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## Preface

The European Court of Justice has to deal with more and more cases concerning direct taxation and the fundamental freedoms. These cases are of interest for academics as well as practitioners and thus they need to be analysed carefully.

On 12-14 November 2009, the conference "Recent and Pending Cases at the ECJ on direct taxation" took place in Vienna. A great number of experts on European tax law accepted our invitation to attend the conference and took part in the discussions. At the conference, cases in the field of direct taxation now pending before the ECJ were presented and discussed. Moreover, the possible consequences of these cases and the future ECJ decisions were taken into account. The results of the conference are published in this book.

The conference would not have been possible without the support of the Wolfgang Gassner Research Fund for International Tax Law, the Austrian Branch of the International Fiscal Association (IFA) and the City of Vienna.

We would like to express our sincere thanks to the authors who contributed to the conference by presenting their cases at the conference and getting actively involved in the discussions. Besides, they supported the entire project and the publication of this book by committing themselves to a strict time schedule.

We are grateful to the publisher Linde for the co-operation and the quick realization of the publication of this book. Linde has generously agreed to include this book in its catalogue.

Our particular thanks go to Renée Pestuka for the smooth organization of the conference, to Margaret Nettinga, who edited and polished the texts of the authors, and to Elke Aumayr, who supported us in deciding on the structure of the conference and in the preparation and publication of this book.

*Michael Lang      Pasquale Pistone      Josef Schuch      Claus Staringer*

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## **Austria: The *Haribo and Salinen* Case and the *Hengartner and Gasser* Case**

*Claus Staringer*

### **I. Overview of Austrian Pending Cases**

#### **II. The *Haribo and Salinen* Case**

1. Facts
2. The Decision of the Lower Tax Court in 2005
3. The Decision of the Supreme Tax Court in 2008
4. Continued Proceedings before the Lower Tax Court
5. Questions referred to the ECJ
6. Overriding Effect of EU Law
7. Foreign Tax Credit Equivalent to Exemption?
8. Credit Method Equivalent to Exemption Method for Non-Member States Dividends?
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10. The new Austrian legislation

#### **III. The *Hengartner and Gasser* Case**

ly a new rule, which applies from its entry into force in Poland, to the taxation of transactions carried out after this entry into force.

The rule has as its sole objective and scope the prevention of double taxation of the same taxable amount and it applies from its entry into force, both to loans taken out after the accession, as well as to loans already taken out prior to Poland's accession, provided that they are converted into shares after the accession.

Such an interpretation of the Capital Duty Directive does not constitute retroactive application of that Directive to facts occurring prior to Poland's accession. On the contrary, it simply amounts to application of the Directive's rule on the prohibition of double taxation as of the date of its entry into force in Poland. The application of this prohibition requires that account be also taken of taxation which took place prior to the entry into force of the prohibition.

#### **6. The assessment of the case and concluding remarks**

The position taken in the ECJ's judgment seems well grounded.

The Polish legislation did not safeguard single taxation in the case of conversion into shares in a capital company of loans granted by a shareholder and taxed prior to Poland's EU accession. Article 9(10)(h) TCLTA, which as from 1 May 2004 provides for an exemption of shareholder loans, assures implementation of the Capital Duty Directive's aims only in respect to conversion of shareholder loans granted from 1 May 2004. Hence, the second indent of Article 5(3) CDD should be directly applicable to Elektrownia.

The application of the second indent of Article 5(3) CDD to determine the taxable base of an increase in capital which took place after Poland's accession to the European Union and resulted from a post-accession conversion into capital of loans taken up before Poland's accession and taxed at that time did not involve any retroactive effect. It only amounted to direct application of Community law, as of the date of its entry into force in Poland, to a taxable event taking place after the accession (the conversion and increase in capital) and to future, i.e. post-accession, effects of events which had taken place before the accession (the taxation of loans at the time of their granting).

