dahlberg, ‘Direct Taxation in Relation to the Freedom of Establishment and the Free Movement of Capital’, Kluwer Law International, 2005, Netherlands, p. 145.

[92] See on this matter the Opinion of AG Jääskinen delivered on 15 December 2011 , C-378/10 VALE Építési kft, ECR Not yet published.

[93] ’Exit taxes: serious obstacles for international business restructurings and movements of capital’-Prepared by the Commission on Taxation,16 June 2006, Document 180-488 Final.

[94] See chapter 6 of this paper.

[95] See section 6, case C-371/10 National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam, 2011, ECR Not yet published.

5. Can emigration taxes on capital gains be justified?

When a case arrives before the ECJ, the MSs tend to justify their restrictive measures in manners that sometimes are accepted by the Court and sometimes are not. For instance, the following reasons might be accepted as justifications for a tax treatment constituting a restriction on one of the basic TFEU freedoms: (i) safeguarding effectiveness of fiscal supervision; (ii) anti-avoidance purpose; (iii) safeguarding the balanced allocation of taxing rights between MSs; (iv) need to prevent the double use of losses; (v) safeguarding the fiscal cohesion of the national tax system; (v) territoriality principle.[96]

However, before analysing each of the above mentioned justifications it is worth discussing the rule of reason[97], which is a doctrine developed by the ECJ in order to add to the grounds of justification already existent under the TFEU.[98]

5.1 The rule of reason test

Before getting to analyse the justifications for the rules imposed by the MSs, the ECJ is, firstly, assessing whether the relevant rules fall within the scope of the free movement provisions and secondly, whether the measures are prohibited by EU law. Further, if the rules are deemed to be prohibited, the ECJ goes on to apply possible justifications to the relevant matter.[99]

For the purpose of this paper, article 51 TFEU lays down derogations with regard to the exercise of official authorities and article 52 TFEU provides for the application of special treatment for foreign nationals on ground of public policy, public security and public health.[100]

On top of the Treaty derogations, the ECJ left the list of justifications open, provided that those justifications fulfil the four requirements necessary for the restricting national measures to pass the rule of reason test. Thus, the measures 'must be applied in a non-discriminatory manner; they must be justified by imperative requirements in the general interest; they must be suitable for securing

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[96] Marjaana Helminen,'EU Tax law- Direct Taxation- 2012', ch. 2.3.1., IBFD Tax Research Platform.

[97] The rule of reason doctrine was first mentioned in the case C- 120/78, Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein (Cassis de Dijon), 1979, ECR 649. See also Maria Hilling, 'Free Movement and Tax Treaties in the Internal Market', 2005, Iustus Förlag AB, Uppsala, p. 94-98, B.J.M. Terra, P.J. Wattel- 'European Tax Law: Student Edition', Fifth Edition, 2008, Kluwer, Amsterdam, p. 31 and Mathieu Isenbaert ' EC Law and the Sovereignty of the Memebr states on Direct Taxation', 2010, IBFD Publications BV,Amsterdam, p.370.

[98] See for that matter Maria Hilling, 'Free Movement and Tax Treaties in the Internal Market', 2005, Iustus Förlag AB, Uppsala, p. 91-94.

[99] Maria Hilling, 'Free Movement and Tax Treaties in the Internal Market', 2005, Iustus Förlag AB, Uppsala, p. 90.

[100] Ibid, p. 92. Article 36 of the TFEU provides for justifications for restrictions to the free movement of goods and article 45 TFEU covers limitations justified on the same grounds but in relation to the free movement of workers.

the attainment of the objective which they pursue; and they must not go beyond what is necessary in order to attain it.'[101]

Taken separately, the first condition proposed by the ECJ in *Gebhard*[102] case suggests that a measure imposed on an EU national that is found to be discriminatory cannot be justified in accordance with the doctrine. It follows that the measures liable to hinder or render less attractive the freedoms granted by the treaty can be accepted, pursuant to the justification principle, unless they are proven discriminatory.[103]

The imperative interest mentioned in the second condition was used in different judgements for justifications like protection of the environment[104] and improvement of the working conditions[105].

Moreover, a measure can be regarded as suitable for securing the attainment of the objective pursued only if it genuinely reflects a concern to attain that objective in a consistent and systematic manner.[106] In order to determine whether a measure is suitable, the ECJ will examine if the means employed by the MSs are appropriate to achieve the objective sought.[107]

Provided that the obstacle to the freedom concerned is justified, the restriction cannot go beyond what is necessary in order to attain the general interest. Tax provisions that constitute a restriction on the basic freedoms are not accepted if there would be a measure available to reach the same objective in a less restrictive manner. In any case, the restrictive tax provision must be in accordance with the principle of proportionality.[108]

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[101] Case C-55/94 Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano, 1995, ECR I-04165, para. 37.

[102] Ibid.

[103] See Maria Hilling, 'Free Movement and Tax Treaties in the Internal Market', 2005, Iustus Förlag AB, Uppsala, p. 94-98 and B.J.M. Terra, P.J. Wattel- 'European Tax Law: Student Edition', Fifth Edition, 2008, Kluwer, Amsterdam, p. 31.

[104] Case C-302/86 Commission v Denmark, 1988, ECR 4607. See also Maria Hilling, 'Free Movement and Tax Treaties in the Internal Market', 2005, Iustus Förlag AB, Uppsala, p. 92.

[105] Case C-155/80 Summary proceedings against Sergius Oebel, 1981, ECR 1993. See also Maria Hilling, 'Free Movement and Tax Treaties in the Internal Market', 2005, Iustus Förlag AB, Uppsala, p.

[106] See e.g. case C-169/07 Hartlauer Handelsgesellschaft mbH v Wiener Landesregierung and Oberösterreichische Landesregierun, 2009, ECR I-1721, para. 55; Joined cases C-171/07 and C-172/07 Apothekerkammer des Saarlandes and Others, 2009, ECR I-4171, para. 42 and case C-137/09 Marc Michael Josemans v Burgemeester van Maastricht, 2010, ECR I-13019, para. 70.

[107] Alina Kaczorowska'European Union Law' Routledge 2013, Abingdon, p.583.

[108] See e.g. C-8/74 Procureur du Roi v Benoît and Gustave Dassonville, 1974, ECR 00837, C-120/78 Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein. (Cassis de Dijon), 1979, ECR 00649, C-55/94 Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano, 1995, ECR I-04165, C-250/95 Futura Participations SA and Singer v Administration des contributions 1997, I-02471, para. 26, C-436/00 X and Y v Riksskatteverket, 2002, ECR I-10829, para. 49, C-9/02 Hughes de Lasteyrie du Saillant v Ministère de l'Économie, des Finances et de l'Industrie, 2004, ECR I-02409, para. 49, C-446/03 Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes), 2005, ECR I-10837, para. 35, C-196/04 Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue, 2006, ECR I-07995, para. 47, C-524/04 Test Claimants in the Thin Cap Group Litigation v Commissioners of Inland Revenue, 2007, ECR I-02107, para. 64, C-157/07 Finanzamt für Körperschaften III in Berlin v Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt GmbH, 2008, ECR I-08061., para. 40, C-414/06 Lidl Belgium GmbH & Co. KG v Finanzamt Heilbronn, 2008, ECR I-03601, para. 27 and 231/05 Oy AA, 2007, ECR I-06373, para. 44.

Further, I will analyse the justifications used by the MSs in cases concerning the matter of exit taxation.

