Exit Taxes: an infringement deferred?

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The Government published a technical consultation paper on 11 December 2012 on Deferring the payment of corporate “exit charges” (the “Consultation”). The proposals extend to all of the UK’s corporate exit charges, namely chargeable gains, loan relationships, derivative contracts and intangible fixed assets. The Consultation is stated to be in response to recent European jurisprudence, in particular the decision of the CJEU in National Grid Indus BV v Inspecteur van de Belastingdienst/kantoor Rotterdam Case (C-371/10) (“NGI”).

The need to ensure that UK legislation complies with EU law was a notable theme amongst the materials published alongside the draft clauses for Finance Bill 2013, being referenced in the context of the group relief rules, section 13 TCGA 1992 and the transfer of assets abroad.

The question in relation to exit taxes is whether they are restrictions on a company’s right of freedom of establishment and, if so, whether such restrictions are justified by overriding reasons in the public interest (namely ensuring the balanced allocation of taxing rights) and are proportionate.

BACKGROUND

The CJEU decided in Hughes de Lasteyrie du Saillant v Ministère de L’Économie, des Finances et de l’Industrie (Case C-9/02) and N v Inspecteur van de Belastingdienst Oost/kantoor Almelo (Case C-470/04), published in March 2004 and September 2006 respectively, that exit taxes levied on individuals were contrary to the right of freedom of establishment.

In December 2006 the European Commission published a Communication on Exit taxation and the need for co-ordination of Member States’ tax policies, stating that:

• the decision in de Lasteyrie had direct implications for exit tax rules on companies;

• taxpayers who exercise their right to freedom of establishment by moving to another Member State may not be subject to an earlier or higher tax charge than taxpayers who remain;

• Member States may assess the amount of income on which they wish to preserve their tax jurisdiction, provided this does not give rise to an immediate charge to tax and that there are no further conditions attached to the deferral;

• Member States may impose reasonable obligations on taxpayers to keep tax authorities regularly informed of the continued holding or disposal of the assets, provided such obligations do not go beyond what is necessary to achieve their objective; and

• Member States could benefit from co-ordination at an EU level to eliminate double taxation and double non-taxation.
The European Council adopted a Resolution on co-ordinating exit taxation in December 2008, but this has not been adopted by Member States.

The decision of the CJEU in NGI was published in November 2011. This is the first case in which the CJEU ruled that a company has, in principle, a right protected by Article 49 TFEU to transfer its place of management to another Member State. An exit tax is a restriction on this right but, so long as it is proportionate to the objective of the legislation, it can be justified as necessary for ensuring the balanced allocation of taxing rights. (This decision has since been re-affirmed in Commission v Portugal (Case C-38/10).)

On 22 March 2012 the Commission formally requested, in a reasoned opinion at the second stage of infringement proceedings, that the UK amend its legislation providing for exit taxes on the unrealised capital gains of companies.

OUTLINE OF PROPOSALS

The Consultation proposes that companies be permitted to defer the payment of exit taxes:

- An EEA incorporated company which is tax resident in the UK which transfers its residence to another EEA jurisdiction can apply to defer payment of exit charges, provided that on ceasing to be tax resident in the UK the company carries on a business in an EEA state and is not treated as resident in a territory outside the EEA for the purposes of any double taxation treaty.

- Two types of exit charge payment plans (“ECPPs”) will be available:
  - Standard instalment payment plan – spreading the exit tax to be deferred over 6 equal annual instalments. There are no reporting/monitoring obligations. This method cannot be used where the obtaining of a deferral of tax payments is a main purpose of the change of tax residence.
  - Realisation method plan – allocating tax due on an asset by asset basis and then deferring payment until disposal or part disposal of chargeable gains assets (other than intangibles) for up to 10 years. For all intangible fixed assets, loan relationships and derivatives, the deferred exit tax will be paid in annual instalments over 10 years (or over the useful life of the asset if shorter) but will become payable earlier if a realisation (full or partial) occurs. This is accompanied by an annual reporting requirement on the realisation and retention of the relevant assets.

- The amount of tax payable under both types of ECPP would be calculated at the time of exit. Amounts deferred will be subject to interest on the balance outstanding from the date the normal exit charge would have been payable.