It must be emphasized that in the case at issue, the taxable event was not the loans, but the increase in capital resulting from conversion of these loans into capital. Since the conversion took place after the accession, and the second indent of Article 5(3) CDD governed only its taxable base, no retroactivity can be identified. For the purpose of taxation of the conversion, the taxation of loans upon their granting was taken into account as a factual circumstance, which had taken place before the accession. The exclusion from the taxable base was just a future effect of a situation (the taxation of the loans) which had taken place before the accession.

## **Portugal: Pending cases**

*Ana Paula Dourado*

### **I. Exit Taxes on Companies (IP/09/1640, 8 October 2009)**

1. Introductory remarks
2. Current tax regime
3. Substance over form Approach to Liquidation – cessation of activity implies an autonomous concept of liquidation in tax law?
4. Cessation of Activity in the Territory with Transfer of Assets and Liabilities Equivalent to a Cross-border Merger, Division (legal fiction)?
  - 4.1. Similar regime to non-neutral taxation of capital gains in the case of a merger, division?
  - 4.2. Title IV b of the Merger Directive
5. The position of the European Commission
6. What are the implications of Cartesio in the ECJ assessment of the Portuguese tax legislation?

### **II. Exit Taxes on Personal Income Tax (IP/09/1635, 29 October 2009)**

## I. Exit Taxes on Companies (IP/09/1640, 8 October 2009)

### 1. Introductory remarks<sup>1</sup>

At the Vienna Conference and in its book on "ECJ – Recent Developments in Direct Taxation 2008",<sup>2</sup> several infringement procedures against Portugal were reported, some of which were still pending at the time the "ECJ – Recent Developments in Direct Taxation 2009" took place:<sup>3</sup> that is the case with regard to the obligation on non-resident taxpayers to appoint a tax representative, and with regard to the tax amnesty regime granting a preferential penalty rate of 2.5 % for investments in Portuguese government bonds. In the present report, I am concentrating my comments on the recent infringement procedure regarding the compatibility with the EC Treaty of exit taxes on companies and will mention the other infringement procedures concerning exit taxes on individuals.

### 2. Current Tax Regime

Under Articles 76-A and 76-B of the Portuguese Corporate Income Tax Code (hereinafter: CITC), in the case of the transfer of seat and place of effective management of a Portuguese company to another Member States where that company ceases its activity in the Portuguese territory, the positive and the negative difference between the market values of the assets and liabilities (real values) and their values for tax purposes at the time the activity ceases is relevant for determining the taxable profit. However, in case the assets and liabilities of the company that transferred its residence are part of a permanent establishment of that entity in the Portuguese territory, there will be no taxation. Taxation will also occur in case a permanent establishment ceases its activities in Portugal or transfers its assets and liabilities located in Portugal to another Member State.

Common to both cases is the requirement that the activity effectively ceases and it is therefore consistently required that the assets not be part of a permanent establishment located in the Portuguese territory. And in both cases, the taxable base of that fiscal year will include any unrealized capital gains in respect of the company's assets; in contrast, unrealized capital gains from purely domestic transactions are not included in the taxable base until the moment the assets are distributed to the shareholders.

<sup>1</sup> I want to thank José Almeida Fernandes, Ricardo da Palma Borges and Miguel Pimentel for having discussed with me the pending infringement procedures and for their comments.

<sup>2</sup> *Dourado/Fernandes*, Portuguese recent and pending cases, in *Lang/Pistone/Schuch/Staringer* (Eds.), *ECJ Recent Developments in Direct Taxation 2008* (2008), pp. 329-341.

<sup>3</sup> WU Wien, 13-14 November 2009.

### 3. Substance over form Approach to Liquidation – cessation of activity implies an autonomous concept of liquidation in tax law?