5.2. Safeguarding the effectiveness of fiscal supervision

In principle, safeguarding the effectiveness of fiscal supervision is accepted by the ECJ as a justification for the obstacles imposed by the MSs. It has been recognized in the ECJ's case law the fact that MSs need information in order to assess the tax liability of a company.[109] However, this argument has lost its importance once the Mutual Assistance Directive was introduced.[110] Nowadays it is difficult to rely on the fiscal supervision argument due to the existence of the proportionality requirement and of both Assistance Directive and Recovery Directive which help MSs with the necessary information.[111]

With regard to the third countries migration, it can be argued that the mere existence of a double tax treaty clause regarding the transfer of information is not sufficient. It is so because the obligations arising from double tax treaties concluded with a third country do not have the same effect as those arising from treaties concluded between MSs of the EU. Here as well, even if the fiscal supervision is accepted as a justification, the proportionality test has to be passed and that is unlikely to happen given the level of compliance costs that can arise for the company concerned.[112]

5.3. Anti-avoidance purpose

The fact that a company is choosing its country of residence based on the advantages that the tax system has to offer is clearly acceptable to a certain limit. There has not been yet drawn a clear line between where the tax planning stops and the tax avoidance begins.[113]

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[109] See e.g. Cases C-120/78 Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein. (Cassis de Dijon), 1979, ECR 00649; C-324/00 Lankhorst-Hohorst GmbH v Finanzamt Steinfurt, 2002, ECR I-11779, para. 44 and C-250/95 Futura Participations SA and Singer v Administration des contributions 1997, I-02471, para. 31.

[110] See e.g. Case C-204/90 Hanns-Martin Bachmann v Belgian State, 1992, ECR I-00249. See also Terra, Ben; Kajus, Julie, 'Mutual Assistance', 1 January 2013, IBFD Tax research platform.

[111] See C-204/90 Hanns-Martin Bachmann v Belgian State, 1992, ECR I-00249, C-55/98 Skatteministeriet v Bent Vestergaard 1999, ECR I-07641, C-422/01 Försäkringsaktiebolaget Skandia (publ) and Ola Ramstedt v Riksskatteverket, 2003, ECR I-06817C-383/05 Talotta, para. 36, C-136/00 Rolf Dieter Danner, 2002, ECR I-08147, C-267/09 European Commission v Portuguese Republic, 2011, ECR I-03197, paras. 38-46, C-132/10 Olivier Halley, Julie Halley and Marie Halley v Belgische Staat 2011, ECR Not yet published, para. 32 and C-520/04 Pirkko Marjatta Turpeinen, 2006, ECR I-10685, paras. 36 and 37.

[112] Daria Zernova, 'Exit Taxes on Companies in the Context of the EU Internal Market', 2011, p.487-488.

[113] Marjaana Helminen,'EU Tax law- Direct Taxation- 2012', ch. 2.3.3.1., IBFD Tax Research Platform.

An EU national is free to choose the tax system that he prefers due to the fact that the EU MSs' tax systems have not been harmonized.[114] The mere fact that, for instance, a subsidiary is lower taxed in a MS does not mean that the parent company should be taxed more burdensome in the other MS.[115]

The ECJ decided that in order for the tax avoidance justification to be accepted: (i) the taxpayer's actions should indicate that one of the objectives of EU law is being pursued (objective test); and (ii) the taxpayer should have no intention to artificially create conditions for benefiting from the fundamental freedoms (subjective test).[116] It was also settled in the ECJ's judgements that the tax avoidance argument is accepted if the measures are aimed at wholly artificial arrangements.[117]

5.4. Safeguarding the balanced allocation of taxing rights between Member States

The EU individuals are free to choose the country where they want to conduct business, regardless of whether the tax system of the chosen country is lower than that of the state of origin.[118] However, it is yet unclear the limit that has to be accepted by the MSs, under EU law, when it comes to transfer of taxable profits from a MS to another and when the transfer leads to unbalanced allocation of taxing rights between MSs.

The justification of safeguarding the balanced allocation of taxing rights between MSs was introduced in case *Marks & Spencer II*[119] and it is a legitimate objective justifying restrictive national measures, provided they are proportionate in relation to the objective pursued.[120] This justification for restrictive rules has

[114] See e.g. C-264/96 ICI, para. 26, C-364/01 The heirs of H. Barbier v Inspecteur van de Belastingdienst Particulieren/Ondernemingen buitenland te Heerlen, 2003, ECR I-15013, C-212/97 Centros Ltd v Erhvervs- og Selskabsstyrelsen, 1999, ECR I-01459, C-167/01 Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd, 2003, ECR I-10155, C-324/00 Lankhorst-Hohorst GmbH v Finanzamt Steinfurt, 2002, ECR I-11779 and C-294/97 Eurowings Luftverkehrs AG v Finanzamt Dortmund-Unna, 1999, ECR I-7463.

[115] See e.g. C-294/97 Eurowings Luftverkehrs AG v Finanzamt Dortmund-Unna, 1999, ECR I-7463, para. 44, C-196/04 Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue, 2006, ECR I-07995, paras. 36-38 and C-315/02 Anneliese Lenz v Finanzlandesdirektion für Tirol, 2004, ECR I-07063.

[116] Daria Zernova, 'Exit Taxes on Companies in the Context of the EU Internal Market', 2011, p.487.

[117] See e.g. Case C-196/04 Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue, 2006, ECR I-07995, para. 38; C-212/97 Centros Ltd v Erhvervs- og Selskabsstyrelsen, 1999, ECR I-01459, para. 18, Case C-167/01 Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd, 2003, ECR I-10155, para. 98.

[118] See case law of the ECJ chapter 6. and further cases: C-324/00 Lankhorst-Hohorst GmbH v Finanzamt Steinfurt, 2002, ECR I-11779 and C-294/97 Eurowings Luftverkehrs AG v Finanzamt Dortmund-Unna, 1999, ECR I-7463.

[119] paragraph 43 of the case C-446/03 Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes), 2005, ECR I-10837. It was reiterated after in cases such as, C-470/04 N v Inspecteur van de Belastingdienst Oost/kantoor Almelo, 2006, ECR I-07409, C-347/04 Rewe Zentralfinanz eG v Finanzamt Köln-Mitte, 2007, ECR I-02647, C-231/05 Oy AA, 2007, ECR I-06373 and C-196/04 Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue, 2006, ECR I-07995.

[120] B.J.M. Terra, P.J. Wattel- 'European Tax Law: Student Edition', section 14.3.5.3, p. 372.

been accepted on its own in the case law of the ECJ [121] but also together with other justifications such as, double use of losses and tax avoidance.[122]

The concept serves to protect the taxing power of the source state against tax base erosion.[123] That is, either through (i) imported tax base reductions wholly alien to its taxing jurisdiction, (ii) through emigration of the taxpayer and his unrealized tax base accrued in the state of origin, or through (iii) 'exportation' of tax base, either artificially or by having to extend group profit contribution schemes across the border of the source state jurisdiction.[124]

5.5. Prevention of double use of losses

The double use of losses is the result of the mechanical functioning of the tax rules of two MSs that operate independently from each other. However, MSs often have included, in the tax treaties concluded between them, provisions to prevent double loss recovery.

In *Marks & Spencer* case[125], the prevention of double losses was used as a justification for a tax treatment that constitutes a restriction on the EU freedoms. The case concerned a situation of use of losses by a subsidiary in the state of residence of the parent company, where the corporate tax rate was higher. The court in this case held that the need to prevent double use of taxes, as well as the balanced allocation of taxing rights and the prevention of tax avoidance, could be accepted as a justification for a restriction in the tax treatment.[126]

The prevention of double use of losses justification can only be accepted by the ECJ if connected with other justifications and if found to be proportionate.[127]

5.6. Safeguarding the fiscal cohesion of the national tax system

The need for safeguarding the fiscal cohesion of the national tax systems was first used as a justification in *Bachmann* case.[128] The case concerned the Belgian tax system under which only insurance premiums paid in Belgium were deductible. In the same time, the insurance premiums payments were deductible if the income related to the payments was taxed in Belgium, while if the income

[121] Case C-337/08 X Holding BV v Staatssecretaris van Financiën, 2010, ECR I-01215. In the X Holding BV case it was decided that the justification concerning safeguarding the balanced allocation of taxing rights can be accepted on its own, without being necessary to use it in connection to other justifications.