- An ECPP will be brought to an end and the outstanding balance of deferred exit tax plus interest will be payable if a “relevant event” occurs, which would include the company ceasing to be resident in the EEA or the commencement of insolvency proceedings.

- Security may be required by HMRC, generally in the form of a bank guarantee. The Consultation asks whether the provision of adequate security against non-payment of the tax liability should be requested only in exceptional circumstances or in all cases.
IS THIS PROPOSAL COMPATIBLE WITH EU LAW?

The Consultation states that the CJEU has clarified that Member States are free to levy exit charges, provided there is an option to defer payment. Responses are therefore not sought on continuing to levy the charges or on the two options for deferral.

Whilst the CJEU did state in NGI that offering taxpayers a choice between immediate payment of tax and deferred payment could be a proportionate measure, it should not be assumed that the terms on which deferral is available are irrelevant to the question of whether the deferral option represents a justifiable and proportionate restriction.

Trigger for deferred payment

In NGI the CJEU was considering national legislation which did not provide for deferral until the time when the capital gains were actually realised. References by the CJEU in that case to allowing deferral should be read as referring to deferral until such realisation.

This reflects the Commission’s 2006 Communication, and represents the most significant defect in the proposals – both of the ECPPs would be time limited, such that the tax becomes due at the end of (at most) 10 years, even if the gain remains unrealised at that time.

Calculation of amount of tax deferred

In contrast to its earlier decision in N, the CJEU stated in NGI that failure to take into account decreases in value cannot be regarded as disproportionate to the objective pursued. Taking account of subsequent changes in value could lead to double taxation, or double deduction of losses; and the Treaty offers no guarantee to a company that transferring its place of effective management to another Member State will be neutral as regards taxation.

The proposal that the amount of tax payable under an ECPP is calculated at the time of exit should therefore comply with the principle of proportionality.

Security

The CJEU found in de Lasteyrie and N that the requirement to provide a guarantee could not be justified; guarantees deprive the taxpayer of the enjoyment of the relevant assets and go beyond what is necessary to ensure the functioning and effectiveness of a tax system – harmonisation measures were less restrictive.

In NGI the CJEU states that account should be taken of the risk of non-recovery of the tax, which increases with the passage of time. Member States may introduce measures such as the provision of a bank guarantee. It was suggested by Advocate General Mengozzi in Commission v Portugal that a guarantee should only be required if there is a genuine and serious risk of non-recovery.

A blanket requirement to provide security as a pre-condition to an ECPP would be disproportionate, but a more targeted provision should be acceptable.

Interest

A provision that interest accrues on the amount of unpaid tax from the date otherwise due would, particularly in the context of a time-limited deferral, appear to be no less restrictive than a requirement to pay the tax immediately.

The possibility of interest being charged was raised by the CJEU in NGI, unfortunately without further explanation, when it said that offering the choice of deferred payment “possibly together with interest” would be less restrictive.
Advocate General Mengozzi considered this language in Commission v Portugal, concluding that there was no objective reason not to charge interest, but the CJEU did not comment.

It is likely that this will be a question which is required to be addressed by the CJEU in the future.

**Reporting requirements**

In NGI the CJEU acknowledged that the administrative burden caused by the deferred recovery of tax may not necessarily be less harmful to the freedom of establishment than the immediate recovery of the tax debt, particularly if the asset situation of a company was very complex. National legislation offering companies a choice between immediate payment of the tax (which creates a cash flow disadvantage) and deferral (which necessarily involves an administrative burden) would be appropriate for ensuring the balanced allocation of powers of taxation.

The absence of reporting obligations in respect of the proposed standard instalment payment plan is clearly compliant; and the proposals relating to the realisation method plan are consistent with what is envisaged by the CJEU in circumstances where the taxpayer has a choice as to whether or not to apply for deferral.

**CONCLUSIONS**

The fundamental concern is that both ECPPs involve a time-limited deferral, without regard to whether the gains have been realised at the expiry of the relevant period. This, coupled with the uncertainties of the CJEU’s own position on interest being charged, means that these proposals are unlikely to be regarded as ensuring that the relevant UK legislation is compliant with EU law. It will be interesting to see whether the Commission continues with the infringement proceedings and refers the UK to the CJEU.

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