One possible line of reasoning is that the regime under analysis corresponds to a substance over form approach to the taxation of profits regarding the fiscal year of the liquidation of the company and taxation of the assets as a result of that liquidation (Articles 73-76 CITC): a company that is not formally liquidated but ceases its activity and transfers its assets is to be taxed on its profits as if it were going to be liquidated. However, taxation does not occur exactly in the same terms as in respect of profits regarding the fiscal year/period of the liquidation, since in this case tax gains are determined and taxed when the assets are distributed to the shareholders and this distribution is legally equivalent to a market sale, the taxable value being the market value of the assets. Besides, the shareholders are taxed on the assets distributed after the liquidation of the company and although the value of those distributed assets characterized as capital income<sup>4</sup> will be deducted from the taxable base of resident shareholders, non-resident shareholders will be subject to discriminatory economic double taxation, as has been recognized in a recent and publicly available Report of the Ministry of Finance on Tax Policy.<sup>5</sup>

In the case of the transfer of the activity and assets abroad, the company is taxed as if it had distributed the assets to its shareholders abroad. Thus, that different regime introduces a legal fiction regarding the distribution of assets to the shareholders. The issue is whether it can be interpreted as an exit tax contrary to the freedom of establishment of companies (Article 43 EC). Moreover, the shareholders of the company that transfers its seat and place of effective management abroad are subject to tax on the difference between the company's net assets (valued at the time of the transfer at market prices) and the acquisition cost of their participation (Article 76-C CITC). Thus, also in respect of the taxation of shareholders, it seems there is a legal fiction that liquidation and partition has occurred, since there is a cross-reference to the regime applicable to the shareholders in the case of the distribution of assets after the company has been (formally) liquidated. Again, non-resident shareholders will be subject to discriminatory economic double taxation in comparison to resident shareholders of a company that has been formally liquidated and the assets distributed to them.

Moreover, it is not clear either whether the transfer of the tax seat and the effective management correspond to the statutory seat and the real seat, respectively, under Portuguese company law. The divergence between the real seat and the stat-

<sup>4</sup> Shareholders will be taxed on the amount attributed to them as a result of the partition, the cost of acquisition of the shares being deducted. When there is a positive result, the amount up to the limit of the difference between the attributed value of the distributed shares and the accounting value of the start-up shares is taxed as capital income whereas the excess is taxed as capital gains.

<sup>5</sup> Relatório do Grupo para o Estudo da Política Fiscal, Competitividade, Eficiência e Justiça da Política Fiscal, Coord. Geral António Carlos dos Santos, António M. Ferreira Martins, Ministério das Finanças, Secretaria de Estrado dos Assuntos Fiscais, 2009, pp. 305-306.

utory seat is possible under Portuguese company law, since either the transfer of the real seat or of the effective seat of the company or of both are allowed without the company's loss of legal personality and without it being obliged to wind-up, as long as the host Member State recognizes that legal personality. This regime is in compliance with *Cartesio* where the European Court of Justice (ECJ) goes beyond *Daily Mail*, when it holds that although the Member State has the power to define the connecting factor required for the company to be regarded as incorporated under the law of that Member State, it cannot prevent a company from converting itself into a company governed by the law of the other Member State without prior winding-up or liquidation, to the extent that this other Member State does not require that winding-up or liquidation.<sup>6</sup>

Since the tax regime requires the transfer of both seats, if the host Member State recognizes the legal personality of the transferring company, the tax regime is more restrictive than the company law regime, in the sense that it treats formal liquidation and transfer of residence and assets in similar terms: it can be argued that the aforementioned concepts and regime are and can be autonomous in relation to company law.

The issue is then whether there is a legitimate autonomous concept of liquidation which would not imply a restrictive exit tax, because in a substance over form approach it is not to be understood as discriminatory; or whether it is an anti-abuse clause requiring application of the "wholly artificial arrangement" test and its proportionality. Let us think of a situation involving the transfer of the statutory seat to another Member State recognizing the legal personality of the Portuguese company transferring its residence and assets and the location of the real seat in a third country.