[122] C-446/03 Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes), 2005, ECR I-10837, para. 51, 414/06 Lidl Belgium GmbH & Co. KG v Finanzamt Heilbronn, 2008, ECR I-03601, para. 42 , C-182/08 Glaxo Wellcome GmbH & Co. KG v Finanzamt München II, September 2009, ECR I-0859 and C-231/05 Oy AA, 2007, ECR I-06373, para. 60. See also C-347/04 Rewe Zentralfinanz eG v Finanzamt Köln-Mitte, 2007, ECR I-02647, para. 41.

[123] B.J.M. Terra, P.J. Wattel- 'European Tax Law: Student Edition', section 14.3.5.3, p. 373.

[124] Ibid.

[125] Case C-446/03 Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes), 2005, ECR I-10837.

[126] Ibid, paras. 43, 49, 51 and 57.

[127] Ibid. See also case C-18/11 The Commissioners for Her Majesty's Revenue & Customs v Philips Electronics UK Ltd, 2012, ECR Not yet published.

[128] Case C-204/90 Hanns-Martin Bachmann v Belgian State, 1992, ECR I-00249.

related to the payment was tax exempt in Belgium then the insurance premium payments were non-deductible. Accordingly, the right to tax deduction and the income taxability were directly connected. However, a restrictive burden cannot be justified by a tax benefit that has no direct link with the tax burden.[129] After the *Bachmann* case[130], the ECJ accepted the fiscal cohesion justification[131] provided that the direct link existed in the case at hand. However, the proportionality of the restriction still has to be proved in order for it to be completely accepted. The discriminatory or restrictive tax measure must be proportional to the national interest protected by the tax measure and the least restrictive measure available must be used.[132]

The fiscal cohesion argument was further used as a justification in cases like *Wielockx*[133] and *N*[134].

In the *Wielockx* case, the concept of fiscal cohesion was assessed at the treaty level, in the sense that, if an applicable tax treaty allocates the exclusive or primary taxing rights to another state, the state of exit may not raise the fiscal cohesion or fiscal territoriality arguments in order to justify restrictions on outbound migration.[135]

Furthermore, in the *N* case, the double tax treaty between UK and Netherlands, drafted after the OECD Model Tax Convention, wrote in art. 13(5) that the exit MS is entitled to tax the capital gains that accrued during five years after emigration of the company. It is said that even if article 13(5) has not extended Netherland's right to tax over the next five years, its exit tax would still have been deemed as compatible with EU law.[136] The reasoning is that the ECJ should not test the compatibility of exit taxation with the double tax treaty but rather, allow the taxation of capital gains accrued during the period when the emigrant was resident of the exit MS.[137]

[129] See C-330/91 The Queen v Inland Revenue Commissioners, ex parte Commerzbank AG, 1993, ECR I-04017, C-107/94 P. H. Asscher v Staatssecretaris van Financiën, 1996, ECR I-03089 and C-136/00 Rolf Dieter Danner, 2002, ECR I-08147, where the direct link did not exist and thus, the fiscal cohesion was not accepted as justification for the restrictive tax measures.

[130] Case C-204/90 Hanns-Martin Bachmann v Belgian State, 1992, ECR I-00249.

[131] C-253/09 European Commission v Republic of Hungary, 2011, ECR Not yet published, Paras. 70-85 and C-250/08 European Commission v Kingdom of Belgium, 2011, ECR Not yet published, Paras. 70-82.

[132] C-436/00 X and Y v Riksskatteverket, 2002, ECR I-10829, paras. 63-71.

[133] Case C-80/94 G. H. E. J. Wielockx v Inspecteur der Directe Belastingen, 1995, ECR I-02493.

[134] Case C-470/04 N v Inspecteur van de Belastingdienst Oost/kantoor Almelo, 2006, ECR I-07409. See also case C- 150/04 Commission of the European Communities v Kingdom of Denmark, 2007, ECR I-01163, case C-157/07, Finanzamt für Körperschaften III in Berlin v Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt GmbH, 2008, ECR I-08061 and case C-418/07, Société Papillon v Ministère du Budget, des Comptes publics et de la Fonction publique, 2008, ECR I-08947.

[135] See Case C-80/94 G.H.E.J. Wielockx v. Inspecteur der Directe Belastingen, para. 25. See also Daria Zernova 'Exit Taxes on Companies in the Context of the EU Internal Market', p.486.

[136] Harm J. van den Broek, 'EU Mergers and Exit Taxes', in Unternehmensnachfolge, ed. Karin E.M. Beck & Christine Osterloh-Konrad, p.171.

[137] Case C-513/03 Heirs of M. E. A. van Hilten-van der Heijden v Inspecteur van de Belastingdienst/Particulieren/Ondernemingen buitenland te Heerlen, 2006, ECR I-01957, para. 48.

5.7. The territoriality principle

The meaning of the fiscal territoriality concept is that, in principle, each state taxes only such income of a non-resident that has a connection with its territory.[138]

The principle of fiscal territoriality was first introduced in case *Futura Participations SA*[139]. The case concerned the loss relief within a Luxemburg branch of a French company. In the case, it is straightforward stated that if a national tax system is in accordance with the fiscal territoriality principle, it will not be found contrary to the Treaty Freedoms.[140] Consequently, under the general view, a MS may tax income that arose during the period that an individual was a resident of that state. Such exit tax legislation would be EU-compatible. However, the measures imposing tax and administrative burdens on the EU individuals must be proportionate with the territoriality principle and must be in line with the EU Treaties as all the other justifications used for imposed restrictions.

The fiscal territoriality principle is closely connected to the coherence of a tax system. If a national tax system does not follow the territoriality principle, then it is difficult to argue that the territoriality principle should justify a restrictive tax measure.[141]

As a result, we can conclude the above by saying that the Union law recognises two types of exceptions that may in principle justify restrictive tax measures that are contradictory to the freedoms' provisions. These are firstly, justifications based on the Treaty law and secondly, justifications based on the concept of 'rule of reason'.

Moreover, we know from the above that the justifications used by the MSs for their restrictive measures can sometimes be invoked on their own and other times in connection to other justifications in order to be seen as plausible before the ECJ. However, it has been made clear by the ECJ in a number of occasions that the justification can be taken in consideration only after it has been proven that the alleged measure is not discriminatory. Once the measure passed the first requirement in the rule of reason test, namely the non-discrimination requirement, the MSs can move on to analyse whether the restrictive measure benefits the public interest and whether it is proportional to the objective that it seeks. Finally, if the restrictive measure complies with the requirements in the rule of reason test, it can be taken into account the possibility that the ECJ approves the justification brought before it.

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138 See the definition of the "territoriality principle" provided by the IBFD International Tax Glossary: "Term used in the context of international taxation to connote the principle of levying tax only within the territorial jurisdiction of a sovereign tax authority or country. The underlying theory is that no taxes can be levied outside this area without violating the sovereign tax authority of another state. Consequently, both residents and non-residents of a state adopting this principle are only taxed on the income from sources in that country and on property situated in that country. Residents are not normally taxed on any foreign-source income (sometimes, however, subject to anti-avoidance measures). The term may also refer to the principle that a state has the right to tax all persons, property or activity within its borders. The term is also used in a similar way in the context of EU direct taxation, although the precise meaning appears still to be evolving".

139 Case C-250/95 Futura Participations SA and Singer v Administration des contributions 1997, I-02471.

140 Ibid, para 20-22.

141 Marjaana Helminen,'EU Tax law- Direct Taxation- 2012', ch. 2.3.7., IBFD Tax Research Platform

6. Case law of the ECJ on exit taxation

This part of the thesis deals with a chronological review of the cases on exit taxation decided by the European Court of Justice. There will be summarised judgements on both, the transfer of management seat and the transfer of assets. The case law discussed covers the period of early 80's until this paper's submission, May 2013. The aim of this chapter is to analyse the development of the EU law on the issue of exit taxation incurred along the time in the cases ruled by the Court.

6.1. Daily Mail case

Background of the case:

The first case to be decided by the ECJ with regard to the transfer of management seat of a company was the *Daily Mail*[142] case. This case concerns a UK holding company (Daily Mail and General Trust plc.) that was quoted on the London stock exchange and that wished to sell a part of its holdings. This action would trigger capital gains taxation which the company wanted to avoid by transferring its seat of management in the Netherlands. There the company would be subject to Netherlands corporation tax, but the transactions envisaged would be taxed only on the basis of any capital gains which accrued after the transfer of its residence for tax purposes.[143]

The UK law required the consent of the Treasury in order for the transfer to happen and the Treasury refused to grant its consent if Daily Mail would not sell or pay tax before leaving the UK jurisdiction.

In response, Daily Mail argued that the conditions set by the Treasury are violating its freedom of establishment which gives a company 'the right to transfer its central management and control to another MS without prior consent or the right to obtain such consent unconditionally'.[144]

Judgement of the ECJ:

The ECJ found in Daily Mail that the freedom of establishment cannot be 'interpreted as conferring on companies incorporated under the laws of a MS a right to transfer their central management and control and their central administration to another MS while retaining their status as companies

[142] Case C-81/87 The Queen v H. M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc, 1988, ECR 05483. See also Maria Hilling, 'Free Movement and Tax Treaties in the Internal Market', 2005, Iustus Förlag AB, Uppsala, p. 129-130 and Peter Jacob Wattèl & B. J. M. Terra, 'European Tax Law', Sixth Edition, 2012, Kluwer, Amsterdam, p. 962 for a discussion on the case.

[143] Case C-81/87 The Queen v H. M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc, 1988, ECR 05483, para 7, the ECJ noted that the transfer of central management and control was tax driven.

[144] Ibid, para 8.

incorporated under the legislation of the first MS'.[145] As EU law did not confer on companies the right to such transfer, the Court did not disqualify the tax measures imposed by the UK. It also stressed that, 'unlike natural persons, companies are creatures of the law and, in the present state of Union law, creatures of national law. They exist only by virtue of the varying national legislation which determines their incorporation and functioning.'[146]

The MSs' legislation with regard to the connecting factor required for the incorporation of a company and the possibility to modify that connecting factor varied widely.[147] However, the Court restrained itself from showing any preferences for one of the connecting factors. It stated that 'the Treaty places on the same footing, as connecting factors, the registered office, central administration and principal place of business of a company'.[148] Thus, the Court concluded that the EU law requires these issues to be dealt with by EU legislation or Conventions concluded between MSs and not under the freedom of establishment.[149]

Final remarks:

The Daily Mail case is a very important case because the Court held that the freedom of establishment would be rendered meaningless if the MS of origin would prohibit economic operators to leave its jurisdiction.[150] It has become settled case law for all Treaty Freedoms.

6.2. Centros case

Background of the case:

In the *Centros*[151] case, a private limited company registered under the laws of the UK that wanted to register a branch in Denmark got its request rejected by the Danish Board. The rejection was granted because it was thought that since the company does not trade in the UK, in reality it was seeking to start a permanent establishment in Denmark, thus avoiding to pay the minimum capital of 200 000 DKK required under the national law of Denmark.

Centros brought proceeding against the decision and maintained that it satisfied the conditions imposed by the Danish law on private limited companies related to the registration of a branch of a foreign company. Centros also claimed that it had the right to register a branch abroad under the freedom of establishment due to it being lawfully formed in the UK.

In response, the Board argued that the refusal was not violating the freedom of establishment of the company since Centros' intention was to avoid the payment

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[145] Ibid, para 24.
[146] Ibid, para 19.
[147] Ibid, para 20.
[148] Ibid, para 21.
[149] Ibid, para 23.
[150] Ibid, para 16.
[151] Case C-212/97 Centros Ltd v Erhvervs- og Selskabsstyrelsen, 1999, ECR I-01459.See also Maria Hilling, 'Free Movement and Tax Treaties in the Internal Market', 2005, Iustus Förlag AB, Uppsala, p. 126-127.

of the minimum share capital. It also stated that the refusal was 'justified by the need to protect private or public creditors and other contracting parties and also by the need to endeavour to prevent fraudulent insolvencies'[152].

Judgement of the ECJ:

The ECJ agreed with Centros in the sense that the establishment of a branch in another MS falls within EU law, regardless of whether or not the company is conducting activity in the MS of origin or if the branch is intended to hold the main, or even the entire activity in the host MS.[153]

It also stated that the refusal to register the branch constituted an obstacle to the exercise of freedom of establishment. Even if the MSs are entitled to take measures against fraudulent behaviour that is in contradiction with EU law[154], in the case at hand the freedom was not abused. The simple fact that the company was legally formed under the laws of UK triggered the freedom of establishment and enabled the company to set up a branch in another MS. The grounds of refusal used by the Board against Centros were not enough to demonstrate fraudulent conduct or abuse. Companies are free to choose the jurisdiction that offers them less restrictive company law rules, as well as they are free to conduct their entire business through a branch.

Moreover, the Board argued that the restriction imposed was justified on the basis of protecting public or private creditors by paying a minimum share capital. Public creditors were protected against the risk of seeing the debts owed to them become irrevocable, since, unlike private creditors, they cannot secure those debts by means of guaranties, the Court stated. All creditors were protected by anticipating the risk of fraudulent bankruptcy due to the companies' insolvency whose initial capitalization was inadequate.[155] The practice in question is not such as to attain this objective since, if Centros had conducted business in the UK, its branch would have been registered in Denmark, even though Danish creditors might have been equally exposed to risk.[156]

Thus, the restriction was not justified and the Court decided that a MS cannot refuse registration of the branch.[157]

Final remarks:

In the *Centros* case the Court did not make any reference to the *Daily Mail*[158] case, nor did the AG[159] in his opinion. The reason for this is that the *Daily Mail* case concerned the rules of the MS in which the company was incorporated, while

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[152] Case C-212/97 Centros Ltd v Erhvervs- og Selskabsstyrelsen, 1999, ECR I-01459, para. 12

[153] Ibid, para 17. See also Segers Case C-79/85 [1986] ECR 2375, para 16.

[154] Ibid, para 24. A case-by-case assessment needs to be conducted by the national courts where objective evidence of fraudulent behaviour is used in order for a benefit of a provisions of EU law to be denied, para 25.

[155] Ibid, para 32.

[156] Ibid, para 35.

[157] Ibid, para 38.

[158] Case C-81/87 The Queen v H. M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc, 1988, ECR 05483.

[159] Opinion of AG La Pergola delivered on 16 July 1998 in case C-212/97 Centros Ltd v Erhvervs- og Selskabsstyrelsen, 1999, ECR I-01459.

Centros dealt with the recognition of a company validity incorporated in another MS.

6.3. Überseering case

Background of the case:

In *Überseering*[160] case, the company Überseering, incorporated under the Netherlands' laws, bought a piece of land in Düsseldorf, Germany. Furthermore, it entered in a contract with NCC that agreed to build a motel and a garage on the property in question. At the completion of the project subject to the agreement, Überseering claimed that the painting work undertaken by NCC was faulty; however, no proceedings were brought against the company.

In 1994, all the shares in Überseering were bought by two German nationals who sought compensation for the defective work in the amount of DEM 1 163 657.77, plus interest, that included the expenses incurred with the remediation of the damage. The German courts dismissed the case and stated that while still incorporated in Netherlands the company changed its centre of administration and became subject to German law ignoring the formalities that had to be followed for such an action. That meant, according to the national court, that Überseering did not have legal capacity in Germany and, thus, it was not allowed to bring proceeding there.[161]

The case was sent to the ECJ by the national court, Bundesgerichtshof, who asked whether the refusal to recognise the legal capacity of a company validly incorporated in another MS and the refusal to allow it to bring legal proceedings was compatible with the freedom of establishment.