In contrast, if the host Member State does not recognize that legal personality, if both seats are moved and if the tax concepts coincide with the company law concepts, a winding-up and liquidation will be required (otherwise the transfer is illegal) which means that the current tax regime applicable to (formal) liquidation would cover the facts under analysis – transfer of seat and effective management. In that case, Article 76-C would not be applicable.

### 4. Cessation of Activity in the Territory with Transfer of Assets and Liabilities Equivalent to a Cross-border Merger, Division (legal fiction)?

#### 4.1. Similar regime to non-neutral taxation of capital gains in the case of a merger, division?

I can also argue that Article 76-A/1 CITC is very similar to Article 4.1. of the Merger Directive, but in the latter case the Directive provides for non taxation of capital gains, unless the required conditions are not fulfilled, and expressly defines "value for tax purposes", whereas Article 76-A/1 does not, but it is reasonable to interpret it in the same way. I recall that according to the Directive, value for tax purposes

<sup>6</sup> *Cartesio*, op. cit., para. 113; *Dourado/Pistone*, Looking Beyond *Cartesio*: Reconciliatory interpretation as a tool to remove tax obstacles on the exercise of the primary right of establishment by companies and other legal entities, *Intertax*, vo. 37, issue 6/7, pp. 342 et seq.

is the value on the basis of which any gain or loss would have been computed for the purposes of tax upon the income, profits or capital gains of the transferring company if such assets or liabilities had been sold at the time of the merger, division or partial division but independently of it.

Thus, another possible interpretation of Article 76-A/1 CITC is that the transfer of residence of the company is taxed in similar terms as a merged company that does not benefit from the tax neutrality regime and therefore is taxed on the positive or negative result that occurs upon the transfer of the assets and liabilities as a consequence of the merger, division or partial division (see Article 68, 1 CITC). In other words, there would be a legal fiction, according to which the company that transfers its residence is "merged" into the "new" company resident in another Member State. The difference is that in respect of the regime under analysis it ceases its activity in the Portuguese territory.

If this interpretation of the regime were followed, it would either be considered discriminatory, if the aim and purpose of Article 4 of the Merger Directive were applicable on the same terms, or Title IV b would instead be invoked as an argument granting legitimacy to it, since the activity ceases in the Portuguese territory and the assets and liabilities of the company are not located there any longer.

#### 4.2. Title IV b of the Merger Directive

The Portuguese regime entered into force on 1 January 2007 (it was enacted on 30 December 2006) and was a result of the amendment to the Merger Directive and interpretation of its Title IV B, e.g. Articles 10 b and 10 d.

According to Article 10 b, where an SE or an SCE transfers its registered office from one Member State to another Member State, or an SE or an SCE which is a resident in the first Member State ceases to be resident in that Member State and becomes resident in another Member State, the transfer of the registered office or the cessation of residence may not give rise to any taxation of capital gains in the Member State from which the registered office has been transferred, derived from those assets and liabilities of the SE or SCE which, in consequence, remain effectively connected with a permanent establishment of the SE or of the SCE in the Member State from which the registered office has been transferred and which play a part in generating the profits or losses taken into account for tax purposes. *A contrario*, if the assets and liabilities of the SE or SCE do not remain effectively connected with a permanent establishment in the Member State of the company that transferred the registered office or residence, that Member State seems authorized to tax, although it is disputable whether it would have to apply the Directive according to the lines of the *N.* case.<sup>7</sup>

<sup>7</sup> See the Commission interpretation on the issue: COM (2006) 825 final, 19.12.2006, Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee, Exit Taxation and the need for co-ordination of Member States' tax policies, pp. 6-7.