Judgement of the ECJ:

In *Überseering* the ECJ stated, in response to the question addressed by the national court, that the refusal to give standing or to recognise the legal capacity of a company validly incorporated in another MS was a restriction to the freedom of establishment.[162]

Moreover, the German Government submitted that the restriction was justified because it was aimed at enhancing legal certainty and creditor protection.[163] It further submits that the restriction was justified on the basis that it protected minority shareholders,[164] employee participation[165] and tax authorities.[166]

The ECJ stated that even if in other circumstances and subject to certain conditions, the overriding requirements could justify restrictions on the freedom

[160] Case C-208/00 Überseering BV v Nordic Construction Company Baumanagement GmbH (NCC), 2002, ECR I-09919. See also Peter Jacob Wattèl & B. J. M. Terra, 'European Tax Law', Sixth Edition, 2012, Kluwer, Amsterdam, p. 963 for a discussion on the case.

[161] Ibid, para. 9.

[162] Ibid, para. 82.

[163] Ibid, para. 87.

[164] Ibid, para. 88.

[165] Ibid, para. 89.

[166] Ibid, para. 90.

of establishment,[167] in the case at hand, the public interest cannot be used as reason to impose those measures.

Finally, the ECJ stated that the host MS cannot deny the legal capacity or the right to sue of a company legally incorporated under the laws of another MS in which it has its registered office.[168]

6.4. Inspire Art case

Background of the case:

The following *Inspire Art*[169] case was very similar to the *Centros* case. Inspire Art Ltd was a company registered under the laws of the UK that carried on all its activities through a branch in Netherlands. The reason for its incorporation in the UK was simply to avail of rules that are more favourable under UK's company law, namely the rules on minimum share capital.

In October 2000, the Netherlands Chamber of Commerce noticed that Inspire Art did not make known that it is a formally foreign company as requested by the national law and applied for an order from the national court to include this indication in the registration of the branch. Under national law, it was mandatory that Inspire Art indicated if it was formally foreign due to it trading exclusively in the Netherlands.[170]

In response, the company submitted that the national law provision does not apply to it and even if it did, it was incompatible with the freedom of establishment.[171]

The national Court staid proceedings and asked the ECJ whether the EU provisions under freedom of establishment can be interpreted in the way that it is allowed to set up a company in a MS with the purpose of establishing in another MS, where its entire activity is to be conducted, thus avoiding the payment of share capital.

Judgement of the ECJ:

The ECJ agreed with the arguments brought by Inspire Art and kept its statements from *Centros*[172] and *Segers*[173] that a company incorporated in a MS with the intention to establish and carry on activity in another MS constitutes an exercise of its freedom of establishment and not an abuse per se.[174]

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[167] Ibid, para. 92.
[168] Ibid, para. 93.
[169] Case C-167/01 Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd, 2003, ECR I-10155.
[170] Ibid, para. 36.
[171] Ibid, para. 37.
[172] Case C-212/97 Centros Ltd v Erhvervs- og Selskabsstyrelsen, 1999, ECR I-01459, para. 17.
[173] Case C-79/85 D. H. M. Segers v Bestuur van de Bedrijfsvereniging voor Bank- en Verzekeringswezen, Groothandel en Vrije Beroepen, 1986, ECR 02375, para. 16.
[174] Case C-167/01 Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd, 2003, ECR I-10155, paras. 95–8. As noted by the Court, the setting up, by a national, of a company in a MS where the company law rules seem least restrictive and then the seeting up of branches in another MS is inherent in the exercise, in a single market, of the freedom of establishment as guaranteed by EU law, para. 138.

This case was distinct from that of *Daily Mail*[175] because, as stated also in *Überseering*[176], it concerned an immigration rather than an emigration situation.[177]

The national rules on formally foreign companies imposed by the Netherlands had mandatory applicability over the foreign companies, as in our case Inspire Art, which carried on their activity entirely or in part on the country's territory.[178] That constituted a restriction on the freedom of establishment of the companies, which means that the national law was found incompatible with EU law, namely art. 49 and 54 TFEU.

6.5. Cartesio case

Background of the case:

The subsequent *Cartesio*[179] case put aside many of the uncertainties that the *Centros, Überseering* and *Inspire Art* cases brought along with their rulings as compared to the *Daily Mail* case. It was thought that the immigration cases superseded the principles set out in the *Daily Mail* case. *Cartesio* case, however, put an end to these discussions.

Cartesio was a company incorporated under the laws of Hungary. In 2005 it filed an application with the regional court for the transfer of its administrative seat in Italy. The request was denied on grounds that the national law did not permit a company to transfer its seat abroad while still being subject to Hungarian law.[180] Such a transfer would first require the company to terminate its legal entity before transferring its seat abroad and reincorporate in compliance with the rules of the MS where it wishes to re-establish.[181]

Cartesio argued that the rules were in contradiction with the EU law, freedom of establishment, and the AG[182] agreed with its argument. The ECJ, however, stick to its decision in *Daily Mail*[183] and reminded that 'companies are creatures of national law and exist only by virtue of the national legislation which determines its incorporation and functioning'[184]. Moreover, the Court recognised that MS legislation varied widely 'in regard to both the factor providing a connection to the national territory required for the incorporation of a company and the question

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175 Case C-81/87 The Queen v H. M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc, 1988, ECR 05483.

176 Case C-208/00 Überseering BV v Nordic Construction Company Baumanagement GmbH (NCC), 2002, ECR I-09919, para. 62.

177 Case C-167/01 Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd, 2003, ECR I-10155, para. 103.

178 Ibid, para. 100.

179 Case C‑210/06 Cartesio Oktató és Szolgáltató bt, ECR I-09641. See also Peter Jacob Wattèl & B. J. M. Terra, 'European Tax Law', Sixth Edition, 2012, Kluwer, Amsterdam, p. 964 for a discussion on the case.

180 Ibid, para. 24.

181 Ibid, para. 103.

182 Opinion of AG Poiares Maduro delivered on 22 May 2008 in the Case C‑210/06 Cartesio Oktató és Szolgáltató bt, ECR I-09641.

183 Case C-81/87 The Queen v H. M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc, 1988, ECR 05483.

184 Case C‑210/06 Cartesio Oktató és Szolgáltató bt, ECR I-09641, para. 104, citing para. 19 of the Case 81/87 The Queen v H. M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc, 1988, ECR 05483.

whether a company incorporated under the legislation of a MS may subsequently modify that connecting factor'[185].

Judgement of the ECJ:

The Court stated in Cartesio that there is an exception where the state of origin cannot require a company to dissolve before transfer. That is, when the host state's legal system provides not only for the recognition of the immigrating legal entity, but also for continuation of its legal personality in the legal form of the state to which it has moved. [186]

If the host state allowed such migration under its laws but the state of origin made it dependent on the prior winding-up or liquidation of the company, then this would be a restriction on the freedom of establishment, according to the Court.[187]

In the case at hand, Cartesio wished to transfer its real seat from Hungary to Italy, while remaining a company governed by Hungarian law without any change as to the national law applicable.[188] Hence, the Court held that this situation is not applicable to the scenario described above.

Final remarks:

It is obvious from both, the *Daily Mail*[189] and *Cartesio*[190] cases that the ECJ does not interfere with the national legislation that refers to the right of a company to exit the state of origin's jurisdiction without dissolution. By contrast, when it comes to the restrictions imposed by the host state on a company wishing to transfer its management seat to its territory the ECJ seems to have more to say.

6.6. National Grid Indus case

Background of the case:

National Grid Indus[191] case took an unexpected turn as compared to the other cases on emigration. In this case, the company concerned, National Grid Indus, transferred its effective management from the Netherlands to UK.

Upon transfer, National Grid Indus ceased to be resident of the Netherlands and became a resident of the UK, according to the Convention between the two countries. This triggered a final settlement of the company's tax liabilities, namely, the unrealised capital gains at the time of the transfer.[192]

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185 Ibid, para. 105, citing para. 20 of the Case 81/87 The Queen v H. M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc, 1988, ECR 05483.
186 Ibid, para. 111. It appears that Italy, Luxembourg and Belgium provide for this advantage.
187 Ibid, para. 112.
188 Ibid, para. 119.
189 Case C-81/87 The Queen v H. M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc, 1988, ECR 05483.
190 C‑210/06 Cartesio Oktató és Szolgáltató bt, ECR I-09641.
191 Case C-371/10 National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam, 2011, ECR Not yet published. See also Peter Jacob Wattèl & B. J. M. Terra, 'European Tax Law', Sixth Edition, 2012, Kluwer, Amsterdam, p.968 for a discussion on the case.
192 Ibid, para. 14.

National Grid Indus claimed that the said exit tax amounted to a breach of its freedom of establishment guaranteed under art 49 TFEU.

The national Court stated that the case at hand is different from *Daily Mail* and *Cartesio* because, unlike in the mentioned cases, the national law of Netherlands does not affect the existence and the functioning of the company.[193] It further considers that even if the exit tax imposed constitutes a restriction on the freedom of establishment it is, however, justified by 'the objective of ensuring the balanced allocation of powers of taxation between MSs'.[194] Furthermore, the national court explains that even if the immediate taxation can be regarded by the ECJ as disproportionate, it has as aim the avoidance of different issues that can arise until the actual time of realisation of the gains.[195]

Judgement of the ECJ:

The ECJ in its assessment of National Grid case recognises the fact that a company incorporated under the Netherlands law that wishes to transfer its place of management abroad is placed at a disadvantage as compared to a company that moves within Netherlands. That is because the national law of Netherlands requires for immediate taxation of capital gains upon transfer of management seat, which can change a company's decision to exit the jurisdiction, while no gains are taxed when a company decides to transfer its seat within the territory.[196] Following these observations, the court stated that the difference of treatment between companies moving their place of management within Netherlands and those that transfer their place of management abroad constitutes a restriction prohibited by the EU law.[197]

It was further assessed whether the restriction could be justified by overriding reasons of public interest.[198] As mentioned before, the national court argued that the restriction was justified by the aim of obtaining a balanced allocation of taxation powers between MSs, in accordance to the principle of territoriality linked to a temporal component.[199]

The ECJ agreed with the justifications brought by the national court and rejected the company's argument that the capital gains were not yet realised and, thus the charge cannot be justified. It stated that a MS is entitled to tax the capital gains generated on its territory and that are not actually realised when the company ceases to obtain profits taxable there.[200]

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[193] Ibid, para. 17.
[194] Ibid, para. 18. See also ch. 5 of this paper for a discussion on the justifications brought by MS for their restrictive rules.
[195] Ibid, para. 19. See also case C-9/02 Hughes de Lasteyrie du Saillant v Ministère de l'Économie, des Finances et de l'Industrie, 2004, ECR I-02409 and case C-470/04 N v Inspecteur van de Belastingdienst Oost/kantoor Almelo, 2006, ECR I-07409.
[196] Ibid, para. 37.
[197] Ibid, para. 41.
[198] Ibid, para. 42. See also Case C 446/03Marks & Spencer [2005] ECR I 10837, paragraph 35; Case C-196/04 Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue, 2006, ECR I-07995, para. 47; Case C-524/04 Test Claimants in the Thin Cap Group Litigation v Commissioners of Inland Revenue, 2007, ECR I-02107, para. 64; and Case C-303/07 Aberdeen Property Fininvest Alpha Oy, 2009, ECR I-05145, para. 57.
[199] Ibid, para 18.
[200] Ibid, para. 49.

The next step was to analyse whether the measures imposed by the Netherlands were proportionate. The Court noted that both the establishment of the amount of tax debt and the recovery of the tax take place at the time of the transfer of the place of effective management, when the company ceased to be taxable in the Netherlands. The Court determined that in order to assess the proportionality of the legislation a distinction had to be made between the establishment of the amount of tax and the recovery of that tax.[201]

The Court highlighted that it was proportionate for a MS to determine the tax due on the unrealized gains at the time when its power of taxation regarding the company in question ceases to exist (at the time of the transfer of the place of effective management to another MS). The Court recalled the *N* case, where it had pointed out that decreases in the value of assets after the emigration of the taxpayer had to be fully taken into account in order for the national rules to be regarded as proportionate, unless those decreases in value had already been taken into account in the host MS.[202]

However, the ECJ distinguished the circumstances of *National Grid Indus* from the *N* case[203]. It pointed out that if the profits of a MC that transfers its place of effective management are taxed in the host MS, the said MS has to take account of fluctuations in the value of assets of that company that occur after the MS of origin loses all fiscal connection with the company.[204] Therefore, the Court held that the MS of origin was not obliged to take account of any exchange rate losses that may occur after the transfer of the place of effective management to the U.K.[205]

Furthermore, with regard to the immediate recovery, the Court admits that recovery of the tax at the actual realisation of the gain in the host MS is more favourable than the immediate taxation on unrealised gains, due to the cash flows problems that the later brings.[206]

However, the Court also stated that there could be a significant administrative burden if the tax debt was deferred, particularly if a large number of assets were involved. The AG explained in her Opinion that the asset situation of an undertaking may be so complex that the precise cross-border tracing of all the fixed and current assets until the unrealised capital gains are realised is almost impossible or involves an effort which the tax authorities cannot reasonably be expected to make. [207] This situation would also entail a considerable burden for the companies concerned which could constitute a hindrance on the freedom of establishment in the same way as the immediate taxation of unrealised capital gains. As a solution, the court stated that the taxpayer should be given the option to choose either to pay the tax debt immediately with no burden but with the

[201] Ibid, para. 51.
[202] Ibid, para. 54; C-470/04 N v Inspecteur van de Belastingdienst Oost/kantoor Almelo, 2006, ECR I-07409, para. 54.
[203] C-470/04 N v Inspecteur van de Belastingdienst Oost/kantoor Almelo, 2006, ECR I-07409.
[204] Case C-371/10 National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam, 2011, ECR Not yet published, para. 58 emphases added.
[205] Ibid, para. 59.
[206] Ibid, para. 68.
[207] Opinion of the AG Kokott delivered on 8 September 2011in Case C‑371/10, National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam, para. 69.

disadvantage of cash flow, or to defer the tax until actual realisation with an administrative burden regarding tracing of assets.[208]

The Court also pointed out that account should be taken of the non-recovery of tax risk and held that the MSs should include in their national legislation provisions, such as the requirement of a bank guarantee, that would be applicable to deferred payments of tax debts.[209]

Moreover, the Court discusses the Mutual Assistance Directive[210] as a response to the Governments' observation which stated that deferring taxes would put an excessive burden on the administrative authorities of the MS. It held that the Mutual Assistance Directive enables the MS of origin to check the truthfulness of the returns made by companies that have opted for deferred payment of the tax.[211]

Finally, the Court dismissed the argument that the Dutch rules were justified by the need to prevent tax avoidance, pointing out that the mere fact that a company transfers its place of management to another MS cannot set up a general presumption of tax evasion and justify a measure that compromises the exercise of a fundamental freedom.[212]

The Court concluded that the national rule of a MS that requests for immediate recovery of tax on unrealised capital gains relating to assets of a company transferring its place of effective management to another MS, at the very time of that transfer, is disproportionate.[213]

Final remarks:

National Grid Indus was not much different from Daily Mail and yet the outcome was at the opposite pole. This shows that EU law is constantly evolving making the situations arising under, among others, the freedom of establishment easier to deal with.