In any case, the ECJ's interpretation of the compatibility of directives with the EC Treaty is often more tolerant than its interpretation of the compatibility of domestic law with the Treaty and therefore the ECJ could consider the Portuguese regime incompatible with the EC Treaty even if it were substantially similar to the taxation of capital gains of the transfer of the registered office of an SE or of an SCE in case the assets and liabilities do not remain connected to a permanent establishment in the Member State from which the residence was transferred. As we discussed in the GREIT seminar in Amsterdam,<sup>8</sup> the Court seldom declares invalid a rule of a directive, and seems to take into account that it contributes to European Integration.

The preamble of the Merger Directive,<sup>9</sup> as well as the Communication on Exit Taxation from the Commission, clarify that the Member State from which a resident departs is not prevented by EC law from assessing the amount of income on which it wishes to preserve its tax jurisdiction, in the latter case provided this does not give rise to an immediate charge to tax and that there are no further conditions attached to the deferral.<sup>10</sup> Such a practice is in line with the principle of fiscal territoriality, connected with a temporal component, namely residence within the territory during the period in which the taxable profit arises.

Thus, if the latter regime would be applicable to cessation of activity and transfer of residence of the company, either there is a deferral of activity and transfer Commission suggests, until the capital gains are realized when the assets and liabilities are transferred to a third person or entity (following the line of reasoning of *De Lasteyrie*<sup>11</sup> and *N.*<sup>12</sup>); or taxation is immediately allowed, if cessation of activity is equivalent to the onerous transfer to a third party. The latter interpretation seems contrary to the internal market or cohesion perspective, as expressed for example in the *Manninen*,<sup>13</sup> *Marks & Spencer*,<sup>14</sup> *Kerckhaert*<sup>15</sup> and *Denkavit*<sup>16</sup> cases, but is perhaps consistent with *Daily Mail*<sup>17</sup> and *Cartesio*.<sup>18</sup> Either regime would have to be applicable in a non-discriminatory way, i.e., both to non-residents and resident shareholders.

<sup>8</sup> Traditional and alternative routes to European tax integration (*primary law, secondary law, soft law, coordination, comitology and their relationship*), Amsterdam, 25-26 September 2009: the papers presented and discussed at the conference will be published in a book. For further details, visit [www.greit-tax.eu](http://www.greit-tax.eu).

<sup>9</sup> Council Directive 2005/19/EC of 17.02.2005.

<sup>10</sup> COM (2006) 825 final, 19.12.2006, op. cit., pp. 5-6.

<sup>11</sup> ECJ 11 March 2004, C-9/02.

<sup>12</sup> ECJ 7 September 2006, C-470/04.

<sup>13</sup> ECJ 7 September 2004, C-319/02.

<sup>14</sup> ECJ 13 December 2005, C-446/03.

<sup>15</sup> ECJ 14 November 2006, C-513/04.

<sup>16</sup> ECJ 14 December 2006, C-170/05.

<sup>17</sup> ECJ 27 September 1988, Case 81/87.

<sup>18</sup> ECJ 16 December 2008, C-216/06.



### 5. The position of the European Commission

According to the Commission, such taxation penalizes those companies that wish to leave Portugal or to transfer assets abroad, as it results in less favourable treatment as compared to those companies which remain in Portugal or transfer assets domestically. The rules in question are likely to dissuade companies from exercising their right of freedom of establishment and, as a result, constitute a restriction of Article 43 EC Treaty and the corresponding provision of the EEA Agreement. The Commission's opinion is based on the fundamental freedoms in the Treaty as interpreted in the *De Lasteryie* case and on its Communication on exit taxation.