6.7. EU MSs' legislation on exit taxation following National Grid Indus

This section presents the remaining selected case law in a different way than they were presented earlier in this chapter. I chose to comprise in a single section the most recent cases on exit taxation that have been decided or are pending before the ECJ. The reason why I analysed the cases bellow differently is that even if they are slightly different in terms of provisions brought into question, they all have as basis the incompatibility of national measures with the ECJ's decision in National Grid case. The Commission's aim with the said proceedings was to have the MSs' measures that are contrary to the freedom of establishment changed, as provided in the National Grid case. Thus, I consider better to put the cases under the same headline, instead of analysing each of them separately. After

[208] Case C-371/10 National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam, 2011, ECR Not yet published, para. 73.
[209] Ibid, para. 74.
[210] Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the MSs in the field of direct taxation.
[211] Case C-371/10 National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam, 2011, ECR Not yet published, para. 78.
[212] Ibid, para. 84.
[213] Ibid, para. 85.

discussing the cases that arrived before the ECJ following the National Grid case, this section will conclude with an outline of the changes occurred in some of the MSs' legislation.

It follows that after the decision in *National Grid Indus* case[214] that took a different turn with regard to exit taxation compared to its standing before this judgement, the Commission initiated proceedings against a number of MSs. The proceedings had as base the changing of provisions that were contrary to the view taken by the ECJ in National Grid case and that the MSs had included in their national legislation on exit taxation[215]. The ECJ found in this case, as discussed above, that the imposition of rules that obliged a company to pay taxes on unrealised gains at the moment of emigration were contrary to EU law, more precisely, to the freedom of establishment enshrined in article 49 TFEU.

However, the ECJ stated further in the case that the mere imposition of exit taxes is not in breach of the EU legislation if the company wishing to migrate is given the option to either pay the tax directly upon emigration or defer it until the actual realisation of the gains on which the tax is imposed.[216]

Consequently, in the most recent cases[217], among which some are still pending before the ECJ[218], the Commission requested that countries like Netherlands, Denmark, UK, Portugal, and France, revise their restrictive measures on corporate exit taxation that would make the migration less attractive for companies.[219]

The Commission, in the said cases, made it clear that it does not dispute the MSs right to tax capital gains that have arisen in their respective territories.[220] Instead, the reason for the objection raised by the Commission concerns the obstacles to the freedom of establishment provided in the national rules of the MSs. These rules enshrine a different fiscal treatment of unrealised capital gains between, on the one hand, a transfer of activities of a company to another MS and, on the other, similar transfers within the MS's territory. The Commission argues that a company exercising its freedom of establishment and transferring activities out of the state of origin cannot result in the imposition of tax that would be levied earlier or would be of a greater amount than the tax applicable to a company that remains within the territory of that state.[221]

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[214] See ch. 6.6. above, case C-371/10 National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam, 2011, ECR Not yet published.

[215]Ibid.

[216] Ibid, para. 73.

[217] See Case C-38/10 European Commission v Portuguese Republic, 2012, ECR Not yet published; Case C-64/11 European Commission v Kingdom of Spain, 2013, ECR Not yet published (General Report - Section 'Information on unpublished decisions'), C-261/11 Commission v Denmark; No judgement, C-301/11 European Commission v Kingdom of the Netherlands 2013, ECR Not yet published (General Report - Section 'Information on unpublished decisions').

[218] Both the cases of Denmark and Spain against the Commission are still waiting to be decided by the ECJ.

[219] See to this effect Case C-380/11 DI. VI. Finanziaria di Diego della Valle & C. SapA v Administration des contributions en matière d'impôts, 2012, ECR Not yet published, paragraph 36.

[220] Case C-38/10 European Commission v Portuguese Republic, 2012, ECR Not yet published, para. 21.

[221] Ibid, para. 22, See also Case C- 301/11, Commission v Netherlands. The only version of the case available at the date of this paper is written in French.

The ECJ used the *National Grid Indus*[222] case as reference in the cases that followed it and stated that the measures that prohibit, impede or render less attractive the exercise of freedom of establishment has to be regarded as restrictions on that freedom.[223] It also cited National Grid Indus with regard to the justifications and their proportionality, and stated that a less harmful measure to the freedom of establishment would be to give the taxpayer the option of immediate pay of the tax on unrealized capital gain or deferment of the owed tax until actual realization of the capital gain.[224]

Furthermore, not all the MSs contested the Commission's position regarding the incompatibility of national rules with EU law. Some proceeded at adjusting the provisions on exit taxation in a manner that is acceptable under EU law following *National Grid Indus*[225] decision.

The main changes made by some MSs in their legislation regarding corporate exit taxation are not identical but they all follow the ECJ's request of giving the MC an option as to when to pay its due capital gains.[226]

For instance, in the Netherlands, a company that wishes to move its seat to another EU MS or EEA or transfer its assets (tangibles or intangibles) to another EU MS or EEA has the option to either split the tax due in ten equal annual instalments or defer the payment until the actual realization of the capital gain.[227]

In the UK, when an eligible company moves its seat to another EEA country, it has to choose between deferral on a maximum period of ten years and payment in six equal annual instalments upon calculation of the tax payable at the time of migration.[228]

In France, the payment of tax will be divided on a five-year period in five equal annual instalments. This applies when a company moves its seat or one of its permanent establishments to another EU MS or to a EEA country that has signed a tax treaty with France for the recovery of tax claims comparable to the provisions of the EU mutual assistance directive or when the transfer implies a transfer of assets (tangibles or intangibles).[229]

France, Norway and Portugal require the payment of tax on unrealized capital gain only upon actual realization of the capital gain in question.[230]

To sum up, the changes brought by the *National Grid Indus* case produced a lot of controversy among MSs and it continues to do so. Even if some of the MSs complied with the Commission's request to change their exit tax provisions, it is

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[222] Case C-371/10 National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam, 2011, ECR Not yet published.

[223] Ibid, para. 35.

[224] Case C-38/10 European Commission v Portuguese Republic, 2012, ECR Not yet published, para. 32.

[225] C-371/10 National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam, 2011, ECR Not yet published.

[226] DLA PIPER, 'Key Changes in EU MS Exit Tax Regimes', it can be accessed on http://www.dlapiper.com/in-wake-of-ecj-ruling-eu-member-states-amend-exit-tax-regimes/.

[227] Both deferral options include interest and bank guarantee. The option to pay the tax on capital gain upon realization requires annual filing of tax balance sheet and tax P&L.

[228] Both deferral options include interest. Bank guarantee is only required when the tax authorities consider it necessary.

[229] DLA PIPER, 'Key Changes in EU MS Exit Tax Regimes', it can be accessed on http://www.dlapiper.com/in-wake-of-ecj-ruling-eu-member-states-amend-exit-tax-regimes/

[230] Norway and Portugal require interest and bank guarantee from the MC.

still questionable if the changes in national legislation make migration more attractive for companies, given the burden that tax deferment entails.

7. Are emigration taxes restrictive?

On the journey towards finding the answer to the question whether the emigration taxes constitute restrictions on the freedom of establishment granted by the EU to its individuals, I intend to make an overall analysis of the evolution of the case law on exit taxation, presented in the previous chapter.

Thus, beginning with the first cases that made the introduction to the concept of exit taxation, it follows that the ECJ considered that exit taxation is hindering a person's ability to move to another MS than that of origin. It could not be allowed by the ECJ that the MSs would take the right to prohibit the companies incorporated under their national law to migrate, because that would make the freedom of establishment loose its intended purposes.

The freedom of establishment is expected, as also provided by the ECJ in its judgements and by the Treaty itself, to grant EU citizens with the right to freely install in a EU state of their choice and pursue economic activities in that state. It is against EU law to hinder a company from moving to a new MS, regardless of the reasons that formed the base of that decision.

On top of that, the EU individuals have the right under the Treaty and in connection to the freedom of establishment, to be treated in the country where they choose to migrate as nationals of that county. That entails enjoyment of the benefits and fulfilment of the obligations required under the new legislation. It has been long known from various sources of EU law that the EU citizens enjoy the same treatment within Europe and that discriminatory treatments of any kind are prohibited, unless justified and proportional.[231]

Furthermore, it was decided in *Centros* that the companies incorporated under the laws of a MS, are entitled to move their centre of management regardless of whether they intend to conduct activities in the host state or not. The freedom of establishment, thus, does not specifically require the migrating company to prove that the reason for migrating is to conduct business in the new state. As long as the conditions for registration of foreign companies in the host country are fulfilled, the MC does not infringe any EU provision. In contrast, the host MS's refusal to allow registration of the MC constitutes an obstacle to the freedom of establishment, as stated by the ECJ.

Moreover, a company has the right, under the EU law, to choose the tax system that is most favourable for it. It is not prohibited that the MC migrates to a MS where the company rules are less restrictive, as it is not prohibited that the MC conducts its entire activity through a branch or an agency.

It is furthermore prohibited, as seen in the previous chapter, that the MS oblige companies to dissolve before migrating to another State and reincorporate there. Provided that the host MS allows the MC to move to its territory without having to reincorporate, the MS of origin cannot hinder the MC from doing so. If the MC wishes to continue existing under the laws of the MS of origin, it is entitled to do so, as provided in the ECJ's rulings. A measure that would impose liquidation on a company, that under the laws of the new state is not obliged to reincorporate, is against the freedom of establishment.

[231] See Chapter 6 on the case law of the ECJ on exit taxation.

The most recent case, National Grid Indus, that was responsible for the changing in legislation of several MSs with regard to exit taxation, made a number of statements that clarified the matter a bit more.

It was discussed that the company moving its centre of management or assets within a MS is placed at a considerable advantage as compared to a company that wishes to move abroad. The company that wishes to move to another MS is required to pay a tax on the unrealised capital gains at the time of the emigration, while the company moving within the MS of origin does not have the same obligation. The reason for the difference of treatment, the MSs contend, is to avoid the issues that could appear during the period between the exit of the company and until the actual realisation of capital gains.

However, this is not enough reason to impose immediate taxation of unrealised capital gains, as seen in National Grid case. It is true that the deferment of the exit tax payment would imply a burden that could as well make the migration non-attractive. That is why it seems like the best solution has been found by the ECJ. The idea of giving the MC the choice to pay the tax on unrealized capital gain directly on emigration or postpone it until the actual realization should bring peace, at least for some time, between the MSs and the MCs. It seems that the solution found by the ECJ corresponds both with the MSs' desire of immediate payment and with the MCs wish to postpone it until realisation.

As shown in the previews chapter, the Commission intended proceeding against a number of MS that had in their national legislation measures on exit taxation that were against the ECJ's decision regarding immediate taxation. Some of the MSs that were facing this problem already managed to change their legislation so that it will no longer be contrary to EU law.

Summarising the above, the MSs are not allowed to: (i) hinder a company incorporated under its laws from migrating to another MS; (ii) treat a foreign company differently from their own nationals (iii) prohibit registration of a company with the reason that the migration has as scope the avoidance of restrictive tax measures; (iv) require immediate taxation of unrealised capital gains (unless there exists a second option of deferring that tax).

Moreover, if we judge from the ECJ's case law perspective, the exit taxes do not represent restrictions on the freedom of establishment in their entirety. As stated in the Court's judgements, if the required conditions are met, the MS of origin is entitled to make sure that the taxes owed to it are not lost or double taxed, and thus collect the taxes from companies wishing to move their place of management or assets outside its territory. The MS of origin is allowed to calculate at the moment of emigration the amount of tax that the MC owes and it can also ask for bank guarantee in order to cover the risk of non-recovery of tax.

If, however, we look from another perspective, the exit taxes imposed on a company wishing to move the seat of management or assets outside its state of origin are in fact hindering the freedom of establishment of companies. For instance, a company wishing to leave its state of origin and settle in another MS will have its taxes relating to emigration calculated in the same way as if the same company will move within that home MS. Moreover, once the emigration takes place, the company will have its due taxes calculated in the new MS in the same way as for an already existent company that is subject to tax in that new MS. This leads to a discriminatory result since the companies wishing to move within a MS do not have the obligation to pay any tax when moving within the MS.

It is obvious that the two situations, moving within a MS or outside it, are not similar. As soon as the MC has left the home jurisdiction, it is more complicated for the tax authorities of the State of origin to make sure that they collect the taxes due without further requirements from the MC, as bank guarantees or annual returns, as provided in the case where the company would move within that state.

It appears from the foregoing that the MSs have the ability to assure the payment of the tax due by the companies moving abroad in a manner that seems proportionate and convenient for the MSs as well as for the MCs, according to the ECJ. However, it is also clear from the above that exit taxes continue to represent an obstacle on the freedom of establishment provided to EU companies wishing to migrate.

8. Conclusions

Following the questions referred in this paper with the aim to cover the areas of exit taxation that are in most cases uncertain, I suggest we proceed to show the outcome that derived from analysing them so as to have a complete image of what has been achieved with the writing of this paper.

Accordingly, when addressing the question whether EU companies can freely migrate, one can argue that the companies' freedom to establish outside their MS of origin is dependent on the MSs' application of the incorporation or the real seat theories. At this point, it seems for me that the companies incorporated in a MS that uses the real seat theory, and wish to migrate, are placed at a disadvantage as compared to those founded in a MS that uses the incorporation theory. That is due to the real seat requirement of a connecting link between the company and the MS of incorporation. However, this is a matter in progress since *Cartesio* indicates that real seat MSs must now allow their companies, at least to be capable of transferring their seat abroad with a change of company law, without being wound up or liquidated, namely through a cross-border conversion.

Furthermore, the MSs levy an exit tax on the unrealised capital gains of the companies moving their seat of management or assets abroad. Now, the question is whether this exit tax constitutes a restriction of the freedom of establishment or the free movement of capital guaranteed by the TFEU to the EU nationals.

The ECJ stated in several occasions that exit taxation is not in its entirety compatible with EU law. Some conditions have to be fulfilled before this type of tax passes the EU compatibility test. As pointed out in its case law, the MSs have the liberty to decide on the incorporation, functioning and dissolution of a company. This, however, does not mean that MSs can use measures that are contradictory to the EU freedoms designed to provide rights on EU nationals in cross border situations. For instance, immediate taxation and administrative burdens are restricted among MSs.

In some cases, as shown in the case law section, the imposition of restrictive measures is acceptable, provided that it can be proved that the measures concerned are justified and proportional. This takes us to the question whether exit taxes can be justified. The justifications used by the MSs for the restrictive measures imposed on the MCs are various and they can be accepted by the ECJ, provided that the rules in question are not discriminatory, they are adopted in the benefit of the public interest and they are proportional to the objective pursued.

Furthermore, I find appropriate to remind in this conclusion the fact that it has been highly encouraged by the ECJ that the MSs' administrative bodies increase the relationships between themselves, in order to mutually assist each other when the situation calls for it. Mutual assistance and coordination is desirable not only to ensure tax compliance and to prevent tax evasion, but also to handle situations of double taxation and double non-taxation.

To sum up, the MSs' exit taxation provisions that are contrary to the freedom of establishment or free movement of capital still have a difficult time trying to get their measures accepted by the ECJ. A contradictory provision that might find a justification in the limited pile of justifications accepted by the ECJ still have to be found proportional and that is no easy job as proven in the already decided case law. However, the fact that the MSs entered the process of changing the provisions that hinder the right to transfer the seat of management or assets of a company, is proof that the exit taxation is heading to a better place as compared to the period before National Grid case.

However, it is very difficult to expect that MSs' tax legislation will get to a point of neutrality, due to the different tax rates, valuation methods and different methods of double taxation relief. The way in which MSs can achieve such neutrality is by coordination and by following the ECJ's proposal of cooperation between them.

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