According to the Commission in its Communication, although the ruling in *De Lasteryie* relates to the facts and circumstances of the case at issue, the ECJ's interpretation of EC law implies conclusions as regards exit taxes in general. "Taxing residents on a realization basis and departing residents on an accrual basis is a difference in treatment which constitutes an obstacle to free movement. Where a Member State decides to assert a right to tax gains accrued during a taxpayer's residence within its territory, it cannot take measures which present a restriction to free movement".<sup>19</sup> Following the *N.* case, the Commission considers that a requirement that the taxpayer submits a tax declaration at the time of the transfer of residence, necessary for the purpose of assessing the income can be considered proportionate having regard to the legitimate objective of the allocation of taxing powers, in particular so as to eliminate double taxation between the Member States.<sup>20</sup>

### 6. What are the implications of *Cartesio* in the ECJ assessment of the Portuguese tax legislation?

We could say that the "connecting factor" analysed under *Cartesio* can be compared to the criteria on the allocation of taxing powers, which are also within the competence of the Member States.<sup>21</sup> In fact, according to the Court in *Cartesio*, "the company intends to reorganize itself in another Member State by moving its seat... , thereby breaking the connecting factor required under the national law of the Member State of incorporation".<sup>22</sup> Again, I would claim that the transfer of residence and the cessation of activity is equivalent for tax purposes to the liquidation of the company. In *Cartesio*, the Court failed, however, to analyse whether the connecting factor did not restrict the freedom of establishment.<sup>23</sup> The Portuguese tax regime under analysis is in this respect less restrictive, since the seat, the effective management and the assets and liabilities are transferred abroad.

<sup>19</sup> COM (2006) 825 final, op. cit., p. 3.

<sup>20</sup> Idem, pp. 3, 4 et seq.

<sup>21</sup> *Dourado/PPistone*, op. cit. p. 342.

<sup>22</sup> ECJ 16 December 2008, Case C-210/06, para. 110.

<sup>23</sup> Idem.

Thus, under the *Cartesio* line of reasoning, one possible interpretation is that the Portuguese tax regime is not incompatible with the Treaty, in the sense that Portugal is free to choose the connecting factor creating the taxation of capital gains. However, a reconciliatory interpretation of the ECJ case law implies a joint application of the doctrine in *Cartesio* and *N.*: the Member State may choose the connecting elements for taxation, but a deferral in taxation is required. The taxpayer would then submit a tax declaration at the time of the transfer of residence, necessary for the purpose of assessing the income. Moreover, the regime would have to be applicable to equivalent domestic situations in a non-discriminatory way. In contrast to *Cartesio*, in *N.* the Court prohibited any restrictions to the freedom of establishment resulting from the connecting factors,<sup>24</sup> in spite of recognizing that preserving the allocation of the power to tax between Member States is a legitimate objective.<sup>25</sup>

### II. Exit Taxes on Personal Income Tax (IP/09/1635, 29 October 2009)

There are also pending infringement procedures against Portugal in respect of exit taxation on individuals. According to Article 10 § 9 a) of the Portuguese Personal Income Tax Code, the transfer of residence if the taxpayer has benefited from tax neutrality upon a previous exchange of shares triggers inclusion of the capital gains or losses in the shareholder's taxable income and accordingly tax in the calendar year where the transfer of residence occurs. In contrast, a resident shareholder who exchanged shares and kept his residence in the Portuguese territory is only taxed in the case of an additional cash payment and as long as the value of the shares received corresponds to the value of the shares transmitted. Also, according to Article 38 § 1 a) of the same Personal Income Tax Code, the transfer to a company of assets and liabilities related to an economic or professional activity by a natural person is exempt if the legal person is a Portuguese resident, whereas the transfer is taxed if the legal person has its seat or place of effective management abroad. The Commission argues that individuals who decide to leave Portugal or transfer assets abroad are less favourably treated, since they are subject to immediate taxation, in contrast to individuals who remain in the Portuguese territory or transfer assets to a resident company: the regime is deemed to be incompatible with Articles 18, 39 and 43 of the EC Treaty. These cases will probably be decided according to the lines of the *De Lasteryie* and the *N.* cases.

<sup>24</sup> ECJ 7 September 2006, Case C-470/04, paras. 31-39.

<sup>25</sup> Idem, paras. 42-47. *Dourado/PPistone*, op. cit., p. 342.